Foreign Investment in U.S. Real Estate – Now More than Ever

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INVESTMENT IN U.S. commercial real estate by non-U.S. investors continues to increase, and not just in gateway cities like New York, Los Angeles, Miami, and San Francisco. Foreign investors increasingly compete with domestic firms, and need sophisticated legal advice from practitioners who know both the law, and the customs, that will determine whether transactions can be successfully consummated.

Over the last several years, the largest source country for these investments was Canada, followed by China and countries in the Middle East. Investment by China-based investors in U.S. real estate, in particular, continues to increase. Perennial investors, such as Western Europeans, and relative newcomers, such as Israelis and Singapore-based investors, also are active in the market. Only countries such as Russia, whose market activities are affected by adverse political developments, show a material decline.

According to the annual survey taken among the members of the Association of Foreign Investors in Real Estate (AFIRE) and released earlier this year¹, 64 percent of respondents say they expect to have modest or major increases in their investment in U.S. real estate in 2016, despite moderate concerns about the impact of higher interest rates. Another 31 percent say they expect to maintain or reinvest their investments. None plans a major decrease. Meanwhile, the United States was also cited as the country providing the best opportunity for capital appreciation.

¹. The survey was conducted in the fourth quarter of 2015 by the James A. Graaskamp Center for Real Estate, Wisconsin School of Business.
The AFIRE survey indicated that, for the second consecutive year, New York outranked London as the top global city for foreign real estate investment. Berlin, ranking fourth, became the first German city to be named among the top five global cities. In the United States, multifamily and industrial properties tied for first place as preferred property types. Retail moved from fourth place last year to third; office moved from third to fourth; hotels remained in fifth. Examples of recent investments by non-U.S. investors in U.S. real estate include:

- Anbang Insurance (China) purchasing the Waldorf Astoria Hotel in New York City for a reported $2 billion (all references to dollar amounts are to U.S. dollars);
- Oxford Properties Group, the real estate arm of Toronto-based OMERS Worldwide Group of Companies, partnering with Related Companies in Hudson Yards in New York, and with DC-based developers for the development of office buildings in Washington DC, and with other institutional investors for the purchase of multiple office buildings in Boston;
- Ivanhoe Cambridge, the real estate arm of Caisse de Depot et Placement du Quebec, acquiring the Wells Fargo Center in Seattle, a 49 percent interest in 1411 Broadway in New York, a portfolio of 73 office buildings in Silicon Valley; and a co-investment with Blackstone in the $5.3 billion acquisition of Stuyvesant Town/Peter Cooper Village in Manhattan;
- Shanghai-based Greenland Holding Group Co. acquiring a 70 percent interest in Forest City Enterprises’ Atlantic Yards project, a 22-acre commercial and residential development in Brooklyn;
- Hamburg based Union Investment GmbH acquiring 1000 Main in Houston; 4085 Campbell Avenue in Menlo Park, CA; 50 S. 10th Street in Minneapolis; and the Godfrey Hotel in Boston and LondonHouse Hotel in Chicago;
- Chinese and Brazilian investors purchasing a 40 percent interest in the General Motors Building in New York City (a joint venture with Boston Properties);
- Fosun International Ltd. (China) acquiring One Chase Manhattan Plaza;
- Norway’s sovereign fund acquiring a part interest in PNC Place in Washington D.C. and a 45 percent interest in Times Square Tower in New York City;
- Middle Eastern investor purchasing The Avenue, a 335-unit luxury multi-family project in Washington DC.;
- Alony Hetz Properties (Israel) purchasing a partial interest in Carr Properties, a Washington DC based developer.

According to the AFIRE survey, the top five U.S. cities for foreign investment in 2016 will be:

- New York (#1 last year);
- Los Angeles (#4 last year);
- San Francisco (#2 last year);
- Washington, DC (#5 last year); and
- Seattle and Boston (#8 and #6 respectively last year).

Given this trend, which builds on over a half century of foreign investment in the United States, real estate lawyers need to: (a) become expert in inbound tax, regulatory and other issues facing non-U.S. investors who have their eyes on U.S. real estate; (b) understand culture and customs that may be different “over here” from “over there”; (c) spot issues that might not affect U.S. investors but that could be important (or even fatal) to an inbound investor, and (d) master the alphabet–soup of statutes peculiar to foreign investment: CFIUS; FIRPTA; OFAC; BEA; IITSSA, and others.

Foreign investors vary in sophistication, business strategy and practices, governance, and capital sources. Some create U.S.-based management teams; some remain operationally offshore and reliant on third party advisors and managers. Some are seeking diversification, while others primarily focus on real estate investment as their business. As compared to their U.S. counterparts,
more are focused on stability and capital preservation than on yield. Some non-U.S. investors will pay a premium in order to invest in a certain kind of asset, or a particularly attractive market. This article concentrates on issues common to foreign investors generally, with an emphasis on representation of investors that are not fully habituated to the U.S. market, and on investors primarily interested in equity investments.

The first thing to remember is that foreign investors are just that—they are foreign. Rules, expectations, and customs are different outside the United States, so be prepared to spend significant time explaining basic principles to your German, Chinese or Middle Eastern client. It is also useful to not treat “foreignness” as a monolithic category. As noted, each client differs, and—without overstressing the point—clients from particular countries and regions may differ as they have been influenced by the history, laws, business culture and economics of their home jurisdiction. Many tend to assume, often inaccurately, that the U.S. market and business environment are comparable to their own, so providing the differentiation is one key value that experienced U.S. counsel can provide. Even when educated in the United States, many foreign investors find the U.S. federal and state systems confusing and, at times, threatening (much like any intelligent U.S. tax lawyer). The key to your success is patience. In our experience, understanding how your non-U.S. clients are thinking—or appreciating the challenges your U.S.-based client may face in dealing with a non-U.S. investor on the opposite side of the table—is critical to getting a deal successfully consummated.

Appreciation of tax consequences of a U.S. investment is also high on the list of priorities. Tax consequences can vary greatly from client to client and from country to country, and home country and U.S. tax principles may be modified by tax treaties. Foreign individuals not considered U.S. tax residents may be subject to withholding taxes, either as estimates of taxes they might owe or as flat tax amounts payable on interest, dividends and other receipts, regardless of a deal’s profitability.

Often, a non-U.S. investor retains an advisor to assist with the identification of opportunities, due diligence, structuring and closing. Advisors range across the gamut from sophisticated, independent third parties to self-interested and problematic cronies of company insiders. Keep in mind that the investor—not the advisor—is your client, but maintaining a strong, trusting relationship with the advisor will be very helpful. Be mindful of confidentiality/privilege considerations when working with the advisor. The advisor can be and often is a strong ally (or sometimes is an impediment) and forging a working relationship in either case will be critical to the successful consummation of the transaction.

Each foreign investor operates with its own unique approval and underwriting process. We suggest becoming completely conversant with your non-U.S. client’s approval process and expectations for timing well before the transaction gets underway. Knowing that process, and being able to explain it to the seller or other counterparty (and to the latter’s brokers and advisors), may be very helpful as the acquisition process unfolds. Some clients require a preliminary valuation before a purchase or investment agreement—or even a letter of intent—can be executed. Make sure you know how the process works. Sellers and their brokers are focused on certainty of closing and the avoidance of deal surprises. The challenge for you is that offshore clients often have lengthy and sometimes cumbersome procedures, and sellers often lose patience while teams of “technical,” “valuation,” and other experts travel to the U.S. to inspect an asset (or portfolio) or in dealing with foreign counterparties whose negotiating style is opaque or at variance with U.S. norms.

Many non-U.S. clients require detailed written advice—almost approaching a legal opinion—before proceeding with a transaction. The advice is sometimes called a “red flag memo,” or a “due diligence report,” and becomes part of the client’s formal underwriting. When representing a

2. Some prominent firms representing foreign investors include Metzler; HQ Capital Real Estate; Atlantic Partners, and JLL.
non-U.S. client for the first time, be sure to find out in advance whether the client will need such a letter – and when. These memoranda can require a significant expenditure of time and effort, even while you are busy negotiating the purchase agreement, joint venture agreement or other key transaction documents. You also need to understand time lags created by the need to translate documents, obtain local governmental or monetary authority sign-offs, and even sign documents, where original or notarized documents are required.

One area where non-U.S. clients are not unique is in their focus on legal fees. Don’t be insulted when your non-U.S. client asks for a legal fee “bid,” because they may very well be seeking “bids” from other qualified lawyers. Be sure to ask the client whether fixed fees, or an estimate, is required, and whether the client requires you to specify hourly rates. An important part of your “bid” will be the assumptions and qualifications, often because you may have insufficient information about the asset or particular client needs and expectations when formulating your bid. Keep in mind, as well, that conflict of interest rules are different outside the U.S., so when conflicts are identified, you will need to understand how the client addresses what would normally be routine waiver requests with domestic clients.

Following are some legal and other issues that often arise in connection with either the representation of non-U.S. investors on U.S. real estate transactions, or the representation of parties doing business with non-U.S. investors on U.S. real estate transactions.

**TAX STRUCTURING** • Cross-border tax planning and structuring for U.S. real estate investment involves levels of tax planning and accounting analysis that can be much more complicated than transactions involving solely U.S. parties, given that the analysis takes into account both home country and U.S. taxation, tax treaties and taxation of any intervening jurisdictions, all in the special context of cross-border capital flows.

