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JANUARY 15, 2016

New Law Brings Some Welcome FIRPTA Changes

On December 18, President Obama signed the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"). Despite the new law's name, a number of its provisions affect foreign investors. The PATH Act introduces several important changes to the Foreign Investment in Real Property Tax Act (FIRPTA), which generally imposes tax on nonresident aliens and foreign corporations investing in U.S. real property interests. The reforms are intended to make foreign investment in U.S. real estate more attractive, though the PATH Act includes certain revenue raisers to temper the reforms' budgetary impact.

One helpful change is the increase of the ownership threshold for foreign "portfolio investors" in publicly traded real estate investment trusts (REITs) from 5 percent to 10 percent. These investors are exempt from FIRPTA tax on the sale of stock of the REIT and on the receipt of capital gain dividends from the REIT on or after December 18, 2015. (Instead, capital gain dividends are treated as ordinary dividends to these investors.) The new 10 percent threshold aligns with the definition of portfolio investor in most U.S. income tax treaties. The PATH Act further provides that the exemption applies to REIT interests held by certain widely held, publicly traded "qualified collective investment vehicles."

Also helpful to REIT investors is the new law's presumption rules for "domestically controlled" status. Gain from the sale of stock of a domestically controlled REIT is not taxed under FIRPTA. A REIT is domestically controlled if foreign persons directly or indirectly own less than 50 percent by value of the REIT's stock during the applicable testing period. Due to the difficulty to determine the foreign or domestic status of small shareholders (i.e., less-than-five-percent shareholders), many REITs had little comfort on the applicability of the exception. Under the PATH Act, a publicly traded REIT can presume that all less-than-five-percent shareholders are U.S. persons unless the REIT has actual knowledge to the contrary. If a REIT's stock is held by a publicly traded REIT or certain publicly traded or open-ended regulated investment companies (RICs), the REIT or RIC will be treated as a U.S. person if it is domestically controlled and as a non-U.S. person otherwise. In cases where a REIT's stock is held by REITs or RICs not described in the preceding rule, the REIT or RIC is treated as U.S. or non-U.S. on a look-through basis.

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The PATH Act also exempts "qualified foreign pension funds" (and entities wholly owned by such funds) from FIRPTA tax, equalizing the treatment of foreign funds to domestic funds on the disposition of U.S. real property interests. A foreign pension fund is qualified if it is subject to government regulation and reporting in its home country, is established to provide retirement or pension benefits to beneficiaries who are current or former employees, has no more-than-five-percent beneficiaries and receives tax benefits on either contributions or investment income in its home country. The exemption applies to direct investments as well as investments through partnerships.

A few revenue-raising provisions are meant to offset the impact of the taxpayer-friendly changes. The FIRPTA withholding rate increases from 10 to 15 percent for dispositions occurring 60 days after enactment. For dispositions on or after December 18, 2015, the PATH Act codifies that the "cleansing rule" of Section 897(c)(1)(B) does not apply to REITs or RICs or any corporation if the corporation or any predecessor was a REIT or RIC during the applicable testing period. Lastly, for purposes of determining whether dividends from a foreign corporation (attributable to dividends from an 80 percent owned domestic corporation) are eligible for the dividends-received deduction under Section 245, dividends from REITs and RICs are no longer treated as dividends from domestic corporations.

Treasury Proposes Rules for Country-by-Country Reporting

Treasury recently issued proposed regulations under Section 6038 on country-by-country (CbC) reporting. A product of the Organization for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) initiative, CbC reporting is meant to add transparency to the operations and tax positions of multinational groups, giving tax authorities a tool to identify potential transfer pricing abuses.

The proposed regulations largely adhere to the OECD guidance while clarifying some vague or undefined items in the OECD template. A U.S. person that is the ultimate parent entity of a multinational group with at least $850 million in annual revenue will be required to report, in aggregate for each jurisdiction:

- Revenues from related party transactions.
- Revenues from unrelated party transactions.
- Profit or loss before income tax.
- Income tax paid on a cash basis to all tax jurisdictions, including taxes withheld.
- Accrued tax expense, reflecting only operations in the relevant annual accounting period and excluding deferred taxes or provisions for uncertain tax positions.
- Stated capital.
- Accumulated earnings.
- Number of employees on a full-time equivalent basis.
- Net book value of tangible assets other than cash or cash equivalents.

Many taxpayers have expressed concern about the safeguarding of CbC information, even though the information would constitute "return information" subject to the confidentiality rules of Section 6103. Companies in the defense

industry have even cited potential national security concerns. Treasury expects to exchange CbC information only pursuant to information exchange agreements. New agreements would be pursued only after Treasury was assured of a potential partner's legal framework for keeping information confidential and its record for compliance with that framework.

Another critical issue raised by the proposed CbC regulations is timing. The U.S. regulations would be effective for tax years beginning on or after the date the regulations are finalized. Meanwhile, the OECD had recommended that countries implement rules for the first reports to be filed in 2017 based on the 2016 year. Assuming final regulations are published in 2016, many U.S. companies may not be required to file the CbC report until 2018—meaning that foreign affiliates may have to supply CbC reports locally even when the ultimate parent is not required to do so. Moreover, the regulations would have the CbC report due with the U.S. parent's federal income tax return (including extensions), while the OECD calls for the CbC report to be filed within 12 months of the end of the fiscal period. It is not clear if or how Treasury might deal with these timing issues.

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