

The Impact of the Four Precedent Decisions on EB-5 Practice

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This article presents a summary of the requirements imposed upon alien entrepreneurs by four precedent decisions issued by the former INS Administrative Appeals Unit: In re Soffici, 22 I&N. Dec.158(1998); In re Izummi, 22 I&N. Dec.169(1998); In re Ho, 22 I&N. Dec.206(1998); and In re Hsiung, 22 I&N. Dec.201(1998). Although these decisions are now 11 years old, they continue to create hurdles for any EB-5 investor to meet, whether the investor is investing in a pooled investment enterprise, a regional center or in his or her own business.

The four above-noted decisions established new and continuing precedential law in the following areas:

I. PROMISSORY NOTES

Promissory notes are expressly included in the definition of “capital” in 8 C.F.R. §204.6(e) so long as they are “secured by assets owned by the alien entrepreneur, provided that the alien entrepreneur is personally and primarily liable and the assets of the new commercial enterprise upon which the petition is based are not used to secure any of the indebtedness.” The precedent decisions impose further restrictions on the use of promissory notes as investment capital that are so extensive as to render promissory notes unusable in a large majority of investor petitions. The requirements fall into three categories: valuation of the promissory note; term of the promissory note; and security for the promissory note.

1. Valuation of the Promissory Note: In re Izummi, *supra* at 193, requires that the promissory note be valued at fair market value and not at its face value. This apparently requires a present value analysis in order to determine what a third party would pay for the note at the present time. This is an unrealistic requirement, as well as being inconsistent with practice under the treaty investor regulations. Presumably, written appraisals from independent sources are required to show that the note is marketable and to prove the present value of the note as discounted for inflation.

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2. Term of the Note: Neither the regulations nor past practice places limits on the terms of promissory notes. However, In re Izummi states that “at a minimum, nearly all of the money due under a promissory note must be payable within two years, without provisions for extensions.” Id. at 194. In order to avoid dealing with what constitutes “nearly all,” the practical impact of this requirement is to limit promissory notes to a term of two years.

3. Security for Promissory Notes: Although an unsecured promissory note is acceptable for purposes of a treaty investor visa application (9 F.A.M. 41.51n.8.1-2), for purposes of an immigrant investor petition the promissory note must be secured by assets owned by the alien entrepreneur. In addition, the alien entrepreneur must be personally and primarily liable; and the assets of the new commercial enterprise cannot be used to secure any of the indebtedness. (8 C.F.R. § 204.6(e)). These regulatory requirements regarding security for the note had been clarified by a series of opinions of INS officials, which established that:
 - The security does not need to meet the requirements for secured transactions under Article 9 of the Uniform Commercial Code;
 - There is no requirement that the lender perfect a security interest in the assets;
 - The investor must be able to identify specific assets that the investor actually possesses and that can be used as security for the note;
 - The Service has the right, in a particular case, to require the alien to identify specifically those assets that are being set aside as security for the note;
 - Where the note is secured by foreign assets, the commercial enterprise must be able to enforce against the collateral; and
 - The fair market value of the assets used to secure the note must, both at the time the indebtedness is entered and until the removal of conditions on the permanent residence status, continue to have a fair market value equal to or greater than the amount of indebtedness.

However, the precedent decisions added significant additional and inconsistent requirements regarding security for the note. In addition to requiring that all notes be fully secured, the Service now requires that the security interest must be perfected. In re Hsiung, supra at 202. In addition, apparently bank accounts cannot be used as security since “bank accounts can easily be dissipated.” In re Izummi, supra at 192. Finally, when foreign assets are used as security, the investor must establish that the laws of the foreign country in which the assets are located would recognize, and permit execution of, a judgment of a U.S. court; or in the alternative, the petitioner must establish that the courts of that foreign country would recognize and enforce the promissory note absent the judgment of the U.S. court. In re Hsiung, supra at 203. Finally, assuming an investor could present acceptable proof of the laws of the foreign country, the investor would then have to subtract the “considerable expense and effort” that would be involved in executing on such foreign assets and reduce the fair market value of the promissory note by such amount.