When real estate transactions in the U.S. involve non-U.S. investors, one of the first questions that arises is the applicability of the Foreign Investment in Real Property Tax Act (FIRPTA). FIRPTA was enacted in 1980 to combat perceived unfair advantages for foreign investors in U.S. real estate, in that foreign investors could in many instances avoid capital gains taxation on repatriated profits from U.S. real estate investments. FIRPTA imposes significant taxes on dispositions of U.S. real property interests. Although gains realized by non-U.S. investors from U.S. stock investments generally are not taxable, income and gain from real estate investments, including the sale of equity interests in “U.S. real property holding corporations,” generally are taxable under the effectively connected income (ECI) rules.

In addition, as explained below, complicated withholding tax rules apply with regard to U.S. counterparties in such transactions.

A U.S. real property interest is defined to mean either a direct interest in U.S. real property, which could include an interest in a partnership or limited liability company, or another indirect interest in U.S. real property. Such indirect interests would include equity in a U.S. corporation that is or has been a U.S. real property holding corporation during a specified testing period (generally five years prior to the sale). A U.S. real property holding corporation is generally defined to mean a domestic corporation in which the fair market value of the corporation’s U.S. real property interests is 50 percent or more of the fair market value of all of its real property assets, including those outside the US and other assets used in the corporation’s trade or business. Note that a real estate investment trust (REIT) is often a U.S. real property holding corporation under this definition.

Rental income or gains from the sale of U.S. real estate (due to FIRPTA), or both, generally are treated as ECI. Also, U.S. source rental income allocable to a foreign investor typically is not entitled to any treaty preferences. ECI is generally taxed to such foreign investors under the same tax rates that apply to U.S. taxpayers, and foreign investors that receive ECI are required to file U.S. federal and
state income tax returns. Finally, the FIRPTA rules described below can also transform sales of stock (or other equity interests) and/or capital gains dividends from REITs into ECI.

Structures

Given these tax challenges, a premium is placed on tax structuring when seeking to attract non-U.S. capital to U.S. real estate investments. Structuring is a task typically undertaken by tax lawyers or accountants, and may involve expertise in both U.S. and home country taxation, tax treaty provisions, and cross-border investment through intermediary countries. However, real estate lawyers need to have a familiarity with the issues and alternatives that are addressed and adopted in cross-border real estate investment. Some of the more common structuring options are described below.

Foreign Investor as Lender

Rather than owning a partnership or membership interest in a fund or equity in a US real property holding corporation, a foreign investor may make a loan secured by U.S. real estate. A non-participating loan generally is not a U.S. real property interest, even if secured by collateral that happens to be a U.S. real property interest, and therefore is not subject to FIRPTA. Even a shared appreciation loan, which is a U.S. real property interest, generally escapes FIRPTA taxation on its interest and principal (although sale of the debt may be subject to FIRPTA taxation). A debt instrument with participation features must be crafted carefully to ensure that it is treated as debt for U.S. federal income tax purposes. In addition, there is a risk that the regulations under Code Section 897 might treat a debt obligation in which the payments and/or value of such an obligation are contingent upon or related to U.S. real property interests as itself a FIRPTA interest. Specifically, regulations under Code Section 897 provide that a direct or an indirect right to share in the appreciation in value of assets of or the gross or net proceeds or profits derived from U.S. real property interest–owning entities may be treated as FIRPTA assets. It is important to keep in mind that if the non-U.S. investor becomes an owner of the collateral, whether through foreclosure or otherwise, the FIRPTA benefits of loans generally will be lost. Using a leveraged blocker or a REIT to hold foreclosed collateral can mitigate the FIRPTA downside in such circumstances.

Leveraged Blocker Corporation

Instead of becoming an equity investor in a real estate fund, a non-U.S. investor may instead invest through, and become, directly or (more typically) indirectly, both a shareholder of and lender to a domestic corporation (a blocker). The blocker in turn would take the money either contributed or lent to it and invest in either a U.S. real estate fund or other entity or directly in U.S. real estate. At first blush, the basic tax theory of a leveraged blocker is counterintuitive; it would not generally seem to make sense that a foreign investor could reduce its overall effective U.S. tax rate on its U.S. real estate investments by owning such real estate through a U.S. taxable corporation. However, the use of shareholder debt, whereby rental income and/or gains from real estate can be converted into tax deductible and withholding tax–free interest income, allows for this result. There are, however, significant limitations and risks with this strategy that need to be considered carefully. First and foremost, new proposed regulations under Code Section 385 threaten to upset longstanding (and quite settled) principles regarding the tax status of intercompany loans as debt. At this point, it is unclear how or when such regulations will be finalized. Assuming the shareholder debt successfully runs the gauntlet of the final Code Section 385 regulations (in whatever form such final regulations may take) and subject to certain technical (but material) limitations, interest on shareholder loans should be deductible. Such deductibility depends on the loans being respected as debt for federal income tax purposes and the interest payments likewise being respected as interest. Thus, one must be careful with loan-to-value ratios and similar underwriting criteria. Income that is not able to be stripped out via interest payments generally will be treated as taxable income, subject to corporate tax at the blocker level, and the after-tax amount usually will be treated as a dividend when distributed by the blocker. Amounts paid on liquidation, however, generally can be distributed tax-free, provided the blocker has disposed of literally all its U.S. real property interests in taxable
transactions. This exception, often referred to as the “cleansing rule,” is why it may make sense to own each U.S. real property interest in a separate corporate entity. The cost of separate blockers will include more than just additional administrative costs, however, as absent a consolidated group acting as an umbrella over all blockers, using losses from one blocker corporation against income or gains from a brother corporation will be difficult.

**Offshore Blockers**

United States real property interests may be acquired in an offshore corporate entity and, later, investors may transfer the equity in such an entity entirely free of U.S. tax. However, any well-advised buyer will discount the purchase price of such an offshore corporation to account for the embedded U.S. tax, and many would-be buyers, particularly U.S. investors, will choose not to invest through an offshore blocker. Moreover, if this offshore corporation is formed in a tax haven, any ECI will not only be fully taxable under U.S. rates but also be subject to an additional 30 percent branch profits tax. The branch profits tax can apply even to offshore corporations that are entitled to the benefits of a U.S. tax treaty (the rate is not reduced to zero under all treaties). For these reasons, one typically sees offshore blockers only in legacy assets (acquired before FIRPTA), for anomalous assets such as the New York Four Seasons Hotel, and/or for assets not expected to generate significant ECI.

**REITs**

REITs often are used by non-U.S. investors to either minimize or avoid U.S. federal income taxation. A REIT is an entity that meets certain asset, gross income, ownership composition, and distribution requirements. If these tests are met, a REIT will escape corporate taxation, despite being viewed as a corporation for most U.S. federal income tax purposes. The benefits of such corporate status include the general avoidance of state tax filings for the jurisdictions where the REIT owns assets, and the conversion of rental income into dividend payments. However, with exceptions under the recently enacted PATH Act (discussed below) and certain limited statutory provisions, gains that a REIT derives from dispositions of U.S. real property interests will be taxable under FIRPTA in the hands of a non-U.S. investor just as if such investor disposed of the U.S. real property interest itself. Importantly, all ordinary REIT dividends should be viewed as dividends under U.S. tax treaties and other provisions, such as Code Section 892, and generally should not be viewed as ECI. This means such ordinary dividends are potentially subject to favorable U.S. withholding rules under tax treaties and/or Code Section 892. Note, however, that ordinary REIT dividends often are subject to less-favorable rates of withholding than corporate dividends under tax treaties. That said, many non-U.S. institutional investors can avail themselves of a zero withholding rate on REIT ordinary dividends (Canadian, UK, Dutch and Japanese pension funds come to mind).

**Publicly Traded REITs**

Foreign investors that own 10 percent or less (until recently, 5 percent or less) of a class of publicly traded REIT stock can receive capital gain distributions without FIRPTA consequences. Such capital gain distributions are viewed as ordinary dividends (potentially subject to tax treaty rates of withholding as low as 0 percent), provided the non-U.S. holder has owned 10 percent or less of such class of shares during the one-year period ending on the date of distribution. Dispositions of such shares should also be exempt from FIRPTA under one or both of two exceptions. The first exception exempts holders of 10 percent or less of publicly traded shares from the FIRPTA rules, provided that such a shareholder has owned 10 percent or less of such class of interests during a five-year period ending on the date of disposition. The second exception is for a REIT that has “domestically controlled” status. A domestically controlled REIT is a REIT in which more than 50 percent (by value) of the stock has been owned at all times by U.S. persons during the shorter of (1) the five-year period ending on the date of the relevant transaction or (2) the period during which the REIT was in existence. Interests in such a domestically controlled REIT generally can be sold without FIRPTA tax.
Private REITs and Joint Ventures

Many real estate investors utilize private REITs as holding vehicles. One advantage of such a REIT vehicle is that U.S. tax-exempt investors in the fund generally are insulated from unrelated business taxable income without regard to their ability to obtain the benefits of the so-called fractions rule (which applies to only certain tax-exempt investors) and/or the fund’s qualification under such rule. To attract significant non-U.S. investors, a fund might acquire and hold each significant U.S. real property interest in its own private REIT and exit such investment via a sale of such ownership interests in such REIT. If the REIT qualifies as a domestically controlled REIT or if the REIT is non-controlled with respect to foreign government investors (such as certain sovereign wealth funds), the gain on the sale of the REIT allocable to these foreign investors should be free of U.S. tax under FIRPTA. In addition, depending on the availability of tax treaties and/or Code Section 892, any operating income passed through such a REIT as ordinary dividends may qualify for favorable withholding rates, sometimes as low as zero. In order that treaty benefits are reliably available to fund investors, the fund should be organized as a general matter as a limited partnership and not a limited liability company, as it is often problematic for foreign investors to obtain treaty benefits on income earned through pass-through limited liability companies. Care should also be taken when structuring holding vehicles for foreign governments, as any entity wholly owned (directly or indirectly) by a foreign government generally will be taxable as a corporation for U.S. tax purposes. Regardless of domestically controlled REIT status or non-controlled REIT status, any actual sales of U.S. real property interests by the REIT usually will trigger FIRPTA tax to the non-U.S. investors (subject to certain PATH Act rules and other Code-based exemptions for public REIT shareholders). Under current IRS guidance, this result applies even if the REIT is liquidated in connection with the sale of its asset.

