

# Starting A Business

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## Starting a Business? 3 Things You Must Know

Starting a new business is a very exciting and busy time. There is so much to be done and so little time to do it in. If you expect to have employees, there are a variety of federal and state forms and applications that will need to be completed to get your business up and running. That's where we can help.

### **Employer Identification Number (EIN)**

Securing an Employer Identification Number (also known as a Federal Tax Identification Number) is the first thing that needs to be done since many other forms require it. The fastest way to apply for an EIN is online through the IRS website or by telephone. Applying by fax and mail generally takes one to two weeks. Note that effective May 21, 2012, you can only apply for one EIN per day. The previous limit was 5.

### **State Withholding, Unemployment, and Sales Tax**

Once you have your EIN, you need to fill out forms to establish an account with the State for payroll tax withholding, Unemployment Insurance Registration, and sales tax collections (if applicable).

### **Payroll Record Keeping**

Payroll reporting and record keeping can be very time-consuming and costly, especially if it isn't handled correctly. Also, keep in mind, that almost all employers are required to transmit federal payroll tax deposits electronically. Personnel files should be kept for each employee and include an employee's employment application as well as the following:

**Form W-4** is completed by the employee and used to calculate their federal income tax withholding. This form also includes necessary information such as address and social security number.

**Form I-9** must be completed by you, the employer, to verify that employees are legally permitted to work in the U.S.

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# Form of Business Organization: Which Should You Choose?

The decision as to which type of business organization to use when starting a business is a major one. And, it's a decision to be revisited periodically as your business develops. While professional advice is critical in making this decision, it's also important to have a general understanding of the options available. This Financial Guide provides just such an overview.

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Businesses fall under one of two federal tax systems:

1. **Taxation of both the entity itself (on the income it earns) and the owners (on dividends or other profit participation the owners receive from the business).** This system applies to the business S-corporation-called the "C-corporation" (C-corp) for reasons we'll see shortly and the system of taxing first the corporation and then its owners is called the "corporate double tax."
2. **Pass-through taxation.** This type of entity is in itself not taxed; however, each owner is each taxed on their proportionate shares of the entity's income. The leading forms of pass-through entity (further explained below) are:

- Partnerships, of various types.
- S-corporations (S-corps), as distinguished from C-corps.
- Limited liability companies (LLCs).

A sole proprietorship such as John Doe Plumbing or Marcus Welby, M.D. is also considered a pass-through entity even though no "organization" may be involved.

The first major consideration (in this case, a tax consideration) in choosing the form of doing business is whether to choose an entity (such as a C-corp) that has two levels of tax on income or a pass-through entity that has only one level (directly on the owners).

Co-owners and investors in pass through entities may need to have their operating agreements require a certain level of cash distributions in profit years, so they will have funds from which to pay taxes.

Losses are directly deductible by pass-through owners while C-corp losses are deducted only against profits (past or future) and don't pass through to owners.

Business and tax planners therefore typically advise new businesses-those expected to have startup losses-to begin as pass through entities, so the owners can deduct losses currently against their other income, from investments or another business.

The major business consideration (as opposed to tax consideration) in choosing the form of business is limitation of liability, that is, to protect your assets from the claims of business creditors. State law grants limitation of liability to corporations (C and S-corps), LLCs, and partners in certain forms of partnership. Liability for corporations and LLCs is generally limited to your actual or promised investment in the business.

## **Types of Business Entities**

### **C and S-Corps**

The S-Corp (so named from a chapter of the tax code) is a tax device created by federal law in 1958. It is a regular corporation with regular limited liability under state law, whose owners elect pass through status for federal tax purposes. That status requires compliance with a number of often constricting rules but, with some exceptions, complying corporations escape federal corporate tax. As regular business S-corporations under state law, they may be taxed under state tax law as regular corporations, or in some other way. Corporations whose owners don't choose to make the federal S-corp election are called C-corps (after another chapter of the tax code).

## **Partnerships**

Ordinary partnerships, called "general partnerships," do not have limited liability under state law.

Limited partnerships limit liability for some partners but not others. A limited partnership has both general partners (who manage the business) and limited partners (who, in essence, are passive investors). The liability of limited partners is generally limited to their investments. The liability of general partners is theoretically unlimited, but can be limited in practice where the general partner is an entity, such as a corporation, with limited liability. A limited partner who takes on what state law considers "too much" management participation is treated as a general partner, losing limited liability.

Both general and limited partnerships are treated as pass-through entities under federal tax law, but there are some relatively minor differences in tax treatment between general and limited partners.

A still more recent development, not yet adopted everywhere, is the limited liability partnership (discussed below) which was designed for professional practices.

Other partnership forms are the giant "publicly traded partnerships" (treated as C-corps for tax purposes) and limited liability limited partnerships (adopted in only a few states) which limit the liability of general partners (where two or more) as well as of limited partners.

## **Limited Liability Companies (LLCs)**

LLCs have become the most popular business form for new entities, and many existing entities have converted to this form. They exist in some form in every state. They embody limited liability features of corporations and pass-through characteristics of partnerships and S-corps, but are more flexible than S-corps.

For business law purposes, LLC members may be either passive investors or active investor-managers. Unlike with limited partnerships, active management won't affect limitation of liability. For federal tax purposes, LLCs are treated as partnerships (unless they elect otherwise).

Since LLC rules vary from state to state, a characteristic, power or rule in the state where an LLC was created may not apply in some other state where it does business.

Some states do, and some states do not, authorize LLCs with only one member.

Where one becomes the sole surviving LLC member in a state that doesn't allow single member LLCs, consider quickly incorporating (to regain limited liability) and electing S-corp status (to retain pass through treatment).

## Choosing the Tax Treatment

Since 1997, the IRS has allowed business owners a previously unheard-of measure of choice as to how the entity will be federally taxed. It allows you to choose between C-corp and pass through treatment (universally called "check-the-box").

A few choices are *not* allowed. If the entity is incorporated, it must be treated as a corporation (which doesn't preclude an S-corp election if otherwise available). *Publicly traded* partnerships and *publicly traded* LLCs must be treated as C-corps.

Special rules apply to foreign entities.

All other forms of partnership may be taxed either as C-corps or as pass-through entities (either as partnerships or, if S-corp status is available and elected, as an S-corp.)

An LLC with two or more members may choose to be taxed as a C-corp, a partnership or an S-corp (if elected). An LLC with a single member (where this is allowed) may choose either to be taxed as a C-corp or an S-corp (if elected) or to have the entity disregarded. In this case, if the LLC is owned by an individual, the individual is taxed directly (and can deduct losses) as with a sole proprietorship.

Typically, partnerships and multimember LLCs choose to be taxed as partnerships while single member LLCs choose to have the entity disregarded. With "check-the-box," the IRS will no longer question your right to combine limited liability with pass through treatment or, if you wish, to waive pass through treatment for an entity otherwise entitled to it (with the exceptions noted above).

Any choice has consequences. For example, if you opted last year for corporate treatment and want partnership treatment this year, you'll be treated as liquidating the corporation, and taxed accordingly (discussed below).

Most-but not all-states that impose corporate taxes follow a taxpayer's federal "check-the-box" choice for state tax purposes. This doesn't necessarily mean that the tax treatment will be the same. For example, a state may accept an LLC's election to be taxed as a partnership and still impose an entity-level tax on the LLC.

An election to be taxed as a certain type of entity for federal tax purposes does not make it such an entity under state business law.

