

# SBA Loan Guarantees and Divorce – Don't Leave Your Client On the Hook

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Divorce actions that involve an SBA loan and which party will be responsible for the loan often end up leaving the wrong spouse responsible for the debt. Attorneys cannot rely on the marital settlement or court division of assets to insulate clients from liability on an SBA loan. Clients need to be released from their SBA obligation with the SBA before or concurrent with a division of assets in the divorce case to avoid SBA liability.

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## INTRODUCTION

Your family law client contacts you to inform you that the Department of Treasury contacted her because she owes a large sum of money on a defaulted SBA loan. The marital settlement agreement specifically stated that the ex-husband would be responsible for the loan. Unfortunately, the Department of Treasury is not interested in the settlement and is looking to your client to pay the full amount of the defaulted SBA loan.

Not only is the Department of Treasury looking to collect but may start garnishing your client's wages, taking her tax refund and even refer the matter to the Department of Justice to sue your client in civil court.

Protect Law Group deals with many clients that thought their marital settlement agreement protected them against any repercussions if the ex-spouse defaulted on an SBA loan. The reality changes when a notice demanding payment, often hundreds of thousands of dollars, arrives from the Department of Treasury.



This paper will address:

- The background of SBA loans
- The SBA personal guarantee
- The basis for liability under the guarantee
- The government's collection structure
- The way to avoid the pitfall of an SBA personal guarantee in the event of divorce

The information contained herein is for informational purposes only and should not be construed as legal advice.

## *SBA LOANS AND THE SBA GUARANTEE*

Generally speaking, the SBA does not make direct loans to small businesses. Rather, SBA sets the guidelines for loans, which are then made by its partners (lenders, community development organizations, and micro-lending institutions, which are often referred to as “third party lenders”). The SBA guarantees that these loans will be repaid, thus eliminating some of the risk to the lending partners. So when a business applies for an SBA loan, it is actually applying for a commercial loan, structured according to SBA requirements with an SBA guaranty. Common SBA loan programs are known as 7a loans, 504 loans, Express loans and Disaster Relief Loans (Disaster Relief Loans are direct loans from the SBA).

The guarantee relationship changes somewhat based on the type of loan, but by way of example we’ll compare 7a and Express loans. In the event that a borrower defaults, the lender has the option to receive from the SBA the face value of the outstanding guaranteed balance. Proceeds from the liquidation of a firm’s assets and any subsequent recoveries are then split in proportion to the guarantee percentage. (For example, if the SBA guarantees 70 percent of the loan, it has claim to 70 percent of recoveries.)

In the Express program, unlike regular 7(a) loans, a borrower’s assets are generally liquidated upon default and before lenders submit the loan to SBA. The lender receives all proceeds from liquidation of the borrower’s assets, and any subsequent recoveries after the lender submits the loan to SBA are split between SBA and the lender according to the guarantee percentage.

For example, assume that a borrower who has a loan with a \$100,000 balance and a 50 percent guarantee defaults and that the borrower’s assets are worth \$60,000. In the regular 7(a) program, the lender submits the defaulted loan to SBA and receives \$50,000 (the guaranteed portion of the loan balance). When the borrower’s assets are later liquidated, the lender and SBA each receive 50 percent of the assets, or \$30,000. The net loss to SBA is \$20,000 (the \$50,000 payment to the lender minus the \$30,000 recovered from the borrower’s assets), and the net loss to the lender is also \$20,000 (the \$100,000 loan balance minus the \$50,000 received from SBA and the \$30,000 recovered from the borrower’s assets).

If the loan was made through the Express program, the lender liquidates the borrower’s assets (worth \$60,000) and then submits the remaining loan balance of \$40,000 to SBA. The lender then receives \$20,000 (the guaranteed portion of the loan balance) from SBA. The net loss to SBA is \$20,000, and the net loss to the lender is also \$20,000. If an additional \$1,000 is later recovered, the lender and SBA would each receive \$500.

