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Legal Sidebar

Eligibility of Religious Organizations for the CARES Act's Paycheck Protection Program

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The recently enacted Coronavirus Aid, Relief, and Economic Security Act (CARES Act) contained a number of provisions authorizing the Small Business Administration (SBA) to provide economic relief to small organizations. One such provision, Section 1102 of the CARES Act, established the Paycheck Protection Program (PPP), which expands the SBA's authority to guarantee loans under Section 7(a) of the Small Business Act, discussed in more detail in this CRS Report. Another provision, Section 1110 of the CARES Act, expands the SBA's authority to grant Economic Injury Disaster Loans (EIDLs) under Section 7(b)(2) of the Small Business Act, discussed in this CRS Report. After the CARES Act was signed into law, there was some uncertainty about whether religious organizations, including churches and other houses of worship, would be eligible for the new PPP or EIDL relief. On April 3, 2020, however, the SBA issued a Frequently Asked Questions (FAQ) document clarifying that "faith-based organizations," including houses of worship, "are eligible to receive SBA loans" under the PPP and EIDL programs. This Legal Sidebar discusses legal considerations related to religious organizations' eligibility for SBA aid. Specifically, this Sidebar explores possible considerations under the Establishment and Free Exercise Clauses of the First Amendment to the U.S. Constitution, both of which are implicated when public funds are provided to religious organizations.

Statutory and Regulatory Authority Governing Section 7(a) Loans

According to the SBA, the 7(a) loan program is the agency's "primary program for providing financial assistance to small businesses." Section 7(a) of the Small Business Act authorizes the SBA to make and guarantee certain types of loans. In practice, the SBA does not provide direct loans under its 7(a) programs, but works with third-party lenders. Prior to the CARES Act amendments, the statute provided that 7(a) loans were generally available to "small business concerns," defined in regulation as certain small for-profit businesses. Another regulation outlining what businesses are ineligible for 7(a) loans excludes "businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting." When the SBA adopted this ineligibility regulation in 1996, the agency explained that the exclusion of primarily religious businesses was driven by Establishment Clause concerns.

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Amending Section 7(a) of the Small Business Act, Section 1102 of the CARES Act created the PPP, authorizing the SBA to guarantee certain third-party loans made to eligible organizations during a specified time period. PPP loans can be used for payroll costs, rent and mortgage interest payments, utilities, and other specified costs. Section 1102 further provides that, in contrast to other 7(a) programs that are solely available to small for-profit businesses, the PPP is available to small "nonprofit organizations." To fall within the meaning of that term, an entity must first qualify as an organization under 26 U.S.C. § 501(c)(3), which includes any corporation "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes." Second, the organization must be tax-exempt under 26 U.S.C. § 501(a), which states that an organization described in § 501(c)(3) "shall be exempt from taxation." Ordinarily, organizations must notify the Internal Revenue Service (IRS) that they are applying for tax-exempt status, although 26 U.S.C. § 508(c)(1) exempts churches from these statutory application requirements. Accordingly, religious organizations, including churches, qualify as a nonprofit organization under the CARES Act if they are (1) "organized and operated exclusively for religious . . . purposes"; and (2) considered tax-exempt by the IRS.

Section 1106 of the CARES Act relates to forgiveness of Section 1102 loans. It provides that "an eligible recipient shall be eligible for forgiveness" on these loans for payroll costs, rent or mortgage interest, and utilities paid during the covered period. Recipients seeking loan forgiveness may apply to their lenders, and the lenders determine whether the recipients are eligible for forgiveness. Once "the amount of forgiveness . . . is determined," the SBA "shall remit to the lender" the amount forgiven, plus interest.

Statutory and Regulatory Authority Governing Economic Injury Disaster Loans

The SBA is also authorized to make "disaster loans," if the President or SBA Administrator declares that certain disasters have occurred. Eligible entities may apply directly to the SBA for these loans, which can be used for "working capital necessary to carry [the business] until resumption of normal operations" and for normal business operating expenses "necessary to alleviate the specific economic injury." Even prior to the CARES Act, the SBA could, in contrast to the 7(a) program, make loans to qualifying "private nonprofit organization[s]," defined by regulation as an entity that the IRS or a state government has determined to be a tax-exempt nonprofit. Accordingly, an organization deemed tax-exempt by the IRS under 26 U.S.C. § 501(c)(3) qualifies as a "private nonprofit organization" under this regulation. Similar to the 7(a) program, another SBA regulation makes certain businesses ineligible for EIDLs, including businesses "principally engaged in teaching, instructing, counseling, or indoctrinating religion or religious beliefs, whether in a religious or secular setting."

Section 1110 of the CARES Act alters the SBA's EIDL authority, temporarily expanding eligibility for these loans and relaxing certain requirements. That section also authorizes the SBA to give advances on covered loans and provides that applicants will not be required to repay those advances (although the advance amount may reduce the amount of loan forgiveness granted under the PPP). Section 1110 does not expressly address nonprofits' or religious organizations' eligibility for the new EIDL authorities.

