TAX MANAGEMENT REAL ESTATE JOURNAL

a monthly professional review of current tax, legislative and economic developments

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Foreign Investment in U.S. Real Estate — FINSA Issues

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FINSA

50 USC App. §2170, as amended by the Foreign Investment and National Security Act of 2007 (''FINSA''), permits the President to prohibit any ''covered transaction'' that threatens to impair the ''national security'' of the United States.[1] A ''covered transaction'' is defined in 50 USC App. §2170(a)(3) to include any acquisition by or with ''foreign persons'' that could result in foreign ''control'' of any person engaged in interstate commerce in the United States. 50 USC App. §2170(a)(5) states that ''national security'' includes issues relating to ''homeland security,'' including its application to ''critical infrastructure.'' 50 USC App. §2170(l) allows the federal government, as a condition to approving a ''covered transaction,'' to negotiate with the parties to the transaction a ''mitigation agreement'' designed to reduce the threat to ''national security'' as a result of the ''covered transaction.'' To guide the President and to negotiate and enforce ''mitigation agreements,'' 50 USC App. §2170(k) establishes the ''Committee on Foreign Investment in the United States'' (''CFIUS''), consisting of representatives of several federal agencies.

This article focuses on the possible application of 50 USC App. §2170 to certain transactions involving U.S. real estate by foreign-

[1] Articles discussing FINSA and its modifications to pre-FINSA Committee on Foreign Investment in the United States (''CFIUS'') practice include: Comment, ''The Reformed CFIUS Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security,'' 25 *Yale J. on Reg.* (2008); LaRussa, Raisner & Wilner, ''Practitioner Note: New Law Heightens Scrutiny of Foreign Investments of U.S. Companies,'' 4 *N. Y .U. J. L. & Bus.* 285 (2007); Note, ''Scrutinizing Foreign Investment: How Much Congressional Involvement is Too Much?'' 93 *Iowa L. Rev.* 325 (2007); Note, ''A Shot Across the Bow: Changing the Paradigm of Foreign Direct Investment Review In the United States,'' 32 *Brooklyn J. Int'l L.* 1157 (2007) (''Brooklyn Note''). 50 USC App. §2170(d)(4) provides generally that the President may exercise the authority to prohibit a ''covered transaction'' only if the President finds that the ''foreign person'' exercising ''control'' might take action that threatens the ''national security,'' and that other provisions of law provide inadequate protection.

controlled U.S. companies and foreign companies themselves. These include: (1) making a loan secured by a mortgage on U.S. real estate; (2) purchasing owner-occupied U.S. real estate as part of purchasing a U.S. operating business; (3) purchasing unimproved U.S. land; (4) purchasing U.S. buildings not presently in use; (5) purchasing U.S. rental buildings already under lease to tenants; (6) entering into a lease as a tenant in a U.S. rental building; (7) entering into a lease as a landlord of a U.S. rental building; and (8) forming a real estate rental building joint venture with a U.S. company.

In April 2008, the Treasury issued proposed regulations under 50 USC App. §2170, as amended by FINSA.[2] These proposed regulations broadly construe the scope of ''covered transactions.'' As discussed below, under these proposed regulations, some, but not all, of the transactions enumerated above will generally be ''covered transactions.''

The April 2008 proposed regulations do not, however, specifically define ''national security'' or ''homeland security.'' Where U.S. real estate is acquired as an incidental part of the acquisition of a ''U.S. business'' that is the owner-occupant of that real estate, the ''national security'' and ''homeland security'' FINSA analysis presumably will be guided principally, though perhaps not exclusively, by the ''national security'' and ''homeland security'' implications of that owner-occupant's ''U.S. business.'' However, the absence of regulations concerning ''national security'' and ''homeland security'' creates doubt as to which, if any, ''covered transactions'' may be prohibited when they involve U.S. buildings that are: (1) owner-occupied by businesses without ''homeland security'' or other ''national security'' implications, (2) rented to tenants with ''homeland security'' or other ''national security'' implications, or (3) rented to tenants without ''homeland security'' or other ''national security'' implications. The Preamble to Prop. 31 CFR Part 800 states that CFIUS is preparing, as required by 50 USC App. §2170(b)(2)(E), public guidance on what types of transactions have raised ''national security'' issues during past CFIUS reviews, which may help clarify some issues.

Tax attorneys are often consulted in structuring large initial U.S. mortgage financings and equity investments in ''U.S. businesses,'' including rental real estate, by foreign investors. These loans or investments may raise ''covered transaction'' issues under FINSA. Consequently, it is worthwhile for tax attorneys to have some familiarity with FINSA.

Tax attorneys are far less frequently consulted when a foreign-controlled but previously established U.S. company makes subsequent U.S. mortgage loans or subsequent purchases of equity investments in U.S. operating businesses or U.S. rental real estate, even though these transactions likewise generally raise ''covered transaction'' issues under FINSA. Similarly, there are myriad other actions, such as an acquisition of ''control'' of a higher-tier foreign entity that indirectly owns U.S. real estate, that might not have U.S. tax implications, but would be ''covered transactions'' under FINSA.[3] Thus, it may be worthwhile for the tax attorney to remind some foreign-controlled U.S. clients or foreign corporate clients, as well as corporate attorney and real estate attorney colleagues, to be aware of FINSA when reviewing subsequent acquisitions or other potential ''covered transaction'' activities by those clients.

Determining Whether to Notify CFIUS

There have been only a modest number of CFIUS reviews.[4] Nevertheless, if the possibility materializes of an order by the President that blocks a prospective ''covered transaction,'' or requires the divestiture of a ''U.S. business'' that has already been acquired in a ''covered transaction,'' the results would typically be extremely adverse. The costs and time involved in arranging the ''covered transaction'' would have been wasted. Undoing a completed ''covered transaction,'' including a completed purchase of a U.S. operating business or a U.S. real estate rental business, could force a distress sale by the ''foreign person.''

There is no requirement in 50 USC App. §2170 that the parties to a ''covered transaction'' submit a notice to CFIUS. However, 50 USC App. §2170(b)(1)(D) allows CFIUS to investigate a ''covered transaction'' without such a voluntary notice. Therefore, as permitted by 50 USC App. §2170(b)(1)(C) and Prop. 31 CFR §800.401(a), parties to a transaction may choose

[2] 73 Fed. Reg. 21861 (4/23/08). Prop. 31 CFR §§800.103 and 800.210 state that the proposed regulations, when finalized, are to be retroactively applied to transactions proposed or concluded earlier. This raises issues where the Prop. 31 CFR Part 800 rules are less favorable than existing CFIUS regulations. *Cf.* ''Klamath Companies Argue Penalties Properly Rejected in Son-of-BOSS Case,'' 2008 *TNT* 91-16 (5/9/08).

[3] *See, e.g.*, Prop. 31 CFR §800.301(c), Ex. (5) (''foreign person'' that acquires other ''foreign person'' that owns a ''U.S. business'' has engaged in a ''covered transaction''). In limited circumstances, such as where the U.S. business generated net operating loss carryforwards, there could be U.S. income tax implications as well from a ''foreign person'' acquiring a ''foreign person'' that owns a ''U.S. business.'' *See, e.g.*, Regs. §1.382-2T(k)(6).

[4] Treasury Department News Release, HP-842, ''Deputy Secretary Robert M. Kimmitt Remarks Before the U.S. Israel Executive Summit'' (2/27/08) (''In 2007, CFIUS reviewed fewer than eight percent of M&A transactions in the United States involving a foreign acquirer and a domestic firm . . . [O]nly a small minority of these transactions required . . . mitigation measures.'')