## **Choosing the Form**

Now consider which form will work best for the way you want to run your business and capitalize on its profits or startup losses. "Compared to what?" will be a major consideration so it is necessary to compare a taxable entity (the C-corp) with a pass through entity as well as compare the pass through entity with other types of entities. Tax consequences of changing from one entity to another should also be examined.

A major decision of whether to use a C-corp or some form of pass through C-corp is sometimes necessary from a business standpoint. For example, if interests in the enterprise are to be publicly traded, only the C-corp is appropriate.

For some activities, states may require the corporate form (banks, for example) and S-corp rules may preclude the S-corp form.

From a tax standpoint, while C-corporations present two levels of tax, the first tax (on the corporation) can be at a rate lower than the tax on the owner and the second tax (on the owner) is usually postponed until the owner receives dividends or other assets from the corporation.

Distribution of appreciated assets to the owner, or sale of such assets and distribution of the proceeds, are taxable both to the corporation and then to owners. They are no longer opportunities, as they once were, to avoid two levels of tax.

The tax on the owner may be at reduced capital gains rates. This is the case for appreciated assets distributed in corporate liquidation and, after 2002 and before 2009, it's also usually the case for dividends distributed by ongoing corporations.

Funds can build up in the corporation at a relatively low rate until distributed. However, the eventual tax on the owner, plus the corporate tax, may eat up more of the profits than the single (pass through) tax on the owner does.

A C-corp can minimize corporate tax by paying out all or almost all of its income to owners in the form of compensation and fringe benefits. Assuming these payments are deductible as business expenses, this approximates pass through treatment, since the corporation isn't

taxed on what it receives and then deducts; the owner-recipients alone are taxed on this. This arrangement works best in personal service businesses, where full business expense deduction is more likely to be allowed.

The IRS and the courts may limit deduction in other settings, finding owner compensation to be "unreasonable" and partly nondeductible where it reflects a distribution of profits from capital or from the efforts of non-owners.

To summarize, some businesses may find C-corp status necessary for business purposes. But only comparatively rarely will it be a preferable tax choice for a new business.

## **Choosing the Pass through Entity**

If you decide on a pass-through entity, which of the several do you choose? The following is a brief discussion of the rules applicable to each.

### **S-corporation**

Limitation of liability gives S-corps the edge-for business reasons-over general partnerships, sole proprietorships, limited partnerships (as to limited partners whose partnership activity might expose them to unlimited liability), and LLCs in states that don't allow single member LLCs.

Limited liability comes at a cost, however, since states may impose a tax on S-corps not imposed on entities with unlimited liability.

S-corps are subject to a number of significant rules and restrictions:

- All owners must agree to S-corp status. This means that one co-owner can exact a price or impose conditions for his or her agreement.
- An S-corp can have only one class of stock, which means that income, losses and other tax attributes are allotted among stockholders in proportion to stock ownership.
- The number of co-owners is limited (to 100, with qualifications, counting members of the same family as one stockholder).
- There are limitations as to who can be co-owners (for example, a nonresident alien cannot) and as to the kind of business that can qualify for as an S-corp (for example, an insurance company cannot).

Failure to meet, or ceasing to meet, these requirements means loss of S status and conversion to C-corp status and C-corp taxes.

These limits and restrictions will be contrasted, below, with the more liberal tax rules for partnerships and LLCs.

S-corps are often preferred because they are simple to operate. However, they are not suitable for many businesses. The much wider range of options for partnerships and LLCs introduces tax planning complexity which may be more than many or most small businesses can effectively use or understand.

## LLCs vs. S-corporations

LLCs and S-corps share the same business advantage-limitation of liability. S-corps are a bit better understood by the business community because LLCs are new and vary from state to state.

The *tax* advantages of LLCs, as compared to S-corps, are the tax advantages of *partnerships*. All the points below where LLCs outscore S-corps arise because LLCs can choose *partnership tax status*.

- LLC can to some degree allocate tax attributes, like income or certain kinds of income, depreciation deductions, etc., disproportionately among members to suit their individual tax situations (unlike S-corps limited by the effect of the single-class-of-stock rule).
- S-corp owners can deduct startup or operating losses up to their investment plus any debt that the S-corp owes *them*. LLC members can do the same but can deduct further, up to their share of the debt the LLC owes *others*.
- Adding co-owners after the entity is formed is easier with LLCs. An outsider's transfer of appreciated property for an LLC membership interest is tax-free. A comparable transfer to an S-corp is taxable unless the new co-owner-transferor (or group of transferors) owns more than 80 percent of the S-corp after the transfer.
- Complex tax adjustments ("basis adjustments") can be made by the LLC when LLC interests change hands or LLC property is distributed. These adjustments, unavailable with S-corps, can have the effect of reducing amounts taxable to certain LLC members.
- Distribution of appreciated LLC property to LLC members is not taxable to the LLC. Comparable S-corp distributions to stockholders **are** taxable to the S-corp.

Depending on circumstances, S-corp status can be preferable to LLC status when the owners leave the business. The LLC is **not** taxed when appreciated property is distributed to its members, which is a standard form of business liquidation. But the members would be taxed on distributions exceeding the "basis" (broadly, the amount they invested) of their interests. S-corp owners, on the other hand, can arrange a tax-free exit, via a corporate reorganization in



which they transfer their S-corp stock for stock in a corporate acquirer. (Later sale of stock in the acquirer would be taxable.)

Depending on state law, S-corps, and LLCs may be taxed at the entity level in states where they do business.

## **LLCs vs. Partnerships**

LLCs, with their limited liability for all members, have the edge on general and limited partnerships from a **business** standpoint. While the federal tax treatment of partners and LLC members is basically the same, there are occasional special tax rules for limited partners (especially self-employment tax rules).

It is not clear whether these special tax rules extend to **non**-manager LLC members.

LLCs are more likely than partnerships to be subject to a state tax.

## **LLCs vs. Proprietorships**

LLCs, with their limited liability, are preferable, where available, for sole proprietors from a business standpoint. Where the sole proprietor so elects, the LLC is ignored and the proprietor is taxed directly under federal tax rules as if no separate entity existed.

Some states do-and some do not-ignore the LLC entity for state tax purposes.

## **Professional Practice Entities**

Professional practices (such as doctors and lawyers) have a number of options as to their form of business entity.

## **Professional Corporations (P.C.s)**

These provide limited liability for general business debts but not for the professional's own malpractice and, in some states, no limited liability for malpractice of fellow practitioners in the firm. They may be C-corps or S-corps. Unlike many other C-corps, a P.C. C-corp can use the cash method of accounting.

## **LLCs**

Most states allow professionals to practice in LLCs, either under a general LLC law or a special Professional Limited Liability Company law (PLLC). In either case, liability is not

limited for the professional's own malpractice but, depending on the state, may be limited for the malpractice of other firm members and for other firm debts. These LLCs share the comparative advantages (and minor disadvantages) of other LLCs.

## Limited Liability Partnerships (LLPs)

LLPs are general partnerships whose general partners have limited liability. They are designed for professional practices. A partner is liable for his or her own malpractice but not for a partner's malpractice or, depending on state law, other acts of partners. Typically they are required by state law to maintain malpractice insurance, and are obliged to pay a per-partner fee to keep their status, but are not subject to entity-level tax.

## Sole Proprietors and Partners

Many practitioners choose to practice as sole proprietors or partners, rather than in a limited liability entity. They reason that their main exposure to liability is to malpractice claims, and the entity won't protect against claims for their own malpractice (or, in some states, for a partner's malpractice). They therefore, choose to rely on malpractice insurance (which practitioners in limited liability entities may have too).

