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OFFSHORE FINANCING FOR UNITED STATES BUSINESS VENTURES*

JORDAN BITTEL†

Because of the proliferating costs of raising venture capital in the United States, an increasing number of persons are finding it too costly to finance their ventures via the domestic capital markets. In addition, responding to today's trend towards internationalism, investors and investment bankers throughout the world are seeking an opportunity to diversify the geographical locale of their portfolios. It is this author's contention that offshore financing may alleviate a businessman's cost problem and simultaneously fulfill investors' desires for diversification more adequately than traditional domestic methods. While many major United States companies have successfully raised money in the offshore markets in recent years, there is no evidence to indicate that small or or new companies have done the same. It is submitted, that for reasons to be indicated later, securities offerings by smaller companies, attractively packaged, might entice offshore investor interest.

This article first examines some of the costs encountered in the United States by businessmen seeking to raise venture capital. Next, the growth of investments in the United States by non-United States persons will be considered. Then, some commonly used techniques to bring to-

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1. E. G. Renk, former General Manager of the Union Bank of Switzerland in Zürich, has indicated that the force of international financial integration "is pressing strongly from every side." International diversification began with the purchase of shares in corporations which operated on a worldwide basis, but today investments in domestic issues of foreign corporations are deemed necessary to obtain the proper degree of geographical spread. See Renk, Foreword to THE PRINCIPAL STOCK EXCHANGES OF THE WORLD — THEIR OPERATION, STRUCTURE AND DEVELOPMENT at vii (D. Spray ed. 1964) [hereinafter cited as Renk].

2. Mobil Oil was one of the first United States companies to raise capital in the offshore market. It was rapidly followed by other major companies, such as Gulf Oil, Honeywell, Pepsi-Cola, Chrysler, American Can, Standard Oil of California, Eastman Kodak, and Ford Motor Company. Today, securities of more than two hundred United States companies are listed and traded on the Amsterdam Stock Exchange.
gether foreign investors and United States businesses are examined, as well as other approaches which may be available.

**COSTS ENCOUNTERED IN RAISING VENTURE CAPITAL IN THE UNITED STATES**

There are many techniques which businessmen may use for capitalizing a new venture or for expanding an existing business. For example, corporate officers regularly seek loans from banks and other financial institutions, use equipment leasing and financing arrangements, and obtain assistance through the Small Business Administration and local development commissions. While such sources may be appropriate ones for existing companies with proven earnings or for promoters with sufficient collateral to meet their standards, many new businesses are not able to raise capital in that manner. Instead, some new firms turn to the capital markets and attempt to raise sufficient funds, either publicly or privately, by selling equity interests in the new venture. It is at this point that a promoter or businessman encounters the costs generated by the regulations of the state securities commissions, the United States Securities and Exchange Commission (SEC), and the National Association of Securities Dealers (NASD).

A majority of state legislatures have enacted laws regulating the sale of securities. The problems of compliance with these laws in connection with a public offering are more difficult than is commonly known.

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3. For an analysis of techniques to finance new business ventures, see J. Mofsky, Blue Sky Restrictions on New Business Promotions (1971) [hereinafter cited as Mofsky].

4. Id.

5. The District of Columbia and all of the states, except Delaware, have some form of blue sky law. The laws vary in their regulatory approach. They may be "fraud" statutes, or they may provide for the registration of securities, or for the licensing and regulation of brokers, dealers, and investment advisers. Most commonly there is a combination of these types of regulation.

Most blue sky laws provide for exceptions from their registration requirements. The most commonly used exception is that applicable to the limited or private offering. Generally, this exception applies if the offering of securities is restricted to a stated number of persons (e.g., ten persons) for a limited period of time. See Mofsky, Reform of the Blue Sky Laws, 23 Vand. L. Rev. 599, 609 (1970). From the promoter's standpoint, however, the limited offering is not always beneficial. The promoter may be unable, on terms satisfactory to him, to raise the requisite capital from a limited offering. For example, the promoter may lose control of the venture. This possibility exists because as the number of contributing offerees becomes smaller, the entrepreneur must raise a larger amount from each offeree; the larger investor tends to be more financially sophisticated than is the smaller investor, and such sophistication is frequently accompanied by demands for bargain purchases and control position. For a more detailed discussion of this control problem, see Mofsky, Blue Sky Restrictions on New Business Promotions, 1969 Duke L.J. 273, 281.
First of all, most of the state laws and rules differ in interpretation and application. 6 Secondly, and more importantly, most states impose a merit test upon the securities of promotional companies. 7 This is accomplished through statutes which permit the state administrators to deny registration to offerings which are, in the discretion of the administrators, unfair, unjust or inequitable, or through statutes which grant the administrators power to deny registration if certain terms of the offering are unreasonable. 8 These statutes lodge enormous discretion with state administrators and, pursuant to that wide latitude, state commissions often administer their law according to informal or ad hoc rules. 9 Discovering these rules and adjusting the company and the terms of the offering to meet them creates additional costs for the organizer of a new venture. Moreover, there are the costs, not only to the promoter and his firm but also to society, that accrue for those companies which cannot make these adjustments. Such companies must seek alternative forms of financing, and for those marginal firms for which there are no other satisfactory methods available, the proposed new venture may have to be abandoned.

In addition to meeting all of the requirements and expenses of complying with the various state regulations, entrepreneurs and promoters must also be concerned with federal laws before offering and selling securities. The Securities Act of 1933 10 requires registration of all securities prior to their being offered for sale unless some exemption is available. 11 One "exemption" from federal registration is the so-called

7. See Mofsky, supra note 3, at 15-17, 19; H. Sowards, THE FEDERAL SECURITIES ACT § 1.02 (1965) [hereinafter cited as Sowards].
8. Typical restrictions are designed to: (1) limit the amount of promotional stock offered by the organizers of the business; (2) limit the amount of dilution of the public investor's interests; (3) require a minimum amount of capital; (4) require escrow of promotional shares and "cheap stock" for a certain time period or until earnings or dividend tests have been satisfied; (5) limit the number of options and warrants granted; (6) restrict the amount of expenses incurred in connection with the public offering; (7) require sinking funds for debt securities; (8) limit the dollar amount of debt securities offered in proportion to some ratio of past earnings of the issuer; (9) regulate the type of securities sold (e.g., non-voting security restrictions); and (10) limit the offering price to some multiple of earnings or to a certain ratio of the organizers' cost per share. See Mofsky, supra note 3, at 32-35.
9. Gray, supra note 6, at 1519.
10. 15 U.S.C. §§ 77a-aa (1970) [hereinafter cited as Securities Act]. For the background, objective and scope of the Securities Act of 1933, see Sowards, supra note 7, §§ 1.01, 1.02; 1 L. Loss, SECURITIES REGULATION 121-28 (2d ed. 1961) [hereinafter cited as Loss].
Regulation A offering which permits less than full registration for offerings up to 500,000 dollars.\textsuperscript{12} The value of this exemption diminishes considerably, however, when the entrepreneur discovers that he: (1) still must have a "junior" registration at a regional SEC office and include an offering circular;\textsuperscript{18} (2) is limited in his sales document;\textsuperscript{14} (3) is subject to compliance with all appropriate state laws;\textsuperscript{15} (4) is subject to out of pocket expenses ranging from 30,000 to 50,000 dollars plus underwriting expenses;\textsuperscript{16} (5) is even harder pressed to find an underwriter because of the small amount of the offering;\textsuperscript{17} (6) will have a two to four month time delay;\textsuperscript{18} and, (7) is subject to all state and federal civil and criminal liabilities.\textsuperscript{19} A second exemption is the "intrastate" offering, which permits avoidance of federal registration\textsuperscript{20} but still requires state compliance. This exemption is fraught with dangers,\textsuperscript{21} difficult for the issuer to police and restrictive of the issue's marketability.\textsuperscript{22}