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ISSN 8755-0628

to submit in advance a voluntary notice about the transaction to CFIUS. Indeed, Prop. 31 CFR §800.401(f) encourages the parties to consult with CFIUS even before filing a voluntary notice. Prop. 31 CFR §800.601 provides generally that if, in response to a voluntary notice, CFIUS determines that the transaction is not a ''covered transaction,'' or is a ''covered transaction'' but CFIUS decides not to recommend that the President act, then Presidential authority to block the transaction or order divestment will not be exercised.

There are usually two sets of issues to be considered by the parties in deciding whether to submit a voluntary notice to CFIUS. First, a determination needs to be made as to the likelihood that the operation would likely be viewed by CFIUS as a ''covered transaction.'' Second, if a ''covered transaction,'' a determination needs to be made as to the likelihood that CFIUS would determine that the ''U.S. business'' whose ''control'' is being acquired raises ''homeland security'' or other ''national security'' concerns, and how CFIUS would insist those concerns be addressed in a ''mitigation agreement.''

"COVERED TRANSACTION" — DEFINITIONS

A ''covered transaction'' is a ''transaction'' by a ''foreign person'' that could result in acquisition of ''control'' of a ''U.S. business.'' The terminology used by FINSA and the Treasury's FINSA regulations differs significantly from that typically used in business parlance, and indeed differs significantly from the terminology often used by federal statutes and regulations outside FINSA, such as the Internal Revenue Code and Treasury's income tax regulations.

For example, as discussed below, the acquisition, by a corporation formed under the laws of the U.S., a significant minority of whose stock is directly or indirectly owned by a non-U.S. citizen, of a significant minority of the stock of a corporation formed under the laws of a foreign country with a U.S. subsidiary, under FINSA would often constitute the acquisition by a ''foreign person'' of ''control'' of a ''U.S. business'' and thus be a ''covered transaction.''[5] In sharp contrast, under Internal Revenue Code provisions, such as the §6038 reporting requirements, such a transaction would typically be characterized in opposing terminology, namely as an acquisition by a ''U.S. person'' of a non-''controlling'' interest in a ''foreign business entity.''

"Foreign Person"

Prop. 31 CFR §800.206 indicates that a transaction is not a ''covered transaction'' unless it involves ''a'' ''foreign person'' which could acquire ''control'' of a ''U.S. business.'' Prop. 31 CFR §800.216 defines the term ''foreign person'' to mean: (a) any ''foreign national,'' any ''foreign government,'' or any ''foreign entity;'' or (b) ''any'' entity (apparently even if not a ''foreign entity'') over which ''control'' is exercised or exercisable by a ''foreign national,'' ''foreign government,'' or ''foreign entity.''

A ''foreign national'' is generally defined by Prop. 31 CFR §800.215 as an individual who is not a U.S. citizen.[6] Thus, for example, an individual who is not a U.S. citizen, but who holds lawful permanent residence in the U.S. for immigration law purposes, or has had practically uninterrupted presence in the U.S. for many years, such as under an intercompany transferee or investor visa, is a ''foreign national'' for purposes of applying 50 USC App. §2170. This again is in sharp contrast to the Internal Revenue Code rules, which generally define ''U.S. person'' to include both lawful permanent residents and visitors who generally spend more than 121 days annually within the U.S.[7]

''Foreign government'' is defined by Prop. 31 CFR §800.213 to include non-U.S. national and subnational governments, including their respective agencies and instrumentalities.[8] Thus, for example, sovereign wealth funds would apparently be viewed by CFIUS as ''foreign governments.'' [9] Individuals acting as unelected heads of states with governmental responsibilities likewise are treated as ''foreign governments.''

A ''foreign entity'' is defined by Prop. 31 CFR §800.212 as any ''entity'' organized under the laws of a foreign state in which ''foreign nationals'' hold, di-

[5] *See* Prop. 31 CFR §800.301(c), Ex. (5), 31 CFR §800.216(b).

[6] Prop. 31 CFR §800.226 excludes from characterization as ''foreign nationals'' individuals who, although not citizens of the United States, owe permanent allegiance to the United States. The courts generally only characterize natives of Samoa and Swains Island as meeting the ''permanent allegiance'' test. *See Puentes Fernandez v. Keisler*, 502 F.3d 337 (4th Cir. 2007).

[7] §7701(a)(30)(A) and (B).

[8] Transactions involving ''foreign governments'' are subject to somewhat lower thresholds for triggering CFIUS investigations under 50 USC App. §2170(b)(1)(B), (2)(B)(i)(II); are listed as factors implicating ''national security'' under 50 USC App. §2170(f)(8); and are the subject of required reports to Congress under FINSA §7(c). Thus, they may be scrutinized more critically by CFIUS.

[9] *See* Treasury Department News Release, HP-823, ''Under Secretary for International Affairs David H. McCormick, Testimony before the Joint Economic Committee'' (2/13/08) (''CFIUS is able to review investments from sovereign wealth funds, just as it would other foreign government-controlled investments.'') For the special income tax rules applicable to foreign governments and ''sovereign wealth funds,'' see Wood, O'Neill, & Le, ''Sovereign Wealth Funds: The Benefits and Burdens of the Sovereign Immunity Exemption from Tax Under §892,'' 37 *BNA Tax Mgmt. Int'l J.* 79 (2/8/08) and ''JCT Analyzes Sovereign Wealth Fund Investment in U.S.,'' 2008 TNT 118-13 (6/18/08).

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ISSN 8755-0628

rectly or indirectly, at least 50% of the outstanding ownership interests in an entity. A ''foreign entity'' also includes a public company organized under the laws of a foreign state whose equity securities are primarily traded on one or more foreign exchanges.

While not explicitly illustrated by any example in Prop. 31 CFR Part 800, a publicly or non-publicly traded corporation, partnership, or limited liability company, formed under U.S. state law, apparently is classified as a ''foreign person,'' whose acquisition of ''control'' of a ''U.S. business'' may be a ''covered transaction'' if that U.S. juridical entity is ''controlled'' by a ''foreign person,'' such as a ''foreign entity'' holding company directly or indirectly 50% or greater owned by non-U.S. citizens.[10] Since foreign investors almost invariably take title to U.S. business real estate in the name of a U.S. juridical entity, and frequently interpose a foreign holding company in the chain between themselves and the U.S. juridical entity, the practical effect often is to classify U.S. real estate companies ''controlled'' by foreign investors as ''foreign persons.''

For U.S. tax reasons, it has been customary to structure the entity used by individual foreign investors to acquire an operating U.S. business, or U.S. rental real estate, or a partnership interest or limited liability company interest in a partnership or limited liability company owning a U.S. operating business or U.S. rental real estate, as a U.S. subsidiary of a non-U.S. holding corporation, which foreign holding company's stock is owned by the foreign individuals.[11] The rationale of this structure is that use of a U.S. corporation, rather than a foreign corporation, to take title to the U.S. operating business or U.S. rental real estate (or partnership or limited liability company interest) avoids the U.S. corporate branch profits surtax that apply to non-U.S. corporations, but not to U.S. corporations, on their undistributed net income that is not reinvested in U.S. business assets. Interposing a foreign holding corporation avoids the U.S. estate tax that can apply to U.S. corporate stock (or to U.S. real estate), but not foreign corporate stock, directly owned by a foreign individual who passes away owning those shares.