Consolidated Group Structures; Domestication of Profits

Different tax concerns and possibilities arise when the foreign investor makes multiple investments. At that time, a consolidated structure might be preferable that, among other things, allows losses in one investment to be offset against gains elsewhere. This is another reason for the use of Delaware corporations—to allow a holding company in which revenues generally are taxed only in the jurisdiction in which they are sited. However, state and local jurisdictions are increasing their scrutiny of transactions among affiliates across jurisdictions, so proper transfer pricing advice is essential to implement such a structure. Moreover, there are a number of tax strategies that can be adopted to effect tax minimization where repatriation is not the immediate objective, such as tax-free exchanges under Code Section 1031 where any boot is tolerable from a tax point of view.

Code Section 892 Investors

Code Section 892 exempts from U.S. federal income taxation income and gain that “foreign governments” receive from investments in the United States in stocks, bonds, or other domestic securities. For these purposes, a partnership interest is not a security, unless the partnership is publicly traded. A “foreign government” for these purposes can be either an “integral part” or “controlled entity” of a “foreign sovereign.” Many sovereign wealth funds and/or non-U.S. governmental pension funds and pension trusts will be categorized as foreign governments under Code Section 892.

The Code Section 892 exclusion does not apply to income (a) derived from the conduct of any “commercial activity,” (b) received directly or indirectly from or by a “controlled commercial entity,” or (c) derived from the disposition of any interest in such a controlled commercial entity. Most important for real estate practitioners, the exclusion under Section 892 also does not apply to income or gain from a United States real property interest (USRPI) as defined under Code Section 897(c)(1)(A)(i). Significantly for non-U.S. governmental investors, stock in a U.S. real property holding corporation (USRPHC) should not constitute a USRPI under Code Section 897(c)(1)(A)(i). Rather such stock is typically a USRPI under Code Section 897(c)(1)(A)(ii).
892 is the use of a REIT to hold real estate investments. Provided that (a) the foreign government does not “control” the subsidiary REIT (generally defined as an ownership threshold of less than 50 percent by vote and value of the REIT, provided effective practical control of the REIT does not otherwise exist) and (b) such REIT pays only ordinary dividends (dividends from operations, not USRPI dispositions), such dividends should generally qualify for the Section 892 exception. In addition, so long as the underlying U.S. real estate investment is sold via a sale of interests in such non-controlled (or domestically controlled) subsidiary REIT, any gain on exit likewise should escape U.S. tax. In addition, the REIT itself (if properly organized and operated) should not be subject to U.S. federal income tax on its income.

Also, although generally viewed as a corporation for purposes of the Code, which is why equity in a REIT is a “security” for Section 892 purposes, a REIT is allowed a dividends paid deduction that can effectively allow the REIT to avoid all U.S. federal corporate tax on its income. Of course, in order to qualify as a REIT, however, a number of technical tax requirements—organizational, asset, gross income and distribution—must be met.

Certain Joint Venture Issues

A common structure for private REIT vehicles is to have such REIT owned by a limited partnership, with the partnership as the sole common shareholder. Such a structure typically allows a more flexible commercial arrangement between the partnership’s investors and sponsor, and allows multiple investments (including those that might not be able to be made via a REIT) without multiple renegotiation of the overall economic deal. Often, a real estate partnership will have other than pro rata distributions to its partners (carried interest, preferred returns, etc.).

Gain on Exit from Investment in U.S. Real Estate Held by a REIT

REIT capital gain distributions derived from a disposition of U.S. real estate, even if followed by a liquidation of the REIT, will be viewed by the IRS as being subject to U.S. income tax. To address this issue, a non-U.S. governmental entity may form joint venture with one or more U.S. investors/sponsors. The joint venture would be structured as a partnership, with the non-U.S. governmental entity a limited partner with a minority interest (less than 50 percent of both vote and value) and minimal control rights. This joint venture forms a subsidiary REIT, and holds 100 percent of the common, non-voting shares of such subsidiary REIT. The subsidiary REIT would hold the real estate and thus would shield the joint venture from any commercial activity. The joint venture must not hold other assets without a corporate blocker unless the tax advisors are confident that no commercial activity will flow into the joint venture (and out of the joint venture to the Code Section 892 investors).

Documentation

The practical challenges involved in representing a client who structures a joint venture with a foreign government/sovereign fund under Section 892, or the foreign government/sovereign are significant, and need to be considered in advance. Because, in order to utilize these provisions properly, a sale of the real property asset will be structured as the sale of the REIT, legal fees (and, possibly, other transaction costs) will be higher, and proper expectations must be set in advance. Among other things, practitioners will need to consider whether the jurisdiction where the property is located will impose transfer and recording taxes on the transfer of indirect—or economic—interests. Other considerations include whether the purchaser will require a “non-imputation of knowledge” title insurance endorsement (if available in that state), and whether the title insurance company will require an indemnity to back up the endorsement. The parties may also consider the extent to which the transaction must be reported to local taxing authorities for purposes of the assessment or reassessment of real property (ad valorem) taxes.3

3. Exiting a U.S. real estate investment through a sale of interests in a REIT is a more complicated undertaking than the sale of real estate. The REIT buyer will want representations, warranties and indemnities (from a credit-worthy
Use of Tax Treaties and Anti-Treaty Shopping Rules

Until the 1980’s, tax treaties with so-called “tax shelter jurisdictions” allowed reduced rates of tax to most entities formed in the jurisdictions, regardless of the situs of ultimate beneficial ownership. This loophole has long been closed except in rare instances, and replaced by rules that significantly limit (but do not wholly preclude) the use of a country’s tax treaties by entities not owned by qualified residents of the treaty party.

Withholding Tax Issues

Regulations under Code Sections 1445 and 1446 impose withholding taxes on proceeds and/or gains from the sale of U.S. real property interests. Specifically, any transferee of a U.S. real property interest from a non-U.S. person typically must withhold 15 percent (until recently, 10 percent) of the gross proceeds and remit the withheld amount to the IRS. (See the discussion of the PATH Act below.) If the transferee obtains a reduced withholding certificate from the IRS, generally by showing that such 15 percent gross basis withholding is more than the tax liability, then lesser amounts may be withheld. For U.S. real property interests sold by a real estate fund, the fund itself must withhold under Code Section 1446 on its allocations to its foreign partners. One strategy to make withholding tax compliance easier for the seller is to own assets through a U.S. partnership. By so doing, purchasers need not withhold under FIRPTA, and the withholding tax obligation is “moved up” to such partnership where, under regulations applicable to the withholding obligations of partnerships, partner-specific tax attributes generally can be considered (the amount of gain actually earned on the sale of U.S. real estate, the status of the partners as individuals, or other entities subject to favorable tax rates, and other considerations).

Absent implementation of an appropriate structure, or issuance of a withholding certificate, the parties will need to enter into a FIRPTA escrow agreement, generally with the title company handling the transaction as the escrow agent. Funds are held by the title company until issuance of a certificate from the IRS, whereupon the funds specified by the IRS are remitted to the government, and the balance is sent to the seller. The FIRPTA escrow agreements are very similar to a standard escrow agreement for an earnest money deposit.

PATH ACT • The Protecting Americans from Tax Hikes Act of 2015 (the “PATH Act) became law on December 18, 2015. The PATH Act includes many significant modifications to the tax treatment of dispositions of foreign investors’ direct and indirect investments in U.S. real estate, in particular investments through REITs.

The PATH Act’s primary changes included:

- Exemptions for Qualified Foreign Pension Funds (QFPF);
- Exemptions for Qualified Shareholders;
- Expansion of domestically controlled REIT provisions;
- 10 percent public REIT shareholder FIRPTA exception;
- 15 percent FIRPTA withholding rate.
QFPF Rules

The most significant change from a source-of-capital perspective is expected to be the new QFPF status. QFPFs (and entities all of the interests of which are “held by” a QFPF) are now simply excluded from FIRPTA. A QFPF’s ordinary operating income from investments in USRPIs still is generally subject to full U.S. tax under ECI rules, and this means that REITs and/or “blocker” corporations are still needed as a general matter. In addition, QFPFs that wish to preserve any applicable benefits under Section 892 and/or tax treaties generally will benefit from continued use of REITs and/or blockers. As noted above, Section 892 benefits include an exemption from U.S. tax on “ordinary” REIT dividends and the proceeds from sales of ownership interests in REITs.

Accordingly, significant additional interest in U.S. real estate investments, including investments in both public and private REITs, are expected from QFPFs. A QFPF is any trust, corporation, or other organization or arrangement that satisfies all of the following tests:

- Created or organized under non-U.S. law;
- Established to provide retirement or pension benefits to current or former employees (or their beneficiaries) of one or more employers “in consideration for services rendered”;
- Does not have a single participant or beneficiary entitled to more than 5 percent of its assets or income;
- Subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which it is established or operates; and
- Under the law of its country of establishment or operation, either: (a) contributions to the organization which otherwise would be subject to tax under such laws are deductible, excludable, or otherwise subject to a reduced rate of tax, or (b) tax on the investment income of the organization is deferred or imposed at a reduced rate.

