

Small Business Administration

§ 107.720

Enterprises. In addition, 100 percent of all Financings made in whole or in part with Leverage in excess of \$90 million (including aggregate Leverage over \$90 million issued by two or more Licensees under Common Control) must have been invested in Smaller Enterprises.

(c) *Special requirement for certain leveraged Licensees.* (1) This paragraph (c) applies if you were licensed on or before September 30, 1996, and you issued Leverage after that date, and you have Regulatory Capital of:

(i) Less than \$10,000,000 if such Leverage included Participating Securities; or

(ii) Less than \$5,000,000 if such Leverage was Debentures only.

(2) At the close of each of your fiscal years, at least 50 percent of the total dollar amount of the Financings you extended after September 30, 1996 must have been invested in Smaller Enterprises.

(d) Financing a change of ownership which results in the creation of a Smaller Enterprises. The Financing of a change of ownership under §107.750 which results in the creation of a Smaller Enterprise qualifies as a Smaller Enterprise Financing.

(e) *Non-compliance with this section.* If you have not reached the required percentage of Smaller Enterprise Financings at the end of any fiscal year, then you must be in compliance by the end of the following fiscal year. However, you will not be eligible for additional Leverage until you reach the required percentage (see §107.1120(c) and (g)).

[62 FR 11760, Mar. 13, 1997, as amended at 63 FR 5866, Feb. 5, 1998; 64 FR 70995, Dec. 20, 1999; 66 FR 30647, June 7, 2001; 74 FR 33915, July 14, 2009]

§ 107.720 Small Businesses that may be ineligible for financing.

(a) *Relenders or reinvestors.* You are not permitted to finance any business that is a relender or reinvestor.

(1) *Definition.* Relenders or reinvestors are businesses whose primary business activity involves, directly or indirectly, providing funds to others, purchasing debt obligations, factoring, or long-term leasing of equipment with no provision for maintenance or repair.

(2) *Exception.* You may provide Venture Capital Financing to Disadvantaged Businesses that are relenders or reinvestors (except banks or savings and loans not insured by agencies of the federal government, and agricultural credit companies). Without SBA's prior written approval, total Financings under this paragraph (a)(2) that are outstanding as of the close of your fiscal year must not exceed your Regulatory Capital.

(b) *Passive Businesses.* You are not permitted to finance a passive business.

(1) *Definition.* A business is passive if:

(i) It is not engaged in a regular and continuous business operation (for purposes of this paragraph (b), the mere receipt of payments such as dividends, rents, lease payments, or royalties is not considered a regular and continuous business operation); or

(ii) Its employees are not carrying on the majority of day to day operations, and the company does not provide effective control and supervision, on a day to day basis, over persons employed under contract; or

(iii) It passes through substantially all of the proceeds of the Financing to another entity.

(2) *Exception for pass-through of proceeds to subsidiary.* You may provide Financing directly to a passive business, including a passive business that you have formed, if it is a Small Business and it passes substantially all the proceeds through to (or uses substantially all the proceeds to acquire) one or more subsidiary companies, each of which is an eligible Small Business that is not passive. For the purpose of this paragraph (b)(2), "subsidiary company" means a company in which the financed passive business either:

(i) Directly owns, or will own as a result of the Financing, at least 50 percent of the outstanding voting securities; or

(ii) Indirectly owns, or will own as a result of the Financing, at least 50 percent of the outstanding voting securities (by directly owning the outstanding voting securities of another passive Small Business that is the direct owner of the outstanding voting securities of the subsidiary company).

(3) *Exception for certain Partnership Licensees.* If you are a Partnership Licensee, you may form one or more blocker entities in accordance with this paragraph (b)(3). For the purposes of this paragraph, a “blocker entity” means a corporation or a limited liability company that elects to be taxed as a corporation for Federal income tax purposes. The sole purpose of a blocker entity must be to provide Financing to one or more eligible, unincorporated Small Businesses. You may form such blocker entities only if a direct Financing to such Small Businesses would cause any of your investors to incur “unrelated business taxable income” under section 511 of the Internal Revenue Code (26 U.S.C. 511) or to incur “effectively connected income” to foreign investors under sections 871 and 882 of the Internal Revenue Code (26 U.S.C. 871 and 882). Your ownership and investment of funds in such blocker entities will not constitute a violation of § 107.730(a). For each passive business financed under this section 107.720(b)(3), you must provide a certification to SBA as required under § 107.610(g). A blocker entity formed under this paragraph may provide Financing:

- (i) Directly to one or more eligible non-passive Small Businesses; or
- (ii) Directly to a passive Small Business that passes substantially all the proceeds directly to (or uses substantially all the proceeds to acquire) one or more eligible non-passive Small Businesses in which the passive Small Business directly owns, or will own as a result of the Financing, at least 50% of the outstanding voting securities.

