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## Foreign Investment In U.S. Real Estate-Beyond FIRPTA: Regulatory Requirements and Planning Strategies

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**FOREIGN INVESTMENT IN U.S. REAL ESTATE — BEYOND  
FIRPTA: REGULATORY REQUIREMENTS AND PLANNING  
STRATEGIES**

Michael Rosenberg

Mark D. Rich\*

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## I. CONFIRM THE FOREIGN STATUS OF YOUR CLIENT

As a prerequisite to advising a foreign client as to how to structure a U.S. investment purchase or sale, it is imperative that the advisor determine that the client is in fact foreign. An entirely different regime of U.S. taxation applies to foreign persons versus U.S. persons. In addition, if the investing vehicle is an entity, it is imperative that the advisor determine how such entity will be treated for U.S. tax purposes (i.e., as an estate or trust, as a partnership, as a corporation, as an association taxed as a corporation, etc.). The relevant U.S. tax consequences will vary greatly depending upon the classification of the entity.

### A. *Individuals*

#### 1. Income Taxation

Effective for tax years beginning after 1984, objective definitions of the terms U.S. income tax "resident alien" ("RA") and "nonresident alien" ("NRA") were incorporated into the Internal Revenue Code of 1986.<sup>1</sup> The statutory definitions are found in I.R.C. § 7701(b) and do not affect the determination of residence for federal estate, gift and generation-skipping transfer tax purposes. An alien individual is considered an RA with respect to any calendar year if such alien individual: (i) is a lawful permanent resident of

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<sup>1</sup> See I.R.C. § 7701(b). All section references are to the Internal Revenue Code of 1986 (the "Code") [hereinafter referred to by I.R.C. § reference only] and the final and proposed Treasury Regulations issued thereunder [hereinafter cited as "Treas. Reg. §" and "Prop. Reg. §," respectively].

the U.S. at any time during the calendar year (the “Green Card Test”); or (ii) such alien individual meets the “Substantial Presence Test.”<sup>2</sup> If an alien individual does not satisfy the Green Card Test or Substantial Presence Test, he or she will be classified as an NRA.<sup>3</sup>

A lawful permanent resident is defined as an individual who has the status of having been lawfully accorded the privilege of residing permanently in the U.S. by the immigration laws, provided such status has neither been revoked nor administratively or judicially determined to have been abandoned.<sup>4</sup> Pursuant to the Substantial Presence Test, an alien individual is classified as an RA for a calendar year (the “Current Year”) if he or she is present in the U.S. for 31 days or more in the Current Year and has been present in the U.S. for 183 days or more during a 3-year period, weighted toward the Current Year.<sup>5</sup>

An individual shall not be treated as meeting the Substantial Presence Test if such individual is present in the U.S. for fewer than 183 days during the Current Year and it is established that for the Current Year, such individual has a “closer connection” with a foreign country and a “tax home” in that country.<sup>6</sup> This closer connection or tax home exception, however, will not apply with respect to an alien who has at any time during the current year, an application pending to change his or her status to permanent resident or who has taken other affirmative steps to apply for status as a lawful permanent U.S. resident.<sup>7</sup>

Moreover, under certain circumstances, foreign government-related individuals, students, teachers and/or trainees are defined as exempt individuals and may avoid application of the Substantial Presence Test.<sup>8</sup> However, in the case of students, teachers or trainees, the exception is limited to a certain number of years.<sup>9</sup> In addition, an alien individual who is unable to leave the U.S. because of a medical condition which arose while the individual was present in the U.S. is not treated as being present in the U.S. for purposes of the

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<sup>2</sup> I.R.C. § 7701(b)(1)(A).

<sup>3</sup> I.R.C. § 7701(b)(1)(B). Section 7701(b)(4) describes a third test, whereby an alien not meeting either the Green Card Test or the Substantial Presence Test and who did not reside in the United States during the year preceding the election year may still be considered an RA if certain residency requirements are met.

<sup>4</sup> I.R.C. § 7701(b)(6).

<sup>5</sup> I.R.C. § 7701(b)(3)(A). An alien is considered an RA during the Current Year if the sum of the days he or she is present in the U.S. during the Current Year, plus one-third (1/3) of the days present during the first preceding year, plus one-sixth (1/6) of the days present during the second preceding year, equals or exceeds 183 days.

<sup>6</sup> I.R.C. § 7701(b)(3)(B).

<sup>7</sup> I.R.C. § 7701(b)(3)(C).

<sup>8</sup> I.R.C. §§ 7701(b)(3)(D)(i) and 7701(b)(5).

<sup>9</sup> I.R.C. § 7701(b)(5)(E).

Substantial Presence Test on any day that such individual was unable to leave the U.S. because of the medical condition.<sup>10</sup> This is a narrow exception limited to persons who require medical attention after arriving in the U.S. and are therefore unable to leave the United States.

Section 7701(b)(7)(A) defines presence in the U.S. as any day that an individual is physically present in the U.S. for any part of the day; however, if an individual regularly commutes to employment in the U.S. from a place of residence in Canada or Mexico, such individual shall not be treated as present in the U.S. on any day during which he or she so commutes.<sup>11</sup> If an individual who is in transit between two points outside the U.S. is physically present in the U.S. for less than twenty-four (24) hours, such individual shall not be treated as present in the U.S. during such transit.<sup>12</sup>

Special rules are also provided to determine an alien's "first year of residency" and "last year of residency."<sup>13</sup> It is important to understand these rules, as appropriate planning around the cut-off dates can prove beneficial or disastrous depending upon the circumstances. Also, these special rules provide that certain nominal presence in the U.S. may be disregarded.<sup>14</sup>

Section 7701(b)(11) provides that regulations may prescribe what annual statements must be filed to report the relevant details for those individuals claiming the benefit of the closer connection/tax home exception, the exempt individual exception, or the medical condition exception.<sup>15</sup>

## 2. Estate, Gift and Generation-Skipping Transfer Taxation

The objective RA definition under I.R.C. § 7701(b) does not affect the definition of residence for federal estate, gift and generation-skipping transfer tax purposes; the determination hereunder is made independently and because the relevant authorities are unclear and inconclusive, such determination constitutes a difficult and subjective factual determination.

The Treasury Regulations define "residence" for these purposes in terms of "domicile" as follows:

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<sup>10</sup> I.R.C. § 7701(b)(3)(D)(ii).

<sup>11</sup> I.R.C. § 7701(b)(7)(B).

<sup>12</sup> I.R.C. § 7701(b)(7)(C).

<sup>13</sup> See I.R.C. § 7701(b)(2).

