Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I International Practice Service Concept Unit

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Part	8.4	FIRPTA	**Level 2 UIL**	9424.04
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Sub-Chapter	N/A	N/A	–	–

Unit Name	Taxation on the Disposition of USRPI by Foreign Persons

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General Overview

Taxation on the Disposition of USRPI by Foreign Persons

Under the Foreign Investment in U.S. Real Property Tax Act of 1980 (FIRPTA), gains or losses from the disposition of a U.S. real property interest (**USRPI**) by certain foreign persons are treated as gains or losses effectively connected with a trade or business within the United States. Foreign persons subject to FIRPTA includes foreign corporations and nonresident aliens (NRAs). The three components necessary for FIRPTA (IRC § 897) to apply to a transaction are that (1) there is a gain or loss on the disposition of (2) a USRPI and (3) such gain or loss is realized by an NRA or a foreign corporation.

IRC § 1445, enacted in 1984, requires withholding on the disposition of USRPI by foreign persons. Foreign persons include foreign corporations, foreign partnerships, foreign trusts and estates, NRAs and other foreign entities.

The Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act") was signed into law on December 18, 2015. Dispositions of REIT stock, REIT distributions and dispositions of any other U.S. Real Property Interests by a foreign person had FIRPTA withholding rate increased from 10% to 15% of the gross purchase price realized on these dispositions with limited exceptions. This rate increase is effective for the aforementioned dispositions occurring 60 days after December 18, 2015.This 15% is required to be withheld by the withholding agent, generally the buyer/transferee, regardless of whether it is a U.S. or foreign person, and be remitted to the IRS by the 20th day after the date of transfer together with the filing of Form 8288 (U.S. Withholding Tax Return for Disposition by Foreign Persons of U.S. Real Property Interests) and Form 8288-A (Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests). The NRA or foreign corporation making the disposition is required to file a U.S. income tax return (Forms 1040NR, 1120-F, etc.) to report its income effectively connected with a trade or business within the United States (**ECI**). The foreign corporation or NRA can claim the amount withheld as a credit against any U.S. income tax due.

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Caution: As mentioned above, the rate of withholding on FIRPTA transactions has increased from 10% to 15% under the new law. For the remainder of this Unit , the prior law's 10% tax rate will be referenced. . Please be aware of the proper rate that should be applied for each case.

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General Overview (cont’d)

Taxation on the Disposition of USRPI by Foreign Persons

A foreign person may request a reduced withholding if proper conditions exist and a Form 8288-B (Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests) is submitted and accepted by the IRS. There are basically six different categories that qualify for a reduced amount of, or, exemption from, withholding. These categories are:

1. Non recognition or Exemption
2. Maximum Tax Liability
3. Installment Sales
4. Security Agreements
5. Blanket Applications
6. Nonstandard Applications

The Form 8288-B applications are processed at the Campus by Tax Examiners and are compared with a check list to determine if proper and all required documentation is submitted. Please see Rev. Proc. 2000-35 for explanation of each withholding certificate application category and Treas. Reg. § 1.1445-3(b) for additional information.

Caution: Since 2006, all FIRPTA related forms and documents are processed at the Ogden Service Center. The mailing address is: Internal Revenue Service Center, P.O. Box 409101, Ogden, UT 84409. The regulations, however, have not been updated to reflect such change.

This Concept Unit is meant to give general information about FIRPTA. Income Tax Treaties permit the United States to tax gains resulting from the disposition of USRPIs under IRC§ 897. Paragraph 1 of Article 13 of the U.S. Model Treaty permits the taxation of gains of a foreign resident from the disposition of real property located in the United States.

CONSULTATION: Consultation with Repatriation/Withholding IPN or your local counsel may be useful.

