

# THE JOURNAL OF FEDERAL AGENCY ACTION

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# Treasury Department Finalizes U.S. Outbound Investment Rules

Nancy A. Fischer, Matthew R. Rabinowitz, Zachary C. Rozen, Samantha Franks, Erin Kwiatkowski, and Marcus J. Burden\*

*The U.S. Department of Treasury has issued the long-awaited final rule implementing its outbound investment review framework. The final rule formalizes a new governmental system to monitor through a notification process and, when necessary, restrict investments in China that may be viewed as a national security risk. The authors of this article discuss the Final Rule.*

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The United States Department of the Treasury has issued the long-awaited Final Rule<sup>1</sup> implementing its outbound investment review framework. This follows prior stages of rulemaking, including an Advance Notice of Proposed Rulemaking in August 2023 and a Notice of Proposed Rulemaking (NPRM) in June 2024, and formalizes a new governmental system to monitor and, when necessary, restrict investments in China that may be viewed as a national security risk.

The Final Rule became effective January 2, 2025. As expected, the Final Rule establishes a system in which (1) U.S. persons will be required to notify the Treasury Department of certain investments in identified sectors of countries of concern (currently China, Hong Kong, and Macau), and (2) certain investments in these same sectors that pose a particularly acute threat to national security will be prohibited.

The Final Rule is largely consistent with the proposed rule, though it contains several key elaborations and updates to the earlier version. Among these updates, the Final Rule narrows the scope of U.S. persons who may “knowingly direct” prohibited transactions, focusing on those with executive responsibilities like officers and directors, excluding senior advisors. Additionally, it establishes a comprehensive approach to the knowledge standard for U.S. persons involved in covered transactions.

## Prohibited and Notifiable Transactions

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The Final Rule establishes the following notification and prohibition requirements, which are largely in line with those outlined in the NPRM.

The Final Rule also prohibits transactions with any entity engaged in “covered activities” (even those only triggering a notification) if it is listed on specific national security and sanctions lists, including the Bureau of Industry and Security (BIS) Entity List and Military End User List, the Treasury Department’s Specially Designated Nationals (SDN) and Non-SDN Chinese Military Industrial Complex Companies Lists, and “Military Intelligence End-Users” as defined by BIS.

The Final Rule includes an exemption from both notification and prohibition requirements for certain transactions involving the development of artificial intelligence (AI) systems. According to Note 3 in sections 850.217 and 850.224 of the Final Rule, customizing, configuring, or fine-tuning a third-party AI model or machine-based system strictly for internal, non-commercial purposes will not trigger notification or prohibition requirements. This exemption applies as long as these activities are not intended for government intelligence, mass surveillance, military use, digital forensics, penetration testing, or robotic control systems. Treasury has not yet defined the exact boundaries of “internal, non-commercial use.”

## Definition of Covered Foreign Persons

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The Final Rule applies to transactions by a U.S. person with a “covered foreign person” from a “country of concern” involved in “covered activities.” The Final Rule defines a “covered foreign person” as an entity involved in one of three sets of circumstances:

1. *Engagement in “Covered Activities” in a “Country of Concern.”* A person or entity is classified as a “covered foreign person” if it is a “person of a country of concern” and engages in a “covered activity” (e.g., certain AI, supercomputer, quantum computing, and semiconductor activities).
2. *Financial or Governance Relationship with a Covered Entity.* A person or entity is considered a “covered foreign person” if:



- It directly or indirectly holds a board seat on, a non-excepted voting or equity interest in, or any contractual power to direct or cause the direction of the management or policies of a “covered foreign person”; and
  - More than 50 percent of the relevant person’s revenue, net income, capital expenditures, or operating expenses come from its relationship with the covered foreign person.
3. *Joint Ventures Involving Covered Foreign Persons.* If a person or entity from a country of concern participates in a joint venture with a U.S. person, and that venture is engaged in a covered activity, the foreign participant is classified as a covered foreign person.
- A “person of a country of concern” is:
- A citizen or permanent resident of a country of concern (excluding U.S. citizens and permanent residents);
  - An entity with a principal place of business in, headquartered in, incorporated in, or otherwise organized under the laws of a country of concern;
  - The government of a country of concern and its political subdivisions; or
  - An entity in which a “person of a country of concern,” individually or in the aggregate, directly or indirectly, holds at least 50 percent of the outstanding voting interest, voting power of the board, or equity interest.