## *THE SBA PERSONAL GUARANTEE*

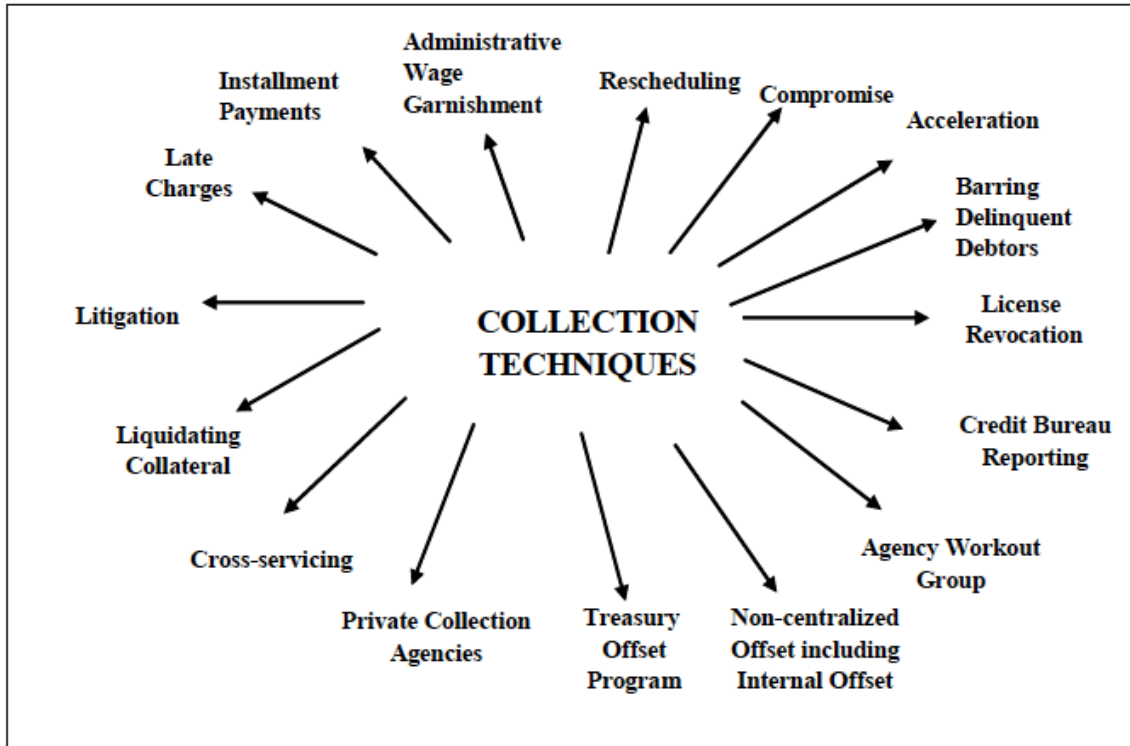
Pursuant to an SBA loan the principals of the business and often their spouses are required to sign a personal guarantee (SBA Form 148 attached for reference). Section 9(D) states “JOINT AND SEVERAL LIABILITY. All individuals and entities signing as Guarantor are jointly and severally liable.”



In its simplest terms, if two spouses sign a personal guarantee, the SBA does not care from whom they collect any deficiency or what percentage. If your client receives a notice from the SBA or the Department of Treasury, those government entities are looking for 100% contribution from your client. Whatever marital settlement agreement or order regarding the marital estate is irrelevant to the government since both spouses are jointly and severally liable.

