New FIRPTA Regulations conform and update changes from the PATH Act

February 23, 2016

In brief

The Treasury and IRS issued temporary and final regulations on February 17, 2016, that generally conform and update the existing regulations to changes made to the Foreign Investment in Real Property Tax Act (FIRPTA) by H.R. 2029, (herein 'the PATH Act'). The PATH Act was signed into law on December 18, 2015. The PATH Act: (i) increased the general rate of withholding on dispositions of US Real Property Interests (USRPIs) from 10% to 15%, (ii) exempted certain foreign retirement funds from the application of FIRPTA, (iii) increased the amount of stock a foreign person may own in a publicly traded real estate investment trust (REIT) from 5% to 10%, (iv) added a new exception for qualified shareholders in REITs, and (v) modified the 'cleansing rule' and the definition of a 'domestically controlled' qualified investment entity.

In detail

Increased withholding tax

Generally, any disposition of a USRPI was subject to a withholding tax equal to 10% of the amount realized. The PATH Act increased the withholding tax to 15%. The increase does not apply to the sale of personal residences with respect to which the purchase price does not exceed $1 million. The Section 1445 regulations have been modified to reflect the increased withholding tax. The increased withholding tax applies to dispositions and distributions made after February 16, 2016.

Address change for notices mailed to the FIRPTA unit

The Section 897 and 1445 regulations have been updated to reflect the new mailing address for the FIRPTA unit. The FIRPTA unit was previously located in the Philadelphia Service Center but relocated to Ogden, Utah. The regulations have been updated to reflect this change. Taxpayers are required to use the revised mailing address. However, the IRS will not assert penalties against taxpayers that use the old mailing address on or before 120 days after the regulations are published in the Federal Register. The regulations are expected to be published on February 19, 2016.

Qualified foreign pension funds

In general, new Section 897(l) provides that Section 897 does not apply to a US real property interest (USRPI) held by a qualified foreign pension fund (QFPF) directly or indirectly through one or more partnerships, or to any distribution received by a QFPF from a real estate investment trust (REIT). Section 897(l) also applies to any entity all of the interests of which are held by a QFPF (for the definition of a QFPF please see our prior news alert New modifications to FIRPTA). Additionally, the PATH Act also amended the definition of a foreign person in Section 1445(f)(3) to provide that QFPFs are not treated as foreign persons under Section 1445 except as otherwise provided by the Secretary.

The PATH Act did not specifically provide a withholding mechanism with respect to an acquisition of a USRPI from a QFPF. Treas. Reg. sec. 1.1445-1(b)(1) provides that except as provided in Treas. Reg. secs. 1.1445-2 and -3, transferees of a USRPI are required to deduct and withhold tax equal to 15% of the amount realized by the transferor if the transferor is a foreign person. Treas. Reg. sec. 1.1445-2(b)(1) states that withholding is not required when the transferor is not a foreign person. In order to establish that the transferor is not a foreign person, the person must provide a certificate of non-foreign status. Treas. Reg. sec. 1.1445-2(b)(2) sets out the general contents of the notice and defines the term 'foreign person'. The definition of a foreign person has been modified to exclude a QFPF as defined under Section 897(l).

Accordingly, it would appear that a QFPF can provide a certificate of non-foreign status in order to avoid withholding on the disposition of a USRPI or on a distribution from a REIT. The QFPF must provide the certificate at the time of, or prior to, the transfer in order to avoid withholding. No particular form is required, but the certificate must include the following information: (i) a statement that the transferor is not a foreign person; (ii) name, address, and identifying number (i.e., an employee ID number (EIN)), and be signed under penalties of perjury.

The regulations do not provide further guidance on the definition of a QFPF and related issues. The summary, however, explicitly requests that interested parties should submit comments regarding what regulations (if any) should be issued pursuant to Section 897(l). This suggests that Treasury and the IRS recognize the need for further guidance on Section 897(l).

Notably, the regulations have not addressed a mechanism for shareholders who are 'qualified shareholders' under Section 897(k).

Cleansing rule modifications

If a USRPHC disposes of all of its USRPIs in taxable transactions within a five-year period preceding the date of disposition of stock in the USRPHC, the stock interest ceases to be a USRPI. The PATH Act modified the cleansing rule by specifying that it does not apply to any corporation that was a RIC or a REIT at any time during the shorter of the ownership period or the five-year period ending on the date of disposition of the stock. Treas. Reg. sec. 1.897-2(f) has been modified to incorporate this change for dispositions occurring on or after December 18, 2015.

The takeaway

Foreign investors should be aware that going forward, all FIRPTA-related notices must be sent to the Ogden FIRPTA unit. Further, dispositions and distributions of USRPIs that were previously subject to 10% withholding are now subject to 15% withholding. Additionally, entities that qualify as a QFPF should be aware that they can provide a certificate of non-foreign status in order to avoid withholding tax. Entities that have concerns under Section 897(l) should consider submitting comments to the Treasury and IRS.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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