Still Time to Get $150,000 from the SBA

Can your business use an infusion of cash to deal with losses caused by the COVID-19 pandemic?

The hugely popular federal Payroll Protection Program (PPP) that paid forgivable loans to millions of businesses ended on August 8 (although it could come back in revised form). But you can still obtain a low-interest Emergency Income Disaster Loan (EIDL) of up to $150,000 from the Small Business Administration (SBA).

Do You Qualify for an EIDL?

You can qualify for an EIDL if your business has fewer than 500 employees and has suffered “substantial economic injury” due to the COVID-19 pandemic. You have suffered economic injury if you’re unable to pay your normal business operating expenses and other bills, or to sell or produce your goods or services because of the pandemic.

You can obtain an EIDL even if you already received a PPP loan. However, you may not use the EIDL to pay the same payroll costs or other expenses you pay with a PPP loan.

How Much Can You Borrow?

The SBA is currently capping EIDLs at $150,000. The amount you receive is intended to cover six months of your business operational expenses. For most small businesses, the loan amount is based on gross revenues minus cost of goods sold during the period from February 1, 2019, through January 31, 2020, divided by two.

What Are the Loan Terms?

These are 30-year loans at a 3.75 percent interest rate. You don’t have to make any payments until one year after you receive the loan (interest continues to accrue during the one-year delay). There is no prepayment penalty.

How Do You Apply?

You apply for an EIDL with the SBA, and the loan is funded directly from the U.S. Treasury. Unlike with PPP loans, banks are not involved. You can apply online, and the SBA has created a streamlined application.

Do You Need to Have Collateral or Make Guarantees?

The SBA does not require a personal guarantee for an EIDL of less than $200,000.

Collateral is required only if the loan is over $25,000.

For loans over $25,000, the SBA obtains a security interest in all tangible and intangible property your business owns or acquires, including inventory, equipment, and receivables. The SBA files a UCC-1 lien against your business.

How You Can Use the Money

The money is supposed to be used to help you carry on your business until life gets back to normal. You can use the money to pay normal operating expenses, such as employee salaries and benefits, rent, utilities, and fixed debt payments. You can continue to take your owner's draw for work you actually perform for the business.

But EIDLs are not supposed to be used to replace lost sales, fund business expansion, start a new business, or refinance long-term debt. Nor can you use them to pay yourself dividends or bonuses. As you can see, EIDLs can be a useful source of low-interest financing during these troubled times.

Seven Things to Know Before You Take Out an EIDL

SBA EIDLs can be a great source of low-interest funding for businesses struggling with the economic impact of the COVID-19 pandemic.

Unlike PPPs, EIDLs are not forgivable—borrowers have to pay them back. But they have a low 3.75 percent interest rate and a long 30-year repayment period. Borrowers can repay them at any time without penalty.

To obtain an EIDL, borrowers must sign a loan authorization and agreement, a note, and a security agreement filled with fine print. Many of these provisions could have a significant impact on the borrower's business for the life of the loan—up to 30 years.

It is vital to understand the terms and conditions before taking out any loan, including an EIDL. Here are seven key provisions borrowers should be aware of.

1. No Changes to the Business

Without SBA approval, EIDL borrowers may not sell the business or change its ownership structure. This includes removing or adding a business partner.

2. No Distributions outside the Usual Course of Business

The owners may not make distributions outside the usual course of business without SBA approval. This includes loans, advances, bonuses, or asset transfers to owners, employees, or other companies.

Distributions within the usual course of business are permitted. SBA officials have said this includes distributions of net income to owners of a pass-through business, such as an S corporation or a limited liability company.

3. Strict Record-Keeping Requirements

The SBA imposes strict record-keeping requirements on EIDL borrowers. They must keep itemized receipts showing how they spend the loan funds. Also required is a full set of financial and operating statements, which must be furnished to the SBA each year. The SBA also has the option of requiring an expensive review of the borrower's records by an independent CPA.

4. Using Other COVID-19 Payments to Pay the SBA

EIDLs are intended to cover disaster losses not compensated by other sources. If an EIDL borrower obtains grants, loans, insurance proceeds, or lawsuit recoveries to help defray COVID-19-related losses, the borrower is required to notify the SBA. The SBA may require that such money be used to repay the EIDL.

But a business may obtain both a PPP loan and an EIDL so long as it doesn't use them for the same expenses.

5. Strict Collateral Requirements

Businesses that borrow more than $25,000 are required to pledge all their business's personal property as collateral. Such collateral includes present and future inventory, equipment, deposit accounts, promissory notes, negotiable instruments, and receivables.

The SBA obtains a security interest in all such collateral the borrower has at the time of the loan, or collateral it acquires or creates in the future. The borrower must

- obtain hazard insurance for its collateral, and
- ask the SBA for permission before selling or otherwise disposing of its collateral, other than selling inventory in the ordinary course of business.

6. Buy American

EIDL borrowers must promise to buy American-made equipment and products with the loan proceeds, to the extent feasible.