SBA Guidance on Eligibility of Religious Organizations for the PPP and EIDLs

Initially, there was some question regarding whether religious organizations would be eligible to participate in the PPP or for EIDLs, given existing SBA regulations excluding certain religious entities from 7(a) programs and the EIDL program, as well as an interim final rule on the PPP that did not specifically address religious organizations' eligibility. On April 3, however, the SBA issued an FAQ document expressly stating that religious organizations would be eligible to participate in both the PPP and the EIDL program notwithstanding any regulations to the contrary. The SBA further clarified that churches and other houses of worship would qualify under both programs even if the IRS had not confirmed their tax-exempt status, so long as they met the definition in 26 U.S.C. § 501(c)(3) and other program requirements. On April 4, the SBA also issued an interim final rule providing that religious

organizations would be exempt from its affiliation rules—which govern when one entity is considered to be affiliated with another, for purposes of determining an organization's size—if applying those rules "would substantially burden those organizations' religious exercise."

The April 3 SBA guidance stated that religious organizations accepting federal funds are generally subject to conditions that would ordinarily apply to any other organizations accepting SBA aid. For example, the SBA stated that religious organizations accepting funds would generally have to comply with regulations prohibiting "recipients of financial assistance" from discriminating on the basis of "race, color, religion, sex, handicap, or national origin" when they provide goods and services or when they make employment decisions. However, the SBA emphasized in the guidance that existing exclusions for religious organizations would continue to apply—and that religious organizations can seek further relief if SBA rules burden their religious exercise. For example, a separate SBA regulation provides that the nondiscrimination regulation does not prevent a religious organization from selecting members or employees "of a particular religion to perform work connected with the carrying on" of the organization's religious activities. Interpreting these quoted regulatory provisions, the SBA guidance said that the SBA would "require a faith-based organization that operates a restaurant or thrift store open to the public to serve the public without regard to the protected traits listed" in its nondiscrimination regulation. At the same time, the guidance stated that the regulations do not "limit a faith-based organization's ability to distribute food or clothing exclusively to its own members or co-religionists."

Finally, in the April 3 guidance, the SBA raised broader constitutional concerns about its regulations excluding religious businesses, stating that it would "decline to enforce" these regulatory provisions and "will propose amendments to conform those regulations to the Constitution." This statement suggests that the SBA will not be enforcing the named regulatory provisions beyond the PPP and EIDL authorities in CARES Act, even in preexisting loan programs. Going forward, the SBA said that "no otherwise eligible organization will be disqualified from receiving a loan because of the religious nature, religious identity, or religious speech of the organization."

Constitutional Considerations

Legal Background

The SBA regulations and guidance governing religious entities' eligibility to participate in its loan programs are undergirded by case law interpreting the two religion clauses of the First Amendment. As mentioned above, the SBA's regulations excluding primarily religious businesses from its loan programs were grounded in constitutional concerns related to supporting religious activities. In general, the Supreme Court has stated that the First Amendment's Establishment Clause forbids "sponsorship, financial support, and active involvement of the sovereign in religious activity." Relying on the Establishment Clause, the Court has invalidated government programs that directly provide money to religious institutions but lack safeguards to ensure that the money is used only "for secular, neutral, and nonideological purposes." The Court has, at times, expressed special concern about using tax dollars to support religious institutions, particularly if the government support is used "to proselytize or advance any one, or to disparage any other, faith or belief." By contrast, the Supreme Court has approved of *indirect* aid programs, like some school voucher programs, if the "aid program is neutral with respect to religion, and provides assistance directly to a broad class of citizens who, in turn, direct government aid to religious schools wholly as a result of their own genuine and independent private choice."

The First Amendment's Free Exercise Clause, which protects the free exercise of religion, has influenced recent changes in SBA policy. SBA's April 3 guidance views its existing regulations as "impermissibly exclud[ing] some religious entities," implicitly invoking a Supreme Court case ruling that excluding religious entities from public benefits programs can violate the Free Exercise Clause. In a 2017 decision, *Trinity Lutheran Church of Columbia v. Comer*, the Court concluded that a state grant program excluding

churches and other religious organizations from receiving grants to purchase rubber playground surfaces violated the Free Exercise Clause. The Court held the program unconstitutional because it discriminated against organizations based on their religious character. The Supreme Court acknowledged that in a prior case, *Locke v. Davey*, it had ruled that a state could, without violating the Free Exercise Clause, prohibit students from using publicly funded scholarships to pursue a degree in devotional theology. In *Locke*, the Court recognized the state's "historical and substantial state interest" in not using government funds to support clergy. *Trinity Lutheran* distinguished *Locke*, saying the state in *Locke* had permissibly chosen to deny a scholarship because of what the recipient "proposed *to do*—use the funds to prepare for the ministry." By contrast, in *Trinity Lutheran*, the Supreme Court held that the state was impermissibly denying funds because of what the recipient "*was*"—a church. Some therefore interpreted the *Trinity Lutheran* opinion as distinguishing between religious use and religious status: governments may deny the use of public funds for religious activities, but may not deny funds on the basis of an applicant's religious identity or character.