<sup>14</sup> I.R.C. § 7701(b)(2)(C).

<sup>15</sup> See Treas. Reg. § 301.7701(b)-8, detailing the various reporting requirements.

"A 'resident' decedent is a decedent who, at the time of his death, had a domicile in the U.S. . . . A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal."<sup>16</sup> In connection with the determination of domicile, some of the most common factors analyzed in the estate and gift tax context are:

- (1) The amount of time spent by the decedent in the U.S., in other countries, and the frequency of travel both between the U.S. and other countries and between places abroad;<sup>17</sup>
- (2) The size, cost and nature of houses or other dwellings, and whether those places were owned or rented by the decedent;<sup>18</sup>
- (3) The area or locality in which the houses and dwelling places are located;<sup>19</sup>
- (4) The location of expensive and cherished personal possessions of the decedent;<sup>20</sup>
- (5) The location of the decedent's family and close friends;<sup>21</sup>
- (6) The places where the decedent has maintained and participated in civic leagues, churches, clubs, etc;<sup>22</sup>
- (7) The location of the decedent's business interests;<sup>23</sup>
- (8) The location of the bulk of the decedent's assets, and the location of his professional advisors;<sup>24</sup>

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<sup>16</sup> See Treas. Reg. §§ 20.0-1(b)(1) and 25.2501-1(b).

<sup>17</sup> See, e.g., *Bank of New York & Trust Co.*, 21 B.T.A. 197 (1930), acq. x-1 C.B. 4 and x-2 C.B. 5 (1931).

<sup>18</sup> See *Estate of Anthony H. G. Fokker*, 10 T.C. 1225 (1948), wherein the decedent maintained a large home in New York and a smaller home in Switzerland. The Tax Court found the decedent to be a U.S. domiciliary. The Court compared the size of the houses and their localities, and stressed that the location of the Swiss home (in St. Moritz) constituted a resort, pleasure oriented community with international appeal.

<sup>19</sup> *Id.*

<sup>20</sup> See *Farmers' Loan & Trust Co. v. U.S.*, 60 F.2d 618 (S.D.N.Y. 1932).

<sup>21</sup> See *Estate of Jan Willem Nienhuys*, 17 T.C. 1149 (1952).

<sup>22</sup> *Id.* See also *Farmers' Loan & Trust Co.*

<sup>23</sup> See *Estate of Anthony H. G. Fokker*.

<sup>24</sup> See *Estate of Edouard H. Paquette*, 46 TCM 1400 (1983).

- (9) The place where the decedent filed tax returns up until his death;<sup>25</sup>
- (10) Declarations of residence or intent made in visa applications or re-entry permits, wills, deeds of gift, trust instruments, letters, and oral statements made by the decedent;<sup>26</sup>
- (11) Whether the decedent used travelers' checks and international credit cards while in the U.S. rather than U.S. issued credit cards and local accounts;
- (12) Whether the decedent obtained and used a U.S. driver's license as opposed to an international one;
- (13) Whether the decedent acquired in his own name (as opposed to renting) an automobile in the U.S.;
- (14) Whether the decedent spent holiday periods with his family, and if so, where;
- (15) Whether the decedent brought his family to the U.S.;
- (16) Whether the decedent was engaged in political activity such as voting, public, or military service, abroad;
- (17) Reasons or motivation for presence of the decedent in the U.S., e.g. health, pleasure, business, war or terrorism in home country or avoidance of political repression or instability in home country.

### B. Entity Classification

A "sampling" of some general concepts that should be considered when determining entity classification is presented below.

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<sup>25</sup> *Id.*

<sup>26</sup> See *Bank of New York & Trust Co.*, 21 B.T.A. 197 (1930) acq., x-1 C.B. 4 and x-2 C.B. 5 (1931), wherein the decedent, a U.S. citizen, spent the last 5 years of her life traveling in France, Italy and other countries in Europe. The Court found that she was a U.S. resident, and that she did not have the intention to abandon her U.S. residence while in Europe since her purposes for being there were pleasure and health. The decedent's declarations and actions indicated that her home was in the U.S. (e.g., when applying for passport renewals she stated that she was abroad only temporarily, and in two trust instruments and a will executed by her she described herself as a resident of Washington, D.C.). See also *Estate of Anthony H. G. Fokker, Frederick Rodiek*, 33 B.T.A. 1020 (1936), *aff'd* 37-1 USTC ¶9032 (2d Cir.); *Estate of Julius Bloch-Sulzberger*, 6 TCM 1201 (1947).

## 1. Corporations.

“Although it is the Internal Revenue Code and Treasury Regulations issued thereunder rather than local law which establish the tests or standards which will be applied in determining the classification in which an organization belongs, local law governs in determining whether the legal relationships which have been established in the formation of an organization are such that the standards are met.”<sup>27</sup> The local law of the foreign jurisdiction must be applied to determine the legal relationships of the members of unincorporated business organizations among themselves and with the public at large, as well as the interests of the members of the organization in its assets.<sup>28</sup>

The characterization of an organization as a corporation rather than as a partnership or trust is based upon an evaluation of the corporate characteristics under the standards of Treas. Reg. § 301.7701-2. Moreover, foreign organizations are analyzed using the same standards applicable to domestic organizations.<sup>29</sup>

The major characteristics found in a pure corporation, which distinguish it from other organizations, are set forth in Treas. Reg. § 301.7701-2(a)(1) and include: associates; an objective to carry on business and divide the gains therefrom; continuity of life; centralization of management; liability for corporate debts limited to corporate property; and free transferability of interests. Because associates and an objective to carry on business for joint profit are essential characteristics of all organizations engaged in business for profit, the absence of either will cause an arrangement among co-owners of property for the development of such property for the separate profit of each not being classified as an association taxable as a corporation.<sup>30</sup> However, the legal entity will be treated as an association taxable as a corporation if the corporate characteristics, including other significant factors in addition to the major characteristics, are such that the organization more resembles a corporation than another entity such as a partnership or a trust.<sup>31</sup>

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<sup>27</sup> Treas. Reg. § 301.7701-1(c).

<sup>28</sup> Rev. Rul. 73-254, 1973-1 C.B. 613. See also *MCA Inc., and Universal City Studios, Inc. v. U.S.*, 82-2 USTC ¶9552 (9th Cir.), *rev'd*, 80-2 USTC ¶9617 (C.D. Cal.).

<sup>29</sup> Rev. Rul. 73-254.

<sup>30</sup> Treas. Reg. § 301.7701-2(a)(2).

