QUESTION: Can I include “Foreign Investors” in a Regulation D, Rule 506 Real Estate Syndication that is buying property in the United States (U.S.)?

NOTE: This article specifically pertains to a domestic (U.S.) “Issuer” of securities (aka, a syndicator, manager or promoter) that is seeking to include foreign investors in a Regulation D, Rule 506 offering whose purpose is to acquire U.S. real estate. This article does not pertain to: a non-U.S. Issuer of securities; Regulation S Offerings offered solely to Non-U.S. Persons; or syndications for purposes other than real estate.

A. SECURITIES LAWS

U.S. Securities Laws; Regulation D: There is no prohibition against bringing foreign investors (“Non-U.S. Persons”) into a Regulation D, Rule 506 offering, however, the offering documents will need to include additional clauses regarding eligibility of Non-U.S. Persons to invest and the risks of including Non-U.S. Persons in a U.S. private securities offering. See the Trowbridge & Taylor article entitled The Legal Aspects of Raising Money from Private Investors regarding the rules for a Regulation D, Rule 506 Securities offering.

“U.S. Persons” are defined as U.S. residents or citizens, U.S. companies, and persons living in the U.S. regardless of nationality, or U.S. residents living abroad (Rule 902(k)).

“Non-U.S. Persons” are all others.

Foreign Securities Laws: Many developed countries have securities laws similar to the U.S., which may include solicitation prohibitions, registration of the offering with the foreign government, or translation of offering documents into the local language, etc. A local securities attorney (or equivalent) should review any securities offering that will be made in a foreign country before it is presented to their residents to ensure that it complies with their securities laws. For this reason alone, it may be impractical to make a single offering available to investors from multiple foreign countries.

B. TAX LAWS

U.S. Tax Laws; FIRPTA. Under the U.S. Foreign Investors in Real Property Tax Act of 1980 (FIRPTA), the Issuer must withhold a certain percentage of any distribution or return to foreign investors and remit it to the IRS on the investor’s behalf. The amount of tax due from a Non-U.S. Person depends on the terms of any tax treaty between their country and the U.S. The Non-U.S. Person will have to obtain a U.S. taxpayer identification number and file a U.S. tax return in order to obtain a refund of the withheld tax if any is due. However, for countries without a U.S. tax treaty or where the tax treaty does not qualify them for a refund, the tax paid will simply be their cost of doing business in the U.S. A Non-U.S. Person should consult their own financial advisors regarding the terms of their tax treaty with the U.S.

An Issuer (e.g., the Manager of a Syndication) that fails to withhold the proper tax will still be liable for payment of the tax to the IRS if the Non-U.S. Person fails to pay the required amount. The additional accounting costs associated with researching FIRPTA withholding requirements, making the necessary filings, etc. will be borne by the Issuer. An Issuer should check with their tax advisor to determine the applicable requirements and anticipated additional accounting costs for dealing with FIRPTA requirements.

Note: Certain debt investments by a Non-U.S. Person, such as a bona fide loan with fixed interest and no relation to performance of the property, may be exempt from FIRPTA. The IRS has several web pages devoted to FIRPTA taxation that are fairly easy to read and informative.

Foreign Tax Laws. Non-U.S. Persons may also be taxed in their own countries on earnings from their U.S. investments. An Issuer should not give Non-U.S. Persons any tax or legal advise, but they do have an obligation to warn them that potential tax consequences may exist, which could dramatically effect their returns. A prospective foreign investor should consult their own legal/tax advisors to determine the U.S. and non-U.S. tax consequences of investing in a U.S. Securities offering.

C. US PATRIOT ACT; HOMELAND SECURITY

Certain “Sanctioned” or “Blocked” foreign nationals; nationals or residents of Sanctioned Countries; or persons with more than 15% of their assets invested in Sanctioned Countries designated by the U.S. government are prohibited from directly or indirectly investing in a U.S. company. These restrictions are aimed at persons or countries identified by the U.S. as rogue nations, terrorist facilitators, weapons of mass destruction (WMD) proliferators, money launderers, drug kingpins, and other national security threats, collectively, these restrictions are known as U.S. “anti-money laundering” (AML) laws. A list of prohibited persons and countries is maintained and periodically updated by the U.S. Dept. of Treasury, Office of Foreign Assets Control (“OFAC”) under the USA PATRIOT Act and related Acts. See http://www.ustreas.gov/offices/enforcement/lists/.