There should be no assumption that a sovereign wealth fund (or any government pension or social welfare plan) per se qualifies as a QFPF. Rather, each entity will have to be tested under the QFPF qualification rules. It is unclear when Treasury Regulations providing further guidance on QFPF status will be issued.

Qualified Shareholders (QS)

Under the PATH Act, REIT interests held by a “qualified shareholder” (QS) are not USRPIs and the FIRPTA withholding requirement does not apply to capital gain distributions from a REIT to a QS. Instead, distributions that would have been capital gain distributions prior to the PATH Act are now recast as ordinary REIT dividends. These rules apparently are intended to benefit non-U.S. entities that function somewhat similarly to U.S. publicly traded REITs. Note that the QS benefits are available for investments in all REITs (publicly traded, publicly registered and private REITs).

To qualify as a QS, an entity must either:

- Be eligible for treaty benefits under a comprehensive tax treaty and have its principal class of interests traded on a recognized stock exchange; or
- Be a foreign limited partnership that (a) is organized in a jurisdiction that has a tax information exchange agreement, (b) has at least 50 percent of the value of its interests traded on the NYSE or NASDAQ; (c) meets the requirements of a qualified collective investment vehicle, and (d) maintains records regarding the identity of any 5 percent and greater holders.

A QS’s FIRPTA benefits can be limited to the extent such QS is owned by an “applicable investor” (an “AI”). An AI is an investor that owns (indirectly through the QS or otherwise) more than 10 percent of a REIT in which the QS holds an interest.
Domestically Controlled REIT

Equity in a REIT is not a USRPI, even if the REIT is a United States real property holding corporation (and thus subject to FIRPTA), provided the REIT is “domestically controlled” (a “DC REIT”). A REIT is “domestically controlled” if less than 50 percent of the value of the interests in the REIT are held, directly or indirectly, by non-U.S. investors through certain time periods described in the Code (generally speaking, a five year look-back period is relevant). An owner who owns less than 5 percent of a public REIT will be treated as a U.S. owner provided the public REIT does not have “actual knowledge” to the contrary. In addition, the PATH ACT provides that a publicly traded REIT that owns interests in a REIT subsidiary will itself be viewed as a domestic owner (in its entirety) of the REIT subsidiary if the public REIT is itself domestically controlled. This change is a significant benefit for non-U.S. investors that co-invest with publicly traded REITs.

10 percent Public REIT Shareholders

Shares of a particular class of equity in a public REIT are excluded from the definition of USRPI if such shares are owned by a non-U.S. investor who owns no more than 10 percent of the publicly traded class of REIT stock. Prior to enactment of the PATH Act, this threshold was 5 percent for publicly traded REITs. Capital gain distributions made to such a shareholder will be carved out from FIRPTA and such distribution generally will be treated as an “ordinary” dividend (and thus potentially—but certainly not always—subject to treaty-based lower withholding taxes or potential exemption under Section 892 for “foreign governments”).

REGULATORY AND OTHER NON-TAX STRUCTURING CONSTRAINTS • in addition to U.S. tax issues, non-U.S. investors can have non-U.S. tax and regulatory concerns. for example, such investors may need to comply with certain informational reporting requirements in their home jurisdictions. in addition, investors from outside the U.S. may have a preference for investing in certain types of entities at both the fund level and the subsidiary level. in some cases, this preference may be a regulatory requirement, in particular for foreign governmental entities that may be constrained in terms of percentage ownership, by either vote and/or value, with regard to investment entities. at the time you are engaged to represent a non-U.S. client, you need to carefully describe those areas where the client will need to seek advice from a practitioner who is knowledgeable about these issues. unless you or your firm have the expertise to advise clients on these issues, you will need to ensure that your client seeks advice either from knowledgeable in-house counsel or qualified counsel in the client’s home country.

EB-5 Investments

The EB-5 program, first established in 1990, has recently gained prominence when major developers, such as Related Companies, have used this source of foreign capital for large development projects. Under the EB-5 legislation, 10,000 EB-5 immigrant visas are allocated each year to qualified individuals seeking “Lawful Permanent Resident” status on the basis of their capital investment in a U.S. commercial enterprise. EB-5 investments are generally in the form of debt or equity.4

To qualify under current rules, the foreign investor must make a minimum investment of $500,000 in a “Targeted Investment Area” (a rural area or an area experiencing unemployment of at least 150 percent of the national average rate) or of $1 million in other areas. Most EB-5 investors elect to invest through TIAs. A second requirement is that at least ten full-time jobs are created for every investor benefitting from the program. Projects must be vetted by “Regional Centers” that pool, process and coordinate the investment.

Funds from the EB-5 program have been used to fund (in many cases as relatively inexpensive, generally passive, subordinated or mezzanine debt) projects throughout the U.S., including some

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4. For a comprehensive discussion of the EB-5 program, see Susan J. Booth, EB-5 Capital in Real Estate Transactions: The Fundamentals, 31 Real Est. Fin. J. 11 (Fall-Winter 2015). Ms. Booth, an ACREL Fellow, provides a detailed description of the manner in which EB-5 investments are structured, and some of their pitfalls.
highly visible large urban developments (which has generated criticism of the Regional Centers in question for lack of consistency with the purpose of the program). Virtually every real estate asset class will support an EB-5 investment. However, projects must be able to absorb the delays incurred before an EB-5 investment has received all requisite approvals, and the attendant complexities.

Over the past year, the EB-5 program’s term has been maintained in existence by short-term extensions while Congress considers modifications that, inter alia, might raise the minimum thresholds, alter the criteria for Regional Centers and tinker with its geographic orientation. The latest extension expires September 30, 2016.

CHOICE OF ENTITY/GENERAL BACKGROUND • Whenever you are representing a non-U.S. entity on a real estate transaction, one of the first questions you will be asked is what type of entity will be appropriate. Unlike in many non-U.S. jurisdictions, non-U.S. investors will be pleased to learn that setting up a business in the U.S. is a fairly simple and quick procedure, devoid (in normal circumstances) of any material discretionary governmental act or determination, making the U.S. an easy place to set up to do business. However, there are certain laws that non-U.S. investors in the U.S. should consider, such as those governing business structures and labor and employment, and several U.S. laws that, if not complied with, could subject investors or their affiliates to criminal or civil penalties, the freezing of assets, or mandatory divestiture of their U.S. investments.

Your non-U.S. client will be interested to know that Delaware is the most common state of organization for U.S. business entities, in large part because Delaware laws governing corporations, partnerships and limited liability companies are more director- and officer-friendly than the laws in many other states and because Delaware courts have extensive experience, relative to the experience of courts of other states, deciding business law issues. As noted, Delaware is also a useful jurisdiction for holding companies of a consolidated group, because it minimizes taxation of revenue generated from outside its borders. The goals and circumstances of a particular enterprise might make a different state a preferable location for formation, and these considerations will need to be discussed with your offshore client.

Very little information regarding U.S. entities is publicly available. Corporations, limited liability companies and most partnerships are required to file formation documents with the secretary of state or similar authority in the state of formation; however, the formation document typically contains only the name of the entity, its principal place of business in the state (which can be the address of a commercial filing service) and other basic information. The formation document does not typically include the names of officers, directors, shareholders, members, partners or managers. Bylaws, partnership agreements, limited liability company agreements and shareholders’ agreements, which typically set forth the names of these parties, are not filed with state authorities (although public companies must file them with the U.S. Securities and Exchange Commission). Minutes of annual and special meetings also are not filed with any state authority. Other than personal property tax or franchise tax filings, which provide minimal information about an entity, U.S. private companies are not required to make financial information publicly available.

This might be changing. The United States Department of Treasury recently issued proposed regulations that, if promulgated, would impose new disclosure obligations on domestic disregarded entities wholly owned by foreign persons (i.e., single-member limited liability companies). Most notably, an affected entity would be required to identify its beneficial owner to the IRS on an annual basis. Such an obligation would constitute a reversal in the IRS’s longstanding practice of treating a single-member LLC as an entity disregarded as separate from its owner for reporting purposes.

The proposed regulations, issued May 6, 2016, 81 Fed. Reg. 28784, are intended to strengthen U.S. civil and criminal tax enforcement as well as to assist foreign tax authorities in obtaining
information regarding their own taxpayers pursuant to tax treaties and tax information exchange agreements. Under the proposed regulations, any domestic disregarded entity owned by a foreign person would be subject to the provisions of Code Section 6038A, which currently imposes annual reporting, recordkeeping, and other compliance requirements on certain foreign owned U.S. corporations.

Under the proposed regulations, an affected entity would be required to file an annual information return (Form 5472) that discloses the identity of its foreign owner and certain “reportable transactions” between the entity and its foreign owner or other foreign related parties. A separate Form 5472 would be required to report each related party with which the affected entity had a reportable transaction during a taxable year. “Reportable transaction” for this purpose is defined broadly to include “any sale, assignment, lease, license, loan, advance, contribution, or other transfer of any interest in or a right to use any property or money, as well as the performance of any services for the benefit of, or on behalf of, another taxpayer.” The proposed regulations specifically provide that any contributions or distributions would be considered a reportable transaction with respect to such affected entities.

An affected entity would be required to maintain permanent books of accounts and records sufficient to establish the accuracy of the information annually reported to the IRS on the Form 5472. Failure to file a Form 5472 or maintain the supporting records as required could result in a $10,000 civil penalty for each failure. Criminal penalties could also apply for failure to submit information or for filing false or fraudulent information.

Because an affected entity has a filing obligation, it would be required to obtain a U.S. taxpayer identification number to identify itself on its filing. Accordingly, the affected entity would be required to file a Form SS-4 to apply for an EIN, which identifies responsible party information to the IRS.