<sup>31</sup> See Treas. Reg. § 301.7701-2. See also *Phillip G. Larson v. Commissioner of Internal Revenue Service*, 66 T.C. 159 (1976) and Rev. Rul. 79-106, 1979-1 C.B. 448. See also I.R.C. §§ 7701(a)(4) and (5) as to the classification of a corporation as domestic or foreign. See also Rev. Rul. 93-4, 1993-1 C.B. 225,



## 2. Partnerships and Limited Liability Companies

For an application of the above principles concerning entity classification in the context of a foreign partnership, see *Elott H. Rafferty Farms, Inc. v. United States*,<sup>32</sup> which involved a Mexican farming operation held taxable as a partnership rather than as a corporation, even though the underlying operation was organized in the form of a Mexican limited responsibility company. On appeal, however, the majority of the court, relying strongly on the fact that the entity in question afforded its owners complete protection from personal liability, and that it acted mainly in its own name and instead found that corporate characteristics predominated.<sup>33</sup> Once the determination of partnership status is made, I.R.C. § 7701(a)(4) defines a domestic partnership as one created or organized in the U.S., or under the law of the U.S. or any state, while I.R.C. § 7701(a)(5) defines a foreign partnership as one which is not domestic.<sup>34</sup>

As to a limited liability company (discussed further in § II.B.5, *infra*), which has both corporate and partnership characteristics as well as certain characteristics which are not common to either, the Internal Revenue Service (the "Service") has concluded that such a company can be taxable as a partnership rather than as a corporation.<sup>35</sup>

## 3. Trusts

Every trust is a potentially taxable entity for Federal income tax purposes. In distinguishing a trust from a corporation, characteristics which are common to both types of entities are not material, since trusts and corporations share centralization of management, continuity of life, free transferability of interests, and limited liability. The focus shifts to the remaining two corporate

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concerning a German GmbH, wherein the Service confirmed that such entity has the corporate characteristics of limited liability and centralized management. However, the Service further noted that German law provides for optional provisions in the memorandum of association so that the status of the GmbH can be that of a corporation or partnership depending upon the construction of that memorandum.

<sup>32</sup> 74-1 USTC ¶9184 (E.D. Mo.), *rev'd*, 75-1 USTC ¶9271 (8th Cir.).

<sup>33</sup> In connection with classification of an entity as a partnership, also consider Treas. Reg. § 301.7701-3(a) and Rev. Rul. 73-254.

<sup>34</sup> See also Priv. Ltr. Rul. 86-35-064 (June 5, 1986) and 87-01-017 (October 3, 1986).

<sup>35</sup> Rev. Rul. 88-76, 1988-2 C.B. 360. See also Rev. Rul. 93-53, 1993-2 C.B. 312, involving a Florida limited liability company.

characteristics (1) associates, and (2) a purpose to carry on business and divide profits.<sup>36</sup>

To determine if a trust is domestic or foreign, the factors to be considered include: jurisdiction where the trust is created, the physical situs of trust assets, situs of trust administration, and the nationality and residence of the trustee, grantor, and beneficiary.<sup>37</sup>

## II. STRUCTURING THE PURCHASE OF THE INVESTMENT

### A. Non-Tax Considerations

Often, the foreign client's immigration needs will dictate the choice of investment entity. Moreover, in many situations, one or more clients will require as much anonymity as possible, thus resulting in a somewhat complex tiered structure which may offer a better opportunity for certain confidentiality but may not be the optimum tax structure. However, in this ever-changing world where the U.S. is constantly entering into income tax treaties, tax information exchange agreements, and other similar arrangements providing for exchange of information, it is difficult for any professional to assure confidentiality to his or her client.

Although the combined U.S. income, estate, gift and generation-skipping transfer tax consequences may also "suggest" a certain structure, the expense and complexity associated therewith may not merit selection of such structure if the amount of the investment is not substantial. In addition to limited liability considerations associated with certain entities, many benefits may or may not be available depending upon the entity used and the status of the entity as foreign versus domestic. For instance, certain federal, state and/or local governmental agencies may not lease space from a foreign entity or will only do so upon the receipt of certain disclosures which a foreign client may not be willing to provide. Furthermore, in connection with real estate, foreign persons may be charged a higher interest rate and/or additional points in connection

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<sup>36</sup> See Reg. § 301.7701-4(a). See also Rev. Rul. 78-371, 1978-2 C.B. 344 and Rev. Rul. 79-77, 1979-1 C.B. 448. See also *Estate of Oei Tjong Swan*, 24 T.C. 829 (1955), *rev'd* on other grounds, 57-2 USTC ¶11,714 (2d Cir.), wherein the Tax Court concluded that two Swiss Stiftungs were in the nature of revocable trusts and not foreign corporations. See Rev. Rul. 79-116, 1979-1 C.B. 213 involving a Liechtenstein Anstalt, and *Oak Commercial Corp.*, 9 T.C. 947 (1947), *aff'd.*, *Aramo-Stiftung v. Comm'r.*, 49-1 USTC ¶9205 (2d Cir.).

<sup>37</sup> Rev. Rul. 60-181, 1960-1 C.B. 257 and Rev. Rul. 87-61, 1987-2 C.B. 219. See also *B.W. Jones Trust*, 46 B.T.A. 531 (1942), *aff'd.*, 43-1 USTC ¶9238 (4th Cir.) and I.R.C. § 7701(a)(31).

with financing, and higher premiums for insurance. Certain filings, for instance, with the Department of Commerce, the Department of Agriculture, and the State of Florida,<sup>38</sup> may also be required in connection with investments by foreign persons.

As a further consideration, in connection with any investment structure involving more than one person, especially where one or more investors are foreign, the appropriate shareholders' agreement, partnership agreement, trust provision or similar provision should address who will be responsible for the fees and costs associated with satisfying the ever-increasing U.S. withholding tax requirements applicable to foreign investors. Such requirements are noted in various parts of this article. The agreement should also address how to handle a situation where funds available for distribution to the investors cannot be distributed without violating one or more of these ever-increasing withholding tax provisions. Furthermore, any advisor or client serving in a fiduciary capacity involving one or more foreign persons may be held liable for such special withholding tax considerations and thus should make certain that he or she is adequately protected.

### *B. U.S. Tax Considerations of Alternative Investment Vehicles*

The following section discusses the tax considerations for alternative investment vehicles.

#### 1. Individual Ownership

The main advantage of individual ownership is that it carries with it an opportunity for only one level of taxation.<sup>39</sup> As an additional advantage, disposition of the investment may result in capital gains which are taxed at the 28% rate.<sup>40</sup> Moreover, if real property is held for investment rather than developed, individual ownership is also the least complex structure and it avoids the onerous branch profits tax ("BPT") and branch level interest tax ("BLIT") which apply to a foreign corporation ("FC") engaged in a trade or business in the U.S. ("USTB"). See § II.B.2, *infra*. An NRA individual owner

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<sup>38</sup> For purposes of this article, it is assumed that the investment will be in Florida.

