

# The SEC's New Intrastate Offering Exemption

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The Securities Act of 1933 (“Securities Act”) requires that all offerings of securities made through “any means or instruments of transportation in interstate commerce” or through the mail must be registered with the Securities and Exchange Commission (“SEC”),<sup>1</sup> unless exempt.<sup>2</sup> The intrastate offering exemption is commonly used in Texas and other populous states. Indeed, Texas has approximately 28.5 million residents, millions more than Australia, North Korea or Taiwan.

The federal intrastate exemption has certain advantages over interstate securities registration exemptions such as Regulation D. For example, Regulation D requires public filings on Form D through the SEC’s EDGAR system which announce the existence of the offering, the principals of the issuer, the amount offered, and, if a Form D amendment has been filed, how much has been raised.<sup>3</sup> Offerings using the federal intrastate offering exemption do not need to make public federal notice filings, thus increasing privacy for issuers who do not want to tell competitors about their financing.

Texas issuers engaging in intrastate offerings must comply with the securities registration provisions of or registration exemptions under the Texas Securities Act.

On April 20, 2017, the SEC’s new intrastate offering exemption, Rule 147A, will become effective.<sup>4</sup> The previous intrastate offering exemption, Rule 147, was not repealed, it was kept with some changes which also become effective April 20, 2017.<sup>5</sup> As a result, the SEC now has two intrastate offering exemptions. The new Rule 147A exemption does not require that the business entity acting as the securities issuer be formed in that state – it can be formed in any state. The new Rule 147A exemption also accommodates Internet-based offerings by looking at whether all the investors are in one state rather than whether the securities were offered in only one state.

Rules 147 and 147A also have multiple technical requirements. Further, Texas issuers must also comply with Texas Securities Act and its rules. Finally, federal and state securities laws require issuers to disclose all material information and not make misrepresentations to investors, regardless of how the offering was sold. So consult your securities attorney.

The following table summarizes the new and amended intrastate offering exemption rules as of April 20, 2017.

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<sup>1</sup> 15 U.S.C. §77f(a) and (c).

<sup>2</sup> See e.g. 15 U.S.C. §77d.

<sup>3</sup> 17 CFR §§230.501- 508.

<sup>4</sup> 81 FR 83494-83494 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016); 17 CFR §147A.

<sup>5</sup> 81 FR 83494-83494 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016); 17 CFR §230.147.

<b>SEC Intrastate Offering Exemptions Safe Harbor</b>	
<b>SEC Rule 147</b>	<b>SEC Rule 147A</b>
<p><b>(Legal Authority)</b> – Section 3(a)(11) of Securities Act of 1933.<sup>6</sup></p>	<p><b>(Legal Authority)</b> –Section 28 of Securities Act of 1933<sup>7</sup> – general exemptive authority.</p>
<p><b>(Required Element)</b> Offers and sales are made only to persons resident within the same state or territory in which the issuer is resident and doing business.<sup>8</sup> Alternatively, the issuer reasonably believes, at the time of the offer and sale, that the purchasers are residents of the state or territory in which the issuer is resident.<sup>9</sup></p> <p>A corporation, partnership, limited liability company, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of the offer and sale to it, it has its principal place of business within such state or territory – that is the state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the purchaser.<sup>10</sup> All of a business entity’s owners are required to be resident of the relevant state if the business entity was formed to purchase the offering’s securities.<sup>11</sup></p>	<p>No requirement to limit offers to a single state or territory.</p> <p><b>(Required Element)</b> Sales must be limited to persons resident within the same state or territory in which the issuer is resident and doing business.<sup>12</sup> Alternatively, the issuer reasonably believes, at the time of the offer and sale, that the purchasers are residents of the state or territory in which the issuer is resident.<sup>13</sup> A corporation, partnership, limited liability company, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of the offer and sale to it, it has its principal place of business within such state or territory – that is the state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the purchaser. <sup>14</sup> All of a business entity’s owners are required to be resident of the relevant state if the business entity was formed to purchase the offering’s securities.<sup>15</sup></p>
<p><b>(Required Element)</b> The issuer of the securities shall be incorporated or organized, and has its principal place of business, if a corporation, limited partnership, trust or other form of business organization that is organized under the offering state or territory law. If a general partnership, the principal place of business shall be in the offering state or territory.<sup>16</sup></p>	<p>No requirement as to state or territory of formation of business entity.</p>

