

Complying with U.S. Direct Investment Reporting Requirements

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Did you know that (1) all foreigners, (2) that invest in a U.S. business *or* U.S. real estate that is not for their own personal use, and (3) that own at least a 10% voting interest (or the equivalent) in the business or real estate that was invested in, *must* report their investment to the U.S. Federal Government?

As currencies such as the Brazilian *real* and the Canadian dollar continue to appreciate against the U.S. dollar, more non-U.S. businesses are analyzing the benefits of establishing a U.S. affiliate, whether through acquisition of an existing enterprise or formation of a new enterprise. In 2005, businesses in countries such as Brazil and Canada significantly increased their Foreign Direct Investment in the U.S. (“FDIUS”), with Brazil showing a 109% increase and Canada a 15% increase. A critical part of the benefit analysis has been the impact that U.S. law will have on planned transactions.

In particular, press generated by recent events such as the failed 2005 takeover by Chinese companies of two marquee U.S. brands, Unocal and Maytag, and the 2006 Dubai Ports debacle, has renewed focus on the FDIUS approval process and related reporting requirements. Good news – unless your FDIUS transaction impacts U.S. national security, or is in certain specific industries (such as airline or maritime transportation) there is no approval process. More good news – although all FDIUS transactions are subject to mandatory reporting, completing and filing the report is relatively straightforward. However, to avoid problems, always check with legal counsel before proceeding with your transaction.

Transactions that Must be Reported; Basic Definitions

Under the International Investment and Trade in Services Survey Act, as amended (the “IITSSA”), all foreign investments in U.S. business enterprises in which a foreign person owns a 10% or more voting interest (or the equivalent) are subject to reporting, including all ownership of real estate, improved and unimproved, other than for personal use.

Basic terms defined:

Foreign Direct Investment in the United States: the ownership or control, directly or indirectly, by a foreign person of 10% or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest in an unincorporated business enterprise, *including a branch*.

Foreign Person: any person resident outside the U.S. or subject to the jurisdiction of a country other than the U.S.

Person: any *individual, branch, partnership, associated group, association, estate, trust, corporation, or other organization* (whether or not organized under the laws of any State), and any *government* (including a foreign government, the United States Government, a State or local government, and any agency, corporation, financial institution, or other entity or instrumentality thereof, including a government-sponsored agency).

Business Enterprise: any organization, association, branch, or venture which exists for profit-making purposes or to otherwise secure economic advantage, and *any ownership of any real estate*.

Branch: operations or activities conducted by a person in a different location in its own name rather than through an incorporated entity.

Who Must Report; Additional Definitions

The core of the FDIUS reporting requirements is the mandatory reporting of investment transactions by *a foreign person or a U.S. affiliate of a foreign person*. A foreign person who, either directly or indirectly, acquires a 10% or more voting interest in a U.S. business enterprise (whether through an acquisition or the establishment of a new entity) must report the investment on the form for initial reporting, Form BE-13. For a copy of Form BE-13, visit <http://www.bea.gov/bea/surveys/fdiusurv.htm>.

Form BE-13 focuses on identifying the U.S. investment, its size, the chain of foreign ownership, which is followed back as far as the “Ultimate Beneficial Owner” (see definitions below), and sources of funding.

Key ownership terms defined:

U.S. Affiliate: an affiliate located in the United States in which a foreign person has a direct investment.

Affiliate: a business enterprise located in one country in which a person located in another country directly or indirectly owns or controls (1) in the case of an incorporated business, 10% or more of its voting stock, or (2) in the case of an unincorporated business (including a branch) an equivalent interest.

Foreign Parent: the first foreign person in the ownership chain of the U.S. Affiliate.

Foreign Affiliate of Foreign Parent: any member of the affiliated foreign group owning the U.S. affiliate that is not a foreign parent of the U.S. affiliate.

Affiliated Foreign Group: (i) the foreign parent, (ii) any foreign person, proceeding up the foreign parent’s ownership chain, which owns more than 50% of the person below it up to and including that person which is not owned more than 50% by another foreign person, and (iii) any foreign person, proceeding down the ownership chain(s) of each of these members, which is owned more than 50% by the person above it.

Ultimate Beneficial Owner: that person, proceeding up the ownership chain beginning with and including the foreign parent, that is not more than 50% owned or controlled by another person. (A person who creates a trust, proxy, power of attorney, arrangement, or device with the purpose or effect of divesting such owner of ownership of an equity interest as part of a plan or scheme to avoid reporting information, is deemed to be the owner of the equity interest.)

Stockholders of a closely or privately held corporation are normally considered to be an associated group and may be an Ultimate Beneficial Owner.

Associated Group: two or more persons who, by the appearance of their actions, by agreement, or by an understanding, exercise their voting privileges in a concerted manner to influence the management of a business enterprise. *Each of the following are deemed to be an associated group*: (1) members of the same family; (2) a business enterprise and one or more of its officers

and directors; (3) members of a syndicate or joint venture; or (4) a corporation and its domestic subsidiaries.

Investment in Real Estate for Personal Use Does Not Have to be Reported

Real Estate for Personal Use: Investments in residential real estate held exclusively for personal use and not for profit-making purposes does not have to be reported. A residence which is an owner's primary residence that is then leased by the owner while outside the United States but which the owner intends to reoccupy, is considered real estate held for personal use. Ownership of residential real estate by a corporation whose sole purpose is to hold the real estate and where the real estate is for the personal use of the individual owner(s) of the corporation, is considered real estate held for personal use.