Sole proprietorships and partnerships are less likely than limited liability entities to be subject to state entity level tax.

## Other Pros and Cons of C-Corps

A C-corp can be preferable to pass through entities as to fringe benefits. As employees, owner-employees of a C-corp qualify for certain employee fringe benefits. On the other hand, self-employed persons (partners, LLC members, sole proprietors, and more than 2 percent stockholders in S-corps) **don't** qualify.

Health insurance can be wholly tax-free to C-corp owner-employees (through full deduction by the C-corp and full tax exemption for the owner-employee). However, it is only partly tax-free to the self-employed, because of their limited tax deduction for this item.

Another modest *advantage* of the C-corp is that they are less likely to be subject to passive loss deduction limitations. These limit the opportunity to deduct losses from activities the taxpayer doesn't "materially participate" in, against income from investments or other businesses. Typically, limited partners have been the group most subject to passive loss limitations.

Another tax *disadvantage* of C-corp status is its limited ability to report for tax purposes on the cash method of accounting, which generally defers tax as compared to the accrual method.

## **Further Insights on S-Corps**

A qualifying S-corp, generally nontaxable, can be subjected to C-corp taxation on certain items without losing S status for other items. This happens when a C-corp converts to an S-corp and carries over appreciated property later sold at a gain. The S-corp pays a corporate tax on the gain, which is then taxed to stockholders (reduced by the corporate tax). Because S-corps are intended to be operating companies rather than holding companies, this also happens when the S-corp has "excessive" passive investment-type income (interest, dividends, and the like, in excess of 25 percent of gross receipts). Here the excess is subject to corporate tax and is then taxed to stockholders (minus the corporate tax).

Some see S-corps as a way to reduce employment taxes. For example, one earning \$120,000 in a sole proprietorship might convert to an S-corp and take \$70,000 in pay and \$50,000 in dividends. Income taxes are unchanged by this but, it's reasoned, \$50,000 now received as dividends escapes employment tax (the \$120,000 of self-employment earnings was subject to both retirement and Medicare tax up to \$102,000 for 2008 and \$97,500 for 2007 and Medicare tax above that). In abuse situations, such as where little or no wages were paid, IRS has treated the dividends as pay subject to employment taxes on the owner-employees and on the S-corp employer. But in cases where substantial wages were paid, along with substantial dividends, IRS has not objected.

## **Changing To Another Entity**

The many advantages of LLCs, for both business and tax reasons, have encouraged many business owners to convert, or consider converting, to the LLC form. But other changes of entity may suit particular situations—for example, general partnership to LLP (for business reasons) or C-corp to S-corp (for tax reasons). For tax purposes, a change of entity via a check-the-box decision is treated for tax purposes as an actual change of the entity (whatever may happen under state business law).

Here, briefly and in broad outline, is what happens for federal tax purposes when entity status is changed (or treated as changed under-check-the-box). How these apply in your own situation must be reviewed in depth with a tax/business advisor.

- C-corp converts to S-corp or vice versa. No tax on the conversion. Pass through treatment applies while it is an S-corp.
- C- corp or S-corp converts to LLC, partnership or sole proprietorship. Generally, a tax on the liquidation of the corporation, with pass through treatment for the new entity (in modified form in the case of a liquidating S-corp).
- Partnership converts to LLC or vice versa; sole proprietorship converts to single member LLC or vice versa. No tax on conversion-pass through treatment continues.
- LLC, partnership or sole proprietorship converts to C or S-corp. Generally, no tax on conversion. Pass through treatment (in modified form) for S-corp income.

## Government and Non-Profit Agencies

- [The Small Business Administration \(SBA\)](#) has offices located throughout the United States. Contact SBA through their website.

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# Advantages of Incorporating

## Why Incorporate?

All legal and tax professionals agree, if your business is not incorporated you may be throwing away thousands of dollars in tax savings and deductions.

In addition, all of your personal assets such as your home, cars, boats, savings and investments are at risk and could be used to satisfy any law suits, debt or liability incurred by the business. Forming a Corporation can provide the protection and tax savings needed to give you peace of mind and make your business even more successful and profitable.

## Some Benefits Include:

**Liability Protection:** Properly forming and maintaining a corporation will provide personal liability protection to the owners or shareholders of the corporation for any debt or liability

incurred by the business. Personal liability of the shareholders is normally limited to the amount of money invested in the corporation.

**Tax Advantages:** Another important benefit is that a corporation can be structured many ways to provide substantial tax savings. You can minimize self-employment taxes and increase the number of allowable deductions lowering the taxes you pay on the income of the business. Many corporations structure retirement and tax deferred savings plans for their owners and employees which can provide even greater tax savings.

**Raising Capital:** Sale of stock for the purposes of raising capital is often more attractive to investors than other forms of equity sales. A corporation can also issue Corporate Bonds to raise capital for expenditures without compromising the ownership of the business.

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## Advantages of Limited Liability Companies

### Combining the Best Aspects of Partnerships and Corporations

A Limited Liability Company, or LLC, is not a corporation, although it offers many of the same advantages. An LLC is best described as a combination of a corporation and a partnership. LLCs offer the limited liability of a corporation while allowing more flexibility in managing the business and organization.

An LLC does not pay any income tax itself. It's a "flow through" entity that allows profits and losses to flow through to the tax returns of the individual members, avoiding the double taxation of C corporations.

While setting up an LLC can be more difficult than creating a partnership (or sole proprietorship), running one is significantly easier than running a corporation. Here are the main features of an LLC:

### Limited Personal Liability

Like shareholders of a corporation, all LLC owners are protected from personal liability for business debts and claims. This means that if the business itself can't pay a creditor -- such as a supplier, a lender, or a landlord -- the creditor cannot legally come after any LLC member's house, car, or other personal possessions. Because only LLC assets are used to pay off business debts, LLC owners stand to lose only the money that they've invested in the LLC. This feature is often called "limited liability."

While LLC owners enjoy limited personal liability for many of their business transactions, it is important to realize that this protection is not absolute. See [Exceptions to Limited Liability](#).

## **LLC Taxes**

Unlike a corporation, an LLC is not considered separate from its owners for tax purposes. Instead, it is what the IRS calls a "pass-through entity," like a partnership or sole proprietorship. This means that business income passes through the business to the LLC members, who report their share of profits -- or losses -- on their individual income tax returns. Each LLC member must make quarterly estimated tax payments to the IRS.

While an LLC itself doesn't pay taxes, co-owned LLCs must file Form 1065, an informational return, with the IRS each year. This form, the same one that a partnership files, sets out each LLC member's share of the LLC's profits (or losses), which the IRS reviews to make sure the LLC members are correctly reporting their income.

## **LLC Management**

The owners of most small LLCs participate equally in the management of their business. This arrangement is called "member management."

The alternative management structure -- somewhat awkwardly called "manager management" -- means that you designate one or more owners (or even an outsider) to take responsibility for managing the LLC. The non-managing owners (sometimes family members who have invested in the company) simply sit back and share in LLC profits. In a manager-managed LLC, only the named managers get to vote on management decisions and act as agents of the LLC.

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# **Business Plans: How To Prepare An Effective One**

One of the major steps in starting a new business or getting financing is to prepare a business plan. This Financial Guide provides you with the basic information that you need to include in your business plan.

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A well thought out business plan is a valuable tool for any new company or one that is seeking financing. It also provides milestones to gauge your success and the process of developing a business plan helps you think through some important issues that you may not have considered yet.

Before you begin preparing your business plan, take the time to explore and evaluate your business (and personal) goals. You can then use this information to build a comprehensive and effective business plan that will help you reach these goals.