These proposed regulations represent the U.S. government’s latest step to expand disclosure by foreign investors, in response to international pressure on the U.S. to collect and disclose information to foreign tax authorities. For example, in January, 2016, the U.S. Financial Crimes Enforcement Network (FinCEN) issued “Geographic Targeting Orders” that required, effective March 1, 2016, the disclosure by certain title insurance companies of the identities of foreign persons behind entities used to purchase high-end residential real estate (including individual condominium units or cooperative apartments) in New York and Miami in all-cash transactions (i.e., without a bank loan), initially only in Manhattan for sales of $3 million or more and in Miami-Dade County, Florida, for sales of $1 million or more. In late July 2016, FinCEN retained these requirements but expanded the program’s reach to the Bronx, Brooklyn, Queens and Staten Island in New York City (for transactions of $1 million or more); Broward and Palm Beach Counties, Florida (for transaction of $1 million or more); Los Angeles County; San Diego County; and San Francisco, San Mateo and Santa Clara Counties, California (for transactions of $2 million or more); and Bexar County, Texas, which includes San Antonio (for transactions of $500,000 or more), and extended the term of this requirement to February 23, 2017.

The filing by the title insurance company (IRS Form 8300) must identify the purchaser and any individual who owns, directly or indirectly, 25 percent or more of the equity interests in the purchaser, and must designate an individual primarily responsible for representing the purchaser. The title company will require either (a) a statement from purchaser’s counsel or a settlement agent stating facts evidencing that the transaction is not one that requires disclosure, or (b) information sufficient to complete IRS Form 8300. The title company is required to obtain certain prescribed identification from beneficial owners and “primarily responsible” persons. In any transaction potentially requiring compliance, Purchaser’s counsel should coordinate in a timely manner with the title insurance company so as to avoid delays in closing.

EXECUTION OF DOCUMENTS • One of the challenges representing a non-U.S. client on a U.S.
real estate transaction is ensuring that documents are properly and timely executed and delivered. Most U.S. recording offices require notarization of documents as a condition for recordation; some lenders and other parties require notarization for other reasons, such as evidence that documents have been properly signed. Foreign notarization is not accepted in many states (but proper notarization in one state is generally accepted in all other states), so an alternative is required if signatories will not be situated in the United States, and this can result in delays and, more importantly, can affect the process and timing of closing transactions. In many countries, rather than a notary, an “Apostille” will provide the same level of authenticity that a notary public provides in the United States. An Apostille is a certificate issued by a designated authority in a country where the Hague Convention Abolishing the Requirement for Legalization of Foreign Public Documents, Apostille Convention, is in force (about 100 countries having elected to participate). Apostilles authenticate the seals and signatures of authorized persons on public documents so that they can be recognized in foreign countries that are parties to the Convention. Apostilles keep their own hours and are often unavailable when you need them, so be sure to plan in advance whenever a notarized signature is required. Also, we suggest you coordinate with the title company handling the transaction, to ensure that the Apostille will be accepted by the local recording office where the document is intended to be recorded. If you have a document that needs to be authenticated for use in a country where the Apostille Convention is not in force, the U.S. Department of State Authentications Office has useful information on its website about the process.5

For documents not requiring notarization, be sure to confirm your non-U.S. client’s particular requirements for execution of documents, and requirements of your counterparties and third parties (such as title insurance companies). Not all documents will be accepted by electronic (e.g., pdf) or telefacsimile delivery. Many non-U.S. clients require two signatures—often by senior executives who may be traveling or on vacation on the day you need them to sign.

**FATCA AND W-8BEN •** A mundane but often overlooked detail associated with the acquisition of U.S. real estate by non-U.S. investors is the often very routine process of signing and delivering an IRS form W-9 to the escrow agent, which is needed by the escrow agent or title company to open an escrow account. For non-U.S. investors, the applicable form is the W-8ben, required by the foreign account tax compliance act (FATCA). While FATCA is focused on U.S. taxpayers who have foreign accounts, its broad reach can affect non-US investors who have domestic accounts used for real estate investment.

**CFIUS**

Section 721 of the defense production act of 1950 (the exon–Florio law), as amended by the foreign investment and national security act of 2007 (FINSA), gives the president broad powers to block certain types of foreign investment in the United States, particularly investments that may affect national security. Sovereign wealth fund investments increasingly are subject to scrutiny because of concerns about foreign government control.

The president, acting through the committee on foreign investment in the United States (CFIUS), a branch of the department of the treasury, can force the divestiture of a completed foreign investment. In general, the sectors most likely to raise potential issues are energy; telecommunications; defense; transportation; banking and finance, postal/shipping; information technology; agriculture/food; water, and public health.

On its face, CFIUS might seem irrelevant to traditional real estate investment. This is an overstatement, and CFIUS should be at least considered in connection with every real estate transaction involving foreign investors. Acquisition of any assets operated as a business undertaking, even if not a separate legal entity, is potentially covered under CFIUS as the acquisition of a “U.S.

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business.” For example, the acquisition of the Waldorf Astoria Hotel in Manhattan was submitted to CFIUS for approval, because the hotel is often the situs for events that arguably have national security implications, including hosting the President of the United States when she or he speaks at the United Nations. Properties involving public infrastructure (e.g., sensitive governmental buildings, or transportation facilities), or even in their vicinity (within their “security parameter), may be subject to review, and the unwind power of the U.S. government is a serious risk for transactions in the penumbra of CFIUS. Transfer of “control,” another CFIUS predicate, can be effected by less than majority ownership, so long as the minority investor has sufficient power to control major business decisions, introducing a factor that is somewhat subjective.

Parties may seek a “safe harbor” from such divestiture by voluntarily notifying CFIUS of their transaction. CFIUS is the executive branch body charged with reviewing mergers, acquisitions, takeovers, sales of securities or assets and certain joint ventures by or with any foreign person that could result in foreign control of a domestic entity, and advising the President on the effects of such transactions on the national security of the United States. The law defined control very broadly—the power, directly or indirectly, whether or not actually exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity.

Most importantly, whenever a transaction involves one of the sectors or interests described above, and a non-U.S. investor (regardless of the particular country), a CFIUS expert will need to be consulted to determine whether an advance CFIUS notification is warranted, given the devastating effect of a divestiture.

CFIUS has the authority to self-initiate the review of a proposed transaction, but when the investment in question potentially affects U.S. national security, parties often decide to submit a voluntary filing to gain approval of the transaction and thereby obtain a “safe harbor” from future divestiture. The confidential CFIUS filing includes information about the proposed acquisition and the background of the proposed purchaser (such as financial information, ownership structure and contacts and relationships with non-U.S. governmental bodies).

Generally, the CFIUS review period is 30 days, but it may be extended for an additional 45-day investigation period in certain circumstances, such as when a transaction threatens U.S. national security and that threat has not been mitigated, when the transaction is a foreign government–controlled transaction, when the transaction would result in foreign control over critical infrastructure or when the lead agency reviewing the transaction recommends an investigation and CFIUS agrees that an investigation should be undertaken. Historically, full investigations were uncommon, but that has changed in recent years.

When a transaction presents a national security risk, CFIUS is authorized to enter into “mitigation agreements” with the parties to the transaction to address and mitigate such national security risks. CFIUS is also authorized to impose significant civil penalties for material misstatements or omissions made to CFIUS; for false certifications made by the parties to the transaction; or for the breach of any mitigation agreement entered into with the parties to a transaction or conditions entered into by, or imposed on, the parties to a transaction under the Exon–Florio Law. Recent regulations emphasize cooperation with CFIUS by parties to transactions, the development and enforcement of mitigation agreements to address potential national security concerns, as well as transactions involving even small amounts of indirect foreign government ownership.

The CFIUS process is a complex procedure that requires parties to navigate regulatory hurdles and, in many instances, negotiate and implement
special measures to mitigate national security concerns. Because national security concerns are likely to intensify, developments in the application of CFIUS should be monitored by attorneys practicing in this area. Just as important is the need for an effective political and media strategy to ensure favorable consideration of sensitive and controversial transactions.

THE PATRIOT ACT • Any investment in the United States could subject the investor to the provisions of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the Patriot Act) and related statutes. The Patriot Act significantly expanded U.S. law enforcement’s authority to detect and prosecute terrorism and terrorist financing. Among other things, the Patriot Act amended the Bank Secrecy Act of 1970, as amended in 2004 (the BSA) to authorize and empower the Secretary of the Treasury to enact regulations that require any “financial institution” (as defined by the BSA) to (a) file suspicious activity reports (SARs) and (b) implement anti-money laundering (AML) programs. Under the authority granted to the Secretary of the Treasury, the Financial Crimes Enforcement Network of the U.S. Department of the Treasury (FinCEN) has enacted regulations implementing such requirements.

Under the BSA, “financial institution” is broadly defined. The regulations promulgated under the BSA do not currently require certain “financial institutions” to file SAR or to implement AML programs, so the regulations should be analyzed carefully before making any investment to determine whether the provisions of the Patriot Act have been satisfied. Nonetheless, this set of requirements must be navigated by any foreign investor who proposes to create banking relationships in the United States and move funds into the United States in establishing a real estate investment business, and the resulting potential delays must be taken into account in the timing of transactions, at least the initial ones.

The Patriot Act is reinforced by Executive Order 13224, which expands the monitoring and proscriptive requirements of the Patriot Act to all business transactions and all persons and entities, and “blocks property and prohibits transactions with persons who commit, threaten to commit, or support terrorism.” as listed on the “Specially Designated Nationals and Blocked Persons (SDN)” list maintained by the U.S. government. In effect, the SDN list must be checked before entering into any business transaction with another party. Some U.S. counterparties have also adopted a rule to report all cash payments over $10,000 to the Federal government.