Short-form Reporting; Exemption from Annual Reporting

FDIUS transactions that involve the investment of US\$3,000,000 or less and the acquisition of less than 200 acres of U.S. land can be reported on the short-form Form BE-13 Supplemental C and are exempt from additional reporting requirements. Specifically, the following types of transactions can use the two (2) page Form BE-13 Supplemental C and are not subject to annual reporting requirements:

An existing U.S. affiliate's (1) acquisition of either a U.S. business enterprise, or a business segment or operating unit of a U.S. business enterprise, that it then merges into its own operations; if (2) the total cost of the acquisition is \$3,000,000 or less; and (3) does not involve the purchase of 200 acres or more of U.S. land. (If the acquisition involves the purchase of 200 acres or more of U.S. land, it must be reported regardless of the total cost of the acquisition.)

An established or acquired U.S. business enterprise, as consolidated, is exempt if its total assets (not the foreign parent's or existing U.S. affiliate's share) at the time of acquisition or immediately after being established are \$3,000,000 or less and it does not own 200 acres or more of U.S. land. (If it owns 200 acres or more of U.S. land, it must report regardless of the value of total assets.)

For a copy of Form BE-13 Supplemental C, visit <http://www.bea.gov/bea/surveys/fdiusurv.htm>.

Practical Aspects of FDIUS Reporting

Timing: FDIUS investment transactions must be reported on Form BE-13 or Form BE-13 Supplemental C no later than forty-five (45) days after the investment transaction occurs. Requests for extension of the due date are typically honored as long as the request itself is received prior to the due date. Transactions that are not reported within 45 days remain subject to mandatory reporting whether or not a deadline extension was requested.

What Must be Filed:

- One (1) original copy of the form (either BE-13 or BE-13 Supplemental C) must be provided to the U.S. Department of Commerce. One (1) copy of the filed form must be retained for three (3) years.
- A copy of the foreign person's annual report or Form 10-K must also be provided. If the foreign person does not issue an annual report or does not file a Form 10-K then the foreign person should provide a copy of its current financial statements.

How to File: FDIUS reports can be filed using the U.S. Postal Service, private courier, facsimile, or electronically through the Automated Survey Transmission and Retrieval (ASTAR) system (<http://www.bea.gov/astar/>).

Protecting Confidential Information

All information provided within the mandatory FDIUS reports, and all information that is filed along with the mandatory report, including the foreign person's annual report, Form 10-K, or financial statements, are confidential and by law can only be used for analytical or statistical purposes. Without the prior written permission of the foreign person, the information that is provided cannot be disclosed in a manner that would individually identify the foreign person. Finally, it is legally mandated that the information provided cannot be used for purposes of taxation, investigation or regulation.

Penalties for Failure to Report

Persons who fail to comply with the mandatory FDIUS reporting requirements are subject to both civil and criminal penalties, including monetary fines, imprisonment, or both.

Civil Penalties: failure to comply with the mandatory FDIUS reporting requirements can result in a fine of not more than US\$10,000 and to injunctive relief commanding such person to comply, or both.

Criminal Penalties: willful failure to submit any required information or willful violation of any other rule, regulation, order or instruction promulgated under IITSSA, can result in a fine of not more than US\$10,000 and imprisonment for not more than one year, or both. Any *officer, director, employee, or agent* of any corporation who knowingly participates in such violation, upon conviction, may be punished by a like fine, imprisonment, or both.

Since the collapse of Enron, WorldCom and other massive U.S. financial and corporate scandals, U.S. regulators have cracked down hard on corporate wrong-doers, white-collar criminals and those who fail to fully comply with sometimes obscure regulations. The most recent example of this trend is the stock-option back-dating scandal. Once untouchable senior executives are receiving double-digit federal prison sentences as long as twenty (20) years. In this environment, it is important to exercise additional care to stay out of the sights of regulators.

Questions?

If you are contemplating or in the midst of a transaction involving foreign direct investment in the United States, and have questions regarding any of the above material, consult the U.S. Department of Commerce, Bureau of Economic Analysis. Forms and additional information can be found by accessing the following website: <http://www.bea.gov/bea/surveys/fdiusurv.htm>.

Address questions or comments to the author of this article, Saboor H. AbdulJaami, Esq., by contacting him at sabduljaami@shajlaw.com.

Conclusion

Under mandatory FDIUS reporting requirements, foreigners who invest in a U.S. business *or* U.S. real estate that is not for their own personal use, and own at least a 10% voting interest (or the equivalent) in the business or real estate that was invested in, *must* report their investment to the U.S. Department of Commerce. Here are five (5) things you can do to make compliance painless:

1. Become familiar with FDIUS reporting requirements by reviewing the initial reporting Form BE-13 or Form BE-13 Supplemental C.
2. Gather data required by Form BE-13 or Form BE-13 Supplemental C during the execution of your transaction.
3. Complete and file the correct form within 45 days of the close of your transaction.
4. Save a copy of the filed form, any appendices, and all back-up data in a single file for future reference.
5. Update your FDIUS file as necessary so that you can quickly and easily comply with any additional reporting requirements.