<sup>39</sup> However, the Revenue Reconciliation Act of 1993 increased the prior maximum thirty-one percent (31%) rate to thirty-six percent (36%) and possibly to thirty-nine and six tenths percent (39.6%) if the surtax applies. I.R.C. § 1.

<sup>40</sup> I.R.C. § 1(h).

can pay out U.S. tax-free foreign source interest on U.S. business related debt if such business assets secure such debt, subject to a percentage limitation.<sup>41</sup> In essence, this avoids the general U.S. withholding tax and BLIT provisions referred to below.

One disadvantage of this investment alternative is that it eliminates any opportunity for anonymity.<sup>42</sup> An additional disadvantage of individual ownership arises upon the disposition of the U.S. real property interest ("USRPI") by the foreign investor. Upon disposition, a withholding tax of 10% of the amount realized (whether it be in the form of cash, notes, property, debt assumption, etc.) must be withheld by the transferee.<sup>43</sup> It should be noted that a USRPI is broadly defined and may include shares of stock in a domestic (e.g., Florida) corporation if more than 50% of such corporation's assets consist of USRPIs such as land, buildings, long-term leases, etc. when measured against the sum of such assets plus foreign real estate and other non-USRPI USTB assets. However, shares of stock in a foreign corporation [except where the special I.R.C. § 897(i) election is in effect] do not constitute a USRPI if such shares are disposed of. A foreign person's gain from the disposition of a USRPI is subject to tax under I.R.C. § 897. The I.R.C. § 1445 withholding tax is oftentimes referred to as "FIRPTA Withholding."<sup>44</sup>

Although the general FIRPTA Withholding amount is ten percent of the amount realized by the foreign transferor, specific exceptions apply in situations where in lieu of a direct disposition of a USRPI to a transferee (e.g., a buyer), the USRPI is disposed of in a liquidation, distribution, or similar manner by an entity to a shareholder, partner, or beneficiary (a detailed discussion of these exceptions is beyond the scope of this article).<sup>45</sup>

Another important disadvantage of individual ownership is "unlimited" liability. Briefly, if a judgment is rendered due to any one of a number of possibilities (e.g., a car accident), it is not uncommon in today's U.S. litigious society that such judgments can be "significant" in amount. Thus, if the NRA lacks sufficient insurance, his or her individually owned assets might be taken by creditors. Because the unlimited liability issue is relevant throughout various

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<sup>41</sup> Treas. Reg. § 1.861-9T(2).

<sup>42</sup> The appropriate legal documentation and recording are done in the name of the individual owner and Form 1040NR, the Nonresident Alien U.S. Individual Income Tax Return, will be required.

<sup>43</sup> See I.R.C. § 1445.

<sup>44</sup> Based on the Foreign Investment Real Property Tax Act of 1980, as amended ("FIRPTA") and the withholding statutes enacted in 1984 to supplement such tax.

<sup>45</sup> See I.R.C. § 1445 and the Treasury Regulations thereunder.

portions of the Article, any foreign client should consult his or her home country attorneys as to local law and the recognition of a U.S. judgment.

Depending upon the type of investment and subject to any contrary treaty provision, individual ownership will often result in the onerous U.S. estate tax in the event of an untimely death,<sup>46</sup> or in a gift tax in the event of a gift.<sup>47</sup> However, if the gifted asset is intangible property (e.g., shares of a corporation, including shares of a USRPI), the gift tax would not apply. The effective U.S. estate and gift tax rates may reach as high as 55% and the deductions, expenses and credits generally available to U.S. persons are curtailed in the case of a nonresident alien domiciliary ("NRAD") in the absence of a contrary treaty provision.<sup>48</sup>

## 2. Direct Ownership by a Foreign Corporation.

The main advantage of ownership of the investment by an FC is avoidance of the U.S. estate tax.<sup>49</sup> Ownership through an FC also provides additional anonymity and most importantly, it provides limited liability against the claims of creditors so long as the FC does not hold other assets.<sup>50</sup> Moreover, it is not an income tax disadvantage to own the investment through an FC since, pursuant to I.R.C. § 11, the existing U.S. corporate income tax is also similar to the maximum individual income tax rate associated with individual ownership.<sup>51</sup> See § II.B.1, *supra*.

An obvious disadvantage of direct ownership by an FC is the initial expense and the annual cost associated with the FC. Next, where the investment involves a USRPI, FIRPTA Withholding will be required on a disposition by an FC of any USRPIs. Assuming direct ownership by an FC may ultimately be

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<sup>46</sup> See I.R.C. § § 2103, 2104 and Treas. Reg. § 20.2104-1(a)(1).

<sup>47</sup> See I.R.C. § 2105.

<sup>48</sup> I.R.C. § § 2001, 2101-2108.

<sup>49</sup> Treas. Reg. § 20.2105-1(a)(1).

<sup>50</sup> Liability may be limited, but if an FC has additional U.S. or third country assets, a U.S. creditor may obtain a U.S. judgment and wish to pursue such additional assets.

<sup>51</sup> The corporate income tax rate reaches a maximum of thirty-five percent (35%) on taxable income in excess of \$10,000,000, with rates of thirty-four percent (34%) on taxable income levels between \$75,001 and \$10,000,000, twenty-five percent (25%) on income levels between \$50,001 and \$75,000, and fifteen percent (15%) on income which does not exceed \$50,000. Also, in the State of Florida, a corporate income tax rate of five and one-half percent (5.5%) will apply. Please note that state income tax is deductible for U.S. income tax purposes.

selected, it is important that the advisor be aware of the potential complexity associated with the FIRPTA Withholding.<sup>52</sup>

Another disadvantage of direct ownership by an FC is the BPT and BLIT applicable to an FC engaged in a USTB.<sup>53</sup> When Congress enacted the BPT, the theory was that it was a substitute for a dividend tax, based on the premise that any effectively connected earnings and profits ("ECEP")<sup>54</sup> not reinvested in the FC's USTB were, in essence, the same as if the FC had paid a dividend to its foreign shareholders. Because certain tax treaties<sup>55</sup> reduce the rate of tax or exempt actual dividends from U.S. tax, and because a domestic corporation would generally be taxed on its undistributed ECEP in any event [while an FC through proper planning could avoid the U.S. effectively connected income rules and thus invest such profits without U.S. income tax], Congress acted to close that loophole. Since the effective date of the BPT on January 1, 1987, many FCs have been surprised by the annual potential double tax consequences resulting therefrom. Also, aside from the annual monitoring to avoid the BPT, many FCs which have not satisfied the Complete Termination Rule<sup>56</sup> have been subjected to double tax during what was thought to be the otherwise U.S. tax-free liquidation stage.