Among other challenges when representing a non-U.S. investor in the context of the Patriot Act, counsel for the investor will be asked to provide advice on whether the non-U.S. investor can make a representation in a purchase agreement, loan agreement or other document as to whether the client complies with the Patriot Act and related legal requirements. Knowledge qualifiers often are insufficient, so further investigation may be required in order to provide helpful advice in this context.6

FOREIGN ASSET CONTROL RULES • For foreign policy and national security reasons, the U.S. government imposes economic sanctions against various countries, entities, individuals and organizations. The sanctions can be either comprehensive or selective, and from time to time the U.S. government uses trade restrictions and the blocking of assets to accomplish foreign policy and national security goals. These sanctions prohibit certain dealings with targeted countries and persons and may require a blocking or “freezing” of assets in which the targeted country or person has an interest. The Office of Foreign Assets Control at the U.S. Department of the Treasury (OFAC) administers and enforces these sanctions.

All “U.S. persons” are required to comply with the sanctions. For purposes of the OFAC sanctions

6. See Steven A. Teitelbaum, Stephanie M. Holmes and Brian Morgenstern, Anti-Terrorism Clauses in Real Estate Transactions, 25 Prac. Real Est. Law. 29 (Mar. 2009). Mr. Teitelbaum (an ACREL Fellow) and his co-authors provide a helpful guide for how to craft representations and warranties on anti-terrorism provisions in legal documents.
programs, the term “U.S. persons” refers to all U.S. citizens and permanent resident aliens, regardless of where they are located, all persons and entities within the United States and all U.S.-incorporated entities and their foreign branches. OFAC regulations often provide for general licenses authorizing certain categories of transactions. OFAC also issues specific licenses on a case-by-case basis under certain limited situations and conditions.

The type and scope of the sanctions vary significantly among sanctions programs (based on the foreign policy and national concerns applicable to the target country, entity or individual). In addition, as U.S. foreign policy and national security concerns shift, the type and scope of the sanctions may change and affect foreign investment.

As part of its enforcement efforts, OFAC publishes a list of individuals, entities and companies owned or controlled by, or acting for or on behalf of, targeted countries, including countries subject to country sanctions. The list also identifies individuals, groups and entities, such as terrorists, narcotics traffickers or what the United States government has termed President Putin’s “cronies,” designated under List-Based Sanctions programs. Collectively, such individuals, groups and entities are called Specially Designated Nationals or SDNs, and the list is known as the List of Specially Designated Nationals and Blocked Persons or the SDN List. U.S. persons are prohibited from engaging in any transactions with SDNs and must block any property in their possession or under their control in which an SDN has an interest.

Violations of the OFAC rules and its sanctions programs can result in substantial penalties.

When you are approached by a new non-U.S. client for assistance on a U.S. real estate transaction, or your domestic client advises you that it intends to enter into a negotiation with a non-U.S. person or entity, checking the SDN List and possibly performing other background research, is advisable. This, like Patriot Act compliance, is not always a simple process, as it sometimes is not easy to definitively determine that a client, or a client investor or affiliate, is not listed, or is being confused with a person or entity that is listed.

**KNOW YOUR CUSTOMER (KYC)** • A foreign investor seeking to commence business operations in the U.S. needs banking relationships, which brings it (as part of the asset control rules referenced above) under the ambit of the “Know Your Customer” or “KYC” requirements. KYC stands for the policies and procedures required to be followed by businesses, such as financial institutions in business relationships with domestic and foreign customers. The terms “Know Your Customer” and “KYC” do not refer to one law or set of regulations, but to a variety of laws and regulations. In the United States, these include the BSA, the Foreign Corrupt Practices Act of 1977 (FCPA), the Annunzio-Wylie Anti-Money Laundering Act of 1992, and the Patriot Act, among others. The relevant regulations are complex and constantly evolving.

Compliance with KYC can create significant timing issues for a foreign investor seeking to consummate a transaction on an accelerated time frame, which has characterized many recent transactions.

In the broadest terms, KYC requirements are intended to prevent money laundering, bribery, and the financing of terrorist activities by compelling businesses to maintain practices designed to detect and deter these prohibited activities. This means undertaking due diligence prior to entering into a business transaction or relationship (e.g., before opening a bank account for a new customer or closing on a real estate loan, and in some instances before acquisition of a direct or indirect ownership interest in an entity that owns real estate assets if a regulated financial institution is a beneficial owner of such entity), as well as ongoing monitoring of account activity. If a financial institution detects signs of prohibited activities, it is subject to certain additional reporting requirements.

A financial institution entering into a banking relationships with or making a real estate loan to
an investor will require that the investor, as a new or returning customer of the financial institution deliver a completed CIP questionnaire that provides basic information about the customer (and, if the customer is an entity, each beneficial owner), such as:

- Name;
- Date of birth;
- Address;
- Taxpayer identification number (for U.S. persons); and
- Passport number and jurisdiction of issuance, alien identification card, or other government-issued identification (for non-U.S. persons).

The investor will also be asked to provide copies of identification of all beneficial owners and identify the source of the customer’s equity funds for the transaction.

Note: Accounts will not be opened, nor will the covered transaction close, until the financial institution’s KYC process is complete. Depending on the facts, KYC can be completed in a matter of a few days or can take considerably longer. It is prudent to discuss and initiate the KYC process with the intended financial institution early in the transaction and to follow up regularly. It could take several weeks for the financial institution to complete the KYC process.

The financial institution’s KYC diligence process will include:

- Comparing the information on the CIP questionnaire and customer identification to the OFAC list and other lists of known “bad actors”;
- Assessing whether the customer or any beneficial owner is a Politically Exposed Person (PEP) (i.e., a person with a prominent public function, such as a head of state or other political figure, and therefore at risk for involvement in bribery);
- Conducting other typical corporate due diligence such as litigation and judgment searches.

For purposes of these rules, a beneficial owner is an individual with control or ownership, or both, over a certain percentage threshold, such as 25 percent, under FinCEN’s Customer Due Diligence Rule. However, depending on the parties and the factual situation, a financial institution may set a lower ownership percentage threshold for KYC diligence.

If the name of a customer (or a beneficial owner) appears on one of the searched lists, or if initial diligence reveals other risk factors or suspicious activity, the financial institution may be required to conduct Enhanced Due Diligence (EDD) to rule out or better identify non-compliance with the applicable regulations. For example, EDD may reveal that a customer’s name found on the OFAC or PEP lists refers not to the customer, but to another person with the same or similar name. Or it may lead to additional investigation and/or reporting to governmental agencies.

Financial institutions may conduct all of their KYC procedures internally or may engage third party vendors for portions of their diligence. KYC requirements typically include ongoing monitoring of account activity to identify high-risk activity and annual updating of basic customer information to ensure ongoing compliance. The institution or its third party vendor may conduct these ongoing procedures.

BUREAU OF ECONOMIC ANALYSIS REPORTS • Every foreign investment in a U.S. business that results in a foreign person or entity owning 10 percent or more of the voting securities of a U.S. business enterprise, or an equivalent interest of an unincorporated U.S. business enterprise, including a branch or real estate (a “U.S. Entity), is subject to reporting requirements under the International Investment and Trade in Services Survey Act (IITSSA). The reporting requirements include filing with the Bureau of Economic Analysis (the “BEA) of the U.S. Department of Commerce (a) a new investment survey, (b) quarterly reports,
annual reports, and (d) quinquennial (five-year) reports, each of which is briefly described below. Persons subject to the reporting requirements of the new investment survey (Form BE-13) and the quinquennial reports (Form BE-12) are required to file whether or not they have been notified by the BEA. Otherwise, persons not notified in writing of their filing obligation by the BEA are not required to complete the quarterly and annual reports.

Reports filed with the BEA are confidential and may be used only for analytical and statistical purposes. Furthermore, BEA reports may not be used for purposes of taxation, investigation or regulation.

Although enforcement actions are rare, failure to comply with the BEA reporting requirements could result in certain civil and criminal penalties, including monetary fines ranging from $2,500 to $25,000 and injunctive relief commanding compliance with the reporting requirements. Anyone who willfully fails to comply with the BEA reporting requirements, upon conviction, may be fined not more than $10,000 and, if an individual, may be imprisoned for not more than one year, or both, and 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.

**New Investment Survey: Form BE-13**

The BE-13 Survey is required for new investment transactions made when (a) a foreign direct investment relationship is established, or (b) an existing U.S. affiliate of a foreign parent establishes a new U.S. Entity, expands its U.S. operations, or acquires a U.S. Entity. The applicable BE-13 Survey Form is due no later than 45 days after the acquisition is completed or the new legal entity is established or the expansion is begun.

**Quarterly Reports: Form BE-605**

After the initial Form BE-13 is filed, the U.S. Entity is required to file with the BEA quarterly reports on Form BE-605 within 30 days after the close of each calendar or fiscal quarter, except that the report for the fourth quarter may be filed 45 days after the close of such quarter. The purpose of the quarterly survey is to report positions and transactions between a U.S. Entity and its foreign parent(s) and foreign affiliates of the foreign parent(s). U.S. entities required to report will be contacted individually by BEA. U.S. entities not contacted by BEA have no reporting responsibilities for the BE-605.

**Annual Reports: Form BE-15**

The purpose of the annual survey is to report annual financial and operating data of U.S. Entities. A Form BE-15 must be filed by a U.S. Entity after any fiscal year at the end of which a foreign person owned 10 percent or more of the U.S. entity’s voting interests or the equivalent (unless the U.S. entity is eligible to file the BE-15 Claim for Exemption described below). U.S. entities required to report will be contacted individually by BEA. U.S. entities not contacted by BEA have no reporting responsibilities for the BE-15.

