

Own a Foreign Business? Unraveling a Little-Known Statute with Excessive Public Burdens

Amy E. D'Agostino, Chadbourne & Parke LLP

In 2008, a 12-page government-issued form — the BE-11A — crossed my desk. The instructions on the pastel-colored form issued by the U.S. Department of Commerce (Bureau of Economic Analysis) informed me that the "Form BE-11A must be filed by each U.S. Person who owns or controls 10% or more of the voting securities of a ... business organized in a foreign jurisdiction...." My attention was drawn to a statement on the public reporting burden: the BE-11A survey averaged 79.3 hours to complete. I found myself both shocked and intrigued by the public burden as I quickly multiplied the number of clients that met the 10 percent foreign ownership threshold noted in the instructions.

The International Investment and Trade in Services Survey Act (Act) could be considered an unknown or little-known statute. The stated mission of the Act is to collect data regarding U.S. interests in foreign businesses and foreign interests in U.S. businesses to further economic stability in the United States. It does so by authorizing the President of the United States, through the Bureau of Economic Analysis (BEA), to collect ownership and economic data on the operations of (i) U.S. companies and their foreign affiliates and (ii) international companies and their U.S. affiliates. The BEA is authorized by the Act and Part 806 of the Code of Federal Regulations (CFR) to obtain data on international investments made by U.S. Persons abroad and international persons in the United States.¹ The BEA uses the data collected to provide a factual framework through

which policy makers and the general public may address and analyze a number of issues. For example, the White House and Congress use BEA data and measures to prepare budget estimates and projections. The Federal Reserve Banks use BEA data to set monetary policy, and trade policy officials use BEA data to negotiate international trade agreements.

The BEA's mission is to promote a better understanding of the U.S. economy by providing the most timely, relevant and accurate economic data in an objective and cost-efficient manner. While the BEA has attempted to take steps to reduce the public burden and minimize costs by developing reporting requirements based on financial thresholds, there is still a duty for U.S. Persons to report quarterly, annually and quinquennially, with each report carrying a different public burden.

Expert guidance can minimize the burden imposed by this complex and specialized area of the law. U.S. Persons who may be subject to BEA reporting must determine not only whether they exceed the ownership thresholds, but also how they can systematize reporting within their organization and coordinate their activities with legal advisors, financial advisors and the BEA. Compliance may be further complicated since the economic accounting concepts contained in the government forms differ from U.S. Generally Accepted Accounting Principles

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P. in the Vol. 1, No. 8 edition of the Bloomberg Law Reports—Corporate Counsel. Reprinted with permission. Bloomberg Law Reports® is a registered trademark and service mark of Bloomberg Finance L.P.

The discussions set forth in this report are for informational purposes only. They do not take into account the qualifications, exceptions and other considerations that may be relevant to particular situations. These discussions should not be construed as legal advice, which has to be addressed to particular facts and circumstances involved in any given situation. Any tax information contained in this report is not intended to be used, and cannot be used, for purposes of avoiding penalties imposed under the United States Internal Revenue Code. The opinions expressed are those of the author. Bloomberg Finance L.P. and its affiliated entities do not take responsibility for the content contained in this report and do not make any representation or warranty as to its completeness or accuracy.

(GAAP), and the reporting deadlines are not congruent with U.S. tax reporting deadlines.

The purpose of this article is to describe key provisions of the Act and the regulations promulgated thereunder (including reporting requirements) and to offer certain practical advice for limiting the burden for reporting U.S. Persons and their advisors.

Reporting Is Mandatory

Practitioners and accounting professionals may not be aware of the Act, but its reporting requirements are mandatory, regardless of whether the BEA has solicited a response. Persons that reported in the immediately preceding year will be required to report in some form, regardless of whether they meet the reporting criteria in the current year. Persons that have not previously reported and who fall below the relevant thresholds do not need to report.

Civil and criminal penalties may be imposed for not reporting as required. Failure to report carries a civil penalty of up to \$25,000, and compliance may be compelled by injunction. Willful failure to report is punishable by up to one year of imprisonment or \$10,000 in fines, or both.