If the FC sold off all of its assets and terminated its USTB without returning the direct or indirect USTB assets or proceeds from the disposition to the U.S. through a corporate vehicle during the three years thereafter, and if certain procedural steps are followed, the BPT can currently be avoided under the Complete Termination Rule. In that situation, the BPT will be eliminated and the effective U.S./Florida tax rate will be approximately 38%.<sup>57</sup>

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<sup>52</sup> See Rev. Proc. 88-23, 1988-1 C.B. 787, and I.R.C. § 1445 and the Treasury Regulations thereunder.

<sup>53</sup> See I.R.C. § 884.

<sup>54</sup> See I.R.C. § 884(d).

<sup>55</sup> See I.R.C. § 884(e).

<sup>56</sup> See Treas. Reg. § 1.884-2T. Also note that there have been several proposals to impose a "double tax" in the situation described in § II.B.3.b. *infra* (the "Proposal"). Should the Proposal ultimately be enacted, it, in combination with the Service, would likely eliminate the BPT Complete Termination Rule which may now be used by an FC to avoid the BPT in the appropriate situation.

<sup>57</sup> The complexities of the BPT rule are many and the authors have only included a general summary in this Article. The effects of the BLIT are discussed in § II.B.9. below. See also § II.B.9. regarding the I.R.C. § 163(j) interest-stripping limitation.

### 3. Direct Ownership by a Domestic Corporation ("USCO") Owned by an FC.

Because the shares of stock of an FC are not subject to U.S. estate tax, and constitute intangible property for U.S. gift tax purposes, this structure avoids such taxes.<sup>58</sup> In addition, this structure provides an extra level of anonymity as well as the same limited liability discussed in § II.B.2, *supra*.

From a U.S. income tax viewpoint, a USCO would be subject to tax at the same combined effective U.S./Florida rate of approximately 38% as discussed in § II.B.2, *supra*. Furthermore, because the BPT applies only to an FC engaged in a USTB, the prospect of being subjected to such tax in the absence of an actual dividend or upon failure to satisfy the Complete Termination Rule requirements is eliminated.<sup>59</sup> However, if the foreign shareholder of a USCO plans to withdraw the USCO's profits as a dividend in any event, the normal I.R.C. § 1441 withholding tax applicable to dividends will apply thus rendering a result similar to the BPT.<sup>60</sup>

The FC parent/USCO subsidiary/U.S. investment structure is generally favored by foreign investors with long-term plans to invest in the U.S. and to retain the U.S. profits without removing them in the form of dividends. The major advantage of this structure over that in § II.B.2, *supra*, is the avoidance of the complex, technical and oftentimes surprising results of the BPT.<sup>61</sup> In fact, with the introduction of the BPT, numerous FCs having USTB status "domesticated" or otherwise restructured their affairs so that the USTB would be operated by a USCO subsidiary of an FC with the FC parent used for U.S. estate tax avoidance purposes.

Where the investment includes a USRPI, another advantage to this structure is the elimination of third party transferee FIRPTA Withholding on the disposition of USRPIs by the USCO.<sup>62</sup> Any such withholding will be at the

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<sup>58</sup> I.R.C. §§ 2104(a) and 2105.

<sup>59</sup> I.R.C. § 884(a).

<sup>60</sup> Consider I.R.C. §§ 861(a), 871(a), 881(a), 884, 1441 and 1442 for the relevant source, taxation and withholding rules.

<sup>61</sup> The foreign shareholder of USCO will know that a dividend withholding tax will be due when a dividend is in fact paid but can avoid the "disguised" manner in which an FC having a USTB with ECEP can be subjected to a similar tax notwithstanding an overall intention to continue its USTB activities.

<sup>62</sup> Note that FIRPTA Withholding applies only to foreign persons disposing of USRPIs. However, as previously mentioned in § II.B.1. above, if USCO distributes USRPIs to FC or enters into certain similar types of transactions, FIRPTA Withholding may result. See Rev. Proc. 88-23, 1988-1 C.B. 787, which addresses such situations.

level of the related parties and this is generally better than withholding by unrelated transferees or having to construct an agreement satisfactory to the Service in lieu of such withholding. However, a disadvantage to this overall structure is that it becomes more complex and costly with the introduction of a new FC parent/USCO subsidiary relationship. The USCO also must file a U.S. corporate income tax return, Form 1120, plus any required state corporate income tax returns.<sup>63</sup>

As mentioned in § II.B.2, above, the Proposal, which has not been enacted, would have resulted in double taxation which would have adversely affected this investment structure. As an illustration, assume the investment is a USRPI. Under current law, if USCO disposes of all of its USRPIs and pays all U.S. income taxes attributable to such gain in full, USCO will "cleanse" itself from the USRPI status and can be disposed of by an FC without any additional U.S. income tax.<sup>64</sup> Absent a contrary treaty provision, the Proposal, which may some day reappear, would tax any foreign shareholder holding a ten percent (10%) or more interest in a USCO on any gain it receives from a liquidation of a USCO "as if" such gain were effectively connected with a USTB of such foreign shareholder. Such gain would be subject to tax at the foreign shareholder's effective rate. Moreover, assuming the FC parent/USCO subsidiary structure, if the FC liquidates a USCO after the USCO has paid the effective U.S./state tax rate receives the net gain proceeds from the USCO (plus a recoupment of the FC's original capital or loan investment), under the Proposal, the FC would again be taxed on such gain at a 34% or 35% to 38% rate thus resulting in an effective overall tax bite of approximately sixty 61%.<sup>65</sup>

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<sup>63</sup> Prior to RRA-93, in connection with a Florida investment, the combined U.S./state approximate thirty-eight percent (38%) income tax rate was more than the pre-RRA-93 thirty-one percent (31%) maximum individual income tax rate. However, RRA-93 has somewhat equalized the corporate versus individual ownership rate comparison with the introduction of the new individual thirty-six percent (36%) and thirty-nine and six tenths percent (39.6%) rates. *See supra* note 51.

<sup>64</sup> I.R.C. § 897(c)(1)(B).