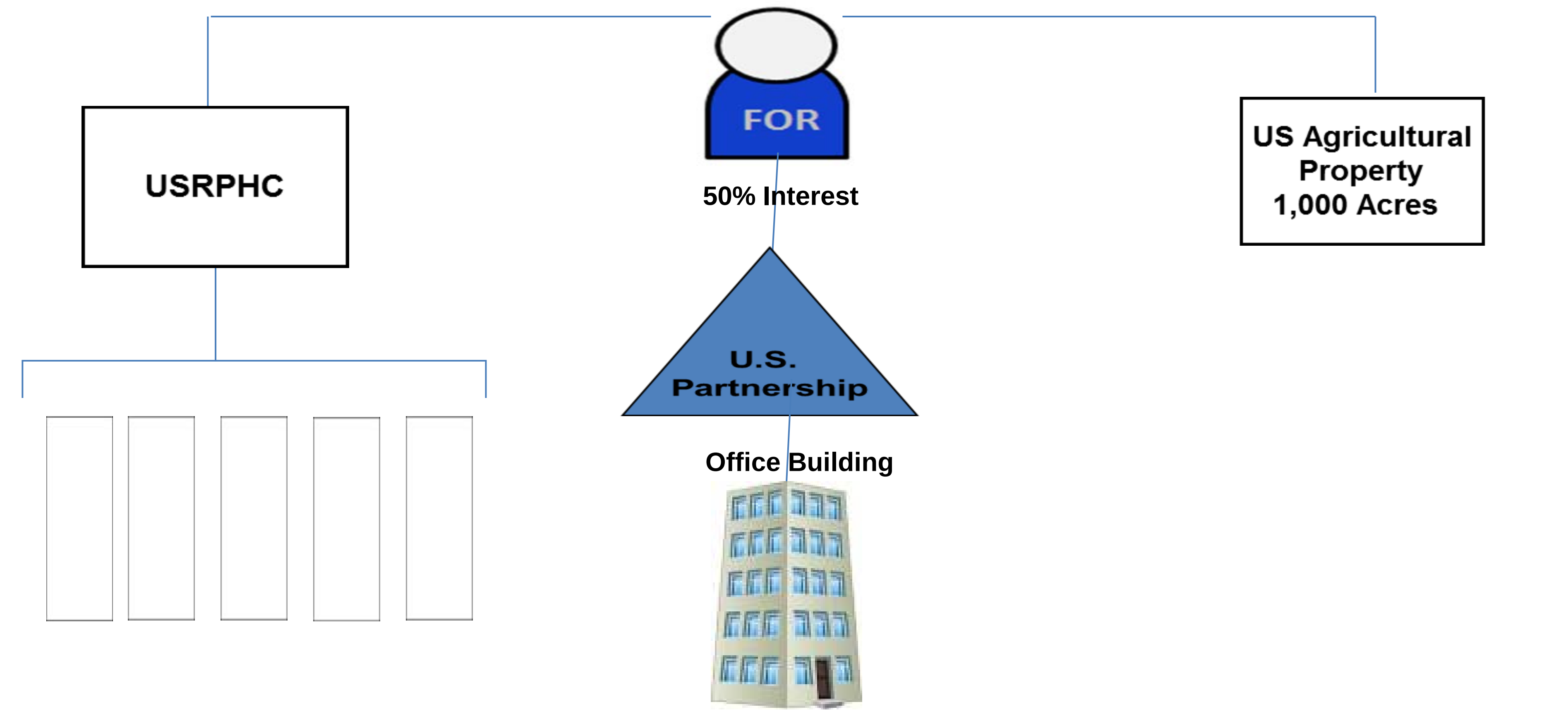
Relevant Key Factors

Taxation on the Disposition of USRPI by Foreign Persons
Key Factors
▪ This Unit analyzes the dispositions of USRPI by a foreign person. The gain or loss from transactions involving dispositions of USRPIs by NRAs or foreign corporations is treated as effectively connected with a U.S. trade or business and such foreign persons were engaged in such U.S. trade or business. The withholding requirements on dispositions of USRPI are specified under IRC § 1445. A detailed discussion of all of these concepts are included in the Detailed Explanation of the Concept below.

Diagram of Concept

Taxation on the Disposition of USRPI by Foreign Persons

Diagram of Concept



Facts of Concept

Taxation on the Disposition of USRPI by Foreign Persons
Facts of Concept
▪ This Unit analyzes the dispositions of USRPI by an NRA as depicted in the diagram supra. Each of the three transactions would require the application of the FIRPTA rules (i.e., IRC §§ 897 and 1445). The diagram reflects that NRA is the sole shareholder of a U.S. Corporation that owns 5 townhouses which it uses as rental property in the United States. NRA also individually owns 1,000 acres of agriculture properly as well as a separate 50% interest in a U.S. partnership that owns an office building in a city in the United States.