Under this frequently used, U.S.-tax-motivated, structure, the foreign holding company would be a ''foreign entity'' described in Prop. 31 CFR §800.212. The U.S. subsidiary, being ''controlled'' by that ''foreign entity,'' would be a ''foreign person'' under Prop. 31 CFR §800.216. Thus, under this structure, if the U.S. subsidiary acquired ''control'' of a ''U.S. business'' that was a U.S. operating business, or owned or was comprised of U.S. rental real estate, the transaction would be a ''covered transaction'' under FINSA.[12] ''Covered transaction'' characterization would apply in this structure even though title to the U.S. real estate and other U.S. assets was taken in the name of the U.S. corporate subsidiary, or in the name of a U.S. partnership or U.S. limited liability company of which the U.S. corporate subsidiary had ''control.'' The fact that the foreign holding company or its foreign stockholders did not take title to any U.S. real estate or other operating assets as part of the acquisition, and may not have increased either the pre-existing foreign ownership in the foreign holding company or the foreign holding company's pre-existing ownership of the U.S. subsidiary as part of the acquisition, would not prevent that acquisition of ''control'' of the ''U.S. business'' from being a ''covered transaction.''[13]

''Control''

Prop. 31 CFR §800.203 sets forth a facts and circumstances approach under which much less than 50%, and indeed much less than 10%, of overall voting power, can constitute ''control.'' The Treasury's test is unlike the bright-line definition of ''control'' in many Internal Revenue Code provisions, such as §§304, 368, or 384, but is similar to the Treasury's definition of ''control'' in the income tax regulations concerning transfer pricing under §482 and the definition of ''effective practical control'' in the temporary income tax regulations concerning foreign

[10] *See* Prop. 31 CFR §800.227, Ex. (1) (non-U.S. corporation's subsidiary that is engaged in interstate commerce in the U.S. is a ''foreign person'' when acquiring a ''U.S. business,'' as well as a ''U.S. business'' when being acquired by a ''foreign person''; no discussion of whether that subsidiary is formed under the laws of the U.S.)

[11] *See*, *e.g.*, Bissell, 944 T.M., *Aliens Who Invest in the United States Through a Low-Tax Jurisdiction*, at X.D.1.(a).2.(b).(1).

[12] Although FINSA and FIRPTA share some initials in their acronyms, their application to transactions involving U.S. real estate is quite different. For example, FINSA ''covered transaction'' characterization typically applies at the time of an acquisition of U.S. land and building by a foreign-controlled U.S. company. By contrast, FIRPTA gain under §897 and FIRPTA withholding under §1445 typically would not apply to such a transaction at the time of acquisition unless, by a rare coincidence, the direct or indirect seller of the U.S. land and building was a non-U.S.-tax-resident, non-U.S. citizen, or non-U.S. corporation, and also typically would not apply at the time of eventual direct or indirect resale by the foreign-owned U.S. corporation.

[13] Conversely, certain acquisitions that are viewed under the Internal Revenue Code as acquisitions by ''foreign persons'' are not viewed as acquisitions by ''foreign persons'' under Prop. 31 CFR §800.216 and thus are not ''covered transactions.'' For example, a wholly-owned foreign subsidiary of an exclusively-U.S.-citizen-owned U.S. parent corporation is favorably viewed as not an acquiring ''foreign person'' by Prop. 31 CFR §800.216, Ex. (1). Thus, the purchase by such a U.S.-''controlled foreign corporation'' of a less than 25% voting interest in an unrelated U.S. corporation, using U.S.-tax deferred funds, as described in §956(b)(2)(F), would not be ''covered transaction.''

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ISSN 8755-0628

government-controlled commercial entities under §892.[14]

Prop. 31 CFR §800.203(a) defines ''control'' of a ''U.S. business'' or other ''entity'' as the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total voting interest in that ''entity,'' contractual arrangements, arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting such ''entity.'' Such important matters may include the sale, lease, mortgage or pledge of any of the ''entity's'' principal assets, whether or not in the ordinary course of business; major capital expenditures; entry into, termination, or non-fulfillment of significant contracts; and appointment or dismissal of officers or senior managers.

Prop. 31 CFR §800.203 Example (1) provides that if a foreign investor has exactly 50% of the voting interest of the ''U.S. business,'' it has acquired ''control,'' even if a single U.S. investor owns the other 50% voting interest. The rationale of Prop. 31 CFR §800.203 Example (1) may be that the ability to deadlock any decision is in effect a power to decide important matters.[15] Thus, while Prop. 31 CFR 800.203(a) describes ''control'' in terms of a subjective evaluation, Prop. 31 CFR §800.203(d) Example (1) effectively adopts a bright-line threshold that 50% or greater overall voting power by a ''foreign person'' will be ''control.''

Prop. 31 CFR §800.203(b) states that in examining questions of ''control,'' the ''control'' rights of multiple ''foreign persons'' may be aggregated if certain factors exist, such as common ''control'' of the ''foreign person,'' or an informal agreement to act in concert. There is no prohibition against CFIUS aggregating ''foreign persons'' from different countries.

Consider the typical tax-oriented structure described above for closely held foreign investment in U.S. rental real estate, of a foreign holding corporation owning all the shares of a U.S. corporation that owns the acquired U.S. operating business or U.S. rental real estate (or an interest in a partnership or limited liability company that owns the U.S. operating business or U.S. rental real estate). Frequently, the foreign investors, to save foreign incorporation and maintenance fees, will form a single foreign holding corporation to provide them insulation from U.S. estate tax on the shares in the U.S. subsidiary, rather than divide the ownership of the U.S. subsidiary among different foreign holding corporations. In other structures, such as pooled investment funds marketed overseas, as a business matter, groups of foreign investors often act through a single foreign holding corporation to invest in one or more U.S. subsidiaries owning a U.S. operating business or U.S. rental real estate. In either event, it is unnecessary for CFIUS to apply aggregation under Prop. 31 CFR §800.203(b). The foreign holding company is itself a ''foreign entity'' under Prop. 31 CFR §800.212. Its U.S. subsidiaries, being ''controlled'' by that ''foreign entity,'' are each a ''foreign person'' under Prop. 31 CFR §800.216. Any acquisition of ''control'' of a ''U.S. business'' by a U.S. subsidiary is thus a ''covered transaction'' under Prop. 31 CFR §800.206.

Rather, the question of aggregation will often apply where different ''foreign persons'' acquire minority voting interests in an acquired ''U.S. business,'' and CFIUS seeks the acquisition to be classified as an acquisition of ''control'' by ''a'' (i.e., single) ''foreign person,'' and thus a ''covered transaction'' under Prop. 31 CFR §800.206. Prop. 31 CFR §800.203(d) Examples (1) and (2) involve a ''U.S. business'' that is a U.S. corporation, 50% of whose voting shares will be acquired equally by five unrelated foreign investors. The remaining 50% of the voting shares are to be owned by a single U.S. investor. Example (1) finds ''control'' by the aggregated five foreign investors, and thus a ''covered transaction,'' where there is an informal arrangement among those investors to act in concert, whereas Example (2) finds no foreign ''control'' where there are no arrangements to act in concert. The issue of aggregation under Prop 31 CFR §800.203(b) could also arise where different ''foreign persons'' directly own minority voting interests in a holding company or operating entity organized under U.S. law that is acquiring ''control'' of a ''U.S. business,'' which acquiring U.S. juridical entity is sought by CFIUS to be classified as a ''foreign person'' under Prop. 31 CFR §800.216.

