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Proposed Legislative Change to Foreign Real Property Investments

CONSTRUCTION, REAL ESTATE, TAX
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The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) was enacted to ensure that gain attributable to the disposition of U.S. Real Property would be subject to U.S. tax for all parties involved, including foreign corporations and individuals. Prior to the enactment of FIRPTA, the Treasury Department submitted a report that showed that foreign investors were able to avoid U.S. tax on gains from dispositions of U.S. real property under the Internal Revenue Code Sections (IRC) 871 and 881, wherein capital gains of foreign persons are generally exempt from U.S. tax unless the gains constitute effectively connected income (ECI).

The enactment of FIRPTA ensured that the gains and losses derived from sales of interest in U.S. real property would be treated as ECI. The Act also defined what constitutes an interest in U.S. real property, including ownership interests in a corporation (not regularly traded on an established security market), partnership, estate or trust to the extent that the entity assets are U.S. Real Property Interests. Accordingly, under IRC 1445 a sale of a partnership interest wherein an amount of the disposition is attributable to a U.S. Real Property would result in U.S. tax withholding on the attributable amount.

One exception to the FIRPTA tax rules is the exclusion from the definition of a U.S. Real Property Interest of ownership interests in a publicly traded partnership or publicly traded trust (domestically controlled REIT) if the holder of the interest owns less than five percent (5%) of the traded class of stock/partnership interest. Recently two members of the House Ways and Means Committee, Reps. Kevin Brady (R-Tex) and Joe Crowley (D-NY) have introduced legislation to increase the percentage to ten percent (10%). The legislation would also exempt foreign pension funds from FIRPTA tax entirely. The goal of the legislation is to encourage more foreign investment into the U.S real estate market. "Modernizing FIRPTA and encouraging foreign investment will boost job growth and expand our local economies," according to Rep. Brady.

The legislation has yet to be voted on, but with the apparent continued support of both parties and both branches of Congress, a passing vote could be coming in the months ahead. However, with the current budget deficit and the direct benefit of the legislation going to foreign investors, it is far from a guarantee to be made law. We will keep you up to date on any future developments.

Contact us regarding the proposed legislation change to the Foreign Investment in Real Property Tax Act (FIRPTA) and visit our Construction and Real Estate services pages for our service offerings.

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