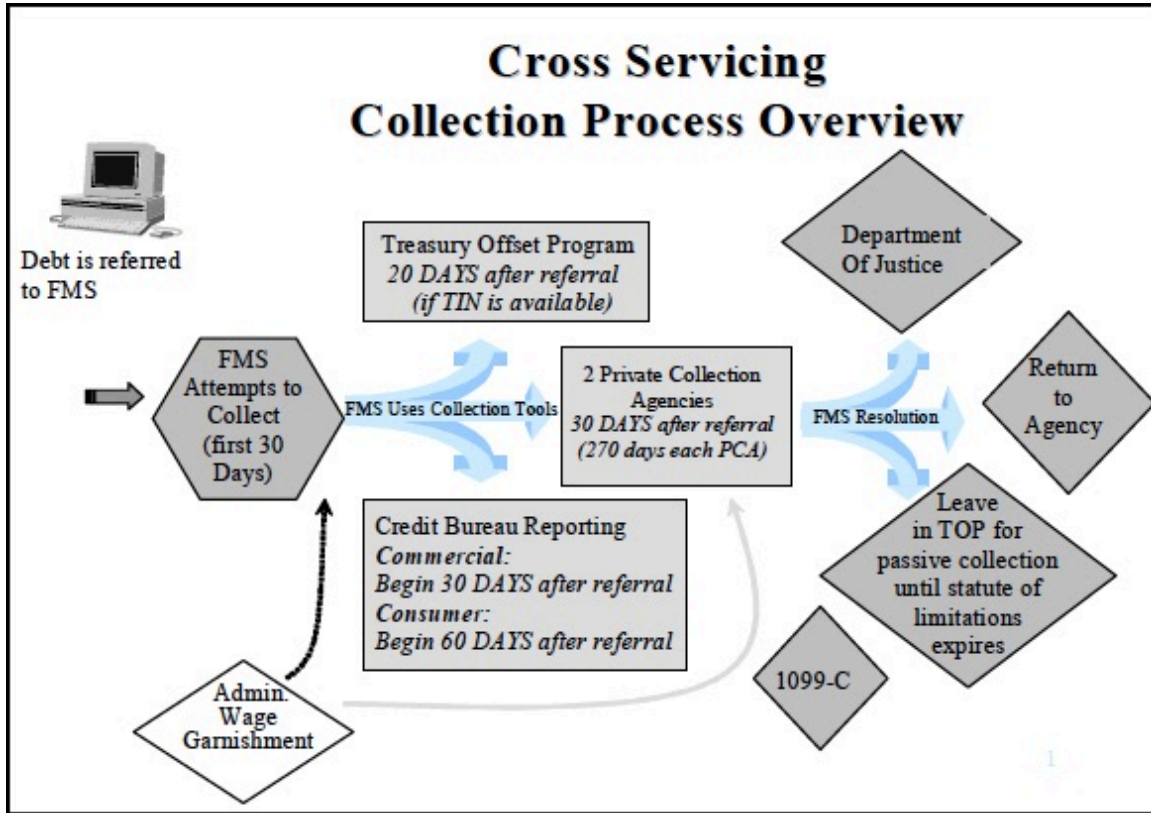
## GOVERNMENTAL COLLECTION

Once the SBA debt is in default, the SBA and the Department of Treasury have several options concerning collection of the debt.<sup>1</sup>



<sup>1</sup> Chart from *Managing Federal Receivables* from the Department of Treasury.

If the SBA cross-services (transfers) the debt to the Department of Treasury, the Department of Treasury through its Financial Management Service (FMS) takes responsibility for collection. The FMS can take several actions against your client.<sup>2</sup>



## REFERRAL TO THE DEPARTMENT OF JUSTICE

Of the many collection actions the government may take if the debt is cross-serviced from the SBA to the Department of Treasury, the most daunting may be referral of the debt to the Department of Justice to file a civil suit against your client to recover damages. Such action can not only result in a judgment against your client but also cost the client tens of thousands of dollars to defend against the suit.

<sup>2</sup> Id.

## ADMINISTRATIVE OFFSET

Administrative offset occurs when the government withholds or intercepts monies due to, or held by the government for, a person to collect amounts owed to the government. Offsets may occur against tax refund payments, salary payments, military and civilian retirement pay, contractor payments, grant payments, tax overpayments, benefit payments, travel reimbursements and other Federal payments.

An agency may offset a debtor's payments using two methods – centralized offset via the Treasury Offset Program (TOP) operated by the Department of Treasury Fiscal Management Service (FMS) and non-centralized offset, that is, ad hoc offset on a case-by-case basis.

The following types of Federal payments are eligible for offset under TOP:

- Internal Revenue Service tax refunds;
- Retirement payments issued by the Office of Personnel Management (OPM);
- Vendor payments;
- Federal salary payments;
- Travel advances and reimbursements;
- Certain Federal benefit payments, such as Social Security retirement and disability payments;
- Grant payments; and
- Active military and military retirement payments.

For some types of payments, the government may not offset the entire payment. Limitations apply to OPM retirement payments (25%); Federal salary payments (15% of disposable pay); and social security, railroad retirement, and black lung benefit payments (15%).