13. Rule 256 (and Schedule 1 thereof) describes the requirements with respect to filing, use, and contents of the offering circular. 17 C.F.R. § 230.256 (1972).
14. Because of the civil liability provisions of the Securities Act, the offering circular requires the same painstaking preparation as a full prospectus. The difficulties in such preparation are described later in the discussion of federal securities regulations. See notes 30-32 infra & text accompanying.
15. See notes 5 & 8 supra.
16. See Morsey, supra note 3, at 31-32; see also the list of expenses involved in a full registration in the text accompanying note 29 infra. If certified accounting statements are not required in the state in which the proposed sale is to take place, the accounting expenses will be less in a Regulation A offering than in a full registration.
17. The difficulties encountered in engaging the services of an underwriter are described in notes 33-38 infra & text accompanying. The Rules of Fair Practice of the NASD discussed there are applicable here with greater force because the dollar amount of the offering is limited under Regulation A to 500,000 dollars.
18. Nevertheless, Regulation A offerings usually take less time to process than full registrations. One possible explanation for this is that Regulation A offerings are processed in SEC regional offices, whereas other offerings are reviewed in Washington, D.C. 17 C.F.R. §§ 230.251 to 230.263 (1972).
20. Section 3(a)(11) of the Securities Act provides an exemption from registration for:
any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.
21. One potential danger lies in the fact that the entire issue must be offered and sold to residents of the state in question. Thus, a single offer or sale to a nonresident of that state may render the entire offering non-exempt. SEC Securities Act Release No. 4434 (Dec. 6, 1961).
The most commonly used exemption under federal law permits the “private placement” of securities to a restricted number of financially sophisticated investors.\textsuperscript{23} To qualify for the exemption, the investors must be furnished with adequate information concerning the company's business, its financial condition, and the use of the proceeds.\textsuperscript{24} In addition, the investors must purchase their securities “for investment,” which usually results in restricted transferability based upon an investment letter, legended stock, and a “stop-transfer order” with the company transfer agent.\textsuperscript{25} Furthermore, while there is no definite number under federal law, it has been suggested that the offering must be limited to 25 offerees.\textsuperscript{26} Moreover, this exemption must be coordinated with state laws which may further restrict the number of offerees.\textsuperscript{27} Besides the difficulties of qualifying for this exemption, the cost of a private placement is frequently very high since investors must accept stock which is not highly marketable.\textsuperscript{28}

Assuming no exemption is available, a company is confronted with a first-time federal registration cost which may be estimated as follows:

\begin{center}
\begin{tabular}{lcc}
 & \textbf{Amount} & \\
\hline
Printing & \$14,000 to \$20,000; \\
Legal Fees & 17,000 to 35,000; \\
Blue Sky Filing Fees & 3,500 to 8,500; \\
Accounting Fees & 5,000 to 15,000; \\
Registrar & Transfer Agent & 3,500 to 4,000; \\
Miscellaneous & 1,000 to 1,500; \\
\hline
Total & \$44,000 to \$84,000. \textsuperscript{29}
\end{tabular}
\end{center}
Add to these costs an underwriter's commission of ten per cent and the total cost of a one million dollar offering can easily reach 175,000 dollars.

Another cost in this area arises because of the kind of disclosure which has been generated by SEC regulations and the civil liability provisions of the Securities Act of 1933. In theory at least, that Act only demands that disclosures be sufficiently complete to enable investors to make intelligent, informed decisions. However, accountants and attorneys preparing the registration documents, including the prospectus, insist on a document that can be defended from a liability point of view. Furthermore, the SEC permits factual statements only and requires detailed elaboration of risks peculiar to a new promotion.

In short, in order to avoid possible liability for failure to disclose material facts and to secure effectiveness of the registration statement, the drafters of these statements use great care and precision, calling attention to every possible item which might go wrong. One might ask: how can a new, or young company, sell its securities without describing its hopes, aspirations, ambitions, and potential? One answer is that some prospective investors will not read the prospectus. But for those new ventures where such disclosure prevents a successful sale of securities, the cost has been great.

Finally, if one can afford the expense and overcome the lack of useful sales tools, there is still the time factor with which to contend. The full registration process can easily consume six months to a year, and some young businesses cannot withstand such a delay in their financing.

After overcoming the hurdles of state "merit" tests and federal costs, restrictions, and time delays, the entrepreneur must find a salesman to sell his securities. Although the promoter is legally permitted to offer the securities himself (with additional filings), the costs occasioned by the neglect of his business and by lack of his expertise in selling securities may be greater than the commission he would pay to an underwriter. If he seeks the services of an underwriter, he will learn that most reliable underwriters are members of the NASD. This organiza-

Offering," in SELECTED ARTICLES ON FEDERAL SECURITIES LAW 27 (H. Wander ed. 1968).

30. Section 11 of the Securities Act of 1933 imposes civil liability in the case of any effective registration statement which contains "an untrue statement of a material fact" or omits to "state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a) (1970).
31. See Sowards, supra note 7, § 1.02.
33. Many states require that an issuer be licensed or registered as a securities dealer before he can sell his own securities. See, e.g., FLA. STAT. ANN. § 517.12(8) (1971).
34. The NASD is a voluntary organization of broker-dealers. Agreements between
tion throws still another roadblock in the way of an entrepreneur seeking to raise capital. The NASD Rules of Fair Practice prohibit its members from participating in underwritings in which the underwriting arrangements are "unfair" or "unreasonable." Factors considered in determining fairness or reasonableness include: the size of the offering, the type of commitment (i.e., firm, best efforts, best efforts-all or none), the type of securities, the lack of restrictions on "cheap stock," and the existence of warrants, options, or other securities received, or to be received, by the underwriter in connection with the offering. The arrangements will generally be considered unfair if the underwriter receives as part of his compensation a security which he can dispose of within one year of the date of the offering. Similarly, the receipt by the underwriter of shares of "cheap stock," options or warrants in excess of ten per cent of the total number of shares being offered will usually be deemed unfair.

Those limitations on underwriting compensation may cause some investment banking firms to refuse to underwrite new or speculative issues, since costs involved, in terms of risks of the underwriter as well as more readily recognizable costs, may be greater than the potential benefits. Clearly, newly promoted companies are at a competitive disadvantage to larger, well-established companies in negotiating for investment banking services. At some marginal point, the NASD restrictions will preclude the use of an underwriter who is an NASD member, and the promoter must then turn to alternate financing techniques.

