

# OVERVIEW OF BUSINESS-RELATED DUE DILIGENCE ISSUES FOR EB-5 INVESTORS AND THEIR COUNSEL

by Mark H. Scribner\*

In addition to the immigration issues that foreign investors must consider when seeking status to live and work in the United States, investors must also consider various business issues that may affect their decision to invest in or operate businesses in the United States. In addition to retaining immigration counsel, foreign investors should retain experienced business counsel to review and advise on all of the business transactional documents associated with the investment and business operations, as well as any securities offering materials (the so-called Private Placement Memorandum) that explain and control the investments.<sup>1</sup>

A foreign investor's due diligence should also include analysis of: (i) the type of business entity the investor will invest in (*i.e.*, in EB-5 parlance, the "New Commercial Enterprise" (NCE)) and what rights the investor will have in such an entity; (ii) the nature of the business operations involved in the investment; (iii) whether the business entity (NCE) will invest in or loan funds to the developer or owner of the business developing the project (*i.e.*, in EB-5 parlance, the "Job Creating Enterprise" (JCE)); (iv) whether any other equity owners or lenders are a part of the capital stack of the business and, if so, the nature of the respective rights and obligations of the third parties and foreign investors; and (v) various ethical and legal practice considerations that the investor's immigration and business counsel should address prior to any investment.

## BUSINESS ENTITY DUE DILIGENCE

A foreign investor and his or her business counsel should conduct a thorough due diligence review of the following items prior to investment:

- The type of business entity that will be used for the investment. Entities that will be considered by the developer's consultants include the corporation, limited or general partnership, limited liability partnership, and limited liability company. In EB-5 cases, it is critical for the developer's counsel to use an entity, and draft appropriate language in the entity formation and governance documents, that permits the EB-5 investors to be "engaged in the management of the new commercial enterprise." This required level of participation means that the business analysis and investor counsel must focus on how and to what extent the EB-5 investor will be involved in the business decisions of the NCE, and whether the NCE gives its owners enough power to successfully meet the active involvement threshold (*i.e.*, whether the investor will be able to recommend policy, exercise day-to-day managerial control, and/or exercise rights normally accorded limited partners under the Uniform Limited Partnership Act, as required by 8 Code of Federal Regulations (CFR) §204.6(j)(5)(iii)).

---

\* **Mark H. Scribner** is of counsel in the Burlington, Vermont office of Primmer, Piper, Eggleston, & Cramer PC where he concentrates his practice in the areas of financial services, banking, business transactions, real estate and securities law. He has been actively involved with immigration counsel in advising sponsors and developers on structuring EB-5 projects to attract foreign investors, including drafting the securities offerings and all business agreements referenced in the offerings. Mr. Scribner also has extensive experience representing commercial lenders in the Northeast on all types of commercial loan originations, credit accommodations, and workouts. He can be reached at [m Scribner@primmer.com](mailto:m Scribner@primmer.com).

<sup>1</sup> This article focuses primarily on issues inherent in EB-5 petitions, but the general due diligence issues discussed also apply in other immigration contexts, such as E-1 treaty trader, E-2 treaty investor, L-1A intracompany transferee, EB-1C multinational executives or managers, and so on. In addition, although the goal of this article is to provide immigration counsel with an overview of some of the most common business-related due diligence issues, additional generally applicable business due diligence resources, including checklists can be found online. Some examples include: <http://pages.stern.nyu.edu/~igid-dy/duediligence.htm>; [http://isites.harvard.edu/dfs/docs/icb.topic451266.files/Practical\\_Checklist\\_for\\_Due\\_Diligence\\_2007.doc](http://isites.harvard.edu/dfs/docs/icb.topic451266.files/Practical_Checklist_for_Due_Diligence_2007.doc); [www.sec.gov/about/offices/ocie/adviser-due-diligence-alternative-investments.pdf](http://www.sec.gov/about/offices/ocie/adviser-due-diligence-alternative-investments.pdf).