The purpose of this Financial Guide is to provide a basic introduction to preparing a business plan, rather than specific details to be incorporated into the plan since those depend on your specific goals and the nature of the specific business. Professional guidance is recommended when it comes to the actual preparation of the plan, particularly for the financial components.

## **If You're Starting a New Business**

If the reason for preparing the business plan is that you are starting a new business, you should first examine your reasons for wanting to go into business. Some of the most common reasons for starting a business are:

- You want to be your own boss.
- You want financial independence.
- You want creative freedom.
- You want to fully use your skills and knowledge.

Next, you need to determine what business is "right for you." Ask yourself these questions:

- What do I like to do with my time?
- What technical skills have I learned or developed?
- What do others say I am good at?
- Will I have the support of my family?
- How much time do I have to run a successful business?
- Do I have any hobbies or interests that are marketable?

Then, you should identify the niche your business will fill. Start by conducting the research necessary to answer questions like these:

- What business am I interested in starting?

- What services or products will I sell?
- Is my idea practical, and will it fill a need?
- What is my competition?
- What is my business's advantage over existing firms?
- Can I deliver a better quality service?
- Can I create a demand for my business?

You will also need to consider several options for getting your business off the ground:

- Do you want to purchase an existing business or start one from scratch?
- Are there franchises available for this type of business? If so, does a franchise make sense for you?

The final step before developing your plan is the pre-business checklist. You should answer these questions:

- What skills and experience do I bring to the business?
- What will be my legal structure?
- How will my company's business records be maintained?
- What insurance coverage will be needed?
- What equipment or supplies will I need?
- How will I compensate myself?
- What financing will I need?
- Where will my business be located?
- What will I name my business?
- Your answers will help you create a focused, well-researched business plan, and that should serve as a blueprint. It should detail how the business will be operated, managed, and capitalized.

Based on your initial answers to the questions listed above, the next step is to formulate a business plan. A business plan sets forth the mission or purpose of the business venture, describes the product or services to be provided, presents an analysis of the market state, outlines goals that the business has and how it intends to achieve those goals, and last but not least, includes a formal financial plan.

In most cases, a business plan is necessary to obtain external capital for your business, but it also serves a number of other purposes. It forces you to critically evaluate the feasibility of your business and whether it will provide a return which is appropriate to the time and money you will invest in the business. The plan provides a benchmark against which you can evaluate the success of your business in later years.



## **What the Business Plan Should Include**

Whether you are starting a new business, seeking financing for an existing business, attempting to analyze a new market, or wanting to define and evaluate future growth, the following outline of a typical business plan can serve as a guide. However, you should adapt it to your specific business.

## **Introduction and Mission Statement**

In the introductory section of your business plan, you should:

- Give a detailed description of the business and its goals.
- Discuss the ownership of the business and its goals.
- List the skills and experience you bring to the business.
- Discuss the advantages you and your business have over your competition.

## **Products, Services and Markets**

In this section, you must describe your products and/or services and:

- Identify the customer demand for your product/service.
- Describe how your product/service is unique.
- Identify your market, as well as its size and locations.
- Explain how your product/service will be advertised and marketed.
- Explain the pricing strategy.

## **Financial Management**

In this section, you should:

- Explain the source and amount of initial equity capital.
- Develop a monthly operating budget for the first year.
- Develop an expected (return on investment), or ROI, and a monthly cash flow for the first year.
- Provide projected income statements and balance sheets for a two-year period.
- Discuss your break-even point.
- Explain your personal balance sheet and method of compensation.
- Discuss who will maintain your accounting records and how they will be kept.
- Provide "what if" statements that address alternative approaches to any problem that may develop.

## **Operations**

In this section it is important to:

- Explain how the business will be managed on a day-to-day basis.
- Discuss hiring and personnel procedures.
- Discuss insurance, lease or rent agreements, and issues pertinent to your business.
- Account for the equipment necessary to produce your product or services.
- Account for production and delivery of products and services.

## **Concluding Statement**

In the ending statement, you summarize your business goals, objectives, and express your commitment to the success of your business.

Once you have completed your business plan, review it with a friend or business associate. When you feel comfortable with the content and structure, make an appointment to review and discuss it with your banker. The business plan is a flexible document that should change as your business grows.

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# **Raising Capital: How To Get Money For a Small Business**

In addition to drive, ambition and a great deal of planning, starting and expanding a small business generally requires capital. Capital may come from family, friends, lenders or others. This Financial Guide provides an overview of how to get the capital you need to start or grow your business.

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One key to successful business start-up and expansion is your ability to obtain and secure appropriate financing. Raising capital is one of the most basic of all business activities. But as many new entrepreneurs quickly discover, raising capital may not be easy. In fact, it can be a complex and frustrating process and professional guidance should be considered, especially with regard to financial information needed for the loan proposal. This Financial Guide focuses on ways a small business can raise money and explains how to prepare a loan proposal.

## **Finding Sources of Money**

There are several sources to consider when looking for financing. It is important to explore all of your options before making a decision. These include:

- **Personal Savings.** The primary source of capital for most new businesses comes from savings and other forms of personal resources. While credit cards are often used to finance business needs, there may be better options available, even for very small loans.
- **Friends and Relatives.** Many entrepreneurs look to private sources such as friends and family when starting out in a business venture. Often, money is loaned interest free or at a low interest rate, which can be beneficial when getting started.
- **Banks and Credit Unions.** The most common source of funding, banks and credit unions, will provide a loan if you can show that your business proposal is sound.
- **Venture Capital Firms.** These firms help expanding companies grow in exchange for equity or partial ownership.

## **Borrowing Money**

It is often said that small business people have a difficult time borrowing money, but this is not necessarily true. Banks make money by lending money; however, the inexperience of many small business owners in financial matters often prompts banks to deny loan requests.

Requesting a loan when you are not properly prepared sends a signal to your lender. That message is: "High Risk!" To be successful in obtaining a loan, you must be prepared and organized. You must know exactly how much money you need, why you need it, and how you will pay it back. You must be able to convince your lender that you are a good credit risk.

Terms of loans may vary from lender to lender, but there are two basic types of loans: short-term and long-term.

A short-term loan generally has a maturity date of one year. These include working capital loans, accounts receivable loans, and lines of credit.

Long-term loans generally mature between one and seven years. Real estate and equipment loans are also considered long-term loans but may have a maturity date of up to 25 years. Long-term loans are used for major business expenses such as purchasing real estate and facilities, construction, durable equipment, furniture and fixtures, vehicles, etc.

## **How to Write a Loan Proposal**

Approval of your loan request depends on how well you present yourself, your business and your financial needs to a lender. Remember, lenders want to make loans, but they must make loans they know will be repaid. The best way to improve your chances of obtaining a loan is to prepare a written proposal.

A good loan proposal will contain the following key elements:

### **General Information**

- Business name, names of principals, social security number for each principal, and the business address.
- Purpose of the loan: exactly what the loan will be used for and why it is needed.
- Amount required: the exact amount you need to achieve your purpose.

### **Business Description**

- History and nature of the business: details of what kind of business it is, its age, number of employees and current business assets.
- Ownership structure: details on your company's legal structure.

### **Management Profile**

Develop a short statement on each principal in your business; provide background, education, experience, skills, and accomplishments.

### **Market Information**

Clearly define your company's products as well as your markets. Identify your competition and explain how your business competes in the marketplace. Profile your customers and explain how your business can satisfy their needs.