While the foregoing discussion was not intended to be an exhaustive study of the costs encountered by small or young companies and their promoters in attempting to raise venture capital, it does demonstrate

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underwriters and between underwriters and "selected dealers" customarily provide that a discount may be allowed to any NASD member. However, under the NASD's Rules of Fair Practice, a member is prohibited from dealing with non-member brokers or dealers except at the same prices as such member charges the general public. NASD Manual, Art. III, § 25. This rule is interpreted as barring members from participating in any underwriting syndicate or selling group that includes non-members. NASD Manual, Interpretation of the Board of Governors following Art. III, § 25.


37. Id.

38. Id. See also Ratner, Regulation of the Compensation of Securities Dealers, 55 CORNELL L. REV. 348 (1970). Subsequent to the publication of Ratner’s article, the NASD Board of Governors on March 10, 1970, issued an expanded version of its previous interpretation concerning “Review of Underwriting Arrangements.” This new interpretation concerned “Review of Corporate Financing.”
some of the problems that exist. Because of the high cost of regulation in the United States, some new companies may desire to seek capital in another market, perhaps the offshore market.

GROWTH OF INTEREST IN UNITED STATES INVESTMENTS BY OFFSHORE INVESTORS

More and more persons are becoming trans-national minded. No longer are people bound within the borders of their city, country, or even continent. Businesses have spread from one country to the next, crossed oceans, and presently conduct their affairs all over the world. The emergence of large international corporations is one of the pre-eminent features of the post-World War II scene. As businesses have internationalized, the average man has become increasingly aware of investment opportunities in other parts of the world and the advantages of geographical diversification of his assets. As a result, world citizens from South and Central America, and the Near and Far East, as well as Europe, have begun to diversify their holdings geographically. Some choose diversification to take advantage of the "secrecy" laws of certain jurisdictions for purposes of tax avoidance or evasion and many prefer bearer shares, but probably the chief motivating factor is the safety that geographical diversification offers. Too many investors have seen fortunes disappear through the ravages of war or the turmoil of political upheaval. In addition, outright government confiscation, such as that seen in Cuba during the late fifties, is always a possibility in politically unstable countries.

It is estimated that in the four years between mid-1967 and mid-1971, approximately 5.2 billion dollars in net foreign money has been placed in United States equities. This is in addition to 4.7 billion dollars placed in the bonds of United States corporations and agencies of the United States government. Little can be determined as to the country of origin of these investors, but a great bulk of the purchases

40. See Renk, supra note 1.
41. INVESTMENT COMPANY INSTITUTE, REPORT ON OPEN-END INVESTMENT COMPANIES THROUGHOUT THE WORLD (1970) [hereinafter cited as REPORT].
42. See Renk, supra note 1. See also Klopstock, Foreign Demand for United States Equities—The Role of Offshore Mutual Funds, MONTHLY REVIEW OF THE FEDERAL RESERVE BANK OF NEW YORK 163, 170 (1970) [hereinafter cited as Klopstock].
43. NEW YORK STOCK EXCHANGE, INC., PERSPECTIVES ON PLANNING I (No. 9, Feb. 1972).
44. Id. The study projects a net inflow in 1972 of approximately six billion dollars.
appear to have come from Switzerland. It is likely, however, that such purchases were made by Swiss banks on behalf of clients residing all over Europe, the Middle East, and Latin America. Large purchases are also shown emanating from such countries as the Netherlands, Bahamas, Bermuda, Belgium, and Luxembourg. Probably, the great majority of these purchases were made on behalf of offshore mutual funds based in those countries but whose own securities were sold throughout the world.

Overseas, as in this country, mutual funds have become increasingly important in the last five years. Door to door campaigns by fund salesmen have resulted in a revolution of the savings and investment habits of middle class Europeans. Their proliferation has been in numbers as well as types. The originators of the offshore mutual fund concept were United States citizens who created the funds to operate offshore and sell shares to non-United States citizens or residents; the proceeds of such sales were then invested in United States securities. The funds, and their management companies, were usually established in “tax-haven” jurisdictions. In recent years, United States financial interests have established more than two hundred such funds, and it is estimated that 400 offshore funds are now in existence.

There are several reasons why offshore investors have bought shares in offshore funds rather than purchase shares in United States registered funds or other United States companies. First, most individual offshore investors never had significant information about United States businesses or an inexpensive way to invest in them until door to door fund salesmen made such investments easy to accomplish. Next, there are important tax advantages in buying shares of an offshore fund rather than directly buying shares in a United States company or fund. These

45. Klopstock, supra note 42, at 165.
46. Id. A study by the International Monetary Fund in 1966 suggested that the money labelled Switzerland, Hong Kong and Bahamas was really being channelled there from other places. See Ferris, supra note 39, at 240.
47. See Klopstock, supra note 42, at 165.
48. Id.
50. Klopstock, supra note 42, at 166.
51. Id.
52. Palamountain, Thoughts on Offshore Funds, 120 THE BANKER 851, 853 (1970) [hereinafter cited as Palamountain]. There were 605 open-end investment companies outside the United States at the end of June, 1970. Report, supra note 41.
include (1) possible diminution of the United States thirty per cent withholding tax on certain interest and dividends by a careful structuring of the fund and use of the United States tax treaties,53 and (2) legal avoidance of United States estate tax on the holdings of the offshore investor.54 Furthermore, secrecy can be assured with the issuance of bearer shares.55

Finally, the offshore fund itself can operate more flexibly than United States registered funds. It need not refrain from selling securities because of United States capital gains taxes since it is not subject to that tax.56 It may diversify its United States securities with investments in other countries (e.g., Australia or Japan) without being subject to the United States interest equalization tax.57 It is not restricted in terms of sales load, salesmen’s commissions, management fees or incentive performance fees.58 Finally, it need not file a prospectus or registration statement with the United States SEC,59 although such regulation may exist in certain foreign countries.

As the dollar volume of investments in other countries (countries other than the residence of the investor) grew, important business and financial implications emerged. Non-United States banks discovered that business which had traditionally been their own was being lost to new competitors. At the same time, as the number of offshore mutual funds multiplied, there developed a scarcity of salesmen available to service them all.60 Some funds therefore turned to European banks as sales outlets and, as more and more banks accepted that work, their expertise and knowledge grew along with their realization that United States promoters were not needed. As the success of the offshore funds managed by United States persons grew, their promotional activities

55. The dividend notice of First Security Capital and Income Fund N.V., Wall Street Journal, Mar. 19, 1971, at 19, col. 3, is interesting in this respect. It contains instructions to the holders of bearer certificates advising them how to obtain payment of their dividend. The identity of the investors is not disclosed. No central register bears the names of the purchasers, and no report of purchasers’ names is filed with any authorities. See Ferris, supra note 39, at 238.
57. Id. §§ 4911-4921, 4931, as amended Interest Equalization Tax Extension Act of 1971, Pub. L. No. 92-9 (Apr. 1, 1971). The interest equalization statute provides for a tax on United States residents who invest in foreign stock and debt obligations of one year or more.
58. See Palamountain, supra note 52, at 852; see also Klopstock, supra note 42, at 167.
59. Klopstock, supra note 42, at 167.
60. Id.
were copied to a great extent by United Kingdom "unit trusts," European investment companies, and finally, foreign banks themselves. Union Bank of Switzerland (together with three private banks) formed Intraga Ltd., and in 1970, the company managed 14 different investment trusts representing thirty million shares, valued at nearly 700 million dollars. Union Bank's more than 200 offices in twelve different countries give investors ready access to distant securities markets. Nor does Union Bank have a monopoly. Swiss Bank Corporation with more than 150 offices and 8,100 employees in twenty countries, and Swiss Credit Bank with almost 100 offices and representatives in ten countries, are both very active in this field.