Establishment Clause Considerations

Prior to the SBA guidance clarifying religious organizations' eligibility for CARES Act aid, some argued that any "direct government funding of inherently religious activities" through the new law would violate the Establishment Clause. With SBA's guidance clarifying that CARES Act loans "can be used to pay the salaries of ministers and other staff engaged in the religious mission of institutions," it seems likely that questions relating to how the SBA's guidance comports with the Establishment Clause will remain.

The PPP could be seen as an indirect aid program for Establishment Clause purposes and thus more likely to be considered constitutional under existing Supreme Court jurisprudence. Under Section 1102, the SBA guarantees loans made by third-party lenders, but the lenders decide whether to loan money to religious organizations. Similarly, under the loan forgiveness program created by Section 1106, third-party lenders review and decide on eligible organizations' applications, and the SBA remits funds to the lenders. Accordingly, under both provisions, the federal aid is directly provided to *third parties*—the lenders—who themselves can decide to fund houses of worship or other religious organizations, similar to the indirect aid programs that the Supreme Court has previously approved. Some have asserted that the program is sufficiently neutral with respect to religion, given that it offers aid to a broad class of organizations, religious and nonreligious, and appears to have a secular purpose of providing broad economic aid, rather than supporting religion. However, prior Supreme Court cases on this issue have involved the provision of indirect funding to religious *schools*, rather than churches as such. Historical concerns about providing taxpayer funds to clergy could cause a court to scrutinize such a program more closely. Ultimately, the Court has not considered a scheme identical to this one, and therefore, it may be open to debate whether this program can be distinguished from other permissible indirect aid programs.

By contrast, the CARES Act's EIDL provisions appear to authorize the SBA to provide money *directly* to qualifying religious organizations, raising heightened concerns under the Court's Establishment Clause jurisprudence. The SBA expressly stated in the guidance document that it did not believe that the Establishment Clause required it to put special restrictions on how religious organizations use CARES Act funds. Accordingly, this program could be subject to challenge under cases invalidating programs that directly provide unrestricted public funds to religious entities. And in particular, *Locke* suggests that supporting clergy is a religious activity that implicates longstanding historical concerns about government support for churches. Nonetheless, some have questioned whether these direct aid cases remain "good law" in light of *Trinity Lutheran*. Further, more recent Supreme Court precedent suggests "neutral . . . assistance programs that . . . offer aid directly to a broad class of individual recipients defined without regard to religion" do not raise heightened Establishment Clause concerns.

Free Exercise Clause Considerations

As mentioned, SBA's April 3 guidance maintained that regulations excluding primarily religious businesses from participating in SBA programs are unconstitutional. The agency stated that it would amend these provisions and not enforce them in the interim. In August 2019, the Department of Justice's Office of Legal Counsel (OLC) expressed similar reservations about a federal statute that limits the Department of Education's ability to guarantee loans to historically black colleges and universities if the loan would go "to an institution in which a substantial portion of its functions is subsumed in a religious mission." OLC, relying on *Trinity Lutheran,* concluded that this statute violated the Free Exercise Clause by "discriminat[ing] based on the religious character of an institution." The SBA's statement that its own regulations "impermissibly . . . . bar the participation of a class of potential recipients based solely on their religious status" implies that the SBA has similar *Trinity Lutheran*-based concerns.

Excluding religious organizations from SBA programs solely because of their religious character would likely raise free exercise concerns, particularly if the exclusion denies funding for activities that "have no direct connection to" the organization's religious activities. To the extent that existing regulations exclude businesses that engage in religious activities regardless of whether the government aid would actually be used to support those activities, they could be seen as impermissibly discriminating based on religious status. On the other hand, the SBA apparently issued this rule excluding religious businesses because of concerns about what they might *do* with federal aid. *Locke* and *Trinity Lutheran* suggest that the government might still be able to prohibit federal funds from being used for religious activities. As noted above, some have argued, based on Establishment Clause-related concerns, that CARES Act funds should not be used to pay the salary of clergy or support facilities used for religious worship.

Even if the Free Exercise Clause forbids the SBA from excluding religious organizations from public aid programs merely because of those organization's *status*, it is unclear whether the government might nonetheless be permitted—or required—to prohibit the use of those funds for certain religious *activities*. The Supreme Court's Establishment Clause jurisprudence is largely unsettled. The Court heard oral arguments in one case involving the indirect provision of funds to religious schools in January—*Espinoza v. Montana Department of Revenue*. *Espinoza* may provide further insight into whether a state may *exclude* religious entities from aid programs without violating the Free Exercise Clause, but is unlikely to provide much clarity on Establishment Clause restrictions on a government's ability to *include* religious entities in aid programs. Accordingly, it is difficult to say definitively whether the SBA's interpretation of the PPP and EIDL provisions of the CARES Act successfully avoid the dual concerns raised by the First Amendment's religion clauses. The Supreme Court has observed that there is "room for play in the joints" between the Free Exercise and Establishment Clauses. If CARES Act programs support religious activities, that aid may test how far the government may go to accommodate religious exercise without violating the Establishment Clause.

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