(4) *Additional conditions for permitted passive business financings.* Financings permitted under paragraphs (b)(2) or (3) of this section must meet all of the following conditions:

- (i) For the purposes of this paragraph (b), “substantially all” means at least 99 percent of the Financing proceeds after deduction of actual application fees, closing fees, and expense reimbursements, which may not exceed those permitted by § 107.860.
- (ii) If you and/or your Associate charge fees permitted by § 107.860 and/or § 107.900, the total amount of such fees charged to all passive and non-passive

businesses that are part of the same Financing may not exceed the fees that would have been permitted if the Financing had been provided directly to a non-passive Small Business. Any such fees received by your Associate must be paid to you in cash within 30 days of the receipt of such fees.

(iii) For the purposes of this part 107, each passive and non-passive business included in the Financing is a Portfolio Concern. The terms of the financing must provide SBA with access to Portfolio Concern information in compliance with this part 107, including without limitation §§ 107.600 and 107.620.

(c) *Real Estate Businesses.* (1) You are not permitted to finance any business classified under North American Industry Classification System (NAICS) codes 531110 (lessors of residential buildings and dwellings), 531120 (lessors of nonresidential buildings except miniwarehouses), 531190 (lessors of other real estate property), 237210 (land subdivision), or 236117 (new housing for-sale builders). You are not permitted to finance any business classified under NAICS codes 236118 (residential remodelers), 236210 (industrial building construction), or 236220 (commercial and institutional building construction), if such business is primarily engaged in construction or renovation of properties on its own account rather than as a hired contractor. You are permitted to finance a business classified under NAICS codes 531210 (offices of real estate agents and brokers), 531311 (residential property managers), 531312 (nonresidential property managers), 531320 (offices of real estate appraisers), or 531390 (other activities related to real estate), only if such business derives at least 80 percent of its revenue from non-Affiliate sources.

(2) You are not permitted to finance a Small Business, regardless of NAICS classification, if the Financing is to be used to acquire or refinance real property, unless the Small Business:

- (i) Is acquiring an existing property and will use at least 51 percent of the usable square footage for an eligible business purpose; or
- (ii) Is building or renovating a building and will use at least 67 percent of the usable square footage for an eligible business purpose; or

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(iii) Occupies the subject property and uses at least 67 percent of the usable square footage for an eligible business purpose.

(d) *Project Financing*. You are not permitted to finance a business if:

(1) The assets of the business are to be reduced or consumed, generally without replacement, as the life of the business progresses, and the nature of the business requires that a stream of cash payments be made to the business's financing sources, on a basis associated with the continuing sale of assets. Examples include real estate development projects and oil and gas wells; or

(2) The primary purpose of the Financing is to fund production of a single item or defined limited number of items, generally over a defined production period, and such production will constitute the majority of the activities of the Small Business. Examples include motion pictures and electric generating plants.

(e) *Farm land purchases*. You are not permitted to finance the acquisition of farm land. Farm land means land which is or is intended to be used for agricultural or forestry purposes, such as the production of food, fiber, or wood, or is so taxed or zoned.

(f) *Public interest*. You are not permitted to finance any business if the proceeds are to be used for purposes contrary to the public interest, including but not limited to activities which are in violation of law, or inconsistent with free competitive enterprise.

(g) *Foreign investment*—(1) *General rule*. You are not permitted to finance a business if:

(i) The funds will be used substantially for a foreign operation; or

(ii) At the time of the Financing or within one year thereafter, more than 49 percent of the employees or tangible assets of the Small Business are located outside the United States (unless you can show, to SBA's satisfaction, that the Financing was used for a specific domestic purpose).

(2) *Exception*. This paragraph (g) does not prohibit a Financing used to acquire foreign materials and equipment or foreign property rights for use or sale in the United States.

(h) *Associated supplier*. You are not permitted to finance a business that purchases, or will purchase, goods or services from a supplier who is your Associate, except under the following conditions:

(1) The amount of goods and services purchased (or to be purchased) from your Associate with the proceeds of the Financing, or with funds released as a result of the Financing, is less than 50 percent of the total amount of the Financing (75 percent for a Section 301(d) Licensee);

(2) The price of such goods and services is no higher than that charged other customers of your Associate; and

(3) The Small Business purchases no capital goods from your Associate.

(i) *Financing Licensees*. You are not permitted to provide funds, directly or indirectly, that the Small Business will use:

(1) To purchase stock in or provide capital to a Licensee; or

(2) To repay an indebtedness incurred for the purpose of investing in a Licensee.

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§ 107.730 Financings which constitute conflicts of interest.

(a) *General rule*. You must not self-deal to the prejudice of a Small Business, the Licensee, its shareholders or partners, or SBA. Unless you obtain a prior written exemption from SBA for special instances in which a Financing may further the purposes of the Act despite presenting a conflict of interest, you must not directly or indirectly:

(1) Provide Financing to any of your Associates, except for a Financing to an Associate that meets all of the following conditions:

(i) The Small Business that receives the Financing is your Associate, pursuant to paragraph (8)(ii) of the Associate definition in §107.50, only because an investment fund that is your Associate holds a 10% or greater equity interest in the Small Business.

(ii) You and the Associate investment fund previously invested in the Small Business at the same time and on the same terms and conditions.