Such rapid growth was not free of problems, however. Concern arose over the mismanagement of many of the mutual funds, particularly the widely publicized troubles of the IOS group of funds and the suspension of redemptions of GRAMCO shares. Also, many governments were unhappy about money leaving their countries. The result was government intervention and control of the sale of offshore mutual funds in many countries. The controls took a variety of forms such as absolute prohibition of sales; liquidity and auditing requirements; and requiring fifty per cent of the fund's assets to be reinvested in the country where fund shares were sold. However, inasmuch as the principal reasons for such investments continue to exist, it may be surmised that investors will find techniques for circumventing these government restrictions.

In addition to the money generated by fund sales, an increasing number of private individuals, who have discretionary investment accounts with their banks, have been counseled by their investment advisors to diversify geographically. Also, the past few years have seen

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61. The fourteen different trusts offer investors an opportunity to choose among SIMS (a Swiss real estate fund), FONSA (a Swiss industrial shares fund), AMCA (a trust for investment in North American-United States and Canada shares), EURIT (for European shares), ITAC (for Italian shares), FRANCIT (for French shares), ESPAC (for Spanish shares), GERMAC (for German shares), SAFIT (for South African shares), and GLOBINTRUST (for worldwide investments), in addition to funds for bonds, specific industries and other specialized categories. Materials published by Intraga Ltd. (undated, but containing data through Aug. 1970) (available at offices of Union Bank of Switzerland).

62. Controls have been instituted by the governments of West Germany, France, Italy, and many South American countries. Klopstock, supra note 42, at 173.

63. Union Bank of Switzerland, Swiss Bank Corporation, and Swiss Credit Bank all manage extensive portfolios of foreign shares for an international clientele. Feirstein, supra note 39, at 24. It may be surmised that the Swiss secrecy in banking assists in attracting this clientele.

64. This information was obtained by me in conversations with several overseas bankers. No specific data is available because the information is carefully guarded. A typical provision in a brochure, describing some of the services of the Foreign Commerce Bank in Zürich, states:
the growth of a retail demand on the part of the small overseas investor for foreign securities. That investor now appears to be willing to buy directly and does so through his bank or, where permitted by local regulations or local banks, through one of the approximately 250 American brokerage offices currently operating abroad.\textsuperscript{66} Finally, institutional investors, e.g., pension funds of international companies, have also become aware of the need for geographical diversity and have looked to the United States as well as other areas.\textsuperscript{66} The United States Government is not unmindful of the significance of foreign investments in this country. The SEC has acknowledged that the capital inflow of such funds has aided the U.S. balance of payments and stimulated new sources of equity capital in the countries in which they are sold.\textsuperscript{67} Moreover, the Institutional Investor Study Report of 1971 indicates that in the two years between 1967 and 1969 "[t]he reported value of offshore fund holdings of U.S. equities held by U.S. custodians alone increased from about $896 million . . . to $2.35 billion . . . ."\textsuperscript{68} That study also indicates awareness of a growing concern overseas over unregulated offshore mutual funds. It suggests that some means should be devised to enable foreign persons to invest in those SEC regulated mutual funds which deal in United States securities. It also urges the retention of tax advantages granted by the Foreign Investors Tax Act of 1966;\textsuperscript{69} the exemption of certain funds from the interest equalization tax;\textsuperscript{70} and that anonymity be provided for the foreign investor with bearer shares.

\textbf{UNITED STATES LAWS AND POLICY}

The overseas capital market, as a source of financing, poses new and different problems for United States companies. In competing for the investment dollar of a non-United States citizen or resident, one...
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must consider various factors. Of principal importance is the economic impact and application of United States taxation on that investor. Equally significant are the United States laws involved in trans-national money and security transactions. Next, if a foreign subsidiary or affiliate of the United States company is used, one must be intimately concerned with the laws of the site of the money raising business entity, as well as the possible use of a form other than a corporation. Finally, the laws of the investor's country must be analyzed along with the interplay of bilateral tax treaties.

If a proposed offering is to be competitive with other investment opportunities available to foreign investors, strong consideration must be given to United States withholding tax requirements and estate taxation. For example, the proposed offering of a nine per cent debenture may be noncompetitive if the interest is subject to United States withholding tax of thirty per cent so as to reduce the net return to the overseas investor to 6.3 per cent, and if the debenture is also subject to United States estate taxes.

Generally speaking, offshore investors are taxed by the United States on both interest income and dividend income from United States source. That tax is ordinarily imposed at a flat thirty per cent rate, without allowance of deductions of any kind. The tax must be withheld by the payor at the source. Thus, if the economic effects of the

71. INT. REV. CODE of 1954, §§ 871, 881. These sections generally impose a tax on “the amount received from sources within the United States.” Sections 861 to 864 provide the rules for determining whether or not income “shall be treated” as income from sources within the United States. For example, gain on the sale of real property located in the United States is treated as income from sources within the United States, id. § 861(a)(5), whereas compensation for personal services performed outside the United States is treated as income from sources outside the United States, id. § 862(a)(3). Income from goods produced within and sold outside the United States is to be allocated, id. § 863(b)(2).

72. This rate is imposed if the income “is not effectively connected with the conduct of a trade or business within the United States.” INT. REV. CODE of 1954, §§ 871, 881. The definition of “effectively connected with the conduct of a trade or business within the United States” is contained in § 864. In determining whether or not income from sources within the United States is so connected, factors to be considered include the use of assets by the taxpayer in the conduct of the business to derive the income, and the activities of the business in the realization of the income.

Income of nonresidents engaged in a trade or business within the United States, which income is effectively connected with their conduct of a trade or business within the United States, is taxed in accordance with §§ 871(b) and 882 at graduated rates. Nonresidents generally are taxed on income not effectively connected with the conduct of a trade or business within the United States only if, in addition to being derived from United States sources, the income satisfies the tests of §§ 871(a) or 881(a) (primarily called “fixed, or determinable” income, such as interest, rents, and dividends); if a tax is imposed, the rate is a flat thirty per cent rate without deductions.

73. INT. REV. CODE of 1954, §§ 873, 882(c).

74. That is, the person making the interest or dividend payment must deduct and
United States tax are to be avoided, the income must either be structured so that it is not deemed to come from a United States source or the tax must be reduced or exempted by some bilateral tax convention between the United States and the offshore investor’s country. Furthermore, capital gains from United States sources are generally taxed by the United States only if an individual nonresident alien is present in the United States for 183 days or more during the taxable year. Capital gains by a foreign corporation are generally not taxed by the United States even if they arise from United States sources.

United States estate tax laws provide for a tax with respect to nonresident aliens on gross taxable estates in excess of 30,000 dollars and do not permit any marital deduction. However, debt or equity securities issued by a foreign corporation (even if a wholly owned subsidiary of a United States entity) do not constitute property situated in the United States and are not includable in a nonresident alien’s gross taxable estate. On the other hand, shares of stock in a United States corporation constitute property located within the United States and will be included

withhold the 30 per cent tax from the payment due the nonresident and remit the 30 per cent tax thus withheld directly to the United States government. Int. Rev. Code of 1954, §§ 1441, 1442.