Even where ownership by a ''foreign person,'' whether as aggregated or not, is much less than 50%

[14] Regs. §1.482-1(i)(4), referred to in Regs. §1.482-1T(i), states: ''Controlled includes any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. It is the reality of the control that is decisive, not its form or the mode of its exercise.'' Regs. §1.892-5T(c)(2) states: ''Effective practical control may be achieved through a minority interest which is sufficiently large to achieve effective control, or through creditor, contractual, or regulatory relationships which, together with ownership interests held by the foreign government, achieve effective control. For example, an entity engaged in commercial activity may be treated as a controlled commercial entity if a foreign government, in addition to holding a small minority interest (by value or voting power), is also a substantial creditor of the entity.'' However, Regs. §1.892-3T(b), Ex. (1)(ix), concludes that 12% stock ownership by a foreign government in a U.S. real property holding company does not constitute ''effective practical control,'' without mentioning factors other than the 12% stock ownership.

[15] By contrast, current 31 CFR §800.301(b)(5), Ex. (2), involving a 50% ''foreign person'' / 50% non-''foreign person'' joint venture, with the 50% ''foreign person'' having veto power, concludes that the ''foreign person'' does not have ''control.''

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ISSN 8755-0628

of voting power, and even where it is much less than 10% of voting power, however, various examples in Prop. 31 CFR §800.203 find ''control.'' Examples (3) and (4) find that a single ''foreign person'' who acquired only between 7% and 9% of the voting interests of a ''U.S. business'' acquired ''control.'' In Example (3), the ''foreign person'' acting alone had a special right to terminate significant contracts of the ''U.S. business.'' In Example (4) the ''foreign person'' acting alone had a special right to veto the dismissal of senior executives of the ''U.S. business.''

Prop. 31 CFR §800.203(c) lists certain minority protections that do not confer ''control'' over an ''entity.'' These include the power to prevent the sale or mortgage of all or substantially all of the assets of an ''entity,'' the power to prevent an ''entity'' from entering into leases or other contracts with majority investors or their affiliates, and a right of first refusal to acquire newly issued equity interests of the ''entity'' to prevent dilution.[16]

Prop. 31 CFR §800.302(c) and Prop. 31 CFR §800.223 provide a safe harbor from ''covered transaction'' characterization. If a ''foreign person'' holds 10% or less of the outstanding voting interests in a ''U.S. business,'' irrespective of how high the dollar value of the interests so acquired, has no plans or intention of exercising ''control,'' does not possess or develop any purpose other than investment, and does not take any action inconsistent with acquiring or holding such interests solely for the purposes of investment, the transaction is not a ''covered transaction.'' [17] By contrast, Prop. 31 CFR §800.302(c) Example (2) indicates that if a ''foreign person'' acquires 9% of the voting interests in a ''U.S. business,'' and negotiates a contractual right to ''control'' important matters of that ''U.S. business,'' the acquisition is not solely for investment, and the acquisition is a ''covered transaction.''

[16] Several comments submitted to Treasury concerning Prop. 31 CFR Part 800 requested that the list of minority protections in Prop. 31 CFR §800.203(c) be expanded. *See, e.g.,* ''Comment from Coalition of International Business Associations and Financial Services Firms,'' http://www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=TREAS-DO-2008-0001 (requesting that a ''foreign person's'' right to prevent fundamental changes in tax status, and to prevent a sale of assets constituting less than substantially all but above a significant threshold, should be excepted from ''control'' by Prop. 31 CFR §800.203(c)).

[17] A structure along the lines of that reported for the proposed 2008 Chrysler Building transaction might satisfy this safe harbor. Weiss, ''Chrysler Building on the Block,'' *New York Post* (6/11/08) (''sovereign wealth fund . . . Abu Dhabi Investment Council is negotiating an $800 million deal for a 75 percent stake . . . Tishman Speyer Properties owns the remaining 25 percent stake in the Chrysler Building and operates the landmark . . . the deal would leave Tishman Speyer in charge of the building, with the Abu Dhabi fund essentially acting as a silent partner.'')

''U.S. Business''

Prop. 31 CFR §800.227 defines a ''U.S. business'' as any ''entity'' engaged in interstate commerce in the U.S. Prop. 31 CFR §800.211 defines ''entity'' to generally include any branch, partnership, corporation or corporate division, government agency, or other organization formed under U.S. or foreign law. An ''entity'' also includes any assets operated by any of the foregoing as a business undertaking in a particular location, even though those assets may not be organized as a separate legal entity. In the context of U.S. rental real estate, it seems doubtful that the ''interstate commerce'' limitation on ''U.S. business'' characterization would exclude commercial rental real estate or even residential rental real estate.[18]

''Transaction''

Prop. 31 CFR §800.224 defines ''transaction'' to include such items as the proposed or consummated acquisition of an ownership interest in an entity, or the formation of a joint venture. It also includes a long-term lease under which the tenant makes substantially all the business decisions concerning the operations of the leased entity, as if the tenant were the owner.

APPLICATION TO U.S. REAL ESTATE LENDING

Mortgages on U.S. real estate offer foreign investors a secured position in U.S. real estate. In the case of a lender that is a ''foreign person'' for purposes of the Internal Revenue Code, tax attorneys are often consulted to seek to provide the U.S. income tax advantages of Internal Revenue Code §§871(h) or 881(c), exemptions from U.S. withholding tax on

[18] *Cf. Jones v. U.S.*, 529 U.S. 848 (2000) (federal statute covering any building ''used in interstate or foreign commerce or in any activity affecting interstate or foreign commerce'' interpreted to exclude owner-occupied houses but to include buildings that were rented). *See* Note, ''Jurisdictional Hooks In the Wake of Raich: On Properly Interpreting Federal Regulations of Interstate Commerce,'' 81 *Notre Dame L. Rev.* 2101 (2006). Since owner-occupied single-family homes were not viewed as ''interstate commerce'' in *Jones*, *Jones* provides an argument that a foreign national's purchase of a U.S. vacation home, perhaps the most frequent foreign investment in U.S. real estate, lacks the ''interstate commerce'' nexus described in 50 USC App. §2170(a)(3) and Prop. 31 CFR §800.227 and thus is not a ''covered transaction.'' Indeed, Prop. 31 CFR §800.211 operates to exclude assets that do not constitute a ''business undertaking'' from characterization as an ''entity'' and thus from characterization as a ''U.S. business.'' On the other hand, since Prop. 31 CFR §800.227, Ex. (3), implies that a ''fixed place of business'' in the U.S. constitutes a ''U.S. business,'' a vacation home could perhaps be viewed as a ''U.S. business'' if the foreign national conducts business while there, or if title is held in a corporation that charges rent to the foreign national. In any event, there would rarely be ''national security'' implications in vacation home transactions.

