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U.S. Stimulus Act Gives More Money & Tax Incentives to Small Businesses and Investors

by Sylvia K. Burks, Craig A. Becker, and Jessica D. Mendoza

Since the creation of the Small Business Administration (the "SBA") in 1958, many small businesses have relied upon the agency for direct loans and loan guarantees. In addition, venture capitalists, banks, and other lending institutions have drawn on the benefits of the SBA's Small Business Investment Company program to leverage funds available for investment in small businesses. The American Recovery and Reinvestment Act of 2009 (the "Stimulus Act") contains a number of provisions intended to make more funding available to small businesses, and also includes tax incentives for small businesses and investors.

Background on SBA Programs

The SBA makes available loan guarantees to small business borrowers (typically entrepreneurs seeking to start, expand or acquire a business) primarily through its 7(a) loan program and through its Certified Development Company ("CDC/504") loan program. To take advantage of these programs, a business seeks a loan through a private sector bank and, if a conventional loan is not available, the business may apply for an SBA guarantee of the loan. Under the 7(a) loan program, the SBA will guarantee loans issued by private sector banks to eligible small businesses for a variety of general business purposes, including working capital, machinery and equipment, furniture and fixtures, land and buildings, leasehold improvements, and debt refinancing. Under its CDC/504 loan program, the SBA guarantees long-term, fixed-rate financing by Certified Development Companies (nonprofit corporations established with the objective of contributing to community economic development) and/or private lenders to small businesses, to acquire real estate, machinery, or equipment for expansion or modernization. The SBA also makes relatively smaller direct loans, usually only to businesses which are unable to obtain conventional lending or loans through the SBA's loan guarantee programs. The eligibility requirements for SBA programs vary from industry to industry and are based either on maximum company revenues or number of employees.

Stimulus for Small Businesses

- **Additional Funds Available.** The Stimulus Act provides $730 million to the SBA and makes changes to the SBA's lending and investment programs in order to allow the SBA to assist more small businesses that need help. The $730 million includes:

  - $375 million for temporarily eliminating fees on SBA-backed loans and raising the SBA's guarantee percentage on certain loans to 90%. As discussed below, these provisions benefit both small business borrowers and their lenders.

  - $255 million for loan guarantees of up to $35,000 through the new Business Stabilization Program (the "BSP"). These loan guarantees will allow small businesses to make up to six months of payments on existing loans. Loans made under the BSP carry no interest, have no fees, and may accept a secondary lien as collateral. BSP loans are to be paid off over five years or less, starting one year after the loan is made. The authority to guarantee new BSP loans terminates September 30, 2010.

- **Loan Fees Eliminated or Reduced; Reimbursement of Loan Fees.** The Stimulus Act provides for the temporary elimination or reduction of loan fees required to be paid by a small business in connection with SBA loan guarantees. Loan fees for borrowers on 7(a) and CDC/504 loans will be eliminated through calendar year 2009, or until the funds are exhausted. The fee elimination is retroactive to February 17, 2009, the day the Stimulus Act was signed. Lenders must reimburse borrowers who have already paid the fee on eligible loans.

- **Reduced Job Creation Goals.** The Stimulus Act reduces the job creation goal for the CDC/504 loan program from one job for each $50,000 borrowed to one job for each $65,000 borrowed.

- **Funds Available for Refinancing.** Prior to the enactment of the Stimulus Act, the SBA was prohibited from using CDC/504 loans to refinance an existing debt. This is no longer the case, as the Stimulus Act allows the SBA to refinance existing loans as part of a new CDC/504 loan if the refinancing is less than half of the loan and meets other conditions.

Stimulus for Lenders

- **Increased Percentage of Loan Guaranteed.** As previously mentioned, one of the primary ways the SBA assists small businesses is through guaranteeing a portion of loans made by private sector lenders to small businesses otherwise unable to obtain such financing. The SBA's loan guarantee decreases the risk of non-payment that a lender must bear and thereby helps to encourage lenders to extend credit to small businesses. Prior to March 16, 2009, the maximum percentage of a loan that the SBA could guarantee was 75-80% of the loan amount. Effective March 16, 2009, the SBA has temporarily raised guarantees to up to 90% on qualifying small business loans.

- **Secondary Market for CDC/504 Program Loans.** The Stimulus Act authorizes the SBA to create an SBA Secondary Market Guarantee Authority to guarantee the loan portion of CDC/504 loan pools that are sold to third-party investors. This guarantee authority is intended to facilitate the practice of pooling loans for sale in the secondary market. By stimulating the market for pooled loans, the loans issued by banks may be more readily sold, providing banks with new capital they can use to make additional loans.

Increased Funds Available to SBA-Licensed Small Business Investment Companies

Small Business Investment Companies ("SBICs"), licensed by the SBA, are privately owned and managed investment firms, including venture capital firms. Using their own capital and funds borrowed at favorable rates through the federal government, SBICs provide venture capital to small businesses, both new and already established.

The Stimulus Act increases the maximum levels of funding that the SBA may provide to SBICs for investment in small businesses. Under the Stimulus Act, SBICs may now leverage up to the lesser of 300% of their private capital or a maximum of $150 million.

Tax Cut Package for Small Businesses

The Stimulus Act also contains various tax incentives for the 2008 and 2009 tax years for small businesses and investors, including those outlined below.

- **Five-Year Carryback Provision to Increase Tax Refunds for Small Businesses.** The Stimulus Act contains a provision that allows businesses with gross receipts of up to $15 million to "carry back" their 2008 net operating losses for up to five years, effectively allowing them a rebate on taxes paid in previous years.
- **Immediate $250,000 Write-Off for Investment in Equipment.** Under the Stimulus Act, small businesses may immediately write off up to $250,000 of qualified equipment placed in service in 2009.
- **Extension of Bonus Depreciation Deductions Through 2009.** Businesses are allowed to take a larger first-year depreciation deduction through a Stimulus Act provision which extends the bonus depreciation deduction for qualified property acquired through the end of 2009.
- **Tax Incentives for Investors to Put Money in Small Businesses.** The Stimulus Act includes a measure to exclude from taxation 75% of the capital gains for investors who acquire qualified small business ("QSB") stock[1] between February 18, 2009 and December 31, 2010, and who hold their QSB stock for five years.

Other Government Programs

- **SBIR Program.** While the Stimulus Act does not make specific changes to the Small Business Innovation Research ("SBIR") program, start-up companies should keep this program in mind. The SBIR program, which is directed and coordinated by the SBA, is funded through federal agencies with annual research budgets exceeding $100 million. These agencies are required to set aside a minimum of 2.5% of their budgets each year for small businesses.

- **Other Appropriations Under the Stimulus Act.** The Stimulus Act contains many provisions that allocate portions of the $787 billion appropriated to aid companies developing clean technologies, broadband, technologies in the energy, transportation and healthcare sectors, and other technologies. These programs are administered by various governmental agencies and are typically available in response to solicitations by governmental agencies. However, absent a specific agency solicitation, it may be possible to apply for some agency grants, loans, and guarantees.

1 As defined in Section 1202 of the Internal Revenue Code.

Pillsbury can provide further details on these new and expanded financing opportunities and tax incentives, and assist in development and implementation of business strategies to capitalize on these opportunities.

For further information, please contact:

Sylvia K. Burks (bio)
Silicon Valley
+1.650.233.4606
sylvia.burks@pillsburylaw.com

Craig A. Becker (bio)
Silicon Valley
+1.650.233.4725
craig.becker@pillsburylaw.com