Detailed Explanation of the Concept

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
Reasons for FIRPTA law ▪ Prior to 1980, foreign persons could dispose USRPIs without paying taxes on the gain unless the gain was effectively connected with a U.S. trade or business. In 1980 Congress passed the Foreign Investment in U.S. Real Property Tax Act which added IRC § 897 and treated gain or loss on the disposition of USRPI as ECI. This law also added IRC § 6039(C) which required foreign property owners to disclose their ownership of U.S. real property. The goal of IRC § 6039(C) was to allow the IRS to monitor the ownership of USRPI by foreign persons in an effort to determine when there was a disposition. For various reasons, this effort was not effective and in 1984, under the Deficit Reduction Act, Congress enacted IRC § 1445. IRC § 1445 requires the buyer/transferee to withhold 10% of the amount realized from the disposition of a USRPI by a foreign person, or 35% of the gain on certain distributions of USRPIs. Temporary regulations under IRC § 1445 were issued on December 31, 1984 and final regulations were issued on December 24, 2006.	▪ T.D. 8000, 1985-1 C.B. 296. ▪ T.D. 8113, 1987-1 C.B. 259.

Detailed Explanation of the Concept (cont'd)

<table>
<tr><th colspan="2">Taxation on the Disposition of USRPI by Foreign Persons</th></tr>
<tr><th>Analysis</th><th>Resources</th></tr>
<tr><td><u>USRPI</u>
▪ USRPI includes more than a direct interest in real estate. A USRPI includes an interest in real property (including an interest in a mine, well, or other nature deposit) located in the United States or the Virgin Islands, and any interest (other than solely as a creditor) in any domestic corporation unless the corporation establishes that it is not a US real property holding corporation (USRPHC) at any time during the specified period (generally 5 years preceding disposition).</td><td>▪ IRC § 897(c)(1)(A).</td></tr>
<tr><td>▪ A corporation is a USRPHC if:
$$\frac{\text{Fair market value (FMV) of its USRPI}}{\text{(FMV of its USRPI + interests in real property located outside the United States + all other assets that are used or held for use in its trade or business)}} = >50\%$$</td><td>▪ IRC § 897(c)(2).</td></tr>
<tr><td>▪ Publicly traded stock of a corporation is not USRPI if held by a 10% or less shareholder. This 10% threshold was increased from 5% or less under the new PATH legislation passed on December 18, 2015.</td><td>▪ IRC § 897(c)(3).</td></tr>
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Detailed Explanation of the Concept (cont'd)

<table>
<tr><th colspan="2">Taxation on the Disposition of USRPI by Foreign Persons</th></tr>
<tr><th>Analysis</th><th>Resources</th></tr>
<tr><td><u>Rule for sales of interest in partnerships, trusts, and estates</u>
▪ The amount of any money, and the FMV of any property, received by an NRA or foreign corporation in exchange for all or part of its interest in a partnership, trust, or estate shall, to the extent attributable to USRPI, be considered as an amount received from the sale or exchange in the United States of such property.

▪ For purposes withholding under IRC § 1445, an interest in a partnership is treated as a USRPI if 50% or more of the value of gross partnership assets consists of USRPIs and 90% or more of the value of the gross partnership assets consists of USRPIs and cash and cash equivalents.</td><td>▪ IRC § 897(g).

• Treas. Reg. § 1.1445-11T(d)(1).</td></tr>
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Detailed Explanation of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
<u>Real property</u> ▪ Local law definitions of real estate are not controlling.	▪ Treas. Reg. § 1.897-1(b)(1).
▪ Land and unsevered products of the land – This includes land, growing crops and timber, mines, wells, and other natural deposits. When crops and timber are severed from the land or ores, minerals and other natural deposits are extracted from the land they are no longer considered to be real property.	▪ Treas. Reg. § 1.897-1(b)(2).
▪ Improvements – This category includes building, any other inherently permanent structure, or the structural components of either. ✓ Building means any structure enclosing a space within its walls, and usually covered by a roof. Examples include apartment houses, factory and office buildings, barns, warehouses, railway and bus stations, and stores. ✓ Inherently permanent structure is any property that is affixed to real property and that will ordinarily remain affixed to the property for an indefinite period of time. Examples include swimming pools, bridges, fences, etc.	▪ Treas. Reg. § 1.897-1(b)(3)(iii).