## **Financial Information**

- Financial statements: balance sheets and income statements for the past three years. If you are just starting out, provide projected balance sheets and income statements.
- Personal financial statements on yourself and other principal owners of the business.
- Collateral you would be willing to pledge as security for the loan.

## **How Your Loan Request Will Be Reviewed**

When reviewing a loan request, the bank official is primarily concerned about repayment. To help determine this ability, many loan officers will order a copy of your business credit report from a credit-reporting agency. Therefore, you should work with these agencies to help them present an accurate picture of your business. Using the credit report and the information you have provided, the lending officer will consider the following issues:

- Have you invested savings or personal equity in your business totaling at least 25 to 50 percent of the loan you are requesting? (Remember, a lender or investor will not finance 100 percent of your business.)
- Do you have a sound record of credit-worthiness as indicated by your credit report, work history and letters of recommendation? This is very important.
- Do you have sufficient experience and training to operate a successful business?
- Have you prepared a loan proposal and business plan that demonstrate your understanding of and commitment to the success of the business?
- Does the business have sufficient cash flow to make the monthly payments on the amount of the loan request?

## **SBA Programs**

The SBA offers a variety of financing options for small businesses. The SBA's assistance usually is in the form of loan guarantees; i.e., it guarantees loans made by banks and other private lenders to small business clients. Generally, the SBA can guarantee up to \$3.75

million or 75 percent of the total loan value. The average size of an SBA-guaranteed loan is \$368,737.

Whether you are looking for a long-term loan for machinery and equipment, a general working capital loan, a revolving line of credit, or a "microloan," the SBA has a financing program to fit your needs.

The SBA guaranteed more than 50,000 loans totaling \$19.2 billion to America's small businesses in fiscal year 2014 that otherwise would not have had such access to capital. It also provides assistance to small businesses and aspiring entrepreneurs through its Small Business Development Centers located throughout the United States and its territories.

The 7(a) Loan Guaranty Program, financing that can satisfy the requirements of almost any new or growing small business. The SBA offers a number of specialized loan and lender delivery programs.

- [7\(a\) Loan and 7\(m\) Microloan Programs](#)
- [CAPLines Program](#)
- [Export Working Capital and International Trade Loans](#)
- [Disaster Assistance Loans](#)
- [SBA Express](#)
- [Certified Development Company \(CDC\) 504 Loan Program](#)

## **The 7(a) Loan Guaranty Program**

The [7\(a\) Loan Guaranty Program](#) is the SBA's primary loan program. The SBA reduces risk to lenders by guaranteeing major portions of loans made to small businesses. This enables the lenders to provide financing to small businesses when funding is otherwise unavailable on reasonable terms.

The eligibility requirements and credit criteria of the program are very broad in order to accommodate a wide range of financing needs.

When a small business applies to a lending institution for a loan, the lender reviews the application and decides if it merits a loan on its own or if it requires additional support in the form of an SBA guaranty. SBA backing on the loan is then requested by the lender. In guaranteeing the loan, the SBA assures the lender that, in the event, the borrower does not repay the loan, the government will reimburse the lender for its loss. By providing this guaranty, the SBA helps tens of thousands of small businesses every year get financing they would not otherwise obtain.

To qualify for an SBA guaranty, a small business must meet the 7(a) criteria and the lender must certify that it could not provide funding on reasonable terms except with an SBA guaranty. SBA can guarantee as much as 85 percent on loans of up to \$150,000 and 75 percent on loans of more than \$150,000. SBA's maximum exposure amount is \$3,750,000. Thus, if a business receives an SBA-guaranteed loan for \$5 million, the maximum guarantee to the lender will be \$3,750,000 or 75 percent. SBA Express loans have a maximum guarantee set at 50 percent.

**How The Procedure Works.** You submit a loan application to a lender for initial review. If the lender approves the loan subject to an SBA guaranty, a copy of the application and a credit analysis are forwarded by the lender to the nearest SBA office. After SBA approval, the lending institution closes the loan and disburses the funds; you make monthly loan payments directly to the lender. As with any loan, you are responsible for repaying the full amount of the loan. There are no balloon payments, prepayment penalties, application fees or points permitted with 7(a) loans. Repayment plans may be tailored to each individual business.

**Permissible Use of Proceeds.** You can use a 7(a) loan to expand or renovate facilities; purchase machinery, equipment, fixtures and leasehold improvements; finance receivables and augment working capital; refinance existing debt (with compelling reason); finance seasonal lines of credit; construct commercial buildings; and/or purchase land or buildings.

**Terms.** The SBA's loan programs are generally intended to encourage longer term small-business financing. However, actual loan maturities are based on the ability to repay, the purpose of the loan proceeds and the useful life of the assets financed. However, maximum loan maturities have been established: 25 years for real estate, up to 10 years for equipment (depending on the useful life of the equipment) and generally up to seven years for working capital. Short-term loans and revolving lines of credit are also available through the SBA to help small businesses meet their short-term and cyclical working capital needs.

**Interest Rates.** Both fixed and variable interest rate structures are available. The maximum rate is composed of two parts, a base rate, and an allowable spread. There are three acceptable base rates (A prime rate published in a daily national newspaper, London Interbank One Month Prime plus 3 percent and an SBA Peg Rate).

Lenders are allowed to add an additional spread to the base rate to arrive at the final rate. For loans with maturities of shorter than seven years, the maximum spread will be no more than 2.25 percent. For loans with maturities of seven years or more, the maximum spread will be 2.75 percent. The spread on loans of less than \$50,000 and loans processed through Express procedures have higher maximums.

**Fees.** Loans guaranteed by the SBA are assessed a guarantee fee. This fee is based on the loan's maturity and the dollar amount guaranteed, not the total loan amount. The lender initially pays the guaranty fee and they have the option to pass that expense on to the borrower at closing. The funds to reimburse the lender can be included in the overall loan proceeds.

On loans under \$150,000 made after October 1, 2013, the fees will be set at zero percent. On any loan greater than \$150,000 with a maturity of one year or shorter, the fee is 0.25 percent of the guaranteed portion of the loan. On loans with maturities of more than one year, the normal fee is 3 percent of the SBA-guaranteed portion on loans of \$150,000 to \$700,000, and 3.5 percent on loans of more than \$700,000. There is also an additional fee of 0.25 percent on any guaranteed portion of more than \$1 million.

**Collateral.** The SBA expects every 7(a) loan to be fully secured, but the SBA will not decline a request to guarantee a loan if the only unfavorable factor is insufficient collateral, provided all available collateral is offered. This means every SBA loan is to be secured by all available assets (both business and personal) until the recovery value equals the loan amount or until all assets have been pledged (to the extent that they are reasonably available). Personal guarantees are required from all owners of 20 percent or more of the equity of the business, and lenders can require personal guarantees of owners with less than 20 percent ownership. Liens on personal assets of the principals may be required.

**Eligibility.** SBA provides loans to businesses; so the requirements of eligibility are based on specific aspects of the business and its principals. As such, the key factors of eligibility are based on what the business does to receive its income, the character of its ownership and where the business operates.

SBA generally does not specify what businesses are eligible. Rather, the agency outlines what businesses are not eligible. However, there are some universally applicable requirements. To be eligible for assistance, businesses must:

- Operate for profit
- Be small, [as defined by SBA](#)
- Be engaged in, or propose to do business in, the United States or its possessions
- Have reasonable invested equity
- Use alternative financial resources, including personal assets, before seeking financial assistance
- Be able to demonstrate a need for the loan proceeds
- Use the funds for a sound business purpose
- Not be delinquent on any existing debt obligations to the U.S. government



**Ineligible Businesses.** A business must be engaged in an activity SBA determines as acceptable for financial assistance from a federal provider. For a [list of businesses types are not eligible for assistance](#) because of the activities they conduct visit the SBA website.