**Quinquennial Reports: Form BE-12**

A Form BE-12 is required to be filed in lieu of a Form BE-15 once every five years, if during such benchmark year a foreign person owns 10 percent or more of a U.S. Entity’s voting interests (or the equivalent).

**General Considerations**

Many non-U.S. clients are unaware of the BEA filing requirements, and even when they are advised of the applicability, are reluctant to provide the necessary information, notwithstanding the limited use of the information. We suggest advising the non-U.S. investor’s tax advisor is often tasked with the preparation of the forms.

**FOREIGN OWNERSHIP OF FARMLAND AND MINERAL RIGHTS**

There are many Federal and state laws implicated by a non-U.S. person’s purchase of farmland in the United States for continued agricultural use. Some states restrict the ability of non-individuals and/or non-U.S. citizens to purchase agricultural land. Some
may require disclosure of foreign ownership when forming or qualifying entities in the state. In addition, there are various Federal laws and regulations that may be implicated in such transactions. The precise attributes of the land, the structure of proposed acquisition and, in some instances, the location of the land itself (including its proximity to or functional relationship to other structures or activities), can affect the analysis of a law’s application to the transaction. We recommend that a detailed analysis of a relevant jurisdiction’s laws and regulations (including review of relevant case law) be conducted before proceeding with a contemplated agricultural transaction in that jurisdiction. In addition, eight states currently prohibit ownership of farmland by non-individuals—i.e., purchases by corporations, limited liability companies and other entities are prohibited. Meanwhile, 19 states impose requirements regarding ownership of farmland by foreign/non-U.S. persons.8 Some of the states have prohibitions on ownership, while some of the states’ requirements are limited to reporting obligations.

If your non-U.S. client is considering the acquisition of farmland in Iowa, Kansas, Maine, Missouri, Minnesota, Oklahoma, North Dakota, South Dakota or Wisconsin, in particular, we suggest you confirm with local counsel (unless you practice in that particular state) as to the specific rules regarding your proposed transaction.

The Agricultural Foreign Investment Disclosure Act and accompanying regulations (AFIDA) establish a nationwide system for the collection of information pertaining to foreign ownership in U.S. agricultural land. The regulations require foreign investors who acquire, transfer or hold an interest in U.S. agricultural land to report such holdings and transactions to the Secretary of Agriculture. The data gained from these disclosures is used in the preparation of periodic reports to the President and Congress concerning the effect of such holdings upon family farms and rural communities.

The regulations require foreign investors who acquire, transfer or hold an interest in U.S. agricultural land to report such holdings and transactions to the Secretary of Agriculture on an AFIDA Form FSA-153. The Report must be filed by any organization in which a significant interest or substantial control (more than 10 percent) is directly or indirectly held by foreign individuals, organizations, or governments and must be filed within 90 days of the date of the transaction. Failure to timely file an accurate report can result in a penalty with fines up to 25 percent of the fair market value of the agricultural land.

Some state laws also restrict foreign ownership or licensing of public lands or exploration and mineral rights.

GERMAN OPEN-END FUNDS • German investors have made significant investments in U.S. real estate over the past several decades. Many of these investments were made by open-end funds, a uniquely German investment vehicle.

A German open-end fund is not a legal entity. Rather, the Fund is a trust (Sondervermögen) that does not have a separate legal existence. An investment company (Kapitalverwaltungsgesellschaft), a special type of credit-institution in the legal form of a limited liability company (GmbH) or a stock corporation (AG), nominally and legally owns the assets (i.e., shares in a subsidiary owning properties—so called real estate subsidiary—or ownership of the property), although these specific assets are commercially allocated to the Fund. An investment company administers the Fund’s assets in its fiduciary capacity as trustee for the investors of the corresponding Fund. Assets allocated to the Fund are only reflected on the individual Fund’s financial statements.

8. In some instances, “foreign” is intended in the relevant statute or regulation to include entities organized in U.S. states other than the state where the land is located. Most states have “qualification” requirements for such out-of-state U.S. “foreign” entities that would treat the foreign entity no differently than domestic entities. Upon qualification to do business, foreign entities are treated no differently than in-state entities. Further research would be necessary to determine if such a streamlined qualification process would be available for non-U.S. entities.
The Fund’s investors do not purchase shares in the investment company, but rather, they acquire units in the Fund. These units (so-called “Anteilscheine”) only reflect the contractual rights of the investor vis-à-vis the investment company that arise as a result of the investor’s cash investment that is paid to the investment company in its capacity as a trustee. One of the defining elements of a German open-end fund is the investor’s right, at any time, to redeem its investment.

Thus, the investment company directly owns all properties in the fund (or shares in real estate subsidiaries) solely and directly; the investors have no rights in rem to the properties; the investors have contractual claims vis-à-vis the investment company, not against the Fund; debts of the investment company not related to the Fund are not allocated to the Fund and the Fund’s assets are protected against claims for such debts of the investment company, and creditors of the investment company have no claim against the assets, because the investment company holds bare legal title to the assets.

Public open-ended funds are regulated by the German Investment Act (KAGB) and related regulations, under the guise of the Federal Financial Supervisory Authority (Bundesamt für Finanzdienstleistungen - BaFin). A Depository or Custodian Bank is appointed for each Fund. The Custodian Bank controls the Fund’s accounts and supervises the investment company’s compliance with the Investment Law and Fund rules. Both the investment company and the Custodian Bank are supervised by the BaFin.

German open-end funds generally acquire U.S. real estate in the name of the investment company, not a single purpose entity that is typical for domestic investors. Under the BaFin rules, the Fund must record a covenant against the real property immediately after the deed of conveyance, putting the world on notice that the asset cannot be sold without the Custodian Bank’s consent. Some covenant documents require that any agreement for sale of the asset must expressly provide that the closing is contingent on obtaining consent of the Custodian Bank.

Under certain circumstances (such as the Fund’s failure to maintain certain liquidity requirements) the Fund’s assets are transferred to the Custodian Bank. Under such circumstances, the Custodian Bank must sell the Fund’s assets and distribute the proceeds to the investors. The Custodian Bank may also be directed by the BaFin to transfer the Fund’s assets to a different investment company that will assume management responsibilities with respect to the assets.

The Investment Act contains a number of limitations on the Fund’s authority to enter into joint venture arrangements. Holding companies are strongly discouraged—if not prohibited. The joint venture documents may not require the Fund to contribute additional capital, and all capital contributions by all investors must be fully funded on the day the joint venture acquires the real property. In addition, the joint venture agreement must not contain unreasonable restrictions on the Fund’s ability to transfer its interest in the venture. The joint venture may not sell the asset for a price less than the most recent annual valuation of the asset by appraisers approved by the Custodian Bank. The Investment Act also contains restrictions on the amount of secured mortgage debt; prohibits the pledge of upper-tier interests as security for partner level loans, and prohibits sales of real estate for a price that is less than the most recent appraisal performed by a German appraiser in accordance with standards promulgated by the BaFin. These appraisals, which are performed annually, must be conducted by German appraisers and not U.S.-based appraisers.

The Investment Act also prohibits Funds from committing to programmatic investments. Any investment needs to be individually assessed and approved, and cannot simply fit pre-agreed parameters. The Fund must have the discretion to say “no thank you” to any particular investment.

SHARI’AH – ISLAMIC FINANCE • We have already discussed the role of U.S. real estate lawyers in introducing foreign clients to aspects of U.S. law and practice. In some instances, U.S. lawyers must learn how to represent foreign clients in transactions that reflect principles of civil or religious law applicable to the foreign clients themselves.
A principal example is the financing of U.S. real estate in accordance with Shari'ah law, the rules governing Islamic finance transactions. An increasing number of foreign investors, as a core principle, will only engage in real estate transactions complying with Shari'ah law, and U.S. real estate transactions, and financing of investments made in U.S. real estate investments, can and have been successfully effected compliance.

The best known Shari’ah law principles are the prohibition of the payment or receipt of interest (RIBA), and prohibitions on certain business activities. These principles influence the structuring of investments and financing, including the formation of joint ventures (particularly provisions for waterfalls), but also may prohibit business transactions involving prohibited activities or counterparties engaged in such activities. Property uses such as gambling or production or sale of alcoholic products are prohibited activities. Thus, Shari’ah law compliance issues can arise for most areas of real estate practice—acquisition, financing, securitization, leasing, and joint venture structuring.

Shari’ah compliance is generally administered by boards of Shari’ah scholars, and there is both variation and flexibility in the interpretation of the rules. For example, Shari’ah compliant capital markets instruments (sukuk) have been developed, both asset-backed and, more frequently, asset-based structures. Similarly, rules exist that allow limited portions of investments to be used for otherwise prohibited purposes.

Due to the lack of standardization as to the application of Shari’ah rules, and a limited number or recognized scholars to administer them, this is not an area for amateurs. It is, however, an area with which U.S. real estate lawyers should become familiar.