Detailed Explanation of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
• Structural components (defined in Treas. Reg. §1.48-1(e)(2)), include for example walls, partitions, floors, ceilings, windows, doors, wiring, plumbing, HVAC systems, lighting fixtures, pipes, elevators, sprinkler systems, fire escapes and other components relating to the operation or maintenance of a building.	
▪ Personal property associated with the use of real property - This includes movable walls, furnishings, and other personal property associated with the use of real property only in (A) mining, farming, and forestry, (B) the improvement of real property, (C) the operation of a lodging facility, or (D) the rental of furnished office and other work space.	▪ Treas. Reg. § 1.897-1(b)(4).

Detailed Explanation of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
Interest in real property ▪ USRPI also includes interest other than solely as a creditor with respect to real property interest. These would include a fee ownership, co-ownership, or leasehold interest in real property, a time sharing interest in real property, and a life estate, remainder, or reversionary interest in such property. ▪ It also includes any direct or indirect right to share in the appreciation in the value, or in the gross or net proceeds or profits generated by, the real property. For example, equity kicker,	▪ Treas. Reg. § 1.897-1(d)(2)(i).

Detailed Explanation of the Concept (cont'd)

<table>
<tr><th colspan="2">Taxation on the Disposition of USRPI by Foreign Persons</th></tr>
<tr><th>Analysis</th><th>Resources</th></tr>
<tr><td><u>Disposition</u>
▪ For purposes of FIRPTA “disposition” means any transfer that would constitute a disposition under the Internal Revenue Code and regulations. This includes but is not limited to:
– Sale or exchange
– Capital contribution, distribution, liquidation and redemptions
– § 1031 Like-kind exchanges (consider non-recognition rules of IRC § 897(e))
– Involuntary conversions
– Gifts</td><td>▪ Treas. Reg. § 1.897-1(g).</td></tr>
<tr><td><u>Foreign person</u>
▪ A foreign person includes a NRA, foreign corporation, foreign partnership, foreign trust, a foreign estate, and any other person that is not a U.S. person.</td><td>▪ Treas. Reg. § 1.1441-1(c)(2).</td></tr>
</table>

Detailed Explanation of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
Taxing the gain ▪ Gain from the sale of USRPIs by a NRA or foreign corporation is subject to tax under IRC § 897. The NRA or foreign corporation may claim deductions that are attributable to income that is treated as effectively connected with a trade or business. However, the NRA or foreign corporation may not make an election under IRC §§ 871(d) or 882(d) for a taxable year in which the foreign person derives no income from the U.S. real property other than gain from the sale of USRPI.	▪ CCA 200504029.

Detailed Explanation of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
<u>Taxing the gain</u> ▪ Some taxpayers that transfer options to acquire a USRPI may not have properly complied with IRC §§ 897 or 1445, usually because they improperly claim that such options are not USRPIs. Options to acquire any interest in real property (other than an interest solely as a creditor) are included in the definition of USRPIs. The transferee of an option to acquire a USRPI must deduct and withhold a tax equal to 10% of the amount realized by the transferor upon the disposition. This withholding requirement does not apply when the option is granted or when it expires.	▪ Treas. Reg. § 1.897-1(d)(2)(ii)(B). ▪ Treas. Reg. § 1.1445-1(b)(3). See also, CCA 200522020.

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
<u>Foreclosures</u> ▪ A NRA or foreign corporation owning a USRPI that was foreclosed is subject to FIRPTA taxes on any gain resulting from the foreclosure. The transferee is the withholding agent and is required to deduct and remit the withholding. ▪ The FIRPTA rules for foreclosures differ from the rules for other dispositions in the following manner: If the transferee (or transferor) notifies the court or trustee having jurisdiction on the date of transfer, and notifies the IRS regarding the transaction, then the withholding would be the lesser of: – The net proceeds if any, determined by the court or trustee, or – The amount otherwise required to be withheld under IRC § 1445(a) , which is 10% of the amount realized (Treas. Reg. § 1.1445-2(d)(3)). This means that if the notification requirements are met, the withholding would work out to be zero if the foreign person is having a loss (which is usually the case).	▪ Treas. Reg. § 1.1445-2(d)(3)(i)(A).