<sup>6</sup> 15 U.S.C. §77c(a)(11).  
<sup>7</sup> 15 U.S.C. §77z-3.  
<sup>8</sup> 17 CFR §230.147(d).  
<sup>9</sup> 17 CFR §230.147A(d).  
<sup>10</sup> 17 CFR §230.147(d)(1).  
<sup>11</sup> 17 CFR §230.147(d)(3).  
<sup>12</sup> 17 CFR §230.147A(c)(1).  
<sup>13</sup> 17 CFR §230.147A(d).  
<sup>14</sup> 17 CFR §230.147A(d)(1).  
<sup>15</sup> 17 CFR §230.147A(d)(3).  
<sup>16</sup> 17 CFR §230.147(c)(1)(i).

<b>SEC Intrastate Offering Exemptions Safe Harbor</b>	
<b>SEC Rule 147</b>	<b>SEC Rule 147A</b>
<b>(Required Element)</b> The issuer shall be deemed to have its principal place of business in a state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issue. <sup>17</sup>	
<b>(Intrastate Alternative Element)</b> The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within the offering state or territory; <sup>18</sup> <b>or</b>	
<b>(Intrastate Alternative Element)</b> The issuer had at the end of its most recent semi-annual fiscal period prior to an initial offer of securities in any offering or subsequent offering pursuant to this section, at least 80% of its assets and those of its subsidiaries on a consolidated basis located within such state or territory; <sup>19</sup> <b>or</b>	
<b>(Intrastate Alternative Element)</b> The issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to Rule 147 in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; <sup>20</sup> <b>or</b>	
<b>(Intrastate Alternative Element)</b> A majority of the issuer’s employees are based in such state or territory. <sup>21</sup>	
<b>(Required Element)</b> For a period of six months from the date of the sale by the issuer of a security pursuant to Rule 147 or Rule 147A, any resale of the security acquired in the Rule 147 or Rule 147A offering shall be made only to persons resident within the state or territory in which the issuer was resident at the time of the sale of the security, including securities held by a gift recipient. <sup>22</sup>	
<b>(Required Element)</b> Issuer shall place a prominent legend on the certificate or other document evidencing the security stating that: “Offers and sales of these securities were made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of these securities, any resale of these securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state or territory of Texas.” <sup>23</sup>	
<b>(Required Element)</b> Issuer shall issue a stop transfer instructions to the issuer’s transfer agent, if any, with respect to the securities, or, if the issuer transfers its own securities, make a notation in the appropriate records of the issuer. <sup>24</sup>	
<b>(Required Element)</b> Issuer shall obtain a written representation from each purchaser as to his or her residence. <sup>25</sup>	

<sup>17</sup> 17 CFR §230.147(c)(1)(i); 17 CFR §230.147A(c)(1).

<sup>18</sup> 17 CFR §230.147(c)(2)(i); 17 CFR §230.147A(c)(2)(i).

<sup>19</sup> 17 CFR §230.147(c)(2)(ii); 17 CFR §230.147A(c)(2)(ii).

<sup>20</sup> 17 CFR §230.147(c)(2)(iii); 17 CFR §230.147A(c)(2)(iii).

<sup>21</sup> 17 CFR §230.147(c)(2)(iv); 17 CFR §230.147A(c)(2)(iv).

<sup>22</sup> 17 CFR §230.147(e); 17 CFR §230.147A(e).

<sup>23</sup> 17 CFR §230.147(f)(1)(i); 17 CFR §230.147A(f)(1)(i).

<sup>24</sup> 17 CFR §230.147(f)(1)(ii); 17 CFR §230.147A(f)(1)(ii).

<sup>25</sup> 17 CFR §230.147(f)(1)(iii); 17 CFR §230.147A(f)(1)(iii).