7. Penalties for Violations

Penalties for violations of the EIDL terms can be severe. The SBA can demand immediate repayment of the entire loan if the borrower breaches any of its terms. The SBA also reports defaults to credit reporting agencies.

Borrowers who misapply EIDL funds—for example, using them to pay personal expenses—are liable to the SBA for an amount equal to one-and-a-half times the original loan.

PPP Update: Two New Rules for Owners of S and C Corporations

The PPP rules are still changing.

During the past month, the SBA issued a new set of frequently asked questions (FAQs) and a new interim final rule, which in combination create the following good news for the PPP:

- **More forgiveness.** The $20,833 cap on corporate owner-employee compensation applies to cash compensation only. It's not an overall compensation limit as the SBA had stated in its prior interim guidance. Under this new rule, the owner-employee can add retirement benefits on top of the cash compensation, creating a new higher cap.
- **Escape owner status.** You are not an owner-employee if you have less than a 5 percent ownership stake in a C or an S corporation. Therefore, the cap on forgiveness for this newly defined non-owner-employee is not $20,833 but rather $46,154.

The new rules override prior guidance and have significance for PPP loan forgiveness today—and perhaps for obtaining additional loan monies retroactively (if Congress reinstates the PPP along with a round for businesses that suffered a big drop in revenue).

Here's one example of how the new rules benefit John, an S corporation owner.

Example. John, the sole owner and worker, operates his business as an S corporation. His 2019 W-2 shows $140,000 in Box 1, of which $20,000 is for health insurance. In addition, the S corporation pays state unemployment taxes of $500 on John's income and contributes $20,000 to his pension plan.

Based on the facts in the example, the corporation is eligible for up to $25,000 of PPP loan forgiveness, as follows:

- $20,833 on John's salary (the cap), which the corporation pays to John at his regular rate in less than 10 weeks during the covered period;
- $4,167 on John's retirement ($20,000 x 20.83 percent); and
- zero on the unemployment taxes because they were paid out in January, before the covered period began.

Advantage. Prior guidance limited forgiveness to $20,833. John's S corporation gains $4,167 in additional forgiveness thanks to the new FAQs, assuming that the S corporation's loan amount is $25,000 or more (which is possible).

The good news in the new guidance is that the corporate retirement contributions on behalf of owner-employees now count for additional forgiveness when the owner-employee has cash compensation greater than $100,000. And with the C corporation, the new guidance allows health insurance for the owner-employee.

The Importance of Keeping a Mileage Log

What is the unpardonable sin in an IRS audit?

Suppose you just received a letter from the IRS telling you that you are the subject of an IRS audit. What one record receives special attention? What one record can create a nightmare for you? What one record makes the IRS suspect that you are the keeper of lousy records?

Think of the record you most hate keeping. That's the one we are talking about. You have probably guessed what that record might be.

Red-Flag Record for the IRS Examiner

Once your audit examination begins, the examiner likes to see this record. If the record is missing or lacking, the IRS examiner knows that your other records probably are lacking, too. This record—the one you probably hate keeping—is the mileage log on your vehicle or vehicles.

The IRS notes that a taxpayer's failure to keep a mileage log on vehicles indicates that the activity under examination is not being conducted in a businesslike manner.

Do as the Tax Form Says

As a one-owner or husband-and-wife-owned business, regardless of whether it's a corporation, a partnership, or a proprietorship, you file a tax form that asks you for the following information about your vehicles:

1. Do you have evidence to support the business/investment use claimed? (If "yes," is the evidence written?)

2. List your total business/investment miles on each vehicle.

3. List your total commuting miles on each vehicle.

4. List your total personal miles on each vehicle.

IRS Form 4562 has columns for answers to the above questions for up to six vehicles used by either a sole proprietor or an owner of more than 5 percent of a corporation, a partnership, or another entity. The mileage log is the record of proof that you need to use for your answers to the tax form questions.

Do What the Audit Would Require

Above, we said to do as the IRS form says. For additional clarification, it is good to know what information the IRS, in a correspondence audit, requires you to provide related to that tax form:

1. Send copies of repair receipts, inspection slips, and other records showing total mileage for the year.

2. Send copies of logbooks and other records to support the business mileage claimed.

3. Provide a copy of your appointment book or calendar of business activities for the year.

4. If you are claiming actual expenses, provide copies of paid bills, invoices, and canceled checks for automobile expenses. These would include gas, oil, tires, repairs, insurance, interest, tags, taxes, parking fees, and tolls.

5. Send a copy of the bill of sale or other verification to establish your basis in the vehicle, including the trade-in of another vehicle.

Note that the IRS is looking for

- a match of the repair bill odometer reading with the mileage in your logbook;
- a match of the inspection slip odometer reading with the mileage in your logbook;
- the mileage between repair stops, to see whether that ties in with your claimed mileage; and
- a business purpose that ties in with your appointment book or other calendar of business activities.

Takeaways

If you want to avoid big trouble during an IRS audit, keep a good mileage log. This takes just minutes a day.

The mileage log is often one of the first records that an IRS examiner will look at. A good mileage log shows that you know the rules and you respect them. Many IRS audits end favorably and quickly upon presentation of a good mileage log.