Detailed Explanation of the Concept (cont'd)

<table>
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<tr><th>Analysis</th><th>Resources</th></tr>
<tr><td><u>Deed in lieu of foreclosure</u>
▪ In some cases a debtor will simply deed over the title of the USRPI serving as the security to the creditor. This transaction is also subject to FIRPTA if the debtor is a foreign person. The amount realized will be the amount encumbering the USRPI, plus any additional amounts paid to the debtor. If the following three conditions are met, however, there will be no withholding requirement under IRC § 1445.
– The transferee is the only person with a security interest in the USRPI;
– No cash or other property (excluding incidental fees) is paid to any person with respect to the transfer; and
– The notice requirements are met (as stated under Foreclosures above).</td><td>▪ Treas. Reg. § 1.1445-2(d)(3)(i)(B).</td></tr>
<tr><td><u>Gifts</u>
▪ Gifts of USRPI by foreign persons may give rise to FIRPTA. For example, if the transferor is relieved of the mortgage or other liabilities secured by the property gifted and such liabilities are in excess of the transferor's basis in the property gifted, the gain recognized could be subject to IRC §§ 897 and 1445.</td><td>▪ See Rev. Rul. 70-626, 1970-2 C. B. 158.</td></tr>
</table>

Detailed Explanation of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
Refunds to foreign person ▪ Any tax withheld and submitted to the IRS on a FIRPTA transaction must be credited to the foreign transferor's tax return. The foreign transferor is to include Form 8288-A which has been stamped by the IRS, with its tax return to establish the amount withheld which is available as a credit. The IRS sometimes runs into situations where the foreign seller does not have a Form 8288-A. For example, the withholding agent does not submit the withholding to the IRS, meaning that the IRS cannot provide the seller with a stamped copy of Form 8288-A. In situations such as this, the foreign transferor may establish the amount of tax withheld by the buyer by attaching substantial evidence to its tax return (e.g., closing documents) showing the withholding amount.	▪ Treas. Reg. § 1.1445-1(f)(1). ▪ Treas. Reg. § 1.1445-1(f)(3)(i)). See also, CCA 201028040.

Detailed Explanation of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons	
Analysis	**Resources**
Treaty application ▪ Generally, income tax treaties generally allow the United States to tax gain attributable to the alienation of real property situated in the United States.	▪ See, Article 13, Paragraph 1 of the 2006 U.S. Model Income Tax Convention.
Disregarded entities ▪ The IRS is aware that some transferees of USRPIs are not withholding 10 percent of the amount realized because the foreign transferor elected, by filing a Form 8832 (Entity Classification Election), to be disregarded as an entity separate from its owner (disregarded entity). This is not proper since a disregarded entity may not certify that it is the transferor of a USRPI for purposes of IRC §§ 897 and 1445. Rather, the owner of the disregarded entity is treated as the transferor of property. **CONSULTATION:** Consultation with Repatriation/Withholding IPN or your local counsel may be useful.	▪ Treas. Reg. § 1.1445-2(b)(2)(iii)

Examples of the Concept

Taxation on the Disposition of USRPI by Foreign Persons
Examples
▪ Consider the following basic facts: 1. NRA is the sole shareholder of a U.S. corporation. The only assets of the corporation are 5 townhouses which are located in the United States. The townhouses are rental properties and are leased by the corporation to renters. The FMV of the only class of stock of the corporation is $1 million. NRA has identical adjusted basis in each share of stock and the aggregate basis of the stock is $600,000. 2. NRA owns a 50% interest in a U.S. partnership. The only asset of the partnership is an office building which is located in the United States. The partnership has no liabilities. The FMV of the office building is $10 million and the partnership's adjusted basis in the office building is $5 million. The FMV of NRA's 50% interest in the partnership is $5 million and the adjusted basis in the interest is $1 million. 3. NRA individually owns 1,000 acres of agricultural land in the United States which he holds as investment. The land is not subject to any liability. The FMV of the land is $2 million and NRA's adjusted basis in the land is $500,000.

