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## The U.S. Finalizes Outbound Investment Restrictions on Technology Development

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**Precedent-Setting Investment Restrictions** – On January 2, 2025, the U.S. will start restricting foreign investments by U.S. persons in certain national security technologies. The Outbound Investment Rule and associated regulations prohibit or require notification by U.S. persons of foreign investments involving the development of three broad categories of technology by a covered foreign person from a “country of concern.” Currently a country of concern consists of China, Hong Kong, and Macao, and a covered foreign person is an individual or entity based in a country of concern. At present, the covered technologies consist of: 1) Semiconductors and microelectronics, 2) Quantum computing, and 3) AI Development.

Determining whether a foreign investment transaction is prohibited or subject to a mandatory U.S. government filing is the most perplexing aspect of the new regulations. While the Outbound Investment Rule prohibits U.S. persons from participating in transactions that meet specific transaction and technology parameters, not all investments in the above-mentioned three technology categories are prohibited. Transactions covered by any of the three technology categories below specified levels are now subject to a notification filing to the U.S. Department of the Treasury, which can be done prior to, or post-closing of the investment.

**Worldwide Chilling Effect of the Outbound Investment Rule** - The Outbound Investment Rule restricts the worldwide activities of U.S. persons. For most U.S. regulatory purposes, the definition of a U.S. person includes U.S. citizens, lawful permanent residents, and business entities organized under U.S. laws. However, for purposes of the Outbound Investment Rule, it includes any foreign branch or controlled foreign entity of a U.S. person, meaning any entity in which a U.S. person has a majority voting interest, or acts as a general partner or managing member. In so doing, the Outbound Investment Rule prohibits and prevents investments by foreign controlled entities to the same degree that its U.S. person owner would be restricted. Given the hundreds of U.S. person-controlled companies worldwide that have already invested or may invest in the further development of covered technologies with Chinese partners, the Outbound Investment Rule could have an immediate chilling effect on U.S. person investment in any covered technology enterprise worldwide where a foreign person from China participates.

In addition, obligations apply as soon as a U.S. person has “knowledge” of a covered transaction, which can be satisfied by actual knowledge, an awareness of a high probability of circumstances, or reason to know of a circumstance’s existence. This knowledge standard is important, since penalties for failure to act in respect of a transaction that is prohibited or subject to a mandatory filing can be affected by whether the U.S. person conducted “a reasonable and diligent inquiry” prior to completing the transaction, as discussed by Treasury’s Office of Investment Security.



**What are the Covered Technologies?** - Development of a covered technology includes pre-production design, substantive modification, or governmental end use, but may omit the customizing of a third party-developed technology system for internal use. As described in the Outbound Investment Rule, covered technologies include:

- Semiconductors and microelectronics, including; electronic design automation software for integrated circuits or advanced packaging, semiconductor fabrication equipment, UV lithography equipment fabrication and advanced packaging tools, equipment for manufacturing various advanced semiconductor chips and associated integrated circuits;
- Quantum computing devices, including: quantum sensing platforms, quantum networks and communications systems, security systems and encryption, and any military, intelligence or surveillance end uses; and
- AI Systems, including: AI systems designed for military, intelligence, or surveillance purposes, and AI systems with computing power  $10^{25}$  computational operations (integer or floating-point operations) or  $10^{24}$  computational operations (using biological sequence data).

**What Transactions are Prohibited?** – Above certain technical thresholds, prohibited transactions” cover U.S. person investments in transactions involving the three technology categories. Representative examples include:

- Acquisition of an equity interest or contingent interest;
- Debt financings affording certain rights to the lender;
- Greenfield and brownfield investments or other corporate expansions;
- Joint ventures with parties based in a country of concern; and
- Certain limited partner investments.

**Notifiable Transactions** – The boundaries of these transactions in covered technologies that are below the level of prohibited transactions but which require a notice filing are somewhat ill defined. However, until further guidance from Treasury, U.S. persons should consider a notice filing to the U.S. Department of the Treasury in the following circumstances, either prior to or within 30 days after a notifiable transaction is completed:

- As to semiconductor and microelectronics, when investing in any business venture involving a covered foreign person involved in the design, fabrication, or packaging of semiconductor and integrated circuit products not subject to prohibition under the Outbound Investment Rule;
- As to quantum computing, there are only prohibited transactions and no current notifiable activities; and
- As to AI development, when a covered transaction includes a covered foreign person involved in the development of non-prohibited AI systems, including systems designed for military applications, government intelligence or mass-surveillance end uses, cyber security, digital forensics, or penetration testing, as well as for AI systems with computational operations more than  $10^{23}$  but less than  $10^{25}$ .



**Excepted Transactions** – Consistent with the saying that most rules have exceptions, the Outbound Investment Rule is no different and allows several categories of excepted transactions, although many are subject to conditions. For example, many exceptions involve a U.S. person's investment in a publicly traded security or pooled fund, the buyout of interests of a covered foreign person in a country of concern such that the entity is no longer a covered foreign person, an intracompany transaction to support existing operations, or the acquisition of a voting interest in a covered foreign person per a condition of a syndicated loan where the U.S. person participated passively. There is also a national interest exception that can be granted under the discretionary authority of the U.S. Department of the Treasury. Since most exceptions are narrow in scope and are triggered by specific conditions, great care should be taken to determine if an exception applies.

**Penalties** - The Outbound Investment Rule imposes significant due diligence and compliance burdens on U.S. persons to determine if an investment in a covered technology involves a covered foreign person from a country of concern. Contrary to the CFIUS review process for incoming foreign investment, the Outbound Investment Rule provides no pre-clearance process and only provides an enforcement mechanism. Consequently, investors must either refrain from covered transactions or file notices when proceeding with permitted transactions under threat of civil penalties, or in the case of willful violations, criminal penalties. Enforcement could include the following:

- Civil penalty of twice the value of the transaction, or US\$360,000, whichever is greater;
- Civil penalty of nullification of a transaction and divestment;
- Criminal penalty of up to US\$1 million per violation;
- Criminal penalty of imprisonment up to 20 years;
- Potential liability for non-U.S. persons, as well as U.S. persons.

**What U.S. Persons Should Do To Mitigate Foreign Investment Risk** – Whether individuals or business entities, U.S. persons should implement a compliance policy and procedure to identify outbound investment risk any transactions involving covered technologies. Such a compliance program might include the following:

- Conduct thorough due diligence to determine if a prospective transaction involves a covered technology, the exact level of the covered technology, a foreign person from a country of concern, and the role played by that covered foreign person;
- Due diligence should include a Restricted Persons Screening to ensure that all transaction parties are not identified on any U.S. export control or sanctions lists;
- If covered foreign persons and covered technologies are involved, determine if the transaction is prohibited or subject to a notice filing;
- If covered foreign persons and covered technologies are involved, determine if an Outbound Investment Rule exception applies;
- Create and maintain comprehensive documentation that records your due diligence process and the reasons for actions or inactions;
- If a notice is filed, ensure all information is complete and accurate; and
- Be prepared to provide Outbound Investment Rule documentation to U.S. regulators and third parties in transactions where showing a track record of company regulatory compliance is necessary.



This article relies on research and writing by Robina Henson, for which the author is grateful. For assistance in identifying and mitigating risk for transactions involving the Outbound Investment Rule, please contact Akana K. Ma, Shareholder in Buchalter's Portland Office and a Co-Chair of Buchalter's International Business and Trade practice group.



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