**What You Need to Take to the Lender.** Once you have decided to apply for a loan guaranteed by the SBA, you will need to collect the appropriate documents for your application. The SBA does not provide direct loans. The process starts with your local lender, working within SBA guidelines.

Use the checklist below to ensure you have everything the lender will ask for to complete your application. Once your loan package is complete, your lender will submit it to the SBA.

1. **SBA Loan Application** - To begin the process, you will need to complete an SBA loan application form. Access the most current form here: [Borrower Information Form - SBA Form 1919](#)
2. **Personal Background and Financial Statement** - To assess your eligibility, the SBA also requires you complete a [Statement of Personal History](#) and [Personal Financial Statement](#).
3. **Business Financial Statements** - To support your application and demonstrate your ability to repay the loan, prepare and include the following financial statements:
  4. Profit and Loss (P&L) Statement - This must be current within 90 days of your application. Also include supplementary schedules from the last three fiscal years.
  5. Projected Financial Statements - Include a detailed, one-year projection of income and finances and attach a written explanation as to how you expect to achieve this projection.
4. **Ownership and Affiliations** - Include a list of names and addresses of any subsidiaries and affiliates, including concerns in which you hold a controlling interest and other concerns that may be affiliated by stock ownership, franchise, proposed merger or otherwise with you.
5. **Business Certificate/License** - Your original business license or certificate of doing business. If your business is a corporation, stamp your corporate seal on the SBA loan application form.
6. **Loan Application History** - Include records of any loans you may have applied for in the past.
7. **Income Tax Returns** - Include signed **personal** and **business** federal income tax returns of your business's principals for previous three years.
8. **Resumes** - Include personal resumes for each principal.
9. **Business Overview and History** - Provide a brief history of the business and its challenges. Include an explanation of why the SBA loan is needed and how it will help the business.
10. **Business Lease** - Include a copy of your business lease, or note from your landlord, giving terms of proposed lease.

11. **If You are Purchasing an Existing Business** - The following information is needed for purchasing an existing business:
12. Current balance sheet and P&L statement of business to be purchased
13. Previous two years federal income tax returns of the business
14. Proposed Bill of Sale including Terms of Sale
15. Asking price with schedule of inventory, machinery and equipment, furniture and fixtures

In addition to the standard loan guaranty, the SBA has targeted programs under 7(a) that are designed to meet specialized needs. Unless otherwise indicated, they are governed by the same rules, regulations, interest rates, fees, etc. as the regular 7(a) loan guaranty.

## **The 7(m) MicroLoan Program**

[The 7\(m\) MicroLoan Program](#) provides small loans up to \$50,000. Under this program, the SBA makes funds available to nonprofit intermediaries; these, in turn, make the loans. The average loan size is \$13,000.

**Use of Proceeds.** Microloans can be used for working capital, inventory or supplies, furniture or fixtures, and machinery or equipment. Proceeds from an SBA microloan cannot be used to pay existing debts or to purchase real estate.

**Terms Interest Rates and Fees.** Loan repayment terms vary according to several factors such as loan amount, planned use of funds, requirements determined by the intermediary lender, and the needs of the small business borrower. The maximum repayment term allowed for an SBA microloan is six years. Interest rates vary, depending on the intermediary lender and costs to the intermediary from the U.S. Treasury. Generally, these rates will be between 8 and 13 percent.

**Collateral.** Each nonprofit lending organization will have its own requirements but must take as collateral any assets purchased with the microloan. In most cases, the personal guaranties of the business owners are also required.

**Eligibility.** Virtually all types of for-profit businesses that meet SBA eligibility requirements qualify.

## **The CAPLines Program**

[The CAPLines Loan Program](#) is the program under which the SBA helps small businesses meet their short-term and cyclical working-capital needs. The maximum CAPLines loan is \$5 million.

Four loan programs for small businesses are available under CAPLines:

1. **Seasonal Line.** Finances the cost associated with contracts, subcontracts or purchase orders. Proceeds can be disbursed before the work begins. If used for one contract or subcontract when all the expenses are incurred before the buyer pays, it will generally not revolve. If used for more than one contract or subcontract, or for contracts and subcontracts where the buyer pays before all work is done, the line of credit can revolve. The loan maturity is usually based on the length of the contract, but no more than 10 years. Contract payments are generally sent directly to the lender, but alternative structures are available.
2. **Contract Line.** Supports the buildup of inventory, accounts receivable or labor and materials above normal usage for seasonal inventory. The business must have been in business for a period of 12 months and must be able to demonstrate that it has a definite established seasonal pattern. The loan may be used over again after a "clean-up" period of 30 days to finance activity for a new season. These loans also may have a maturity of up to five years. The business may not have another seasonal line of credit outstanding but may have other lines for non-seasonal working capital needs.
3. **Builders Line.** Provides financing for small contractors or developers to construct or rehabilitate residential or commercial property that will be sold to a third party that is not known at the time construction/rehabilitation begins. Loan maturity is generally three years but can be extended up to five years, if necessary, to facilitate the sale of the property. Proceeds are used solely for direct expenses of acquisition, immediate construction and/or significant rehabilitation of the residential or commercial structures. Land purchase can be included if it does not exceed 20 percent of the loan proceeds. Up to five percent of the proceeds can be used for community improvements that benefit the overall property.
4. **Working Capital Line of Credit.** A revolving line of credit (up to \$5,000,000) that provides short-term working capital. Businesses that generally use these lines provide credit to their customers or have inventory as their major asset. Disbursements are generally based on the size of a borrower's accounts receivable and/or inventory. Repayment comes from the collection of accounts receivable or sale of inventory. The specific structure is negotiated with the lender. There may be extra servicing and monitoring of the collateral for which the lender can charge additional fees to the borrower.

**Use of Proceeds.** CAPLines may be used to:

- Finance seasonal working-capital needs

- Finance direct costs needed to perform construction, service and supply contracts, subcontracts, or purchase orders
- Finance direct costs associated with commercial and residential building construction
- Provide general working capital lines of credit that have specific requirements for repayment

## The Export Working Capital Program

[The Export Working Capital \(EWCP\) Loan](#) provides advances for up to \$5 million to fund export transactions from purchase order to collections. This loan has a low guaranty fee and quick processing time.

Contact your local lender to see if they are approved to underwrite EWCP loans. You can apply for EWCP loans before finalizing an export sale or contract.

With an approved EWCP loan in place, you have greater flexibility in negotiating export payment terms. However, disbursements can only be made against firm purchase orders from a foreign buyer or to support foreign accounts receivable.

**Use of Proceeds.** Proceeds may be used for:

- Financing for suppliers, inventory, WIP, or production of export goods or services
- Working capital to support foreign accounts receivable during long payment cycles
- Financing for standby letters of credit used as bid or performance bonds or as down payment guarantees

## The International Trade Loan Program

[The International Trade Loan](#) offers loans up to \$5 million for fixed assets and working capital for businesses that plan to start or continue exporting.

**Eligibility.** International Trade Loans are available if your small business is in a position to expand existing export markets or develop new export markets. These loans are also available if your small business has been adversely affected by import competition and can demonstrate that the loan proceeds will improve your competitive position. Contact your existing lender to determine if they are an SBA-approved 7(a) lender. If so, they are authorized to underwrite an International Trade Loan. SBA will work with your lender to determine borrower eligibility.