There Are Two Sides to Every Survey

Simply put, there are two circumstances when surveys must be filed by a U.S. Person: (i) when that U.S. Person owns more than 10 percent of a foreign entity and (ii) when that U.S. Person is owned more than 10 percent by a foreign entity. The Act deals separately with domestic direct investment abroad and foreign direct investment in the United States, and it establishes multiple reporting requirements for each. The Act defines "direct investment" as the ownership or control of 10 percent or more of the voting securities of an incorporated business. The term "voting securities" is not independently defined in the Act or in the CFR; however, the term is used interchangeably with "voting interest". "Voting interest" is defined as the percentage of ownership in the voting equity of the relevant entity. Essentially, ownership of 10 percent of a foreign entity that establishes a capacity to vote and influence corpo-

rate action appears to be the defining feature of what constitutes a foreign direct investment abroad. On the flip side, ownership of 10 percent of a U.S. entity by a foreign person that establishes a capacity to vote and influence corporate action appears to be the defining feature of what constitutes a foreign direct investment in the United States.

1. Reporting U.S. Direct Investment Abroad

A U.S. Person with direct investment in a foreign business (U.S. Reporter) bears the dual obligation of reporting its own operations and its operations with respect to each of its "Foreign Affiliates."² However, a U.S. Reporter is exempt from reporting with respect to its Foreign Affiliate when (1) total assets, (2) net sales or gross operating revenues (excluding taxes), or (3) net income (loss) after foreign income taxes fall below certain financial thresholds for that affiliate. Certain real estate holdings must also be reported with an exception for real estate held or owned for personal use.

Below is a description of the forms, reporting criteria and exemptions for each required survey of U.S. direct investment abroad required by the Act. It should be noted that this article identifies the exemption levels (lowest level financial thresholds) and related forms in an effort to point out the absolute financial cut offs required. Higher level thresholds exist that would require a U.S. Reporter to fill out additional and different forms.

A. Quarterly Survey of U.S. Direct Investment Abroad: Form BE-577

Generally, one quarterly Form BE-577 must be filed within 30 days of the close of each fiscal quarter for each Foreign Affiliate exceeding or expected to exceed an exemption level of \$40 million (positive or negative) in (1) total assets, (2) net sales or gross operating revenues (excluding taxes), or (3) net income (loss) after foreign income taxes in the year (with real estate transactions to be analyzed similarly). The U.S. Reporter need not report direct transactions with Foreign Affiliates in which it does not hold a direct equity interest, unless the intercompany balance for the quarter exceeds \$1 million.

*B. Annual Survey of U.S. Direct Investment
Abroad: Form BE-11*

A U.S. Reporter must file annually a Form BE-11A regarding its own operations, and a Form BE-11B or Form BE-11C for each of its Foreign Affiliates exceeding the exemption threshold of \$60 million (positive or negative) in (1) total assets, (2) net sales or gross operating revenues (excluding taxes), or (3) net income (loss) after foreign income taxes in the year (with real estate transactions to be analyzed similarly), unless a Foreign Affiliate is in its first year of operation, in which case the threshold is \$10 million. An exemption to filing in this category exists if the affiliate is less than 20 percent owned by all U.S. Reporters of the affiliate combined.

*C. Benchmark Survey of U.S. Direct Investment
Abroad: Form BE-10*

The BEA Benchmark Survey (BE-10) is the most comprehensive survey and creates the highest public burden—it must be completed for every Foreign Affiliate regardless of the financial threshold. The Benchmark Survey is conducted once every five years (since 1989) within six months of the last day of the fiscal year and must be completed by every U.S. Reporter who holds a Foreign Affiliate at any time during the fiscal year in which a Benchmark Survey is conducted. The U.S. Benchmark Survey notes an additional burden: if a U.S. Person had no Foreign Affiliates during the fiscal year concerned, a BE-10 Claim for Not Filing must be submitted and no further forms are required.

*2. Reporting of Foreign Direct Investment in the
United States*

There are a number of reporting requirements for a U.S. entity in which a foreign person has a direct investment ("U.S. Affiliate").

A. Initial Investment Reports: Form BE-13

A U.S. Affiliate must file a Form BE-13 within 45 days of the formation or acquisition of 10 percent or more of the voting securities of a U.S. business, or the purchase of real property by a foreign per-

son. However, a Form BE-13 is not required when: (1) the total assets of the newly created or acquired entity are less than \$3 million or (2) the cost of the transaction is less than \$3 million and the transaction does not involve the purchase of 200 or more acres of U.S. land. Completing a BE-13 Exemption Claim will discharge the reporting requirement ordinarily associated with the transaction.