<sup>65</sup> It is hoped that the Proposal will not be enacted as it would have a substantial adverse effect on all foreign investors who restructured their USRPI holdings into the FC/USCO/USRPI format in order to avoid the onerous BPT. The Proposal would also adversely affect NRA investors owning ten percent (10%) or more of the shares of a USCO.



#### 4. NRA/NRAD Directly Owns USCO Which in Turn Owns the Investment.

The advantages of this structure are that some anonymity is obtained; corporate limited liability is preserved; the U.S. gift tax exemption on intangibles applies; there is no I.R.C. § 1445 FIRPTA Withholding when the USRPI is disposed of; the BPT does not apply; the effective U.S./Florida tax rate of approximately 38% applies, and only one level of tax applies, if dividends are avoided, without having to satisfy the BPT Complete Termination Rule.

The disadvantage of this structure is that in the absence of a contrary treaty provision, the structure would give rise to U.S. estate tax.<sup>66</sup> Also, if the Proposal is ultimately enacted, then the second tax at the NRA shareholder level would be taxed.

#### 5. Ownership of the USRPI by a Limited Liability Company ("LLC").

Many states including Florida have enacted statutes to permit this new type of entity.<sup>67</sup> The LLC is oftentimes viewed as the NRA's alternative to the single level S corporation, as an S corporation cannot currently have an NRA shareholder.<sup>68</sup> As stated in § I.B.2, *supra*, an LLC can be taxed as a partnership for U.S. income tax purposes thus permitting the underlying ordinary profits to be taxed directly to the members resulting in the NRA 36% or 39.6% income tax rate where the member is an NRA. An additional advantage of the LLC is that such entity provides limited liability. Certain foreign countries have also adopted LLC statutes and although it is far from clear, use of a foreign LLC may afford a better opportunity to avoid U.S. gift tax, and arguably U.S. estate tax. Next, some anonymity is possible although probably not as much as in the corporate structures discussed in §§ II.B.2 and 3, *supra*, and no BPT or BLIT will apply so long as no member is an FC. Furthermore, whether or not the

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<sup>66</sup> I.R.C. § 2104 and Treas. Reg. § 20.2104-1 provide that property that is located in the U.S. will be subject to U.S. estate tax, unless exempted under these sections or I.R.C. § 2105. Stock in a U.S. domestic corporation is specifically designated as property which is sourced in the United States.

<sup>67</sup> See generally "Limited Liability Companies," FLA. STAT. ch. 608 (1982).

<sup>68</sup> I.R.C. § 1361(b)(1)(C). Certain treaty country NRAs should consider Prop. Reg. § 301.7701(b)-7(4)(a)(iii) and (iv) which, if adopted, would permit NRA filing status and S corporation ownership under certain circumstances. Also, occasional proposals, if enacted, would expand S corporation ownership to an NRA.

Proposal is ultimately enacted, it will not affect the LLC structure so long as no member is an FC and the LLC qualifies for partnership treatment.

However, for U.S. estate tax purposes, the shares of a domestic LLC may be viewed by the Service as shares of a USCO and thus be subject to estate tax. In the alternative, if the Service successfully "pierces" the LLC for U.S. estate and gift tax purposes,<sup>69</sup> U.S. estate and gift tax consequences would result even if the LLC were foreign. Also, notwithstanding an LLC can be treated like a partnership with pass-through consequences to the members for U.S. income tax purposes, Florida treats an LLC as a USCO and would thus subject it to the 5.5% Florida corporate income tax.<sup>70</sup>

An additional important consideration is that notwithstanding the limited liability that attaches to an LLC, if the LLC activities go beyond the boundaries of the state in which such LLC is incorporated (e.g., to a state having no or different LLC legislation), it is possible that such other state(s) may not recognize the LLC concept and may permit unlimited liability should a creditor obtain a judgment in another state wherein assets of the LLC exist.

In addition, the I.R.C. § 1446 withholding tax on a foreign member's share of effectively connected income will likely apply. Such tax is in the nature of a quarterly estimated tax payment and applies to any partnership (foreign or domestic) engaged in a USTB.<sup>71</sup>

#### 6. Ownership of the Investment by a Partnership Where the Partners Include an NRA or an FC.

Where the partner in a partnership is an NRA, only one level of U.S. income tax will result at the I.R.C. § 1 tax rates.<sup>72</sup> Also, the opportunity exists for the 28% capital gains rate to apply. If the partnership is limited rather than general, any limited partner may obtain limited liability. If the partner in a partnership is an FC, the I.R.C. § 11 rates are applicable and the Florida corporate income tax rate must be considered.

An additional advantage of the partnership structure is that the BPT will not apply unless a partner in a partnership is an FC. Furthermore, although

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<sup>69</sup> Treating any NRA member as owning the underlying U.S. investment.

<sup>70</sup> See FLA. STAT. ch. 608 (1982).

<sup>71</sup> Including "deemed" USTB gain from the disposition of non-USTB USRPIs (e.g., the sale of real land). Note that the I.R.C. § 1446 withholding rules are complex and create significant administrative burdens. The procedures, penalties and significant concepts are contained in Rev. Proc. 89-31, 1989-1 C.B. 895.

<sup>72</sup> I.R.C. § 701.

some good arguments may be made that no U.S. gift tax should apply to a gift of an interest in a partnership (an intangible), the Service's position is not clear to the extent a partnership owns U.S. situated investments (e.g., USRPIs). Also, unless the partner in a partnership is an FC, U.S. estate tax may result on the partner's proportionate value of the U.S. business assets or the U.S. situated investments.<sup>73</sup>

The disadvantages of this structure are that USTB status of a partnership and the U.S. permanent establishment of the partnership will be attributable directly to the partnership's foreign partners requiring such foreign partners to file the appropriate U.S. income tax returns.<sup>74</sup> Also, the partnership will be required to file a U.S. partnership income tax return (Form 1065). As noted above, it may be difficult for an NRAD partner to avoid U.S. estate and possibly gift tax through the vehicle of the partnership as the Service oftentimes views the partnership assets (e.g., the U.S. situated investments) to be treated as owned by such partner. Furthermore, the I.R.C. § 1446 partnership withholding rules discussed in § II.B.5, *supra*, must be carefully considered. Next, due to the filing requirements, anonymity is not likely. Finally, if the partner is an FC, the Proposal discussed in §§ II.B.2 and 3, *supra*, should be reviewed.

#### 7. Ownership Through an Irrevocable U.S. or Foreign Trust (Respectively "UST" or "FT").

Although a UST or FT can be revocable, the U.S. tax consequences would flow through to the NRA settlor and because the NRA direct ownership consequences were previously considered in § II.B.1, *supra*, they will not be reconsidered at this point. The advantages and disadvantages that follow assume the UST or FT is irrevocable.

