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New U.S. Outbound Investment Restrictions on High-Technology Sectors in China

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On August 9, 2023, President Biden issued a long-awaited [Executive Order](#) establishing the legal authority for the U.S. Department of Treasury ("Treasury Department") to institute an unprecedented regulatory regime restricting outbound U.S. investments in China. The Treasury Department issued an [advance notice of proposed rulemaking](#) ("ANPRM") on the same day.

The Executive Order is a novel use of presidential authority under the International Emergency Economic Powers Act (50 U.S.C. § 1701 et seq.) ("IEEPA") and the National Emergencies Act (50 U.S.C. § 1601 et seq.) ("NEA"), two laws heretofore used to issue economic sanctions regulations. This is also the most significant step the U.S. Government has taken to impose a U.S. outbound investment regime.

The Executive Order does not ban *all* U.S. investment in China. Instead, it targets investments into three limited sectors ([artificial intelligence](#), [semiconductors and microelectronics](#), and [quantum information technologies](#)).

The restrictions cover investments by U.S. persons (including U.S. entities and entities controlled by U.S. persons), into businesses headquartered or formed in China (including Hong Kong and Macau),¹ *as well as* investments into entities owned by such Chinese businesses or by Chinese citizens or permanent residents (who are not also U.S. citizens or permanent residents).

The Executive Order calls for two types of treatment for the different technologies: flat prohibition of investments into some technologies and products, and mandatory notifications for certain lower-sensitivity investments.

1. The [prohibitions](#) are expected to cover investments in (a) certain advanced semiconductor and microelectronics technologies, (b) certain quantum information technologies and products, and (c) certain artificial intelligence systems designed for military, government intelligence, or mass-surveillance end uses.
2. The [notification](#) requirements are expected to apply to investments in (a) certain other semiconductors and microelectronics technologies and products and (b) artificial intelligence systems for other specified end uses. It is not yet clear whether this will be a pre- or post-closing notification requirement, with the ANPRM calling for comments on this matter and the applicable time periods that would apply in each case.

The Treasury Department has proposed that the restricted investment targets be businesses that have 50% or more consolidated revenue, net income, capital expenditure, or operating expenses related to the covered products and technologies.

The types of investments covered by the proposed rule are generally the acquisition of equity interests, greenfield investments, joint ventures, and certain debt financing transactions that are convertible to equity.

The Treasury Department has proposed excepting certain investments from the program's coverage, including (1) certain U.S. investments into publicly-traded securities, index funds, mutual funds, and exchange-traded funds, (2) certain passive limited partner investments below a *de minimis* threshold, (3) committed but uncalled capital investments, and (4) intracompany transfers of funds from a U.S. parent company to its subsidiary.

The Treasury Department has stated that it does not anticipate retroactive application of the regime to before the regulations are implemented. However, it may request information regarding transactions that closed or were agreed to after August 9, 2023.

The Treasury Department is considering penalizing: (1) material misstatements in or material omissions from information submitted to the Treasury Department, (2) undertaking a prohibited transaction, or (3) failure to timely notify a transaction for which notification is required. Penalties could be civil penalties up to the maximum allowed under the IEEPA (\$356,579 or twice the amount of the transaction, whichever is greater).

The regulations will undergo the customary public notice and comment period.

There are open questions regarding how the program will be reconciled with proposed statutory outbound investment restrictions currently being considered in Congress in connection with proposed amendments to the pending National Defense Authorization Act.²

Conclusion

With the release of this Executive Order, the United States is continuing to erect barriers to the transfer of the most sensitive U.S.-origin technology to the People's Republic of China, now through a novel outbound investment restriction. Potential investors in these technology sectors in China or owned by Chinese persons would be well-advised to consider this new law in connection with potential new investments as well as investment strategies broadly.



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¹ The inclusion of Hong Kong in the Executive Order is consistent with the U.S. Government's revocation of Hong Kong's preferential trade status and assessment that Hong Kong is not "sufficiently autonomous to justify differential treatment in relation to the People's Republic of China," which was first promulgated in Executive Order 13936 in July 2020. Executive Order 13936 (Jul. 14, 2020); see also President Joseph R. Biden Jr., Message to the Congress on the Continuation of the National Emergency with Respect to Hong Kong (July 11, 2023), <https://hk.usconsulate.gov/n-2023071101/>. The U.S. Government has also increasingly identified Macau as a destination that may serve as a point of diversion into China. See 88 Fed. Reg. 2821, 2823 (Jan. 17, 2023).

² See Title VIII – Protection of Covered Sectors, S. 2226, 118th Cong. (as passed by Senate, July 27, 2023).

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