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ISSN 8755-0628

non-effectively connected portfolio interest. Sometimes tax attorneys are also called on to advise a foreign mortgagee on the use of tax treaties to avoid U.S. interest withholding tax.[19]

Suppose, for example, a majority-foreign-owned foreign (or U.S., though in that case a U.S. tax attorney is less likely to become involved) entity that is a lender, and which is thus ''foreign person,'' proposes to make a mortgage loan to a company in an industry related to U.S. ''national security.'' Further suppose that upon foreclosure the lender could receive assets of the U.S. borrower that would be viewed as a ''U.S. business.'' As another example, suppose that a majority-foreign-owned foreign (or U.S., though in that case a U.S. tax attorney is also less likely to become involved) entity that is a lender, and which is thus a ''foreign person,'' proposes to make a mortgage loan to a mortgagee having no relation whatsoever to U.S. ''national security'' concerns, but the mortgagor's owner guarantees the mortgage, and to secure that guarantee, pledges as collateral shares constituting ''control'' in a ''U.S. business'' relating to U.S. ''national security.'' In either situation, Prop. 31 CFR §800.303, titled ''lending transactions,'' is implicated.

Prop. 31 CFR §800.303 holds that, absent other indicia of the acquisition of ''control'' by the ''foreign person'' lender at the time of the loan, that loan, even if secured by a mortgage, is not a ''covered transaction.'' However, upon default, a foreclosure by a lender that is a ''foreign person,'' involving the assets of, or a ''control'' voting interest in, a ''U.S. business,'' may constitute a ''covered transaction.'' This creates the risk that in foreclosure rights by a ''foreign person,'' against assets of, or interests in of, a ''U.S. business'' involving ''national security'' at the time of the foreclosure, may be blocked under FINSA. It does not seem possible for a foreign lender to protect against this by seeking a favorable determination by CFIUS shortly before the time the loan is made. Prop. 31 CFR §800.303(a)(1) states that CFIUS review is available only when, because of imminent or actual default or other condition, there is a significant possibility that the ''foreign person'' lender may obtain ''control'' of the borrower's ''U.S. business.''

Nevertheless, Prop. 31 CFR §800.303(a)(2) suggests that if the foreclosing ''foreign person'' is a lender that makes loans in the ordinary course of business, and has provided that, upon foreclosure, management decisions and day-to-day ''control'' of the acquired ''U.S. business'' will be transferred to U.S. citizens, CFIUS may favorably view this as avoiding ''covered transaction'' characterization of the foreclosure. Another special foreclosure-related exception in Prop. 31 CFR §800.303(b) excludes from ''covered transaction'' characterization the acquisition of limited rights over a foreclosed-upon ''U.S. business'' by non-controlling foreign participants, in connection with a syndicated loan that has defaulted.[20]

APPLICATION TO U.S. REAL ESTATE ACQUISITIONS

Owner-Occupied Real Estate

A transaction involving the acquisition of ''control'' of a ''U.S. business'' that is not involved in rental U.S. real estate, whether or not it incidentally owns and occupies U.S. real estate, will be a ''covered transaction'' under Prop. 31 CFR §800.206.

Unimproved Land

Prop. 31 CFR §800.302(d) specifically excludes from ''covered transaction'' characterization an acquisition by a ''foreign person'' of assets or any part of an ''entity'' in the U.S. that does not constitute a ''U.S. business.'' Thus, Example (1) of that regulation indicates that a ''foreign person's'' acquisition of only U.S. land from a U.S. person does not constitute a ''covered transaction.''

Likewise, Prop. 31 CFR §800.301 indicates that acquisition of ''control'' of only an existing ''U.S. business,'' not forming a new, ''controlled,'' ''U.S. business,'' can constitute a ''covered transaction.'' Prop. 31 CFR §800.301(c) Example (3) involves a typical structure of a U.S. subsidiary newly formed by a ''foreign person'' parent corporation to establish a new U.S. operating business. The U.S. subsidiary arranges for the construction of a plant to make a new product, purchases the necessary supplies, equipment, and technology, and hires personnel. Example (3) finds that since the U.S. subsidiary did not have a ''U.S. business'' at the time the U.S. subsidiary was formed, an existing ''U.S. business'' was not acquired, and there is no ''covered transaction.'' Thus, for example, foreign investors who enter the U.S. real estate devel-

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[19] *See, e.g.,* Article 11 of the U.S.-United Kingdom Income Tax Treaty, which can provide U.K.-resident mortgagees even a broader U.S. income tax exemption for non-effectively-connected U.S. source mortgage interest than the statutory portfolio interest exemption, such as for contingent mortgage interest or for mortgage interest received in the ordinary course of the mortgagee's foreign banking business.

[20] Some foreign banks have requested that Prop. 31 CFR §800.303 be amended to indicate that CFIUS will ordinarily defer to federal or state banking laws governing foreclosures on loans previously made in good faith. *See* Comment of Deutsche Bank Securities, Inc., http://www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=TREAS-DO-2008-0001.

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ISSN 8755-0628

opment business by forming a U.S. entity to purchase land, which then hires a construction company to build on that land, should not be viewed as engaging in a "covered transaction."

Buildings Not Presently In Use

Prop. 31 CFR §800.301(c) Example (6) involves a "foreign person" acquiring land and an empty warehouse building in the U.S. from a "U.S. business." The acquisition is limited to the warehouse facility, and does not include customer lists, intellectual property, other proprietary information, other intangible assets or the transfer of personnel. Example (6) concludes that the warehouse is not a "U.S. business," so that its acquisition is not a "covered transaction." By contrast, Prop. 31 CFR §800.301(c) Example (7) concludes that if a "foreign person" had hypothetically acquired, along with the warehouse facility, the transferor's personnel, customer list, equipment, and inventory management software used to operate the warehouse, the "foreign person" would be engaging in a "covered transaction." Further, even if the warehouse and personnel had, as result of the former U.S. owner's bankruptcy, been idle for a year at the time of the "foreign person's" acquisition, but the warehouse and equipment were still in working condition, key personnel had agreed to return if the warehouse was revived, and the customer list and software were still current, 31 CFR §800.302(d) Example (5) indicates the "foreign person's" acquisition of the warehouse, customer list, equipment, and inventory management software would likewise be a "covered transaction." [21]

Neither Example provides a clear answer when, as is the case of a typical U.S. rental real estate building acquired when its most recent tenant has moved out, there are no employees, customer lists, equipment, and inventory management software needed to restart the rental operation. Rather, all that may be needed by the "foreign person" acquirer to restart the U.S. leasing business is to locate a local building management and leasing company. Independent contractors are often readily available for that purpose. The preamble to Prop. 31 CFR §800.302(d) states that an "entity," and thus a "U.S. business," will be found where the U.S. assets acquired "could be readily operated as a separate, stand-alone business." Thus, notwithstanding Prop. 31 CFR §800.301(c) Example (6), CFIUS could view a building that is readily operable for rental, although vacant when acquired, as a "U.S. business."

Buildings Already Leased to Tenants

Prop. 31 CFR Part 800 does not discuss whether the rental of a building itself necessarily constitutes a "U.S. business." Prop. 31 CFR §800.211 states that "business undertakings in a particular location" engaged in interstate commerce are a "U.S. business." Prop. 31 CFR §800.301(c) Example (7) indicates that operating a public warehouse in the U.S. through employees is a "U.S. business." By analogy to Example (7), a shopping center or rental office building which are actively operated by employees of the owner would likewise be viewed by CFIUS as a "U.S. business."

Concepts exist in the income tax law holding that very limited U.S. real estate rental activities, such as a ownership of a single net leased building managed by independent contractors, do not rise to the level of a business.[22] Nevertheless, such concepts are not referred to in Prop. 31 CFR Part 800. Therefore, the conservative view would be that CFIUS could consider that a "foreign person's" acquisition of "control" of even net leased buildings operated by independent contractors constitutes a "covered transaction." Under that view, the key to a "foreign person" avoiding "covered transaction" characterization when it acquires an interest in a company already owning rented U.S. real estate would be to avoid obtaining "control" of that company.