- The state law under which the business entity is organized, incorporated or otherwise set up, to properly advise the foreign investor on governing law questions. This may include consideration of the “blue sky” laws of the state from which the investor interests (*i.e.*, the securities) are issued.
- Officers, directors, managing members, managing partners, etc. of the business entity. Depending on the type of investment and immigration status the foreign investor is pursuing, the investor may be an owner of the entity but not retain day-to-day decision making authority on behalf of the entity. In this case, the entity would consider, appoint, and authorize parties such as officers, directors, managing members, or managing partners to act on its behalf.
- The organizational documents of the entity such as the articles of organization (LLC or corporation) or partnership certificates (limited partnerships) filed with the Secretary of State of the state of organization of the investment entity.
- The governance documents of the entity such as the bylaws (corporation), operating agreement (LLC), or partnership agreement. Counsel should pay particular attention to provisions in such agreements that might create an “artificial” market for the sale of the investor's shares or membership/partnership interests by providing a mechanism for the purchase of the investor's interests by other owners or the business entity itself. Typically these types of provisions arise in the context of an exit strategy for the investor **once** he or she has successfully obtained the sought-after immigration status using such an investment.<sup>2</sup>
- The stock, membership, or partnership certificates issued to the investor to evidence the investment, and review and discuss any restrictions on resale noted on the certificates, including any time or securities restrictions on resale.

#### BUSINESS START-UP DUE DILIGENCE

- The business plan outlining the goals, projections, and financial analyses of the proposed investment entity before the investor commits funds to the entity.
- Federal and state regulatory and disclosure requirements, depending on the nature of the business investment, if stated in the investment business plan, and questioned if not included.
- The tax status of the entity, whether it has a federal Employer Identification Number (EIN), and any tax filings for such entity.
- Social security number (SSN) and work authorization of the investor. If the investor is not work authorized, then the investor may want to apply for an Individual Tax Identification Number (ITIN) with the Internal Revenue Service (IRS) to facilitate the receipt of tax filings pertinent to his or her investment, such as K-1 statements.
- The proposed plan for receipt and use of the investor's funds, including any escrow arrangements, and what events will trigger the release of those funds to the entity or back to the investor.
- Intellectual property (IP) rights that might be involved, even tangentially, with the investment or business plan such as copyrights, trademarks, patents, trade names, and trade secrets. Depending on the nature of the investment and project, this may include a review of foreign IP filings and application approvals.
- Other government filings. Depending on the nature of the investment and how the investment will be used, the entity may be required to make other government filings such as those with the Department of Commerce, Department of Agriculture, Department of the Treasury's Office of Foreign Assets Control (OFAC), U.S. Customs, IRS, Securities and Exchange Commission (SEC), or Department of Justice, etc. Offerings to solicit investment, even from overseas investors, trigger SEC and state securities laws

<sup>2</sup> These provisions need to be carefully considered by both immigration counsel and business counsel to ensure that the provisions do not violate current immigration law and policy against certain “redemption” provisions in EB-5 cases. For a discussion of the immigration-related issues of redemption provisions in the EB-5 context, see E. Carroll, “A Search for the Meaning of ‘Redemption’ in EB-5 Cases,” elsewhere in this volume.

and regulations (so-called "blue sky" laws), although exemptions are typically used under Regulation D and Regulation S to avoid full-blown registrations of the offerings.

- Collateral agreements needed to facilitate the investment project. These may include, for instance, a Private Placement Memorandum, and certain real estate, licensing, distribution and management agreements.
- Zoning and/or title documents. If the investment is in connection with a real estate project, zoning or title issues might affect the investment. Counsel should also review the project's responses to such issues.