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<sup>73</sup> Various theories can be asserted against the imposition of U.S. estate tax with regard to the partnership, but the law remains unclear. For instance, arguments for foreign situs of the partnership include: (i) look to where the partnership having a passive U.S. investment conducts its foreign business activities if a partner's death does not terminate the partnership; *See* Rev. Rul. 55-701, 1955-2 C.B. 836 and *Sanchez v. Bowers*, 70 F.2d 715 (2d Cir. 1934); (ii) issue the partnership bearer certificates and argue that the situs of such an intangible is where the certificate is kept [*see* Treas. Reg. § 20.2104-1(a)]; (iii) look to where the partnership is formed [*consider* GCM 18718, 1937-2 C.B. 476 declared obsolete by Rev. Rul. 70-59, 1970-1 C.B. 280, and *Sanchez v. Bowers*]; and (iv) look to where the NRAD is domiciled. *See* *Blodgett v. Silberman*, 277 U.S. 1 (1927).

<sup>74</sup> I.R.C. § 871(a)(1). *See also* Rev. Rul. 85-66, 1985-1 C.B. 187 and Rev. Rul. 91-32, 1991-1 C.B. 107. *See also* *Donroy, Ltd. et. al. v. U.S.*, 301 F.2d 200 (9th Cir. 1962) and *Unger v. Comm'r.*, 936 F.2d 1316 (D.C. Cir. 1991).

If the NRA/NRAD client is willing to give up all “rights, title, interest, powers, and any other tainted relationship” in the UST or FT which are required from a U.S. tax viewpoint to avoid adverse U.S. tax consequences, this structure will: avoid U.S. estate tax, result in one level individual income tax rates avoid the BPT and eliminate the potential adverse consequences that could result from the Proposal. If an FT is used, such trust may be able to pay out U.S. tax-free foreign source interest on U.S. business related debt if such business assets secure such debt, subject to a percentage limitation.<sup>75</sup> In essence, this avoids the general U.S. withholding tax and BLIT provisions. In addition, the I.R.C. § 1446 partnership withholding rules discussed in §§ II.B.5 and 6, *supra*, would not apply. Please note, the BPT can result to an FC beneficiary of a UST or FT.

However, if income of the UST or FT is not distributed to or required to be paid out to one or more beneficiaries, the RRA-93 increased the income tax rates applicable to trusts<sup>76</sup> to 36% and 39.6% rates at \$5,500 and \$7,500 of income, respectively. Such levels are significantly lower than those for individuals. Where the income of the UST or FT is distributed to or required to be paid out to a foreign beneficiary, the USTB status of the UST or FT passes through to any foreign beneficiary so that such beneficiary will be taxed directly on its share of trust income.<sup>77</sup> The appropriate U.S. income tax return will also have to be filed for the UST or FT (Form 1041 or 1040NR) and for the respective beneficiaries.

#### 8. Hedging Against the U.S. Estate Tax.

Although direct ownership of a USRPI by an NRA or ownership thereof through a USCO, LLC, partnership, or revocable UST or FT can result in U.S. estate tax, the U.S. advisor should be aware of the fact that proceeds of a U.S. life insurance policy on the life of an NRAD are exempt from U.S. estate tax.<sup>78</sup> Such a policy can be used as a “hedge” against any U.S. estate tax that could result if an NRA/NRAD client died owning U.S. situated assets.<sup>79</sup> Life insurance can also be used as a “hedge” against U.S. estate tax in those occasional situations where the Service may attempt to “pierce” an FC which

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<sup>75</sup> See I.R.C. §§ 871(a)(1)(A), 861(a)(1), 871(h) and Treas. Reg. § 1.861-9T(d)(2).

<sup>76</sup> See *id.* § 1(e).

<sup>77</sup> I.R.C. § 875.

<sup>78</sup> I.R.C. § 2105(a).

<sup>79</sup> For example, a USRPI or the shares of, or an interest in, a USCO, LLC, partnership, or revocable UST or FT which in turn owns such USRPI.

has not been properly structured, operated or maintained so as to tax the NRAD directly on the FC's U.S. situated assets. The premium on such insurance and the availability of insurance will of course depend upon the client's age, health, country of residence, and possibly other factors, but such premium can be far less than the additional administrative costs and income taxes which oftentimes result from arranging more complex structures in order to avoid the U.S. estate tax.

#### 9. Other Important U.S. Tax Considerations.

Numerous other tax considerations may apply. If certain complex tests are met, the I.R.C. § 163(j), "interest-stripping limitation provisions," limit the current year's interest deduction of a corporation paying interest to related parties where the interest is exempt from the normal U.S. withholding tax or is otherwise subject to a reduced rate of tax.<sup>80</sup> This limitation is applicable to a USCO as well as an FC having a USTB.<sup>81</sup> Some investors may further attempt the use of interest-free loans subject to I.R.C. §§ 482 and 7872 to structure loans to "defer" U.S. withholding tax, BPT and BLIT consequences by taking out earnings as loan repayments rather than as dividends or interest subject to U.S. withholding tax.

In addition, an important planning technique in connection with the investment in USRPIs by foreign persons involves the portfolio interest exemption ("PIE").<sup>82</sup> In very broad terms, the provisions permit a less than 10% shareholder (as to a corporate borrower) or partner (as to a partnership borrower) to make an interest-bearing loan to a USTB and to receive such interest exempt from U.S. withholding tax at the 30% or lower treaty rate.<sup>83</sup> Broad attribution ownership rules are applied. Where the recipient of the interest will not be subject to home country taxation because of the home country tax rules, operating loss carryovers or other reasons, the PIE creates a significant advantage and also gives rise to a deduction for the USTB subject, in certain cases, to the I.R.C. § 163(j) interest stripping rules alluded to above. The RRA-93 restricted the PIE by excluding "contingent interest" therefrom.<sup>84</sup>

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<sup>80</sup> I.R.C. § 163(j).

<sup>81</sup> *Id.*

<sup>82</sup> I.R.C. §§ 871(h) and 881(c).

<sup>83</sup> *Id.*

<sup>84</sup> I.R.C. §§ 871(h)(4) and 881(c)(4). Contingent interest is defined to include amounts determined by reference to the debtor's or a related person's receipts, sales, other cash flow, income, profits, change in value of property, or any dividend, partnership distribution or similar payment.