Entering Into Lease As Tenant

Prop. 31 CFR §800.224(f) states that a "transaction" includes a long-term lease under which the tenant makes substantially all business decisions concerning the operation of the leased entity. The Example in Prop. 31 CFR §800.224(f) deals with a situation where a "foreign person" receives a 99-year concession to operate a U.S. toll road business. The person granting the concession performs safety and security requirements. It also monitors and enforces, under penalties including termination for breach, the "foreign person" operator's compliance with other aspects of the operating agreement. The Example concludes that this is not a "transaction," and therefore, not a "covered transaction."

The Example does not address several questions that could arise in the typical case of a lease by a "foreign person" as tenant in a U.S. building. These include how much shorter than 99 years the lease would have to be to not be viewed as "long-term," and whether the landlord's retention of the safety and security requirements is sufficient to avoid "transac-

[21] *See also* Prop. 31 CFR §800.301(c), Ex. (4) (one-week suspension of business activities before the acquisition did not prevent finding that "U.S. business" was acquired.)

[22] *See Neill v. Comr.*, 46 B.T.A. 197 (1942); Rev. Rul. 73-522, 1973-2 C.B. 226.

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ISSN 8755-0628

tion'' status when, as is more typically the situation in U.S. building leases, there is no ''operating agreement'' that deprives the ''foreign person'' tenant of significant business discretion as to use of the rented building. It may be, however, that by analogy to Prop. 31 CFR §800.302(d) Example (1), which treats vacant land as not being an ''entity,'' vacant office space that cannot be subleased by the ''foreign person'' tenant is likewise not an ''entity.'' Under that view, there is no leased ''entity'' under Prop. 31 CFR §800.224(f), nor acquired ''U.S. business'' under Prop. 31 CFR §800.227, and thus no ''covered transaction.''

Entering Into Lease As Landlord

If a ''foreign person,'' as owner-landlord, enters into a lease on a U.S. building it already owns with a ''U.S. business'' as tenant, it is doubtful whether this lease could be a ''covered transaction.'' First, it may be questioned whether the lease is a ''transaction'' described in Prop. 31 CFR §800.224, since the ''foreign person'' landlord's right to receive periodic cash rent from the ''U.S. business'' is not the acquisition of a ''U.S. business.''[23] It seems unlikely that Prop. 31 CFR §800.224(f), which classifies a lease as a ''transaction'' if the tenant makes substantially all the business decisions concerning the leased space, was meant to apply where the landlord ceding substantially all the business decisions to the tenant is the ''foreign person'' whose acquisition of ''control'' is being tested.

Moreover, even if the lease is a ''transaction,'' Prop. 31 CFR §800.203(a) indicates that only contractual arrangements which directly or indirectly determine important matters affecting a ''U.S. business'' can constitute ''control'' of the ''U.S. business.'' It would seem unlikely, though possible, that a lease would grant a ''foreign person'' landlord such extensive rights as to constitute ''control'' of the ''U.S. business'' tenant.[24]

Forming a U.S. Real Estate Joint Venture

Prop. 31 CFR §800.301(d) includes as a ''covered transaction'' a joint venture by which a ''foreign person'' acquires, through the joint venture, ''control'' of a ''U.S. business'' contributed by the other venturer. Thus, Prop. 31 CFR §800.301(d) Example (1) indicates there is a ''covered transaction'' where a ''foreign person'' contributes cash, and another person contributes a ''U.S. business,'' such as a U.S. rental real estate business, of equal value, for a 50% interest in a newly formed U.S. company, with the ''foreign person'' having veto rights over many important matters. By contrast, Prop. 31 CFR §800.301(d) Example (2) indicates there is no ''covered transaction'' where a ''foreign person'' contributes cash to be used for development of the land for use in ''U.S. business'' to be created, and another person contributes U.S. land, since the land contributed by the other person does not constitute a ''U.S. business.''

NATIONAL SECURITY AND MITIGATION

Ultimately, what often determines whether or not a ''foreign person,'' that is acquiring what may be viewed by CFIUS as ''control'' of a U.S. operating business or U.S. rental real estate, decides to undertake the cost and delay involved in seeking a favorable advance CFIUS decision, is the risk that the acquisition will ultimately be viewed by CFIUS and the President as threatening to impair the ''national security'' of the United States.

Neither 50 USC App. §2170 nor Prop. 31 CFR Part 800 defines ''national security,'' thereby preserving for CFIUS considerable flexibility. After the September 11, 2001 terrorist attacks on the World Trade Center, commentators argued that the ''national security'' criteria under the predecessor of FINSA could be used by CFIUS to encompass terrorist threats to U.S. commercial buildings.[25] Indeed, other commentators point out that the terrorist threat was the basis of the CFIUS review and ultimate Congressional controversy over the proposed but withdrawn 2006 Dubai Ports World

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[23] Prop. 31 CFR §800.302(d), Ex. (2), concludes that a ''foreign person'' that executes a long-term contract to receive the annual production of armored personnel carriers of a U.S. manufacturer in exchange for paying the cash purchase price of each carrier has not acquired a ''U.S. business.'' It would seem that a long-term contract to receive only rent likewise is not a ''U.S. business.'' The fact that some routine leasehold improvements would become the property of the ''foreign person'' at expiration of the lease should arguably not change that conclusion.

[24] A lease would often give the landlord the right to approve the tenant's assignment or sublease. Prop. 31 CFR §800.203(a)(1) lists, as one of the indicia of ''control,'' important decisions involving the transfer by the ''U.S. business'' of any of its principal assets. On the other hand, Prop. 31 CFR §800.303(a) states that the fact that a loan from a ''foreign person'' to a ''U.S. business'' is secured does not constitute acquisition of ''control'' of the ''U.S. business'' by the ''foreign person'' lender. Although not addressed in Prop. 31 §CFR 800.303(a), a secured loan would typically prohibit the ''U.S. business'' from disposing of the collateral without the ''foreign person'' lender's consent.

[25] *See* Note, ''U.S. Policy Towards Direct Foreign Investment Post-September 11: Exon-Florio in the Age of Transnational Security,'' 41 *Colum. J. Transnat'l L.* 195, at 239 (2002) (''[50 USC App. §2170] could be extended to cover industries and critical infrastructure considered vulnerable to attack. Justification for domestic ownership could include the need for special supervision and/or enforcement of safety measures. Scope of coverage could include physical infrastructure, such as commercial buildings.'')

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ISSN 8755-0628

acquisition of the company managing several U.S. seaports.[26] Many of the post-September 11, 2001, pre-FINSA, terror-related prosecutions have involved alleged plots, like the September 11 World Trade Center crashes, to attack major U.S. rental office buildings, rental apartment buildings, and shopping centers.[27] The mastermind of the September 11 attacks reportedly desired to blow up 20 U.S. rental apartment buildings.[28] Thus, one might argue that a ''covered transaction'' involving the purchase of 20 rental apartment buildings could present ''national security'' concerns.

50 USC App. §2170(a)(5), enacted by FINSA, states: ''Clarification . . . 'national security' [includes] 'homeland security,' including . . . critical infrastructure.'' This suggests that CFIUS can take into account issues relating to ''national security'' that do not involve ''homeland security,'' and issues relating to ''homeland security'' that do not involve ''critical infrastructure.'' [29] To the extent that rental real estate, which has been a terror target, arguably implicates ''national security,'' CFIUS arguably can review a ''covered transaction'' involving rental real estate.