75. The United States has tax conventions with more than twenty foreign countries which either reduce or eliminate the United States withholding tax on payment of certain types of dividends or interest to residents of the contracting foreign country. See notes 130-31 infra & text accompanying.


78. Id. § 881. Unless indicated to the contrary in the text, it is assumed that a foreign corporation is one, of which more than fifty per cent is owned by nonresident aliens, and which is not a foreign personal holding company or a controlled foreign corporation for United States tax purposes. A controlled foreign corporation is a foreign corporation of which more than fifty per cent of the total combined voting power of all classes of voting stock is owned or deemed to be owned by United States shareholders at any time during its taxable year. Id. § 957(a). A United States shareholder includes any United States person who owns or is considered to own ten per cent or more of the total voting power of the foreign company. Id. § 951 (b). A foreign personal holding company is generally a foreign corporation whose gross income (as defined in § 555(a)) for the taxable year consists of at least fifty per cent foreign personal holding company income (as defined in § 553) and whose outstanding stock at any time during the taxable year is more than fifty per cent in value owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States. Id. § 552.

79. Int. Rev. Code of 1954, § 2106. Because of the estate tax’s relatively minor effect, offshore investors are not highly concerned with estate tax liabilities. In addition, since many nonresident aliens make their investments in the United States through a wholly owned foreign corporation, they may purchase land, buildings, or securities of United States companies and other assets located within the United States without concern for United States (or state) estate taxes.

in the nonresident alien’s gross estate for estate tax purposes if owned by him at the time of his death. Debt securities of a United States corporation (or other business entity) owned by a nonresident alien at the time of his death also constitute property located within the United States and will be included in his gross estate for estate tax purposes unless the interest on the obligation is treated as foreign source income. State inheritance or income taxes usually pose no serious problem because these taxes generally are imposed only on residents of that state and then only with respect to property located within that state.

Besides income and estate taxes, one cannot overlook taxation on the purchase by United States persons of certain foreign securities (hereinafter called the “interest equalization tax” or IET) or United States “foreign direct investment regulations” (hereinafter called FDIR). Following the conclusion of World War II, in an effort to bolster the recovery of the European economy, the United States encouraged United States investors to make investments abroad by enacting Federal tax laws which gave United States businesses and investors an incentive to leave their offshore profits offshore. After 1962, however, the continuing deficit in the United States balance of payments made a series of adjustments necessary. The result was the following series of steps:

1962: Revenue Act—eliminating deferral of income tax on some offshore profits whether or not repatriated;

1963: Interest Equalization Tax Act—placing a tax on the purchase by United States persons of certain foreign securities and debt obligations;

81. Id. § 2104(a).
82. Id. § 2104(c). In order for the interest to be treated as foreign source income, more than 80 per cent of the debt issuer’s gross income from all sources must have been derived from non-United States sources during the appropriate time period. Id. § 861(a)(1).
83. See, e.g., FLA. STAT. ANN. §§ 198.02-198.04 (1971).
84. For example, by not taxing income from most foreign investments until they were repatriated to the United States, the government bestowed substantial benefits upon businessmen operating overseas. See generally W. Gibbons, TAX FACTORS IN BASING INTERNATIONAL BUSINESS ABROAD (1957).
85. We have experienced an over-all balance of payments deficit — on a liquidity basis — in 17 of the last 18 years, the only exception being 1957 when extraordinary factors produced a small surplus. BNA TAX MANAGEMENT PORTFOLIO No. 215, at A-2 n.5 (1969) (Remarks of Joseph W. Bartlett, Under Secretary of Commerce, Cleveland, Ohio, October 30, 1968) [hereinafter cited as PORTFOLIO].
1966: Foreign Investors Tax Act—designed to induce off-shore investors to invest in the United States;{88}

1968: Foreign Direct Investment Regulations—designed to restrict the amount of offshore investments by United States persons;{89} and

1970: Public Law 91-508—providing for reporting of all international money transactions of 5,000 dollars and more.{90}

The above actions were designed to slow the flow of money from the United States and increase the flow into this country. In part, it has been successful.{91} More significant, perhaps, has been the increasing desire of offshore investors to invest in the United States economy. With present United States fiscal policy favoring offshore investors investing in this country, United States companies seeking to raise capital overseas may find the current laws to be of some assistance in overcoming the high costs of raising capital at home.

The International Finance Subsidiary

The international finance subsidiary came into use as a device for enabling United States companies to invest abroad or to continue to finance their already existing overseas commitments, while at the


90. 84 Stat. 1114 (1970). Ostensibly, this law was designed to curb the illegal flow of money from the United States. Presumably, it was also intended to stop Americans from trading in United States stocks through foreign banks and thereby avoiding margin requirements and other restrictions. But, as drafted, the law can be interpreted to require every person or institution receiving or sending 5,000 dollars or more to file reports. Many foreign countries have exchange control restrictions, limitations on the amounts of money which can be taken out of the country, and repatriation requirements. If reports of all international transactions of 5,000 dollars or more are required, offshore investors may fear that such reports will be made available to their governments and that repercussions might follow at home. The reporting requirements, therefore, are likely to discourage offshore investments in the United States. At the least, the controls will raise the costs of the investments as offshore investors devise techniques to avoid the necessity for filing such reports.

Furthermore, Public Law 91-508 may be the harbinger of United States Foreign Exchange Controls. In many countries laws similar to Public Law 91-508 have represented the first step toward complete governmental control over all monetary assets of the individual, repatriation of foreign situs assets, maintenance of artificial official exchange rates, a new monetary system or currency, and government monopoly of all foreign exchange transactions.

same time complying with the new United States laws and regulations and
not contributing to the United States balance of payments deficit. At
times a domestic international finance subsidiary (DIFS) of a United
States parent company (Parent) was used and sometimes a foreign
international finance subsidiary (FIFS) was employed.

The DIFS formula was not too complex. Usually a wholly owned
United States subsidiary (the new DIFS) of the Parent was formed in
Delaware. The purpose of the DIFS was to make a public offering
of debt obligations to offshore investors. The debentures usually would
be guaranteed as to both principal and interest by the Parent; mature in
five to twenty years; be in denominations of 1,000 United States dol-

\[92. \text{Delaware was usually used because its corporations law permits maximum}
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\[93. \text{As interest rates increased in 1968 and 1969 and fear of a United States}
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devaluation mounted, an increasing number of companies used a “convertible” or
“exchangeable” debt security. The debt obligation was “convertible” into an equity
security of the Parent at a specified later date at a set price. If convertible, the
25, 1968), must not be exchangeable less than six months from the date of original
issue.

\[94. \text{As the sophistication of issuers in this area grew, other currencies, such as}
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\[95. \text{For example, it might have been provided that a change in the tax laws or tax}
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treaties of the United States requiring the obligor to pay additional interest in ac-

\[96. \text{INT. REV. CODE of 1954, §§ 861-64.}
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\[97. \text{Id. § 861(a)(1)(B)}
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\[98. \text{Id. §§ 861(a)(1), 862(a).}
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holding tax will be due on interest payments made to offshore investors and that the issue has no Interest Equalization Tax (IET) exemption so that any United States purchaser must pay the IET. Secondly, the SEC should be requested to issue a no-action letter, which it will usually do, provided the IRS has previously stated there is no IET exemption. Finally, the Office of Foreign Direct Investments should be asked for a ruling which will permit fulfillment of the Parent's guarantee, if necessary, without FDIR violation.