## Covered Transactions

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The Final Rule defines “covered transactions” to include a U.S. person’s direct or indirect involvement in the following categories of transactions:

- *Equity and Contingent Equity Interests.* This includes direct acquisitions of equity in a covered foreign person, as well as convertible debt or other contingent interests that may eventually become equity.
- *Debt Financing with Equity-Like Characteristics.* Debt financing is covered if it grants the lender governance rights typical of equity investments, such as the right

to appoint board members or access profits, rather than standard loan terms.

- *Greenfield and Brownfield Investments.* Establishing new operations (greenfield) or expanding existing ones (brownfield) in a country of concern is covered if the U.S. person knows or plans that these activities will lead to engagement in a covered activity.
- *Joint Ventures.* Any joint venture between a U.S. person and a foreign person from a country of concern is covered if the venture engages in or is expected to engage in a covered activity.
- *Limited Partnership (LP) Investments.* U.S. persons investing as limited partners in non-U.S. pooled funds are covered if these funds invest in covered foreign persons and the U.S. person knows at the time of the investment that the fund will likely invest in a person of a country of concern in the semiconductor, microelectronics, quantum information technologies, or AI sectors.

However, some LP investments may be excepted from coverage if certain conditions, like investment caps or binding assurances, are met. LP investments are exempt from regulation, provided they meet one of the following criteria:

- *Size Threshold.* LP investments that are \$2 million or less are generally exempt.
- *Contractual Safeguards.* An investment above \$2 million can still be exempt if the LP receives a binding contractual commitment that its funds will not be used for prohibited or notifiable activities.
- *Standard Minority Rights Only.* LPs are exempt if they possess only standard minority investor protections without additional rights that influence management or investment decisions.

Treasury notes that this approach aims to support passive, low-risk LP investments by clarifying that only those investments with a potential for influence or financial scale that could impact national security are restricted. Treasury believes this balance allows for regulatory oversight of high-risk transactions while easing compliance for low-influence LPs in broader pooled funds.

## Knowingly Direct

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U.S. persons are prohibited from knowingly directing transactions by non-U.S. persons that the U.S. person knows at the time would be a prohibited transaction if engaged in by a U.S. person. A U.S. person knowingly directs a transaction when they (1) have authority to make or substantially participate in decisions on behalf of a non-U.S. person entity, and (2) exercise that authority to direct, order, decide on, or approve a transaction that would be a prohibited transaction if engaged in by a U.S. person. However, the Final Rule states that if a U.S. person recuses themselves from certain activities (e.g., formal approval, decision-making processes, reviewing or approving transactional documents, or engaging in negotiations) they will not be considered to have exercised their authority to direct, order, decide on, or approve a transaction.

## Knowledge Standard

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Importantly, the Final Rules holds that certain provisions, including the provision that defines covered transactions, will apply only if a U.S. person knows relevant facts or circumstances at the time of a transaction. Knowledge is defined as having actual knowledge that a fact or circumstance exists or is substantially certain to occur, an awareness of a high probability of a fact or circumstance's existence or future occurrence, or reason to know of a fact or circumstance's existence.

This means that U.S. persons must know, or having reason to know, at the time of a transaction that it involves a covered foreign person, will result or is planned to result in the establishment of a covered foreign person, or will result or is planned to result in a person of a country of concern's engagement in a covered activity. To meet this knowledge standard, U.S. persons are expected to perform a "reasonable and diligent inquiry" about the transaction that is commensurate with the risk of the transaction. This due diligence includes efforts to gather relevant information and seek contractual assurances. Treasury indicates in the Final Rule that it plans to provide further guidance on applying the knowledge standard.

If a U.S. person after the completion date of a transaction gains actual knowledge that the transaction would have been a covered

transaction at the time of the completion date, they must, within 30 calendar days, submit a notification to the Treasury under § 850.403. This retroactive knowledge requirement is limited to actual knowledge.

## Looking Forward

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The Final Rule establishes significant new parameters for U.S. investments in sensitive technologies within countries of concern, effective as of January 2, 2025. U.S. companies investing in semiconductors, supercomputing, quantum computing, and AI industries in China should be aware of the outbound investment requirements and restrictions in the Final Rule and establish diligent compliance practices.

## Notes

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