## ADMINISTRATIVE WAGE GARNISHMENT

In the absence of extenuating circumstances, such as successfully challenging the existence or the amount of the debt or proving an extreme financial hardship, if your client is employed, your client could face a paycheck garnishment of 15%. The Debt Collection Improvement Act authorizes the collection of a delinquent debt by administrative garnishment of the pay of a delinquent debtor who is employed by any organization, business, state or local government, or other entity other than a Federal agency.



## REFERRAL TO PRIVATE COLLECTION AGENCY (PCA)

Debts that are referred to FMS for cross-servicing will be referred to a private collection agency (PCA) on FMS's list. Currently, there are four such PCAs: Pioneer Credit Recovery, CBE Group, Performant, and Conserve. When using PCAs, funds collected by the PCAs are remitted to the SBA by FMS with supporting detailed debt information. Under the terms of the FMS task order, PCAs charge fees, which are paid out of amounts collected. FMS provides guidance and standards for PCAs to follow when negotiating acceptable repayment plans and compromise agreements with debtors based on creditor agency parameters contained in the agency's letter of agreement with FMS.

## CREDIT BUREAU REPORTING

Reporting delinquent debts to credit bureaus is an essential part of an agency's debt collection efforts. The Debt Collection Improvement Act requires Federal agencies, including the SBA, to report to credit bureaus information on all delinquent Federal consumer debts. Federal agencies have been required, as a matter of policy, to report all delinquent commercial debts since September 1983.

## STATUTE OF LIMITATIONS

A six-year statute of limitations only applies to the ability of the Department of Justice to sue in civil court. The other remedies cited by this paper have **no statute of limitations**. This means that your client could be subject to, for instance, an administrative wage garnishment 10 years after the default. State statutes of limitations do not apply and your client will be subject to the collection action until the debt is paid, compromised or otherwise terminated (i.e., through bankruptcy). Therefore, do not advise your clients that because so many years have past any collection action by the government does not apply to the client – it does!

## RELIEF FROM THE PERSONAL GUARANTEE

A spouse that wishes to avoid liability on a personal guarantee must be released from the personal guarantee before any default occurs. **Each situation is different and legal advice on this issue should be sought**, but in general the following steps have to be followed and/or conditions exist to obtain a release:

1. The status of the loan. It should be current in all respects without a history of unjustified delinquencies, unpaid taxes, or deferment of installments.
2. Written requests. The field office must have a written request from the borrower, the guarantor to be released, or the proposed substitute.
3. Consent of other parties. The written consent of all parties (e.g., other guarantors, standby creditors, etc.) must be obtained before the transaction is finalized.
4. Opinion of counsel. You must obtain the opinion of SBA counsel showing that no legal rights of the Agency will be adversely affected.
5. Evaluation of substitute guarantors. Before the SBA can recommend accepting a substitute guarantor in place of the original, the SBA will analyze/compare the values of the guarantors. The borrower must furnish personal financial statements and any other information satisfactory to the approving official.

Several clients have retained Protect Law Firm years, if not more than a decade, after going through a divorce having never sought to be released from their SBA personal guarantee. These clients relied on the representation of their divorce counsel and their separation agreement that they would not be responsible for the SBA loan. But years later, when the ex-spouse defaulted on the loan, the government looked to the client for payment. In fact, in some situations the ex-spouse had filed personal bankruptcy leaving the client as the only person liable on the SBA loan.

## CONCLUSION

This white paper presented you with an overview of the SBA personal guarantee and the problems that arise in divorce cases with the SBA personal guarantee. Far too often clients rely on the marital settlement agreement or other division of assets instrument to protect them from collection on a defaulted SBA loan. Furthermore, many times counsel has advised the client that the marital settlement provides protection. In fact, a marital settlement or order provides no protection to your client. Your client must be released from the personal guarantee in order to avoid future collection demands after the ex-spouse defaults on the loan.



## *Contact Protect Law Group Today*

Our firm has helped clients all over the country resolve their SBA loan problems.

Protect Law Group will fight for your client when the federal government comes to collect.

Please contact us at:

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