Examples of the Concept (cont'd)

Taxation on the Disposition of USRPI by Foreign Persons
Examples

- Examples of FIRPTA transactions:
  1. NRA sells 25% ownership of USRPHC for cash of $250,000 to a U.S. individual. The amount NRA realized on the sale is $250,000. The stock sold has an adjusted basis of $150,000. NRA should recognize $100,000 of gain and such gain should be treated as ECI. U.S. individual buyer/transferee is required to withhold $25,000 ($250,000 amount realized x 15% withholding rate) under IRC § 1445.
  2. Dispositions of certain interests in a partnership are treated as USRPI whereby IRC §§ 897 and 1445 may apply . Specifically if 50% or more of the value of gross partnership assets consists of USRPIs and 90% or more of the value of the gross partnership assets consists of USRPIs and cash and cash equivalents, the interest in a partnership is treated as a USRPI and a 10% withholding would apply to any amount realized by NRA. In example 2, NRA gives 5% of his interest in the U.S. partnership to a niece as a college graduation present. The gift of the 5% interest in the partnership is a disposition for purposes of IRC §§ 897 and 1445. If NRA receives any considerations (including relief of liability) in exchange for all or part of an interest in such partnership, gain or loss will be recognized and taxed as ECI to the extent attributable to a USRPI. Since the disposition in the example is a gift and NRA did not have any amount realized (including any relief of liability) on the disposition, NRA would not recognize any gain and the disposition would not be subject to any withholding. The tax results would differ if the office building was subject to a mortgage and there was an amount realized related to a relief of liability subject to 10% FIRPTA withholding.
  3. NRA exchanges his 1,000 acres of U.S. agricultural land for 100 acres of undeveloped commercial land located in the United States of equal value in a simultaneous like-kind exchanges under IRC § 1031. NRA did not recognize any gain or loss on the exchange. This transaction may not be subject to withholding because it is a "nonrecognition transaction," provided the notice requirements under Treas. Reg. § 1.1445-2(d)(2) are satisfied.
     – See Treas. Reg. 1.1445-2(d)(2)(iv) for consequences related to like-kind exchanges that do not qualify for nonrecognition treatment in their entirety and to deferred like-kind exchanges.

Training and Additional Resources

Taxation on the Disposition of USRPI by Foreign Persons		
Type of Resource	**Description(s) and/or Instructions for Accessing**	**References**
CENTRA sessions	International Foreign Investment in Real Property Tax (FIRPTA) International Liquidation and Distributions under FIRPTA	(PHW900469) (JWJ328927)
Other Training Materials	Overview of Withholding under FIRPTA for Sales by Individuals (§1445)	IIC Transactional Practice Unit

Glossary of Terms and Acronyms

Acronym	Definition
CPE	Continuing Professional Education
FIRPTA	Foreign Investment in Real Property Tax Act of 1980
IPN	International Practice Network
NRA	Nonresident Alien
UIL	Uniform Issue List
USRPHC	U.S. Real Property Holding Corporation

Index of Related Issues

Issue	Associated UIL(s)	References
This unit provides an overview of the withholding and filing requirements when foreign persons dispose of U.S. real property interest under IRC §§ 897 and 1445.	9424.04 – FIRPTA	Narrative for Chapter 8.4 ion IPS library.
This unit provides an overview of the withholding and filing requirements on REIT distributions (liquidating and non-liquidating)	9424.04.01 – FIRPTA	Taxation and Withholding on REIT Distributions *(Liquidating and Non-Liquidating)* RPW/9424.04_012013
This unit provides an overview of how to determine a USRPHC, what is the significanc4 of a USRPHC, and how withholding and filing requirements apply	9424.04 -04 FIRPTA	Unit to be Developed
This unit provides an overview of the withholding and filing requirements on liquidations and distributions by USRPHC	9424.04.04 – FIRPTA	Unit to be Developed
This unit provides an overview of problems incurred with questionable claims	9424.04 -05 FIRPTA	Unit to be Developed