Where the U.S. investment may or may not rise to the level of a USTB, the advisor should be aware that for taxable years ending after July 31, 1990, a true and accurate return must be filed on a timely basis in order to receive the benefit of deductions, expenses, and credits.<sup>85</sup> Failure to timely file may result in the loss of such deductions, expenses, or credits. Furthermore, if the U.S. investment involves a USRPI, in order to avoid the flat 30% withholding tax on gross rents in a non-USTB, the advisor should be familiar with the real estate "net election."<sup>86</sup> Although the issue is not without doubt, any net operating loss carryovers resulting from the net elections should be available for carryover(back) purposes.<sup>87</sup> In those situations where a USRPI investment is non-income producing, a potential risk exists that various expenses for carrying costs, which may not be capitalized if not otherwise deductible, may never be recouped. It is suggested that "some" income be derived from passive USRPI investments (such as raw land) so that the net election can be made. Income from the USRPI is a condition for making the net election. The election should provide for the option to capitalize those expenses otherwise deductible.<sup>88</sup> Moreover, under RRA-93, the Service has been given broad authority to issue regulations re-characterizing any multiple party financing transaction as a transaction directly among any two or more of such parties where the Secretary determines that such re-characterization is appropriate to prevent avoidance of any income tax.<sup>89</sup>

### III. U.S. TAX CONSIDERATIONS IN STRUCTURING THE SALE.

The following section outlines various considerations the U.S. advisor should consider in structuring the sale of a U.S. investment.

#### A. *The PIE.*

In such cases where a cash deal is not possible (which is more likely than not), a portion of the sales price will generally be paid on a deferred basis. The seller should take advantage of the PIE, which if properly structured may result in the avoidance of U.S. withholding tax on interest payments. This benefit is

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<sup>85</sup> See I.R.C. §§ 874(a) and 882(c) and the Treasury Regulations thereunder.

<sup>86</sup> I.R.C. §§ 871(d) and 882(d).

<sup>87</sup> See Rev. Rul. 92-74, 1992-2 C.B. 156; Priv. Ltr. Rul. 91-030-10, (Oct. 18, 1990); Treas. Reg. §§ 1.871-10(c) and 1.882-2(a).

<sup>88</sup> Consider Rev. Rul. 91-7, 1991-1 C.B. 110.

<sup>89</sup> See I.R.C. § 7701(l) and the Treasury Regulations thereunder.

also important where the seller is a U.S. entity which may eventually distribute the interest bearing debt to an NRA or an FC shareholder or beneficiary. If a NRA/NRAD dies owning a U.S. person's note qualifying for the PIE, the note payable can avoid U.S. estate tax but RRA-93 precludes the value of the note attributable to contingent interest from qualifying for this estate tax benefit.<sup>90</sup>

*B. U.S. Withholding Tax Considerations.*

In addition to the advisor considering the potential U.S. withholding tax consequences and the possible avoidance and/or reduction thereof during the acquisition stage, the advisor should review such provisions in advance of the sale so as to minimize the withholding tax and/or administrative complexities.<sup>91</sup> With regard to I.R.C. § 1445 FIRPTA Withholding in particular, the exemptions and withholding application procedures may eliminate or reduce the tax otherwise required to be withheld. Such complexities can also work to the detriment of the selling client. Furthermore, in those situations where the selling client may be entitled to PIE or a similar treaty exemption or reduction, the appropriate procedural requirements (e.g., providing a Form W-8, Form 1001, etc.) should be followed. The authors strongly urge that all advisors to foreign clients, even the most experienced, work closely with a CPA experienced in dealing with the procedural and filing requirements relevant to foreign persons.

*C. Partnership Withholding Tax Surprises on Debt Discharges or Reductions.*

During depressed or stagnant real estate markets, various workout techniques have been developed. It is very common for a borrower to successfully negotiate a reduction or forgiveness of debt in connection with a real estate investment, and in situations where a domestic or foreign partnership successfully negotiates a reduction or forgiveness of partnership debt, the I.R.C. § 1446 withholding tax provisions become a trap for the unwary. These rules require the partnership to withhold the tax attributable to any foreign partner's allocable portion of the partnership's effectively connected taxable income, such

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<sup>90</sup> I.R.C. § 2105(b)(3).

<sup>91</sup> See generally I.R.C. §§ 1441, 1442, 1443, 1445, 1446, and possibly 1447 if the Proposal is ever enacted.

withholding to be at the maximum effective tax rates for a respective foreign partner.<sup>92</sup>

However, under I.R.C. § 108, there are numerous mechanisms by which a partner may exclude from gross income all or part of the negotiated reduction or forgiveness pass-through income by reducing its otherwise favorable tax attributes such as net operating losses and basis of other property. Because such exclusions are determined at the partner, and not at the partnership level, the I.R.C. § 1446 withholding requirements appear to be mandatory. The authors therefore believe that the mechanics of I.R.C. § 1446 can have a tremendously adverse effect on any partnership having foreign partners in a situation involving debt discharge.

#### *D. Selling a Foreign Corporation.*

Where the U.S. investment is a USRPI owned by an FC, the sale of the FC by an NRA will generally be tax-free as the FC is not a USRPI.<sup>93</sup> This is not, however, easy to accomplish and other factors must be considered.

#### *E. Selling a Partnership Interest.*

If a partnership disposes of a USRPI and such partnership has a foreign partner, I.R.C. § 1446 withholding results, and the foreign partner cannot avoid or reduce such withholding by using prior losses.<sup>94</sup> However, if the foreign partner disposes of his interest in the partnership (i.e., a USRPI), the foreign partner's prior losses can be presented in a withholding certificate to reduce the I.R.C. § 1445 withholding tax.<sup>95</sup>

#### *F. Other Relevant Considerations.*

If the seller of the U.S. investment is an FC, consider the BPT complete termination rule to potentially help avoid the BPT. In connection with the sale of a USRPI and/or distributions to foreign persons having interests in domestic entities selling a USRPI, the following areas (among others) merit some

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<sup>92</sup> I.R.C. § 1446(b)(1).

<sup>93</sup> I.R.C. § 897(c)(1)(A).

<sup>94</sup> See I.R.C. § 1446 (definition of taxable income).

<sup>95</sup> Compare Rev. Proc. 89-31 (dealing with I.R.C. § 1446) with Rev. Proc. 88-23 (dealing with I.R.C. § 1445).



attention: I.R.C. § 1031 - Exchange of Property Held for Productive Use or Investment; I.R.C. § 1033 - Involuntary Conversions; I.R.C. § 1060 - Special Allocation Rules for Certain Asset Acquisitions (where the USRPI is or constitutes part of a trade or business); and I.R.C. §§ 453, 453A, and 453B should also be considered with regard to obtaining the benefits, if any, of installment taxation versus electing out.