**Use of Proceeds.** The borrower may use loan proceeds to acquire, construct, renovate, modernize, improve, or expand facilities and equipment to be used in the United States to produce goods or service involved in international trade and to develop and penetrate foreign markets. Funds also may be used to refinance an existing loan.

## Disaster Assistance Loans Program

SBA provides low-interest [Disaster Assistance Loans](#) to businesses of all sizes, private non-profit organizations, homeowners, and renters. SBA disaster loans can be used to repair or replace the following items damaged or destroyed in a declared disaster: real estate, personal property, machinery and equipment, and inventory and business assets.

Types of loans include:

- **Physical Damage loans** - These loans to cover repairs and replacement of physical assets damaged in a declared disaster. Homeowners, renters, nonprofit organizations, and businesses of all sizes are eligible to apply for physical disaster assistance. There are two types of Physical Damage loans: Home and personal property loans and Business physical disaster loans.

**Home and personal property loans** - If you live in a declared disaster area and have experienced damage to your home or personal property, you may be eligible for financial assistance from SBA — even if you do not own a business. As a homeowner, renter or personal property owner, you may apply to SBA for a loan to help you recover from a disaster.

Homeowners may apply for up to \$200,000 to replace or repair their primary residence. The loans may not be used to upgrade homes or make additions unless required by local building code. If you make improvements that help prevent the risk of future property damage caused by a similar disaster, you may be eligible for up to a 20 percent loan amount increase above the real estate damage, as verified by the SBA.

Renters and homeowners may borrow up to \$40,000 to replace or repair personal property such as clothing, furniture, cars, and appliances damaged or destroyed in a disaster.

**Business physical disaster** - The SBA Business Physical Disaster Loan covers disaster losses not fully covered by insurance. If you own a business located in a declared disaster area that has experienced damage, you may be eligible for financial assistance from SBA. Businesses of any size and most private non-profit organizations may apply to SBA for a loan to recover after a disaster. The SBA Business Physical Disaster Loan covers disaster losses not fully covered by insurance.

SBA makes physical disaster loans of up to \$2 million to qualified businesses or

most private nonprofit organizations in a declared disaster area that have experienced damage to your business. Businesses of any size and most private nonprofit organizations may apply to the SBA for a loan to recover after a disaster. These loan proceeds may be used for the repair or replacement of real property, machinery, equipment, fixtures, inventory, and leasehold improvements.

- Economic Injury Disaster Loans - Small business, small agricultural cooperative, or most private nonprofit organizations. The SBA can provide up to \$2 million (maximum term of 30 years, maximum interest rate of 4 percent) to help meet financial obligations and operating expenses that could have been met had the disaster not occurred. Your loan amount will be based on your actual economic injury and your company's financial needs, regardless of whether the business suffered any property damage.
- Military Reservists Economic Injury Loans (MREIDL) - Provides funds (up to \$2 million, maximum 30 years, maximum interest rate of 4 percent) to help an eligible small business meet its ordinary and necessary operating expenses that it could have met, but is unable to, because an essential employee was called-up to active duty in his or her role as a military reservist.  
The amount of each loan is limited to the actual economic injury as calculated by SBA. The amount is also limited by business interruption insurance and whether the business and/or its owners have sufficient funds to operate. If a business is a major source of employment, SBA has authority to waive the \$2 million statutory limit.
- Mitigation Assistance loans - These loans provide funding to cover small business operating expenses after a declared disaster. You can protect your home or business and reduce property damage with the help of SBA. If you've been affected by a disaster, you can rebuild a stronger business by increasing your SBA disaster assistance loan up to 20% of your verified physical damage to make mitigation improvements. Borrowers generally have two years after their loan approval to request an increase for higher rebuilding costs, code-required upgrades or mitigation. Projects covered by this type of loan include improvements related to flooding, wildfires, wind, and earthquakes.

## **SBA Express Loan Program**

The [SBA Express Loan Program](#) features an accelerated turnaround time of 36 hours for SBA review in response to an application. Capital is available to businesses seeking loans of up to \$350,000 without requiring the lender to use the SBA process. Lenders use their existing documentation and procedures to make and service loans plus SBA Form 1919. The SBA guarantees up to 50 percent of an SBA Express loan. Loans made under this

program generally follow SBA's standards for the 7(a) Loan Program. Your local SBA office can provide you with a list of SBA Express lenders.

Lenders and borrowers can negotiate the interest rate. Rates can be fixed or variable and are tied to the prime rate (as published in The Wall Street Journal), LIBOR, or the optional peg rate (published quarterly in the Federal Register) and may be fixed or variable, but they may not exceed SBA maximums: lenders may charge up to 6.5 percent over the base rate for loans of \$50,000 or less, and up to 4.5 percent over for loans over \$50,000. Lenders are not required to take collateral for loans up to \$25,000; may use their existing collateral policy for loans over \$25,000 up to \$350,000. For revolving credits, small business owners may take up to seven years after the first disbursement to repay the loan.

## **The Certified Development Company (504) Loan Program**

[The Certified Development Company \(504\) Loan Program](#) enables a nonprofit corporation (Certified Development Company or CDC) to contribute to the economic development of its community. CDCs are located nationwide and operate primarily in their state of incorporation (Area of Operation). CDCs work with SBA and private-sector lenders to provide financing to small businesses through the CDC/504 Loan Program, which provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings.

The Role of CDCs is to market the 504 program; package and process 504 loan applications; close and service 504 loans in its Area of Operation. A portfolio must be diversified by business sector. CDCs should also provide small businesses with financial and technical assistance, or help small businesses obtain assistance from other sources, including preparing, closing, and servicing loans under contract with lenders in SBA's 7(a) Loan Program. Loan amounts to the borrower equal to the value of all or part of the borrower's contribution to a project in the form of cash or land, including site improvements.

Newly certified CDCs will be on probation for a period of two years.

**Eligibility.** A CDC must:

- Be a nonprofit corporation in good standing.
- Have at least 25 members representing government organizations responsible for economic development in the Area of Operation and acceptable to SBA; Financial institutions that provide commercial long-term fixed asset financing in the Area of Operation; Community organizations dedicated to economic development in the Area of Operation, such as chambers of commerce, foundations, trade associations, colleges, or universities; Businesses in the Area of Operation; and Additional membership requirements are provided in 13 CFR 120.822.



- Have a Board of Directors chosen from the membership, and representing, at least, three of the four membership groups. Additional Board of Directors requirements are provided in 13 CFR 120.823.
- Have full-time professional management, including an Executive Director (or the equivalent) managing daily operations and a full-time professional staff qualified by training and experience to market the 504 Program; package and process loan applications; close loans; service, and, if authorized by SBA, liquidate the loan portfolio; and sustain a sufficient level of service and activity in the Area of Operation. CDCs may obtain, under written contract and with prior approval from SBA, marketing, packaging, processing, closing, servicing or liquidation services by qualified individuals and entities who live or do business in the CDC's Area of Operation.
- Meet a minimum level of lending activity, providing, at least, two 504 loan approvals each full fiscal year. A CDC's portfolio must reflect an average of one job opportunity per \$65,000 of 504 loan funding.

## **Small Business Investment Company Program**

There is a variety of alternatives to bank financing for small businesses, especially business start-ups. The Small Business Investment Company Program fills the gap between the availability of venture capital and the needs of small businesses that are either starting or growing. Licensed and regulated by the SBA, SBICs are privately owned and managed investment firms that make capital available to small businesses through investments or loans. They use their own funds plus funds obtained at favorable rates with SBA guarantees and/or by selling their preferred stock to the SBA.