Like ''national security,'' the term ''homeland security'' is not further defined in 50 USC App. §2170 or Prop. 31 CFR Part 800. The President's ''National Strategy for the Physical Protection of Critical Infrastructure and Key Assets'' (''National Strategy'') identifies several categories of what it calls ''key assets.'' [30] These ''key assets'' apparently are not themselves viewed by the President as ''critical infrastructure,'' but nevertheless apparently are viewed as having ''homeland security'' implications. ''Key assets'' include prominent shopping centers, office buildings, sports stadiums, and iconic privately owned buildings.[31]

50 USC App. §2170(a)(6) defines ''critical infrastructure'' to include, subject to future regulations, those physical assets ''so vital to the United States that the incapacity or destruction of such . . . assets would have a debilitating impact on national security.'' Prop. 31 CFR §800.207 does not expand the definition of ''critical infrastructure.'' Rather, it views ''critical infrastructure'' to include assets ''so vital to the United States that the incapacity or destruction of . . . the particular . . . assets of the entity over which control is acquired pursuant to the covered transaction would have a debilitating impact on national security.''

''Critical infrastructure,'' being not further defined in 50 USC App. §2170(a)(6) or Prop. 31 CFR §800.207, thus is not correlated by statute or CFIUS regulation to specific industry sectors. Nevertheless, various federal government reports have listed assets used in specific industry sectors as comprising ''critical infrastructure.'' For example, the National Strategy lists the following ''critical infrastructure'' sectors: (1) agriculture and food; (2) water; (3) public health; (4) emergency services; (5) government; (6) defense industrial base; (7) information and telecommunications; (8) energy; (9) transportation; (10) banking and finance; (11) chemical industry; (12) postal and shipping; and (13) national monuments and icons.[32] Rental real estate is not one of these specified industry sectors. Nevertheless, rental real estate is of-

[26] Mostanghel, ''Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?,'' 70 *Alb. L. Rev.* 583 (2007).

[27] Whoriskey and Eggen, ''7 Held in Miami in Terror Plot Targeting Sears Tower,'' *The Washington Post*, (6/23/06), at A26; Eggen, ''U.S. Details Case Against Terror Suspect,'' *The Washington Post*, at A01 (6/2/04) (alleged mission to blow up as many as 20 apartment buildings by sealing off apartments, filling them with natural gas and using timers to set off the explosions); Schmidt, ''Suspect Pleads Guilty in Ohio Mall Plot,'' *The Washington Post* (7/31/07). *See also* Zagorin, ''Inside Al-Qaeda's Files,'' *Time* (8/8/04), available through http://www.time.com (surveillance reports found on Al-Qaeda computers in Pakistan contained some 500 photographs of targeted buildings, such as the Citicorp Center in New York and the Prudential Plaza building in Newark, and discussions about how to destroy them.) However, none of the alleged plots to date apparently envisaged the terrorists investing in, or becoming tenants under a lease in which the tenants assumed safety and security functions, of the buildings sought to be blown up, in ''covered transactions'' described in Prop. 31 CFR Part 800.

[28] *See* Locy, ''Authorities: Padilla plot included plan to blow up apartments,'' *USA Today* (6/1/04) (''Mohammed, the alleged mastermind of the 9/11 attacks, wanted Padilla and his accomplice . . . to destroy 20 apartment buildings simultaneously . . . The plan called for Padilla and his accomplice to target buildings supplied with natural gas. They would rent two apartments in each building, seal them, turn on the gas and set detonation timers. But Padilla allegedly told Mohammed that renting so many units would attract attention and that it was more feasible to hit two or three buildings.'')

[29] On the other hand, transactions involving ''critical infrastructure'' (as possibly distinguished from ''key assets'' that are not ''critical infrastructure,'' such as, perhaps, iconic rental buildings) are subject to somewhat lower thresholds for triggering CFIUS investigations under 50 USC App. §2170(b)(2)(B)(i)(III), are listed as factors implicating ''national security'' under 50 USC App. §2170(f)(6), and are the subject of required reports to Congress under FINSA §7(c). ''Covered transactions'' that involve ''critical infrastructure'' may thus be more critically scrutinized by CFIUS.

[30] The *National Strategy,* published in 2002, is available at http://www.whitehouse.gov/pcipb/physical.html.

[31] *Id.* at 71. The *National Strategy*, at 9, concludes there are 460 skyscrapers that are ''key assets.'' The Department of Homeland Security publishes a daily ''Open Source Infrastructure Report,'' organized by sector, with ''commercial facilities'' being a listed sector. It is available through http://www.dhs.gov/xinfoshare/programs/editorial_0542.shtm. For example, the April 30, 2008 report identified, under ''commercial facilities,'' incidents at a rock concert at The BankAtlantic Center near Fort Lauderdale and at the offices of Downtown Disney in Orlando.

[32] Note 30, above, at 35. *See* Congressional Research Service,

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ISSN 8755-0628

ten leased to tenants engaged in one of the covered sectors. Even when a tenant is not within one of the enumerated sectors, the elevators and plumbing and wiring in rental buildings provide food, water, emergency services, communications, and similar services to the tenants.

In summary, a theoretical argument can be made that practically every ''covered transaction'' involving U.S. rental real estate is reviewable by CFIUS. However, there are countervailing factors suggesting that CFIUS review upon CFIUS' own motion will be far more limited.

For example, the Homeland Security Act, as codified in 6 USC §121(d)(2), contemplates the Department of Homeland Security will ''plan for securing the key resources and critical infrastructures in the United States,'' including against terrorist attacks. ''Key resources'' is defined in 6 USC §101(9) as ''publicly or privately controlled resources essential to the minimal operations of the economy and government.'' To define ''critical infrastructure,'' 6 USC §101(4) incorporates the definition in the Patriot Act, codified in 42 USC §5195c(e), which defines ''critical infrastructure'' as ''systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters.'' By contrast, 50 USC App. §2170 does not mention ''key resources,'' ''national economic security,'' or ''national public health or safety.'' Since specific U.S. rental buildings would not typically give rise to a level of concern commensurate with ''key resources,'' ''national economic security,'' or ''national public health and safety,'' much less ''critical infrastructure,'' it would seem unlikely they were intended for special scrutiny by FINSA.

In evaluating whether a rental building is ''critical infrastructure,'' it appears that Prop. 31 CFR §800.207, by focusing on the ''particular'' assets of the acquired ''U.S. business,'' is meant to suggest that in large industries providing comparable services, only the major participants will be scrutinized. For example, destruction of all the rental buildings in the U.S., or even the destruction of a subsector, such as the entire U.S. rental office building or rental apartment stock, would arguably have a debilitating impact on ''national security,'' yet the destruction of all the ''particular'' holdings of all but perhaps the very largest owners of non-iconic general office buildings or rental apartment buildings would be unlikely to be debilitating. A conclusion that the focus is on the importance of the assets of the particular ''U.S. business'' being acquired, not the entire industry, finds support in Prop. 31 CFR §800.402, which lists the information to be filed in a voluntary disclosure to CFIUS with respect to the ''U.S. business'' being acquired. For a ''U.S. business'' not related to defense contracting or other U.S. government activities, the description required of that ''U.S. business'' in Prop. 31 CFR §800.402(c) is generally limited to a description of the transaction, including the price paid, the product line, and market share.[33]

The House Report on a predecessor bill to FINSA states that CFIUS determinations should be ''objective, based upon criteria that are reasonably related to protecting the security of the United States.''[34] 50 USC App. §2170(f) lists eleven objective criteria. One objective criterion is whether the acquirer is a ''foreign government,'' and a second criterion is a catch-all for ''other factors.'' The remaining nine criteria generally deal with traditional ''national security'' concerns, such as ensuring the availability of products, technology, and services needed by the U.S. defense industry. Except in atypical cases, the nine other criteria in 50 USC App. §2170(f) would not be significantly implicated in acquisitions of general purpose rental buildings.

