

New SEC Interpretations Regarding Accredited Investors Impact EB-5 Reg D Offerings
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On July 3, 2014, the Division of Corporation Finance (Division) of the Securities and Exchange Commission (SEC) released Compliance and Disclosure Interpretations relating to accredited investors (AI Interpretations). The AI Interpretations are of particular importance to the EB-5 community because they clarify verification matters that often apply to non-U.S. persons.

The Jumpstart Our Business Startups Act, enacted in 2012, required the SEC to adopt rules and measures that amended existing exemptions from registration under the Securities Act of 1933 and that created new exemptions that allow issuers to raise capital without registration. As a result, Rule 506(c) of Regulation D was adopted, which eliminates the SEC's prohibition against using general solicitation and advertising in private offerings of securities under Rule 506 if all investors are *accredited investors*, the issuer takes reasonable steps to verify their accredited investor status, and certain other conditions of Regulation D are satisfied. In order to verify the accreditation of its investors, the issuer may employ one of four non-exclusive safe harbor verification methods or use the principles-based verification method. This method requires an objective determination by the issuer as to whether the steps taken were "reasonable" in the context of the given facts and circumstances of each investor and transaction.

In evaluating accreditation under the principles-based method, an issuer should consider: (1) the nature of the investor and the type of accredited investor that the investor claims to be; (2) the amount and type of information the issuer has regarding the investor; and (3) the nature of the offering, including such information as the manner in which the investor was solicited to participate in the offering and the terms of the offering (e.g., the minimum investment amount).

Under Rule 501 of Regulation D, an "accredited investor" includes a natural person who: (1) has earned income that exceeded \$200,000 (or \$300,000 together with a spouse) in each of the two previous years, and reasonably expects to earn a comparable amount for the current year (income-based verification); or (2) has a net worth that exceeds \$1 million (as interpreted by the SEC), either alone or together with a spouse (net worth-based verification). Pursuant to the Division's recent AI Interpretations and of importance to EB-5 practitioners, if a potential investor's income is not reported in U.S. dollars, it can be converted to U.S. currency to determine whether the investor meets the income-based requirement by using either the exchange rate in effect on the last day of the year for which income is being determined, or by using the average exchange rate for that year. By analogy, if a potential investor's net worth is not represented in U.S. currency, it too can be similarly converted to determine net worth accreditation.

The Division provided the following recommendations, in an effort to facilitate an issuer's determination under the principles-based method of income-based verification: (1) that the issuer review the potential investor's Internal Revenue Service (IRS) forms reporting income for the

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previous two years; and (2) that the issuer obtain written representations from the potential investor stating: (i) that the IRS forms for the recently completed year are not yet available; (ii) the amount of income received for the most recently completed year; (iii) that such income was sufficient to qualify as an accredited investor under the income test; and (iv) that the investor reasonably expects to reach the requisite level of income in the current year.

The Division further clarified that if the investor is not a U.S. taxpayer and thus is unable to provide an IRS tax form that reports his or her income, the issuer may be unable to rely upon comparable tax forms from a foreign jurisdiction in order to rely on the safe harbor income verification method provided in Rule 506(c)(2)(ii)(A). In making this clarification, the SEC reasoned that this safe harbor was provided in light of the “numerous penalties for falsely reporting information” to the IRS – a comfort that is not altogether guaranteed by similar forms in foreign jurisdictions. The Division has indicated, however, that an issuer could reasonably satisfy the principles-based income verification requirements by reviewing foreign-filed tax forms that report income where the foreign jurisdiction imposes comparable penalties for falsely reported information.

For the purposes of the net worth safe harbor, the Division provided guidance that an issuer may not use a consumer report prepared by a non-U.S. consumer reporting agency that performs similar functions, but could employ the principles-based method to verify investor net worth accreditation. Additionally, the Division stated that an issuer may not use a potential investor’s tax assessment to verify accreditation if the document is more than three months old. However, the issuer may be able to verify investor net worth accreditation under the principles-based method when the potential investor’s most recent tax assessment shows a value that (after deducting liabilities) demonstrates a net worth that substantially exceeds the \$1 million threshold amount. For the purposes of this provision, under 26 U.S.C. § 6203, “[a tax] assessment is a bookkeeping entry ‘recording the liability of the taxpayer’ . . . made when a taxpayer ‘[s]elf-assesses,’ i.e., files a personal income tax return, or, when the IRS prepares a substitute for return.”

The AI Interpretations reinforce the importance of reviewing reliable documents, and provide some flexibility in determining which methods are available to satisfy verification requirements. As the burden remains on the issuer to demonstrate compliance with these provisions, the Division warns that where there is reason to question a potential investor’s accredited status, the issuer must take additional steps to verify the investor’s status in order to establish that the issuer has fulfilled all of its reasonable verification obligations.

Although the AI Interpretations relate more to Regulation D offerings than to the Regulation S offerings that are most often used in EB-5 financings, these clarifications are relevant in the context of concurrent domestic and foreign offerings and, in the case of large Regulation S offerings, may become relevant for purposes of determining whether an issuer is required to register under Section 12(g) of the Securities Exchange Act of 1934 if the issuer has 500 or more non-accredited investors.