HART-SCOTT-RODINO • Another Federal statute of some potential relevance to foreign real estate investors is the Hart-Scott-Rodino Antitrust Improvements Act of 1976, an anti-trust regulation that requires pre-merger reporting to the Federal Trade Commission and Department of Justice in connection with certain merger and acquisition transactions. Reporting under Hart-Scott-Rodino is triggered if certain dollar thresholds for the parties’ annual sales, total assets or stock are exceeded. The sales, assets or stock, as applicable, of the parties’ parent companies and the parent’s other subsidiaries are included in the analysis. The most significant threshold in determining reportability is the minimum size of transaction. This is often referred to as the “$50 million (as adjusted)” threshold because it started at $50 million and is now adjusted annually. For 2016, that threshold will be $78.2 million. Hart-Scott-Rodino, which is equally applicable to domestic and foreign acquirers, requires filing and vetting with Federal authorities unless the acquisition is exempt. Fortunately, most acquisitions of real estate for investment purposes will be exempt from the requirements of Hart-Scott-Rodino, regardless of size, but it may apply if the transaction involves the acquisition of operating assets besides investment real estate, such as processing facilities ancillary to agricultural land use, and should be thought about if the transaction has characteristics beyond “pure” real estate, and certainly if such assets as manufacturing property are involved, or for potentially “mixed” assets such as casinos or race tracks. Even in a transaction involving only real estate in an exempted class, if the dollar amount of the transaction or the sales or assets of either of the parties (with their ultimate parent and affiliates) is such that reporting requirements under Hart-Scott Rodino would otherwise be triggered, the exemptions for real estate assets must be analyzed closely to determine if reporting is required.

Non-U.S. clients often inquire, at the outset, whether there are any “antitrust implications” for a potential investment. This question cannot be taken lightly, even if “antitrust compliance” may not appear on your conventional acquisition checklist. Be prepared to provide a thoughtful response when this question arises.

ORIENTING FOREIGN INVESTORS TO THE U.S. ENVIRONMENT • Many foreign investors approach investment in the United States without a deep understanding of U.S. business practices, or even basic structural aspects of U.S. investment. These investors can be very
sophisticated institutional investors, or individuals seeking to park flight capital (legitimately) in the United States, or anything in between. It is a disservice to them to assume their familiarity with the United States, or “how things are done.”

Following are some common items that might be on a checklist of general topics to be discussed with, or kept in mind when dealing with, potential foreign investors:

The Federal system. In our experience, the basic division of responsibilities between Federal, state and local governments is often misunderstood. As noted above, while Federal taxation is a preeminent concern, the fact that real estate zoning and development is largely local (or, in such states as California, local, regional and statewide), and that real estate law is largely state law (although state law is largely consistent in basic principles), is worth noting. Conversely, the growing effect of state and local taxation is important, particularly because state law (e.g., taxation of REITs) may be inconsistent with Federal law. You may find yourself in the role of a civics teacher, patiently and clearly explaining the various levels of government in the United States.

Taxes. Certain categories of state and local tax are peculiar to real estate and should be made known to the client—real estate property taxation, transfer taxes, mortgage taxes and even local income taxes.9

Exit strategy and tax structuring. This article reflects the importance of tax efficiency, maximized by proper structuring. However, what is sometimes overlooked is the need to match tax structuring not just with the client’s immediate investment focus, but with its ultimate goals and exit strategy. Different strategies may be suggested if the client is interested in creating a portfolio, or eventually an operating business, rather than a one-off or limited number of investments.

Transparency and objectivity. Many clients do not understand two core factors of the U.S. system: its relative transparency, and its rule-based nature. The U.S. system is generally at the favorable end of the spectrum of economies in both the availability of information and the lack of any systemic bias against foreign capital sources (with increasing exceptions noted above).

Limits on governmental involvement. In many foreign jurisdictions, ownership of land and buildings is highly regulated, and direct ownership in fee of property is limited or subject to governmental approval—or in some cases prohibited. This is not generally the case in the U.S. (except for areas noted above), which is not always understood by unpracticed foreign clients. Moreover, the fact that issuance of licenses and permits is generally unaffected by the nationality of the applicant is important, as is the fact that certain jurisdictions make some differentiations between foreign and domestic investors.

Liquor licenses and gaming licenses. Liquor licensing is a well-known, but crucial, exception to the general rule that U.S. real estate investment is transparent as to nationality, as are gaming licenses. If an investor has an interest in investments requiring liquor or gaming licenses, this should be identified up-front. (For a liquor license, background checks and fingerprinting may be required for named executives of the entities involved; in some jurisdictions, a U.S.-citizen or permanent resident may be required for licensing.) See above for special rules relating to farming and mineral exploration.

Secrecy and confidentiality. As noted above, the real estate market can provide a considerable screen of confidentiality over a real estate transaction, particularly public notice of ultimate beneficial ownership of real estate investments. However, this has limitations, both as to public knowledge and governmental rights to information, which should be discussed with a client to whom these issues are important. One area that concerns and surprises foreign clients is the reach of discovery in U.S.-based litigation. A discussion of “best practices” in file management and e-mail etiquette is often a useful prophylactic. Some clients are not aware of

9. In the District of Columbia, for example, there is an unusual “unincorporated business tax” that imposes a tax on a pass-through entity’s taxable income at a rate of 9.75 percent. Foreign investors (and many experienced non-DC lawyers) will be surprised to learn about this tax.
the potential benefits of the shield afforded by the attorney-client privilege; others are not aware of the fragility of the privilege if not properly utilized.

Advisors. It is critical to know who the client has selected as advisors, their assigned roles, their political relationship to management, their functional relationship to decision-makers and their level of expertise. This assessment is perhaps the most sensitive role of counsel, but a counsel needs this information to provide effective representation. It is also critical to identify advisory expertise that the client needs, but has not yet obtained, and to assist the client in filling in the holes. (Moreover, dealing with inadequate or self-interested advisors is not an infrequent challenge, and quite difficult to navigate.) This area multiplies in difficulty as language barriers intervene. The goal is to assist the client in the creation, organization, and coordination of an effective, integrated team.

Counsel. In our own minds, real estate lawyers tend to see themselves as consigliore as well as technicians and drafters, and have that skill when asked to perform it. This is a function, in part, of a system that emphasizes a lawyer’s duty to the client, and to a business culture that has allowed lawyers to participate in the business aspects of a transaction. Foreign clients may have a domestic culture in which lawyers have a much more circumscribed role, or are less trusted, particularly lawyers who the business principals may not have met, and who may not speak the same language. In other situations, clients (or their senior management) may come from an environment where proper “contacts” and insider cultures may make legal expertise unnecessary, and may result in basic errors in operating in the U.S. environment. Bridging this gap, and “selling” the role of counsel, should be a goal of the real estate lawyer faced with a new foreign client. A different issue is that legal documentation in the United States is more business oriented, detailed and voluminous than in many other countries, and that proper attention to its negotiation is generally value added. Simply put, the cost and time commitment to closely negotiate documentation may not be self-evident to foreign clients, and attorneys must not only negotiate, but also elicit the client’s cooperation, participation and trust in the negotiation process.

Brokers. Brokers are valuable and necessary. However, foreign clients may not understand how initial contacts with brokers can give rise to unintended or conflicting brokerage claims. Few foreign clients understand that in many jurisdictions (e.g., New York), brokers may be able to claim commissions on unconsummated transactions, or without a signed brokerage agreement. This is a valuable orientation point for a lawyer to address.

Title insurance. The role of title insurance is so central to real estate practice that it isn’t thought of as special. Foreign clients may come from a very different legal framework, and it is worth explaining.

The process. Foreign clients may not have a clear understanding of the process of negotiating and concluding a transaction. Providing a general, but understandable overview (including a timeline) is a very significant task of counsel. Some foreign clients will find having a checklist extremely helpful, and doing your best to avoid surprises that could create anxiety is key. Having a summary of the transaction costs—e.g., transfer taxes, title insurance, necessary third party reports, etc.—ready to provide to the client will be appreciated.

Labor laws. U.S. labor laws may be unfamiliar to foreign investors. This is particularly important when a potential investment comes with a collective bargaining agreement that must be assumed. Other labor laws also may be relevant (e.g., the Warn Act, if significant layoffs are contemplated). Real estate lawyers should be sensitive as to when to bring in labor counsel to cover these issues.

Due diligence regime. Foreign investors may not be familiar with the due diligence process and the categories of due diligence that a prudent investor in a comparable transaction would undertake, or the time periods to effect due diligence. Attorneys can provide the framework for the investor to script the appropriate due diligence protocol for the transaction in question.
Environmental. The strict liability regime imposed by U.S. environmental laws may be unfamiliar to foreign investors, as well as the potential reach of these laws to owners and operators, even for pre-existing conditions. They may also be unaware of the role and protections provided by compliant environmental audits, and the existence of environmental insurance.

Personal liability of direct and indirect equity holders. Many foreign investors, directly or indirectly, are very high net worth individuals or families. While they are prepared to invest in the United States, they will want to limit or eliminate the exposure of other assets to claims arising from the United States. A thorough discussion of this topic is outside the scope of this analysis. However, the topic should cover liability not only for claims (e.g., FICA tax, environmental, etc.) from the U.S. real estate activities, but also for claims that, by participating in the U.S. activities (e.g., by a chain of pass-through vehicles, or by a sufficient duration of physical presence in the United States to qualify as a U.S. resident), the client has become obligated to file U.S. tax returns, and perhaps subject to Federal, state and local tax (including gift an estate tax). This is yet another area where proper defensive planning is critical, and worthy of discussion.

Timing. We have already identified timing constraints imposed by the current business and regulatory environment. Some timing concerns of the investor (e.g., time to form entities in the United States) will turn out not to be material; other constraints, which may or may not be familiar (e.g., KYC), will prove more difficult to navigate. It is important to work with the investor to establish a realistic time line for its entry into the United States and for setting itself up to effectively bid for, negotiate for, finance and close its real estate transactions, particularly its initial ones.

CONCLUSION • Representing non-U.S. investors on real estate projects in the United States presents an entirely different set of challenges to U.S. lawyers, due to both an increasingly complex regulatory regime, and the need to understand and successfully manage cultural and other differences that may affect the process and dictate whether or not your client’s investment is successful.

Auf Wiedersehen! 再见 Ciao!