Obviously the effect - - and undoubtedly the purpose - - of these rules regarding promissory notes is to, in most cases, eliminate the use of promissory notes by EB-5 petitioners.

II. RETURNS TO THE INVESTOR

The precedent decisions stray far from business reality on the issue of returns to the investor. The decisions clearly restrict returns to the investor while the investor still owes money to the business. It is not clear to what extent the precedent decisions would disallow guaranteed returns to the investor as being violative of the “at-risk” provisions where the investor does not owe any money to the business.

In re Izummi expressly holds that guaranteed annual payments by an investor do not constitute a contribution of capital where the investor’s obligation to make annual payments to the partnership is conditioned upon the annual distributions from the partnership. More troubling is the following statement: “The AAU does not at this time reach the issue of whether it is ever appropriate for a business to distribute profits to an alien who still owes money to the business.” In re Izummi, supra at 181. This portends the possibility that no investor could receive any returns whatsoever from the investment – whether guaranteed or speculative – at least during the period of time in which payments under a promissory note had not been completed.

III. REDEMPTION AGREEMENTS

Prior to the precedent decisions, the INS recognized business reality in holding that 8 C.F.R. §204.6(j)(2)’s requirement that the capital be “at risk” does not prohibit an investor from taking normal steps to protect his investment:

“Neither the statute nor the regulations require, however, that that risk be an absolute one. We believe that aliens investing the relatively large amount of capital required for immigrant investor classification under Section 203 (b)(5) of the Act should be able to expect a relatively risk-free minimum return of their investments...Certainly, nothing in the statute or the regulations requires an alien investor to engage in unsound or unorthodox business practices in order to obtain benefits under Section 203(b)(5) of the Act. (Opinion of INS General Counsel, C.O. 204.6 (September 10, 1993)).”

Compare this statement with the language contained in the opinion in In re Izummi, supra at 187:

“The alien must go into the investment not knowing for sure if he will be able to sell his interest at all after he obtains his unconditional permanent resident status; and if he is successful in selling his interest, the sale price may be disappointingly low (or surprising high and more than what he paid). This way, the alien risks both gain and loss.”

Does this mean that the alien is required to engage in “unsound or unorthodox business practices” in order to obtain the benefits of Section 203(b)(5)?

In re Izummi, id at 186-7, apparently prohibits any agreement between the investor and the new commercial enterprise prior to the end of the two year period of conditional residence whereby the investor could be assured of redemption rights. In the event that the term of the promissory

note goes beyond the two year period of conditional residence, there can be no agreement with regard to redemption prior to the conclusion of the payments on the promissory note. These prohibitions go well beyond the Opinion of INS General Counsel dated December 19, 1997, which allowed redemption provisions so long as they were at fair market value.

It appears that In re Izummi also prohibits third party guarantees to the investor whereby a bank, insurance company or other institution commits to reimburse an investor if the investment enterprise becomes insolvent or if the investment enterprise is unable to meet its commitments to the investor. Although the INS had previously stated that only a third party guarantee backed by an unconditional federal, state or municipal obligation would be considered to remove impermissibly the required risk, it would appear that all such third party guarantees to the investor are now prohibited. Apparently, the possibility of an investor being able to sell back or liquidate his investment at any time in the future cannot be discussed or agreed to, at least until after the removal of conditional residence. The investor is therefore required to invest the full amount of his money without knowing if he will ever be able to exit the investment.