SBICs are for-profit firms whose incentive is to share in the success of a small business. In addition to equity capital and long-term loans, SBICs provide debt-equity investments and management assistance.

The Small Business Investment Company (SBIC) Program, administered by the U.S. Small Business Administration (SBA), is a multi-billion investment program created in 1958 to bridge the gap between entrepreneurs' need for capital and traditional sources of financing. Over the past five years, the program has channeled \$17 billion of capital to more than 5,900 U.S. small businesses representing a variety of industries across the country. These results were achieved through a proven public-private partnership that leverages the full faith and credit of the U.S. government to increase the pool of investment capital available to small businesses.

The SBIC Program provides funding to all types of manufacturing and service industries. Some investment companies specialize in certain fields while others seek out small businesses with new products or services because of the strong growth potential. Most, however, consider a wide variety of investment opportunities.



## Surety Bond Program

By law, prime contractors to the federal government must post surety bonds on federal construction projects valued at \$150,000 or more. Many state, county, city and private-sector projects require bonding as well. SBA helps small contractors by guaranteeing bid, performance, and payment bonds issued by participating surety companies for contracts up to \$6.5 million. SBA can guarantee a bond for a contract up to \$10 million if a Federal contracting officer certifies that SBA's guarantee is necessary for the small business to obtain bonding.

**Fees.** SBA charges the small business 0.729 percent of the contract price for a payment or performance bond. There is no charge for a bid bond. SBA charges the surety company 26 percent of the fee the surety company charges the small business.

## Quick Reference to SBA Loan Programs

[Click here](#) for information on funding your business. If you are interested in obtaining further information for a specific loan program listed below, click on the loan program and you will be brought to the SBA Web site.

### **PROGRAM: 7(a) Loan Guaranty Program (the SBA's primary loan program).**

- **Maximum Amount Guaranteed:** \$3,750,000 in most cases Percent of Guarantee (Max.): 75 percent (85 percent if the total loan is \$150,000 or less)
- **Use of Proceeds:** Expansion or renovation; construction of new facility; purchase land or buildings; purchase equipment, fixtures, leasehold improvements; working capital; refinance debt for compelling reasons; seasonal line of credit; inventory acquisition
- **Maturity.** Depends on ability to repay; generally working capital is up to 7 years; machinery/equipment is up to 10 years; real estate and construction, up to 25 years (not to exceed life of equipment) Maximum Interest Rates: Negotiable with lender: loans under 7 years, maximum prime + 2.25 percent; 7 years or more, maximum 2.75 percent over prime; under \$50,000, rates may be slightly higher Guaranty and Other Fees: Paid by lender (usually passed onto borrower).
- Amount of **SBA** exposure (based on maturity): 1 year or less - 0.25 percent (0 percent for loans made after Oct. 1, 2013)
- Over 1 year and SBA share \$150,000 - \$700,000 - 3 percent;
- Over 1 year and SBA share more than \$700,000 -3.5 percent
- Additional fee of 0.25 percent on any guaranteed portion of more than \$1 million

- **Eligibility:** Must be operated for profit; meet SBA size standards; show good character, management expertise and commitment, and always show ability to repay; may not be involved in speculation or investment

#### PROGRAM: 7(m) MicroLoan Program

- **Maximum Amount Guaranteed:** \$50,000 (total loan amount)
- **Percent of Guarantee** (maximum): NA
- **Use of Proceeds:** Purchase equipment, machinery, fixtures, leasehold improvements; finance increased receivables; working capital; may not be used to repay existing debt
- **Maturity:** Shortest term possible, not to exceed 6 years
- **Maximum Interest Rates:** Negotiable with intermediary
- **Guaranty and Other Fees:** No guaranty fee
- **Eligibility:** Same as 7(a)

#### PROGRAM: CAPLines, Short-Term and RLCs; Seasonal, Contract, Builders, Standard Asset-Based, Small Asset-Based

- **Maximum Amount Guaranteed:** \$5 million
- **Use of Proceeds:** Finance seasonal working-capital needs; costs to perform; construction costs; advances against existing inventory and receivables; consolidation of short-term debts possible
- **Maturity:** Up to 10 years
- **Eligibility:** Existing businesses, see 7(a)

#### PROGRAM: Export Working Capital Program

- **Features:** Low guaranty fee and quick processing time
- **Maximum Amount Guaranteed:** \$5 million (may be combined with the International Trade Loan)
- **Use of Proceeds:** Short-term working-capital loans to finance export transactions
- **Eligibility:** Small business exporters who need short-term working capital; see 7(a) for other qualifications

#### PROGRAM: International Trade Loan Program, Short- and Long-Term Financing

- **Features:** Loans up to \$5 million for fixed assets and working capital for businesses that plan to start or continue exporting.
- **Maximum Amount Guaranteed:** \$5 million
- **Use of Proceeds:** Working capital; improvements in U.S. for producing goods or services for international trade; finance an existing loan

- **Eligibility:** Small businesses engaged or preparing to engage in international trade or adversely affected by competition from imports; see 7(a) for other qualifications

#### PROGRAM: Disaster Assistance Loan Program

- **Features:** Low-interest loans to businesses of all sizes, private non-profit organizations, homeowners, and renters.
- **Maximum Amount Guaranteed:** \$2 million
- **Percent of Guarantee (maximum):** Depends on whether done under 7(a) or 504; see both
- **Use of Proceeds:** Repair or replace real estate, personal property, machinery and equipment, and inventory and business assets damaged or destroyed in a declared disaster.
- **Maturity:** 30 years
- **Maximum Interest Rates:** 4 percent
- **Eligibility:** Declared disaster area; essential employee was called-up to active duty in his or her role as a military reservist.

#### PROGRAM: SBA Express

- **Features:** Lender approves loan, no additional paperwork for SBA, 36 hour turnaround
- **Maximum Amount Guaranteed:** \$350,000 (total loan amount)
- **Percent of Guarantee (maximum):** 50 percent
- **Use of Proceeds:** Same as 7(a)
- **Maturity:** Term loan same as 7(a); no more than 7 years on revolving line of credit
- **Maximum Interest Rates:** Negotiable between lender and borrower
- **Guaranty and Other Fees:** See 7(a)
- **Eligibility:** See 7(a)

#### The Certified Development Company (504) Loan Program

- **Features:** CDCs work with SBA and private-sector lenders to provide financing to small businesses through the CDC/504 Loan Program, which provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings. Must create or retain one job for every \$65,000 provided by the SBA, except for small manufacturers, which have a \$100,000 job creation or retention goal
- **Maximum Amount Guaranteed:** Limit on SBA portion of project is \$4, \$4.5, and \$5 million
- **Percent of Guarantee (maximum):** 40 percent of project (100 percent SBA-backed debenture); private lender unlimited
- **Use of Proceeds:** Purchase of major fixed assets such as land, buildings, improvements, long-term equipment, construction, renovation

- **Maturity:** 10 or 20 years only
- **Maximum Interest Rates:** Pegged to an increment above the current market rate for 5-year and 10-year U.S. Treasury issues
- **Guaranty and Other Fees:** Fees related to debenture, approximately 3 percent. May be financed with the loan.
- **Eligibility:** Tangible net worth less than \$15 million and an average net income less than \$5.0 million after taxes for the preceding two years.

## Government and Non-Profit Agencies

- [U.S. Small Business Administration](#)  
The SBA has offices located throughout the United States. For the one nearest you look under "U.S. Government" in your telephone directory, call the SBA Answer Desk at (800) 827-5722, or visit the SBA website for a list of [SBA District Offices](#).