With respect to terrorism, the House Report states that foreign investors who are directly involved with foreign governments that have failed to ban groups designated by the U.S. State Department as terrorist groups should be of particular concern.[35] 50 USC App. §2170(b)(4) requires the U.S. Director of National Intelligence to inform CFIUS of ''national security'' threats posed by each ''covered transaction.''

''Critical Infrastructures: Background, Policy and Implementation,'' RL30153 (updated 2/17/05).

[33] *See also* 50 USC App. §2170(f)(6), listing, as a factor to be taken into account by CFIUS in a ''national security'' review, the effects on ''critical infrastructure, including major energy assets.'' This reference to ''major'' suggests that the size of the ''covered transaction'' under review may be important to determine whether ''national security'' is implicated. The small number of voluntary submissions expected by CFIUS also suggests that CFIUS expects to concern itself with only very significant transactions. The preamble to Prop. 31 CFR Part 800 states that over each of the next few years, CFIUS expects an average of only 120 voluntary notices, of which no more than 12 will be the subject of a protracted investigation or a mitigation agreement. The Canada Pension Plan Investment Board has asked Treasury in a comment letter to amend Prop. 31 CFR Part 800 to specifically exclude from ''critical infrastructure'' assets for which there are numerous viable alternatives. http://www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=TREAS-DO-2008-0001.

[34] H.R. Rep. 24, part 1, 110th Cong., 1st Sess. at 15 (2007). *See also* ''OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies'' (6/5/08) (''investment safeguards should be . . . predictable [and] proportional to clearly-identified national security risks''). http://www.olis.oecd.org/olis/2008doc.nsf/LinkTo/NT000032DE/$FILE/JT03247225.PDF.

[35] *Id.* at 16.

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ISSN 8755-0628

One would suspect that, absent specific intelligence supplied by the Director of National Intelligence to CFIUS indicating the existence of such a threat, purely private investment groups from all countries, and government investment funds from countries that have banned U.S.-designated terrorist groups, will be unlikely to attract CFIUS disapproval. There is no indication CFIUS would be guided by the entirely conjectural possibility those foreign investor groups could decide to blow up or contaminate their own U.S. rental building at the economic cost of blowing up or contaminating their investment in those buildings.

The House Report states that CFIUS determinations are to be ''encouraging and respecting [of] a general policy of openness toward foreign investment, a policy that is reflected in various international agreements to which the United States and other countries are parties.''[36] President Bush's January 2008 statement concerning CFIUS procedures explicitly ''reaffirms . . . our commitment to open economies and our policy of welcoming foreign investment and the important economic benefits that such investment brings.''[37] The Treasury Department release accompanying Prop. 31 CFR Part 800 states that ''these regulations reflect America's strong and continued commitment to safeguarding U.S. national security in a manner that reinforces the longstanding U.S. policy of welcoming foreign investment.''[38]

In summary, it would seem that CFIUS could take into account all the facts and circumstances, such as whether the building is used in a business sector relating to ''critical infrastructure,'' ''homeland security,'' or other ''national security'' aspects, whether the building was a major skyscraper or otherwise had iconic status, the square footage of the building, any intelligence concerning the proposed foreign investor group, and the division of safety and security responsibilities between the landlord and tenant under the building leases, in determining whether to take the rare and drastic step of recommending that the President prohibit the acquisition of such U.S. rental buildings by a ''foreign person.''

''Mitigation Agreements''

50 USC App. §2170(l) permits CFIUS to negotiate a ''mitigation agreement'' which, when agreed to by the ''foreign person'' acquirer, will cause CFIUS to refrain from providing an unfavorable recommendation with respect to a ''covered transaction.'' For example, in the proposed Dubai Ports World transaction, CFIUS required a ''mitigation agreement'' as a condition for clearing the purchase of the U.S. port management company. That ''mitigation agreement'' originally required the ''foreign person'' acquirer to: (1) maintain current levels of cooperation in security arrangements; (2) provide the Department of Homeland Security with 30 days advance notice of change in membership or cooperation with security arrangements; (3) operate the U.S. facilities to the extent possible with current U.S. management; (4) designate a responsible corporate officer to serve as a point of contact with the Department of Homeland Security on security matters; (5) provide relevant information to Department of Homeland Security upon request; (6) disclose to U.S. law enforcement information on the design and operation of the U.S. facilities; and (7) provide records relating to foreign direction of the U.S. facilities.[39]

After media criticism that this CFIUS ''mitigation agreement'' was not strict enough, the ''mitigation agreement'' was amended to provide that: (8) state of the art inspection devices would be installed at the U.S. facilities; (9) the Department of Homeland Security would be given a right to veto the choice of chief executive, board members, security officials, and all senior officers; and (10) there would be a supermajority of U.S. citizens on the board of directors.[40] In addition, the ''foreign person'' acquirer volunteered to: (11) maintain all records relating to U.S. security operations in the United States and make them available upon request, and (12) establish a security oversight board chaired by U.S. citizens reporting annually to the Department of Homeland Security.[41]

It would seem that similar agreements could satisfy CFIUS with respect to acquisitions of U.S. rental real estate that otherwise would implicate ''national security.'' However, in view of the fact that, even after the amended Dubai Ports World mitigation agreement, Dubai Ports World found it necessary to abandon the proposed transaction, it is unclear whether CFIUS would view such a ''mitigation agreement'' as sufficient.

CONCLUSION

A U.S. company that is foreign-controlled, or a foreign company itself, can be subject to potential

[36] *Id.* at 15.

[37] http://www.whitehouse.gov/news/releases/2008/01/20080123-11.html, issued in connection with Executive Order 11858.

[38] Treasury Department News Release, HP-937, ''Treasury Issues Proposed CFIUS Regulations; Lowery to Hold Briefing Today'' (4/21/08). *See also* Treasury Department News Release HP-1001, ''Remarks by U.S. Treasury Secretary Henry M. Paulson, Jr. on Open Investment Before the U.S.-UAE Business Council'' (6/2/08) (favorably contrasts narrow CFIUS national security-based review to broad barriers in Gulf states to U.S. ownership of real estate.)

[39] Brooklyn Note, note 1 above, at 1166 fn. 56 (2007).

[40] Brooklyn Note, note 1 above, at 1167.

[41] *Id.*

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ISSN 8755-0628

CFIUS review if that company engages in any of a broad variety of U.S. real estate transactions, such as foreclosing a mortgage loan on U.S. rental buildings, buying U.S. rental buildings, or forming a joint venture with a U.S. company with respect to that U.S. company's existing rental buildings. Whether CFIUS will actually take the unusual step of reviewing such transactions absent a voluntary submission, and the results of any CFIUS review, could depend on the relationship of the tenants in the buildings to U.S. ''homeland security,'' the iconic status of the buildings, and other factors.

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ISSN 8755-0628