IV. AMOUNT OF INVESTMENT

The precedent decisions exclude from the calculation of the amount of capital investment certain amounts that appear to qualify under the regulations and that would normally be considered investments of capital in a commercial enterprise for any purpose other than an immigrant investor petition:

1. Any amount related to the establishment of the new commercial enterprise must be deducted from the amount of capital contributed to the new commercial enterprise. Specifically, “[t]he full amount of money must be made available to the business(es) most closely responsible for creating the employment upon which the petition is based.” In re Izummi, supra at 179. Presumably, this includes administrative fees, legal fees, finders fees and start-up costs. Certainly, such start-up costs and expenses of a business in attracting foreign investments are common in investment arrangements and included for other purposes in the calculation of the total amount of investment.
2. Funds set aside by the new commercial enterprise as “reserve funds” to cover extraordinary expenses or contingencies are not considered available for purposes of job creation and therefore are not considered part of the capital placed at risk. In re Izummi, supra at 189. Again, reserve funds are perfectly normal business practices; and reserve funds are considered assets of a business enterprise. Nevertheless, these amounts that would be considered contributions of capital for other purposes are not considered contributions of capital for purposes of an immigrant investor petition.
3. Funds deposited into a corporate bank account are not considered part of the investor’s contribution of capital, at least if the investor is the sole shareholder of the business. In re Ho, supra at 209-10. The theory of this is apparently that

these amounts are not at risk because the investor could withdraw the funds from the corporate bank account. It is not clear to what extent this restriction would apply if the investor owns less than 100% of the business.

V. ESTABLISHMENT OF A NEW COMMERCIAL ENTERPRISE

In re Ho, supra at 210, requires the investment enterprise actually to be undertaking business activity at the time of the filing of the petition. Signing a lease agreement or “simply formulating an idea for future business activity” is not sufficient.

8 C.F.R. §204.6(h)(2) considers “the purchase of an existing business and simultaneous or subsequent restructuring or reorganization such that a new commercial enterprise results” to be sufficient to meet the requirement of establishing a new commercial enterprise. In re Soffici, supra at 166, states that new ownership, a new corporation, a new marketing strategy and changes to the décor of a hotel are not sufficient restructuring and reorganization to be considered the establishment of a new commercial enterprise. This leaves severe doubt as to what types of activities would be considered sufficient restructuring or reorganization in the context of the purchase of an existing business.

VI. EMPLOYMENT CREATION

The precedent decisions set forth numerous requirements relating to employment creation:

Although it is not necessary for the investment enterprise to create employment for ten full-time workers at the time of filing of the initial petition, the enterprise must submit a “comprehensive business plan,” which must include, at a minimum, a description of the business; the business’ objective; a market analysis including names of competing businesses and their relative strengths and weaknesses; a comparison of the competition’s products and pricing structures; a description of the target market and prospective customers; a description of any manufacturing or production processes, materials required and supply sources; details of any contracts executed; marketing strategy including pricing, advertising, and servicing; organizational structure; and sales, costs and income projections and details of the bases therefore. In addition, specifically with respect to employment, the business plan must set forth the company’s personnel experience, staffing requirements, job description for all positions and timetable for hiring. In re Ho, supra at 213.

Although 8 C.F.R. §204.6(e) considers a holding company and its wholly-owned subsidiaries to constitute a “commercial enterprise,” In re Izummi does not allow any of the investment capital to go to the holding company. Rather, “the full amount of money must be made available to the business(es) most closely responsible for creating the employment upon which the petition is based.” In re Izummi, id at 179.

8 C.F.R. §204.6(m)(7) allows an investor to meet the employment creation requirements by showing indirect employment creation if the qualifying investment is within an approved “regional center.” In re Izummi, id at 174-5, expands upon this requirement by stating that

(apparently) all of the activities of the enterprise must benefit the regional center's approved geographical area, or else the investor must establish direct employment creation. Similarly, In re Izummi, id at 173, requires that, in order for an investor to avail himself of the reduced capital investment requirement based upon an investment in a targeted employment area, the investor must prove that the transactions in which the enterprise engages benefit (exclusively?) the targeted employment area.

VII. CONCLUSION

Absent new EB-5 regulations, counsel is left to deal with outdated regulations and these four precedent decisions to guide them in counseling investors. Much to the chagrin of many investors, these decisions have as much impact today as they did when they were issued more than a decade ago.