#### **BUSINESS OPERATIONS' DUE DILIGENCE**

- The developer's approach to and ongoing handling of tax filings, which may affect the investor's ability to timely make personal filings. An investor must make personal income tax filings annually with the IRS and, possibly, more frequently if estimated tax filings are required. The entity must make tax filings with the IRS initially, quarterly and/or annually, depending on the nature of entity.
- Periodic obligations such as real property taxes, business property taxes, unemployment fund payments, and tax withholding payments. The investor's business counsel should ensure that such payments are made.
- Insurance obligations such as premises liability insurance, workers compensation insurance, casualty insurance, and business interruption insurance. Such insurance may prove beneficial if the project encounters claims and indemnification requests for negligence, misconduct, property loss, and other insurable events.
- Recurring filings with the Secretary of State, which may be required to maintain the good standing of the investment entity and/or job creating entity, including, for example, annual reports for corporations and limited liability companies. Business counsel should ask to be copied on such filings in order to keep apprised of the status of such entities.
- Real estate or capital lease agreements or purchase and sale agreements if investor funds are being used to lease, buy, or develop real estate, or lease or purchase capital equipment.
- Business contracts with customers, suppliers, etc. of the investment and/or job creating entity.

#### **MISCELLANEOUS INVESTOR BUSINESS ISSUES**

- The capital stack sources, the rights and preferences of each level of funding, and the resulting strength of the investor's and investment entity's investment or loan, if the Job Creating Enterprise or project will raise capital from a variety of sources. Other sources may include traditional financial institution lending, mezzanine lending, venture capital, and various kinds of tax credits.
- The mechanism used by the project to access the investor's funds, whether it is an equity investment or a loan by the entity into which the investor has contributed funds. If the project is borrowing the funds, business counsel must review the loan documents, including any collateral documents used to pledge security for the loan.
- Securities laws applicable to the project's marketing and advertising to ensure that the developer has complied with certain restrictions applicable to exempt securities offerings to ensure that the investor will not be adversely affected if the sponsor/issuer violates such rules. General solicitation and advertising is now permissible if the securities issuer meets certain disclosure and due diligence requirements, so business counsel should familiarize himself or herself with the current regulations.

#### **ETHICAL/LEGAL PRACTICE CONSIDERATIONS**

Counsel should also review and consider the following potential issues when working with an investor client:

- Counsel with clients seeking entry based on their investment into and operation of U.S. businesses must consider their clients' business interests in addition to their immigration goals, which may conflict.

- Immigration practitioners with foreign investor clients are urged to associate with business transactional attorneys with experience handling foreign investment matters in the United States. Separate counsel may be needed to advise the investor and the business entity. In an EB-5 project, for example, the entity is typically created by a U.S. developer or entrepreneur seeking to profit from investors who must decide if the project is suitable for their purposes. These differing viewpoints and the possibility for conflicts in some instances suggest that the investor should have independent business counsel.
- Immigration and business counsel with foreign investor clients should advise their clients to retain a competent certified public accountant (CPA) to handle all tax and accounting issues for the investor that result from living in the United States. This may involve a determination of tax obligations under a tax treaty between the United States and the investor's tax residence country. In addition, the CPA can assist the client with review of the business, tax, and accounting issues that may arise with any business investment project. These may include analysis of the business plan, an evaluation of the soundness of financial projections, advice on recordkeeping and assistance gathering documents for U.S. taxation purposes, tax planning, and preparation and filing of Federal and State tax returns.
- Immigration practitioners with foreign investor clients should work closely with business transactional counsel and the CPA to ensure that each professional is consulted at all critical stages of the investment and the business project. Whether the investor client will qualify for the immigration status being pursued is dependent on many factors, including the sustainability of the business. The other retained professionals will be more qualified to review with the client things such as the nature of the business entity, the business interest being purchased, and the capitalization of the business entity.

#### CONCLUSION

EB-5 and other investment-related immigration cases can create complex issues at the intersection of immigration law and business law, so it is critical that immigration counsel understand the basic need for such foreign investors to engage competent business counsel (and tax professionals) to protect clients' investment-related interests beyond obtaining immigration benefits. In addition, by helping to analyze the business-related issues, such outside professionals can help to eliminate potential business-related problems that could ultimately cause immigration-related problems on substantive EB-5 requirements, such as sustaining the investor's capital or creating a sufficient number of jobs.