From a DIFS it was a short step to an FIFS. A DIFS could not lend the proceeds of its public offering to the Parent because the interest received by the DIFS from the Parent would be United States source income and consequently would subject the interest paid by the DIFS to its debenture holders to the United States withholding tax. That thirty per cent withholding tax would probably make the proposed offering uncompetitive. However, if a FIFS were formed in a foreign jurisdiction so that the IET and favorable tax treaty benefits would be applicable, the problems of loaning the proceeds to the Parent could be avoided. There would be no United States withholding tax on payment of interest by the Parent to the FIFS, or the tax would be at a

100. See SEC Securities Act Release No. 4708 (July 9, 1964). The IET presumably would discourage any United States investor from purchasing the security. See note 57 supra. The IET rate is fixed by Executive Order, and is currently 11.25 per cent for stock. The rate for debt securities depends upon the time remaining until maturity, but the maximum is 11.25 per cent. Exec. Order No. 11464, 34 Fed. Reg. 6233 (1969).

A FIFS is a foreign issuer and the IET will apply to its securities. Int. Rev. Code of 1954, § 4920(a)(3). A DIFS will be deemed to be a foreign issuer if the funds raised by the issuance of its securities are used to finance overseas operations of the Parent or the DIFS. Id. § 4912(b)(3).

101. The OFDI will accept requests for rulings or interpretative opinions. 15 C.F.R. §§ 1040.211-1040.222 (1971). The FDIR prohibits the direct or indirect transfer of capital to points outside the United States unless such transfer is specifically authorized by the Secretary of Commerce or his delegate. Capital transfers amounting to less than two million dollars per year are generally authorized by the Regulations. The permitted authorization is higher if the transfer is made to a less developed country.


103. For example, by virtue of the United States tax convention with the Netherlands, tax on interest paid to a Netherlands company will not be withheld at the source, provided that the Netherlands company's permanent establishment is not in the United States, and that the property giving rise to the income is effectively connected with such permanent establishment. Treaty with Netherlands on the Avoidance of Double Taxation, Dec. 30, 1965, [1966] 17 U.S.T. 896, T.I.A.S. No. 6051. If the income is not effectively connected with the conduct of a trade or business in the United States by the Netherlands company, the company will be considered not to have a permanent establishment in the United States. Int. Rev. Code of 1954, § 894(b).
reduced rate by virtue of an applicable tax treaty provision.\textsuperscript{104}

We have mentioned the need for a no-action letter from the SEC. In theory, a public offering of a United States corporation's securities would be subject to the registration requirements of the Securities Act of 1933 unless some exemption were available. To implement a recommendation contained in the "Fowler Report,"\textsuperscript{105} the SEC issued the following statement:

\ldots the Commission has traditionally taken the position that the registration requirements of Section 5 of the Act are primarily intended to protect American investors. Accordingly, the Commission has not taken any action for failure to register securities of United States corporations distributed abroad to foreign nationals, even though use of jurisdictional means may be involved in the offering. It is assumed \ldots that the distribution is to be effected in a manner which will result in the securities coming to rest abroad.\textsuperscript{106}

For the protection of investors, a no-action letter is usually requested and will generally be issued without problem providing that the IRS has ruled that the IET would apply to United States purchasers of the security and the underwriters represent that the securities will not be sold to United States persons.\textsuperscript{107}

In choosing a foreign jurisdiction in which to incorporate the FIFS, we must be concerned with several factors. Of primary importance are the withholding or other taxes imposed by the jurisdiction on the debenture holders, as well as the income taxes on the FIFS and other costs of operating the FIFS in the given jurisdiction. Equally significant for

\footnotesize
\textsuperscript{104} See id.
\textsuperscript{107} See note 100 supra & text accompanying. Requests for no-action letters are regularly made in connection with Eurodollar offerings, and obtaining such a letter for international finance subsidiary offerings normally presents no problems. To satisfy itself that the requirements of SEC Securities Act Release No. 4708 (July 9, 1964) are met, the SEC often relies on the application of the IET to purchases of the security by United States citizens, and the lead underwriters' assurance that the debentures will not be sold to United States persons. \textit{Portfolio}, supra note 85, at A-58.

The IET does not apply to direct investors. \textit{Int. Rev. Code} of 1954, § 4915(a)(1). A direct investor is one who, immediately after his purchase, owns ten per cent of the total combined voting power of all classes of stock of the foreign corporation. \textit{Id}. Therefore, the IET is inapplicable to the acquisition by the Parent of all of the FIFS's voting shares.
our consideration is tax treaty relief, if any, between the given jurisdiction and the United States and also estate or inheritance taxes imposed by that jurisdiction. Other general factors entering into the choice of a jurisdiction include: political stability, economic stability, ease of exchange controls, modern corporate laws, and good transportation, communication, and banking facilities.

A current favorite jurisdiction is the Netherlands Antilles. It meets all of the general factors stated in the preceding paragraph. It does not impose any inheritance tax on the issue of a resident company except on those persons domiciled in the Netherlands Antilles at the time of their death; it has reasonable charges and fees for incorporation, payment of capital stock tax, and annual maintenance; and it imposes no withholding tax on payments of interest to nonresidents with respect to a debenture issued by a Netherlands Antilles company. Moreover, the relevant tax treaty provides that interest paid by a Netherlands Antilles subsidiary of a United States company is exempt from United States tax as long as the recipient is not a United States citizen, resident or corporation. Thus, under the treaty there will be no United States withholding tax on payments of interest by the Netherlands Antilles subsidiary regardless of whether such interest is United States source income. The tax treaty also states that certain types of interest paid by a United States Parent to a Netherlands Antilles subsidiary will be exempt from United States tax provided the interest income is not effectively connected with a United States permanent establishment. Thus, there may be no United States withholding tax on interest payments by a Parent to the FIFS, or on interest payments by the FIFS to its offshore debenture holders.

The Netherlands Antilles imposes a minimum 24 per cent cor-

108. Other jurisdictions in which factors favoring incorporation exist include the Netherlands and Luxembourg.
109. See PORTFOLIO, supra note 85, at A-61.
110. Approximately 2,000 dollars should be adequate to pay for the costs of incorporation of a company with a nominal authorized capital.
111. PORTFOLIO, supra note 85, at A-61.
112. Id. at A-60.
114. Id. If the income is not effectively connected with a United States trade or business engaged in by the recipient of the interest, he is considered not to have a permanent establishment in the United States. INT. REV. CODE of 1954, § 894(b). For a discussion of "income effectively connected with a trade or business in the United States," see notes 71 and 72 supra.
porate income tax, but that tax should be nominal because it is imposed on the net income of the FIFS, not the gross. The Netherlands Antilles government requires a one per cent spread between the rate of interest paid by the FIFS and the interest received from the Parent. Thus, in a one million dollar offering, the spread would be 10,000 dollars and the tax might be 2,400 dollars. This amount would probably be reduced after maintenance and business expenses in operating the FIFS were deducted from the 10,000 dollars “profit.”