An Issuer of securities to Non-U.S. Persons will have strict liability for conformance with these requirements. Failure to comply may subject the Issuer to accusations of participation in such activities. As a safeguard, for any Non-U.S. Person, the Issuer must inquire, verify, and maintain records of:

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The identity of each investor and whether they are prohibited from investing in the U.S. by obtaining a copy of a passport or other applicable residency or company documentation and verifying it against such lists, and depending on the circumstances, an Issuer may be obligated to file a Suspicious Activity Report (SAR) with the Financial Crimes Enforcement Network (FinCEN), a bureau within the U.S. Department of Treasury if: (i) a transaction is conducted or attempted to be conducted by, at, or through the Issuer’s investment opportunity; (ii) the transaction exceeds $5,000; and (iii) the Issuer knows, suspects, or has reason to suspect that the transaction, among other things, involves funds or is intended to disguise funds derived from illegal activity, or involves the use of the investment to facilitate criminal activity. Reporting information is available on FinCEN’s website at www.fincen.gov.

In addition to the above requirements, U.S. banks may be required to report to various federal and/or state agencies certain deposits into a U.S. bank account by a Non-U.S. Person. An Issuer should check with their banking institution to determine the applicable banking rules and whether deposits from their Non-U.S. Persons will trigger such reporting. Finally, exchange rates must be factored into each transaction involving a foreign investor.

**D. WHAT IF THE NON-U.S. PERSON SIMPLY FORMS A U.S. ENTITY?**

It may be possible to shift some of the burdens regarding compliance with FIRPTA and AML laws if the Non-U.S. Person forms and funds a U.S. limited liability company, partnership, or corporation that becomes the purchaser of the securities. In the process of setting up their legal entity in the U.S., which should be done with their own, independent U.S. legal counsel, the foreign investor will have effectively become a U.S. Person. However, in most cases, the Issuer has a fiduciary duty to all of its investors to protect their investment, so it would be incumbent on the Issuer to conduct the same investor identification and tax withholding protocol for all Non-U.S. Persons, regardless of whether they invest via a U.S. legal entity, a foreign entity, or as foreign individuals rather than relying on the Non-U.S. Person to comply with U.S. laws when their failure to do it correctly could have a significant financial impact on the entire Syndication.

An Issuer that intends to include Non-U.S. Persons as investors, should:

1) Adopt and implement a rigorous investor identification and recordkeeping program;

2) Hire a U.S. CPA and/or tax attorney versed in taxation of foreign investors in a group real estate investment setting to maintain the appropriate books, records, and tax filings for the offering;

3) Consult with a securities attorney (or equivalent) in the foreign country regarding the proposed offering; and

4) Recommend that all Non-U.S. Persons obtain the advise of their own financial advisors in both their countries and the US before making an investment decision.

The Issuer should always verify whether an investor is a U.S. or Non-U.S. Person, and if they are a foreign investor, whether they are prohibited from investing in the U.S. Further inquiry and verification will be required if the Issuer suspects or has reason to believe that the investor is among the list of prohibited persons or that the investor has pooled funds from others in order to make the investment.

**E. RISK V. REWARD**

While there may be advantages to including foreign investors in a Regulation D securities offering, doing so will likely increase the overall accounting and legal expenses associated with the company, and it may increase the Issuer’s liability risks. As always, a risk versus reward analysis should be conducted before an Issuer decides whether to include Non-U.S. Persons as investors in a Regulation D Securities Offering.

Further, if all investors in a single offering will be Non-U.S. Persons, a Regulation S Offering may be more appropriate. See Trowbridge & Taylor article on Regulation S Real Estate Syndication Offerings Solely to Foreign Investors.

**WHAT’S YOUR QUESTION?**

For a free 30-minute consultation, call (858) 349-8953 or email: Kim@SyndicationLawyers.com.

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**INCLUDING FOREIGN INVESTORS IN A REG. D RULE 506 REAL ESTATE SYNDICATION**

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