<b>SEC Intrastate Offering Exemptions Safe Harbor</b>	
<b>SEC Rule 147</b>	<b>SEC Rule 147A</b>
<p><b>(Required Element)</b> The issuer shall, at the time of any offer or sale by it of a security pursuant to Rule 147 and 147A, prominently disclose to each offeree in the manner in which any such offer is communicated and to each purchaser of such security in writing a reasonable period of time before the date of sale, the following (for Texas intrastate offerings):</p> <p style="padding-left: 40px;">“Sales will be made only to residents of Texas. Offers and sales of these securities are made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of the securities, any resale of the securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state of Texas.”<sup>26</sup></p>	

Rules 147 and 147A have other requirements:

**Issuer’s Reasonable Belief as to Purchaser’s Residency Status.**

As stated above, Rule 147 and 147A require that issuers have a “reasonable belief” as to the securities purchaser’s residency status. The SEC guidance states that this reasonable belief must be based on something more than an investor questionnaire. The issuer must look to other facts or circumstances, including:

. . . for example, a pre-existing relationship between the issuer and the prospective purchaser that provides the issuer with sufficient knowledge about the prospective purchaser’s principal residence or principal place of business so as to enable the issuer to have a reasonable basis to believe that the prospective purchaser is an in-state resident . . . (or) such as evidence of the home address of the prospective purchaser, as documented by a recently dated utility bill, pay-stub, information contained in state or federal tax returns, any documentation issued by a federal, state, or local government authority, such as a driver’s license or identification card, or a public or private database that the issuer has determined is reasonably reliable, including credit bureau databases, directory listings, and public records.<sup>27</sup>

The SEC continued: “(t)he burden will continue to be on the issuer to establish that the purchaser is an in-state resident or that the issuer had a reasonable belief as to residency.”<sup>28</sup>

<sup>26</sup> 17 CFR §230.147(f)(3); 17 CFR §230.147A(f)(3).

<sup>27</sup> 81 FR 83494, 83503 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).

<sup>28</sup> 81 FR 83494, 83503 fn 129 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).

## **Resale Limitations.**

Purchasers of securities sold pursuant to Rules 147 and 147A cannot resell the securities in an interstate transaction for a six-month period.<sup>29</sup> They can resell the securities to purchasers in which the issuer was resident before six months after the purchase.<sup>30</sup> This includes securities obtained by conversion of convertible securities. Bona fide gifts to persons in a different state are acceptable as such transfers are for no value.<sup>31</sup> But, issuers would expect that such gifts be part of a personal relationship such as a family relationship. Otherwise it looks like a sales transaction. Subsequent sales of the gifted securities would still be subject to the resale restrictions, regardless of where the gift recipient resides.<sup>32</sup>

Rules 147 and 147A are not conditioned on the purchase complying with the resale limitations.<sup>33</sup> But, the issuer will be required to put stop transfer instructions with the transfer agent<sup>34</sup> and place a legend on the certificate or documents representing the securities referencing the six month holding period.<sup>35</sup>

## **Offering Integration.**

Integration of securities offerings is a securities regulation concept to ensure that securities offerings that are part of the same plan of financing are not segmented into pieces in order to meet claimed exemptions from securities registration. Rules 147 and 147A provide an offering integration safe harbor that covers:

- (1) offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to Rules 147 or 147A;<sup>36</sup>
- (2) offers or sales of securities made after the completion of the securities offers and sales pursuant to Rules 147 and 147A that are made pursuant to an offering qualified by the SEC under SEC Regulation A;<sup>37</sup>
- (3) offers or sales of securities made after the completion of the securities offers and sales pursuant to Rule 147 and 147A that are made pursuant to a securities registration exemption under SEC Rule 701 which covers securities issued to the issuer's employees, directors, general partners, trustees (where the issuer is a business trust), officers, or consultants and advisors, and their family members and the issuer is not filing periodic reports with the SEC;<sup>38</sup>
- (4) offers or sales of securities made after the completion of the securities offers and sales pursuant to federal crowdfunding securities registration exemptions;<sup>39</sup>

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<sup>29</sup> 17 CFR §230.147(e); 17 CFR §230.147A(e).

<sup>30</sup> 17 CFR §230.147(e); 17 CFR §230.147A(e).

<sup>31</sup> 81 FR 83494, 83505 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).

<sup>32</sup> 81 FR 83494, 83505 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).

<sup>33</sup> 81 FR 83494, 83505 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).

<sup>34</sup> 17 CFR §230.147(f)(1)(ii); 17 CFR §230.147A(f)(1)(ii).

<sup>35</sup> 17 CFR §230.147(f)(1)(i); 17 CFR §230.147A(f)(1)(i).

<sup>36</sup> 17 CFR §230.147(g)(1); 17 CFR §230.147A(g)(1).

<sup>37</sup> 17 CFR §230.147(g)(2)(ii); 17 CFR §230.147A(g)(2)(ii).

<sup>38</sup> 17 CFR §230.147(g)(2)(iii); 17 CFR §230.147A(g)(2)(iii).