While the FIFS has thus far been used primarily by major companies seeking multi-millions of dollars, there seems to be no reason why a smaller company seeking one to five million dollars could not use the same structure successfully. The model requires the Parent to form an FIFS with an equity investment equal to twenty per cent of the proposed offering. The Parent must file the required information returns, forms, and elections, and rulings from the OFDI, IRS, and SEC should be obtained where appropriate. The total dollar costs involved, including printing of the offering circular, legal fees, organization of the FIFS, accounting fees and miscellaneous expenses, should be approximately one-half of the minimum expenses set forth earlier in this article as the estimated costs of a first public offering registered in the United States. The other costs avoided with the use of a FIFS (compared to a United States registration) are many. There are usually: no statutory or administrative “merit” tests; no state “Blue Sky” registrations; no federal registration under any of the Securities Laws; no limitations on promotion or sales costs; no restrictive debt limitations; no sinking fund requirements; no long and detailed disclosure requirements resulting in a blunting of offering circulars as a sales tool; no statutory requirements for audited financial statements; and no civil or criminal penalties for violations of the United States securities laws. Finally, from start to finish, a complete package can be assembled in as little as three months’ time.

Besides the FIFS, recent congressional changes in the Internal Revenue Code have created still another option for offshore financing. In

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116. *Id*.
117. One per cent is the current spread required by the Netherlands Antilles for the privilege of incorporating therein. *Portfolio*, supra note 85, at A-61. The spread is supposedly subject to negotiation, but at the present time is fairly standard. Members of the author’s law office have participated in such negotiations.
118. While this list of avoided costs is technically accurate, it may be necessary, because of regulations of the country of sale or of requirements of the foreign underwriter, that some of these costs be incurred.
April of 1971, Congress passed the Interest Equalization Extension Act of 1971, extending the IET until March 31, 1973, and added §§ 4912(c) and 861(a)(1)(G) to the Internal Revenue Code. These changes were designed to permit a United States company to publicly sell Eurodollar debt obligations and to use the proceeds of the sale in this country without subjecting payments made on such obligations to the United States income withholding tax. Section 4912(c) provides that a domestic corporation, or partnership, may elect to have certain of its debt obligations treated as debt obligations of a foreign entity, while § 861(a)(1)(G) states that interest paid on debt obligations covered by § 4912(c) will not be considered United States source income and therefore is not subject to withholding tax. Intended to eliminate the need for a FIFS, these new sections of the Code have limitations. First, they apply only to debt obligations (not equity securities), and then only to those obligations with a maturity of not more than fifteen years. Next, they require the purchase of the obligations by one or more underwriters with a view to distribution through resale. Offshore investors may be subject to United States taxes if they own these debt obligations at the time of their death.

Individual Unique Plans

If the entrepreneur is not interested in raising money via the debt route, the equity avenue should be explored, for perhaps the entrepreneur’s United States company can issue its own equity securities directly to offshore investors. The SEC has indicated that the Commission has not taken any action “for failure to register securities of [a] United States corporation” provided that “the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.” That

120. INT. REV. CODE of 1954, § 861(a)(1)(G).
121. Id.
122. The holders of DIFS debt obligations are not subject to United States estate taxes by virtue of § 2104(c)(2) of the Code. No similar exemption has been enacted to cover the class of debt obligations covered by §§ 4912(c) and 861(a)(1)(G).
123. SEC Securities Act Release No. 4708 (July 9, 1964). It is not entirely clear what “circumstances” will be acceptable to the SEC. In the case of an issuance of securities by a FIFS, or a DIFS organized to assist in the financing of overseas business operations, the IET is applicable. However, the IET will not be applicable to the proposed offering of equity securities, and thus the deterrent of the IET to a purchase by a United States person will not be present. See notes 100 & 107 supra.

No-action letters have usually been requested and obtained for overseas offerings of international finance subsidiaries. See PORTFOLIO, supra note 85, at A-58. There is little assurance that the staff of the SEC will issue such a letter in the case of a
is to say, if the offering is distributed to offshore investors under the circumstances just described, it will be immaterial if the United States issuer is engaged in interstate commerce in the United States, uses the mails of the United States to help effect his distribution, originates the offering from within the United States, or uses domestic or foreign broker-dealers to assist in the distribution. Further, there will be no “integration” of a “private placement” in the United States under § 4(2) of the Securities Act of 1933 even if made simultaneously with the offshore offering.124

In addition, the IET will not apply because the securities being issued are those of a domestic corporation. There will be no FDIR application because no money is being transferred overseas nor is there any guarantee of the Parent effective as to offshore investors. The last consideration for a direct equity offering overseas is the tax consequence to the offshore investor. As discussed earlier, there will be almost no United States capital gains tax problem,125 and that is where the potential profit lies for a small or young company. There will be a United States estate tax126 but this will not be likely to deter many offshore investors.127 Finally, there is the United States withholding tax128 which, without treaty exemption, is a flat thirty per cent.129 In the beginning of a corporation’s existence, there will probably be no cash dividends as it is likely that all profits will be reinvested. Thus, it is unlikely that there will be a tax problem at that point. Eventually, however, dividends may be available and therefore it is useful to search the United States tax conventions to find countries whose citizens can get relief from that thirty

direct offering of securities of a United States company not meeting the requirements regarding IET application. In such a case, the issuer should take precautions to avoid a violation of United States securities laws. These might include: a representation by the lead underwriter that the securities will be offered for sale outside the United States and only to offshore investors (non-United States nationals); appropriate language on the cover of the offering circular; a restrictive legend on the certificates prohibiting transfer to, or ownership by, United States persons; and the placement of a “stop transfer” order with the transfer agent. Investment letters stating the country of residence of the investor may be undesirable in terms of marketing requirements, but might be helpful from a United States securities law standpoint. The use of bearer shares may complicate the entire problem.

125. Capital gains of foreign corporations generally are not taxed by the United States, even if derived from United States sources. Int. Rev. Code of 1954, § 881. Capital gains of individual nonresident aliens from United States sources are taxed by the United States only if the individual nonresident alien is present in the United States for 183 days or more during the taxable year. Id. § 871(a) (2).
127. See note 79 supra.
129. Id. §§ 871(a) (1), 881(a).
per cent tax by virtue of a bilateral tax treaty. For example, by way of bilateral tax treaties, dividends paid by a United States corporation to a Swiss resident or Netherlands corporation are taxed by the United States at only 15 per cent.\(^\text{130}\) There are at least 18 other countries which are party to tax treaties with the United States.\(^\text{131}\) These treaty provisions may reduce the United States withholding tax on dividends to between five and fifteen per cent.

Another modification of this model is the formation of an offshore company which sells combination units of equity securities and debentures in the offshore company, with the proceeds realized from the sale used in part to buy equity securities in the United States corporation, and in part as a loan to the United States corporation. Or, one might form an offshore company which sells its own equity securities.

