

on a Federal loan and caused the Federal government or any of its agencies or Departments to sustain a loss in any of its programs. For purposes of this section, a compromise agreement shall also be considered a loss; and

(r) Businesses primarily engaged in political or lobbying activities.

§ 120.111 What conditions must an Eligible Passive Company satisfy?

An Eligible Passive Company must use loan proceeds to acquire or lease, and/or improve or renovate real or personal property (including eligible refinancing) that it leases to an Operating Company for the conduct of the Operating Company's business. Any ownership structure or legal form may qualify as a Eligible Passive Company, except revocable trusts and other grantor trusts.

(a) Conditions that apply to all legal forms:

(1) The Operating Company is an eligible small business, and the proposed use of the proceeds would have been an eligible use if the Operating Company were obtaining the financing directly;

(2) Both the Eligible Passive Company and the Operating Company must be small under the appropriate size standards in part 121 of this chapter;

(3) The lease between the Eligible Passive Company and the Operating Company must be in writing and must be subordinated to SBA's mortgage, trust deed lien, or security interest on the property. Also, the Eligible Passive Company (as landlord) must furnish as collateral for the loan an assignment of all rents paid under the lease;

(4) The lease, including options to renew exercisable solely by the Operating Company, must have a remaining term at least equal to the term of the loan;

(5) The Operating Company must be a guarantor or a co-borrower (with the Eligible Passive Company) of the loan; and

(6) Each holder of an ownership interest constituting at least 20 percent of the Eligible Passive Company or the Operating Company must guarantee the loan (the trustee shall execute the guarantee on behalf of any trust).

(b) Additional conditions that apply to irrevocable trusts. A trust qualifying as a Eligible Passive Company may engage in other activities as authorized by its trust agreement. For purposes of this section, the trustee shall certify to SBA that:

(1) The trustee has authority to act;

(2) The trust is irrevocable, and is not regarded as a grantor trust for tax purposes;

(3) The trust has the authority to borrow funds, pledge trust assets, and lease the property to the Operating Company;

(4) The trustee has provided accurate, pertinent language from the trust agreement confirming the above; and

(5) The trustee has provided and will continue to provide SBA with a true and complete list of all trustees and donors.

Uses of Proceeds

§ 120.120 What are eligible uses of proceeds?

A small business must use an SBA loan for sound business purposes. The uses of proceeds are prescribed in each loan's Authorization.

(a) A Borrower may use loan proceeds from any SBA loan to:

- (1) Acquire land (by purchase or lease);
- (2) Improve a site (grading, streets, parking lots, landscaping);
- (3) Purchase an existing building;
- (4) Convert, expand or renovate an existing building;
- (5) Construct a new building; and/or
- (6) Acquire (by purchase or lease) and install machinery and equipment (in the 504 program, with a useful life of at least 10 years and at a fixed location, unless essential to the Project).

(b) A Borrower may also use 7(a) and microloan proceeds for:

- (1) Inventory;
- (2) Supplies;
- (3) Raw materials;
- (4) Working capital; and
- (5) Refinancing certain outstanding debts.

§ 120.130 Restrictions on uses of proceeds.

SBA will not authorize nor may a Borrower use loan proceeds for the following purposes (including the replacement of funds used for any such purpose):

(a) Payments, distributions or loans to Associates of the applicant (except for ordinary compensation for services rendered);

(b) Refinancing a debt owed to a Small Business Investment Company ("SBIC");

(c) Speculation in any kind of real or personal property;

(d) Floor plan financing or other revolving line credit, except under § 120.390;

(e) Investments in real or personal property acquired and held primarily for sale, lease, or investment and not used within 3 years in an otherwise eligible business (except for a loan to an Eligible Passive Company or to a small contractor under § 120.310);

(f) A purpose which does not benefit the small business; or

(g) Any use restricted by §§ 120.201–120.203 and 120.884 (specific to 7(a) loans and 504 loans respectively).

Ethical Requirements

§ 120.140 What ethical requirements apply to participants?

Lenders, Intermediaries, CDCs, Associate Development Companies ("ADCs") and their Associates (in this section "Participants") must act ethically and exhibit good character. Ethical indiscretion of an Associate shall be attributed to the Participant. A Participant must promptly notify SBA if it obtains information concerning the unethical behavior of an Associate. The following are examples of such unethical behavior. A Participant may not:

- (a) Self-deal;
- (b) Have a real or apparent conflict of interest with a small business with which it is dealing (including any of its Associates) or SBA;
- (c) Own an equity interest in a business that has received or is applying to receive SBA financing (during the term of the loan or within 6 months prior to the loan application);
- (d) Be incarcerated, on parole, or on probation;

(e) Knowingly misrepresent or make a false statement to SBA;

(f) Engage in conduct reflecting a lack of business integrity or honesty;

(g) Be a convicted felon, or have an adverse final civil judgment (in a case involving fraud, breach of trust, or other conduct) that would cause the public to question the Participant's business integrity, taking into consideration such factors as the magnitude, repetition, harm caused, and remoteness in time of the activity or activities in question;

(h) Accept funding from any source that restricts, prioritizes, or conditions the types of small businesses that the CDC, ADC, or Intermediary may assist under an SBA program or that imposes any conditions or requirements upon recipients of SBA assistance inconsistent with SBA's loan programs or regulations;

(i) Fail to disclose to SBA all relationships between the small business and its Associates, the Participant, and/or the lenders financing the Project;

(j) Fail to disclose to SBA whether the loan will:

(1) Reduce the exposure of a Lender in a position to sustain a loss;

(2) Directly or indirectly finance the purchase of real estate, personal property or services (including insurance) from the Participant;

(3) Repay or refinance a debt due a Participant;