<sup>39</sup> 17 CFR §230.147(g)(2)(vi); 17 CFR §230.147A(g)(2)(vi).

- (5) offers or sales made pursuant to an employee benefit plan;<sup>40</sup>
- (6) offers or sales made to non-US residents pursuant to SEC Regulation S;<sup>41</sup>
- (7) offers or sales of securities made more than six months after the completion of the securities offers and sales;<sup>42</sup>
- (8) offers or sales of securities made after the completion of the securities offers and sales pursuant to Rule 147 and 147A limited to “qualified institutional buyers” and/or “institutional accredited investors,” that are made pursuant to an effective registration statement for a securities offering registered with the SEC;<sup>43</sup> and
- (9) offers or sales of securities made after the completion of the securities offers and sales pursuant to Rule 147 and 147A sold to purchasers other than “qualified institutional buyers” and/or “institutional accredited investors,” that are made pursuant to an effective registration statement for a securities offering registered with the SEC, provided that at least thirty days have passed between the conclusion of the Rule 147/147A offering and the filing of the registration statement with the SEC.<sup>44</sup>

### **Intrastate Broker-Dealer**

The Securities Exchange Act of 1934 has a carveout from the broker-dealer registration provisions for brokers and dealers “whose business is exclusively intrastate and who does not make use of any facilities of a national securities exchange.”<sup>45</sup> In its Rule 147/147A final rule release, the SEC provided guidance that, in support of Rule 147/147A offerings:

. . . a broker-dealer whose business otherwise meets the requirements of the intrastate broker-dealer exemption should not cease to qualify for the intrastate broker-dealer exemption solely because it has a website that may be viewed by out-of-state persons, so long as the broker-dealer takes measures reasonably designed to ensure that its business remains exclusively intrastate.<sup>46</sup>

### **Investment Companies**

Investment companies required to be registered under the Investment Company Act of 1940 (“Investment Company Act”) may not use Rules 147<sup>47</sup> or 147A.<sup>48</sup> Typically, the Investment Company Act requires registration of investment companies that engage in public solicitation. Investment companies that are exempt from Investment Company Act registration may use Rules 147 and 147A.<sup>49</sup>

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<sup>40</sup> 17 CFR §230.147(g)(2)(iv); 17 CFR §230.147A(g)(2)(iv).

<sup>41</sup> 17 CFR §230.147(g)(2)(v); 17 CFR §230.147A(g)(2)(v).

<sup>42</sup> 17 CFR §230.147(g)(2)(vii); 17 CFR §230.147A(g)(2)(vii).

<sup>43</sup> 17 CFR §§230.147(g)(2)(i), 230.147(h); 17 CFR §§230.147A(g)(2)(i), 230.147A(h).

<sup>44</sup> 17 CFR §§230.147(g)(2)(i), 230.147(h); 17 CFR §§230.147A(g)(2)(i), 230.147A(h).

<sup>45</sup> 15 U.S.C. §78o(a)(1).

<sup>46</sup> 81 FR 83494, 83510 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).

<sup>47</sup> “The exemption provided by paragraph (11) of said section 3(a) shall not apply to any security of which a registered investment company is the issuer.” 15 U.S.C. §80a-24(d).

<sup>48</sup> 17 CFR §230.147A(a).

<sup>49</sup> 81 FR 83494, 83511 fn 241 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).

## Trust Indenture Act

The Trust Indenture Act of 1939 (“Trust Indenture Act”) applies to debt offerings of \$50 million or more in principal amount in a twelve-month period made through interstate commerce.<sup>50</sup> The Trust Indenture Act specifically exempts Rule 147 offerings from its scope because that rule was authorized under Section 3(a)(11) of the Securities Act.<sup>51</sup> But, Rule 147A offerings of \$50 million or more in principal amount in a twelve month period made through interstate commerce are not exempt from the Trust Indenture Act because the SEC promulgated that rule under its general exemptive authority in Section 28 of the Securities Act.<sup>52</sup>

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<sup>50</sup> 15 U.S.C. §77ddd(a)(1) and (8); 17 CFR §260.4a-1.

<sup>51</sup> 15 U.S.C. §77ddd(a)(4)(A).

<sup>52</sup> 81 FR 83494, 83512 (November 21, 2016); SEC Release Nos. 33-10238, File No. S7-22-15 (2016).