In certain cases, even the choice of the United States entity may vary. For example, if a United States entrepreneur wishes to buy a shopping center or apartment complex, he may want to save the United States tax depreciation for himself.\(^\text{132}\) Thus, it may be desirable that he purchase improved real estate in his individual name, or perhaps in the name of a general or limited partnership. A first mortgage secured by the real estate might be placed with a United States mortgagee. Next, an offshore corporation might be formed in a jurisdiction with a favorable United States tax treaty, to issue financing units to be secured by a second mortgage on the property. With proper structuring, the entrepreneur might secure a large percentage of financing together with high interest and depreciation deductions to shelter his (or the partnership's) ordinary income. There are many possible variations on the above theme. The needs of the entrepreneur, his desires, and his long and short range plans should enter into the choice of structure, type of security, situs of offshore jurisdiction, and situs of sales.

**Offshore Underwriting**

Having decided to seek financing offshore, the problem arises as to who will sell the product. For the United States entrepreneur seeking offshore financing, the answer in Europe, as in this country, is to deal

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131. These countries are Australia, Austria, Belgium, Canada, Denmark, Finland, Federal Republic of Germany, France, Ireland, Italy, Japan, Luxembourg, Netherlands Antilles, New Zealand, Norway, Pakistan, Sweden, and the United Kingdom. There are various types of restrictions on the use of the rate reduction, and each treaty must be examined to determine its particular restrictions.

with a reputable underwriter. Unlike the situation in the United States, however, in Europe most investment bankers and underwriters are banks. These banks can, and almost invariably do, perform most or all of the following functions: (1) assisting in the establishment of holding companies for which the bank subsequently becomes the site of domicile and depositary; (2) acting as manager, underwriter, and seller of internationally syndicated Euro-currency issues, and subsequently becoming after-market dealers; (3) performing as managers of mutual funds, and also as custodian, registrar and transfer agent for independently owned funds; (4) by virtue of membership on the local stock exchange (such as the Luxembourg, Amsterdam, or Zürich Exchanges) acting as dealers in securities, including locally listed securities of that country as well as locally listed securities of trans-national companies; and (5) acting as investment advisors and managers of discretionary investment accounts.

More than ever before, European banks are engaging in the securities business in a major way. It is not uncommon for more than sixty European banks in ten different countries to participate in an underwriting. In some countries, the only major underwriters are banks, and in most countries banks dominate the underwriters list. In most European countries, the banks act as brokers, are represented on the local stock exchanges, are investment bankers and are underwriters. They are active in stock exchange trading, over the counter market transactions, and private placements. It is common today to walk into European banks and find on the counters and on convenient tables, copies of offering circulars of specific issues, lists of securities in which the bank maintains a market, or pamphlets containing current recommendations of the bank. European banks today are no longer content to stand by and watch investment dollars from their country pass through the hands of foreign promoters. In their capacity as investment advisors, underwriters, and broker-dealers, they are becoming more active in the original issue and after-market trading of offshore securities.

The United States entrepreneur seeking their assistance in an offshore offering comes to them as an ally and source of business, not as a competitor. The United States entrepreneur does not want a sales commission, nor does he want management fees, or trading fees (all of

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135. In March of 1971, while on a business trip to Luxembourg, Amsterdam, and Zürich, I found such materials available in the following banks: Kredietbank S.A. Luxembourgeoise in Luxembourg; Algemene Bank Nederland N.V. in Amsterdam; and Handelsbank in Zürich.
which are commanded by the offshore mutual funds). All the entrepreneur wants is the sale of his securities and an opportunity to use the proceeds to develop the business entity for himself and his fellow shareholders.

A unique problem faced by an entrepreneur in interesting a European bank or underwriter to undertake a lead position in the offering of the proposed United States securities is the hidden "cost" of investigating the proposed offering prior to issue and thereafter following the issuer's progress. This cost accrues because of the geographical distance between underwriters and issuer. That "distance," however, has lost its meaning in a world where economic integration is powerfully supported by the technological compression of the globe and the "one world" concept is fast becoming a reality. Indeed, since United States restrictions on underwriting compensation do not apply, it may be easier to interest a European bank in underwriting an issue than a United States underwriter. The foreign underwriter is readily available, with representatives of banks from almost every country in the free world being situated in the United States today. In addition, underwriters in Europe generally agree to take all shares before attempting to sell them elsewhere, thereby guaranteeing the success of the issue. They are well paid for it, and new issue underwriting is much sought after:

It is a "placement market," in which no effort is made to sell the bonds (or securities) to the public in the first instance: the professionals take them up, then feed them out to buyers.

Admittedly, in most new issues of a small or young company, the risk to the foreign investor will usually be greater than those contained in the offering of a seasoned company. Similarly, the reputation of the European bank as a wise investment advisor will be at stake. However, if the potential rewards to the investor, and underwriter, are commensurate with the risks, and all parties are aware of the circumstances, European banks will not deny their clients the opportunity to make such investments. High risk or speculative new issues will not generally be placed in a conservatively oriented discretionary account, but in

136. See Renk, supra note 1.
137. Banks with offices or agencies in New York City include Credit Lyonnais, Credit Suisse, Creditanstalt Bankverein, Credito Italiano, Freditbank N.V., Kreditbank S.A., Union Bank of Switzerland, Swiss Bank Corp., Banque de Bruxelles, Banque Nationale de Paris, Bank of West Africa Ltd., Swiss Israel Trade Bank, Bank Leumi Le-Israel, Bank Mees and Hope N.V., Bank Negara Indonesia, Banco di Napoli, Bank of Tokyo Ltd., Bank of Nova Scotia, Bank of Montreal, and IDP Bankholding Corporation Limited.
Europe as in this country, there is a wide spectrum of investors with varying investment objectives.

**CONCLUSION**

In this article I have attempted to demonstrate two major needs: (1) a need for foreign investors to secure additional safety in geographical diversification of their portfolios, and (2) a need for some United States entrepreneurs to be able to promote a new venture while avoiding some of the high regulatory costs prevailing in the United States.

In my view, there exists a means to satisfy these needs. Structures are made possible by United States tax incentives and tax treaties. A sales outlet is provided by the desire of foreign banks to satisfy the demands of their customers. It is not suggested that the proposed solutions are a cure-all. European bankers and investors are as sophisticated and intelligent as their counterparts in this country. However, the offshore investor admits a need to diversify which is not yet readily apparent in this country. While not all offerings of securities will be accepted offshore, it is submitted that a workable concept has been advanced that may, in the future, result in as large a capital market offshore as presently exists in the United States for its entrepreneurs.

It is clear that the internationalization of the free world securities markets has just begun.\(^{139}\) Since the close of World War II, we have seen the formation of the European common market for trading, the Benelux countries' relaxation of border and trade controls, the conversion of the United Kingdom to a decimal system of currency, and the steady drive of the European economic community of nations toward full economic and monetary union.\(^{140}\) With tomorrow's possible computer capabilities, it is easy to envision a worldwide securities market stretching from Melbourne to New York to London to Caracas.

\(^{139}\) At the first meeting of the World Congress on Stock Exchanges, W. J. Casey, Chairman of the SEC, stated that domestic securities markets throughout the world are becoming international public markets, and that investors no longer view geographic or political boundaries as barriers. He pointed out that in today's world of multi-national business enterprises, such restraints have become outmoded and unrealistic. BNA Sec. Reg. L. Rep., Mar. 22, 1972, at A-11.

\(^{140}\) See Barron's, Mar. 15, 1971, at 10, col. 1.