B. Quarterly Reports: Form BE-605

In most cases, quarterly reports must be submitted on a Form BE-605 within 30 days of the close of each quarter by every U.S. Affiliate for which one of the following exceeds an exemption level of \$60 million (positive or negative): (1) total assets; (2) net sales or gross operating revenues (excluding taxes); or (3) net income (loss) after foreign income taxes (with real estate transactions to be analyzed similarly). If the foreign ownership is indirect (through another U.S. Affiliate), and the U.S. Affiliate has no relationship with its Foreign Affiliate, then the U.S. Affiliate can discharge its reporting obligation by completing item C and the "Person to Consult" portion of Form BE-605 Certificate of Exemption — a requirement that is not derived from the Act or the regulations but is specified only on the form itself.

C. Annual Reports: Form BE-15

A Form BE-15 must be completed within six months from the last day of each calendar year by each U.S. Affiliate exceeding an exemption level of \$40 million (positive or negative) in: (1) total assets; (2) net sales or gross operating revenues (excluding taxes); or (3) net income (loss) after foreign income taxes (with real estate transactions to be analyzed similarly). Additional BE-15 forms are necessary for reporters who meet higher financial thresholds set by the government.

A Form BE-15 Claim for Exemption is required if foreign ownership in a U.S. Affiliate falls below 10 percent, the U.S. Affiliate is fully consolidated or merged into another U.S. Affiliate, or if all of the following three items for the U.S. Affiliate are \$40 million or less (positive or negative): (1) total assets; (2) annual sales or gross operating revenues; and (3)

annual net income (loss) after provision for U.S. income taxes. Exempt U.S. Affiliates should file a BE-15 Claim for Exemption. Provided the U.S. Affiliate continues to meet the exemption criteria, it is not necessary to file again.

D. Benchmark Survey Reports: Form BE-12

The BE-12 Benchmark Survey must be submitted within six months from the last day of every fifth calendar year after 1987. While the BEA benchmark surveys remove the financial exemption thresholds, a BE-12 Mini will satisfy the reporting requirement where the affiliate's (1) total assets, (2) net sales or gross operating revenues (excluding taxes) and (3) net income (loss) after foreign income taxes (or aggregate real estate), are not greater than \$40 million. Unlike the BE-10 Benchmark of U.S. Direct Investment Abroad, the owner is not required to report in such circumstances.

Privacy Concerns?

Information collected under the Act is confidential and may not be published or made available in any manner such that the person to whom the information relates can be specifically identified. The exchange of collected information between government agencies is permitted in order to carry out the purposes of the Act, but the information may only be used for analytical or statistical purposes or for a proceeding under the penalty provisions. It cannot be used for taxation, investigation, or regulatory purposes, and copies retained by any U.S. Reporter are given extra protections from legal process.

When reporting, the use of pseudonyms is permitted. In fact, pseudonyms are required in some instances due to the BEA's rule of mandatory consolidation that creates a fictitious entity if consolidation is needed.

The Act leaves the door open for even wider reporting requirements, stating that "reports may be required from... U.S. intermediaries, and U.S. Persons which assist or intervene in the purchase or sale of direct investment interests, such as real estate brokers and brokerage houses acting as managers of

tender offers." This requirement is given partial expression in the Form BE-14. The BE-14 is required of any U.S. Person assisting in a transaction which is reportable under Form BE-13, or who enters into a joint venture in the United States with a foreign person to create a U.S. business. A U.S. Person must also report on a BE-14 when foreign involvement in the transaction is known.

Practical Advice

The first step to unraveling this little-known statute is to understand the ever-changing reporting requirements and corresponding forms. The next step is to properly educate the client and financial advisors who are best situated to access information needed to complete the forms. Lastly, it is necessary to set up a process for determining financial thresholds by calendar quarter and a system for compliance. The BEA is now accepting internet filings, which speeds the process considerably. Advisors may also review the BEA's website for additional reporting requirements and forms for certain international service transactions at <http://www.bea.gov/surveys/iussurv.htm>.

Amy E. D'Agostino is an associate in the corporate practice at Chadbourne & Parke LLP. Ms. D'Agostino can be reached at 212-408-1023 or adagostino@chadbourne.com. Beatrice Kirkbright, a legal assistant at the firm, assisted with the research and preparation of the article.

¹ The definition of "U.S. Person" includes corporations, partnerships, trusts, trust companies and individuals.

² A "Foreign Affiliate" is an entity outside the United States in which the U.S. Person has a direct investment.