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## International Banking and Finance

JEFFREY H. AIKEN\*

This report consists of three unrelated articles prepared by the same author. These articles discuss the following topics: (1) Florida's international banking act; (2) U.K. removal of currency exchange controls; and (3) the Agricultural Foreign Investment Disclosure Act.

### RECENT CHANGES IN FLORIDA'S REGULATION OF INTERNATIONAL BANK AGENCIES AND REPRESENTATIVE OFFICES

On June 8, 1977, Florida enacted its international banking act (the Act).<sup>1</sup> To help establish Florida as an international financial center, the Act permitted foreign banks to operate agencies and representative offices in Florida.<sup>2</sup>

In 1978, President Carter signed the federal International Banking Act (IBA). The IBA authorized bank agencies to be licensed by the federal government. Florida responded to the IBA with several legislative and administrative changes. This article will describe these new developments.

#### *Summary of the Amendments*

One of the Act's legislative amendments is designed to establish competitive equality between Florida-chartered and federally-chartered agencies. The Florida legislature passed this amendment, in part, to induce agencies to choose to be licensed, and consequently regulated, by the State of Florida. The amendment permits the Florida Department of Banking and Finance to authorize Florida-licensed international bank agencies to exercise any power it could exercise if it was operating in the state as a federally-chartered agency pursuant to the IBA. The amendment also prohibits Florida-chartered agencies, unless otherwise authorized by statute, from exercising any powers that a federally-chartered agency may not exercise.

In response to this statute, Florida's Department of Banking and Finance issued new regulations. These regulations provide that

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1. FLA. STAT. § 659.67 (1979).

2. See Roussakis, *International Banking and Finance*, 11 LAW. AM. 528 (1979).

notwithstanding other restrictions imposed by the regulations, Florida-licensed agencies may exercise any power that a state bank may exercise, except for exercising fiduciary powers and taking deposits from United States residents. If, however, federally-chartered agencies may not exercise a certain power, the regulations provide that neither may Florida-chartered agencies, absent express permission by Florida's international banking act. In addition, a Florida-chartered agency is subject to the same limitations as is a state-licensed bank under the Florida Banking Code.

Another statutory amendment has been added to clearly express the Florida legislature's intent that bank branches may not operate in Florida, under either the federal or Florida international banking act.<sup>3</sup> A third statutory amendment subjects representative offices to license application requirements that are similar to those imposed upon agencies.<sup>4</sup> Although the assets of an agency must exceed its liabilities by \$25,000,000 in order to receive a license, the amendment requires the assets of a representative office to exceed its liabilities by \$10,000,000.

Florida imposes an annual franchise tax on the net income of banks and savings associations.<sup>5</sup> The amount of the tax is five percent of the bank's or savings association's taxable income, as defined by the Internal Revenue Code (I.R.C.), with certain adjustments. The term "bank" previously was defined as a federally-registered bank holding company, or a bank or trust company, doing business under either federal or state law, if: (1) a substantial portion of its business consists of deposit taking, making loans and discounts, or exercising fiduciary powers which national banks are permitted to exercise; and (2) the business is supervised and examined by the governmental authority which supervises banks. The Florida legislature has amended this definition of "bank" to include international banking corporations doing business in Florida pursuant to Florida's international banking act.

The last statutory amendment exempts loans from Florida's civil usury penalties if they are made by an international bank agency or a domestic bank, including an Edge Act corporation.<sup>6</sup> The exemption is available only if the borrower is a United States, nonresident

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3. FLA. STAT. § 659.67(6)(g) (1979).

4. FLA. STAT. § 659.67(5) (1979).

5. FLA. STAT. § 220.63(1) (1979).

6. FLA. STAT. § 687.13 (1979).

alien, and the loan is "clearly related to, and usual in, international or foreign business."

### *Regulations Establish Definitions*

As previously mentioned, Florida's Department of Banking and Finance has recently issued regulations to govern the operation of Florida's international banking act.<sup>7</sup> These regulations first set out several definitions. Excluded from the definition of the term "international banking corporations" are foreign subsidiaries of domestic banks and bank holding companies. The regulations then permit an entity which "has predominantly corporate characteristics" to be treated as a corporation, even if it is not termed a corporation in the foreign country of organization. Finally, several factors are listed which the Department of Banking and Finance will use to determine whether an entity is engaged in banking. These factors include: (1) taking deposits from the public; (2) making loans to the public; (3) buying or selling checks, notes, or other debt for the public on a regular basis; (4) issuing letters of credit and negotiating drafts for the public; (5) providing trust services for the public; and (6) financing foreign exchange transactions for the public.

### *Permissible Activities*

Florida's international banking act permits international banking corporations to transact business only if the business is clearly related to, and usual in, international business and financing international commerce. The regulations delineate some of the permissible activities, which include maintaining credit balances and loaning money.

Although Florida agencies may not take deposits, they may maintain credit balances for the account of others if the balances are incidental to, or arising out of, the exercise of permitted activities. Agencies may not, however, reduce or disburse credit balances so that they would be "the functional equivalent" of demand deposits. The regulations list permitted credit balances. They include:

- (1) proceeds of loans to customers where such proceeds are not immediately disbursed;
- (2) proceeds of incoming remittances;

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7. Rules of Department of Banking and Finance, ch. 3C-15. The Department of Banking and Finance is now authorized to adjust an agency's reserve requirements pursuant to FLA. STAT. § 659.67(7) (1979).

- (3) proceeds of collections made for customers' accounts;
- (4) funds delivered by customers to settle letters of credit accounts with the banking agency prior to settlement date;
- (5) proceeds of export bills negotiated;
- (6) cash collateral resulting from collections arising out of a loan transaction with a customer;
- (7) undisbursed proceeds of a loan retained by a banking agency in the nature of a compensating balance from the borrowing customer;
- (8) funds delivered prior to execution of money transfers undertaken on behalf of customers;
- (9) funds delivered or received on account of the purchase or sale of securities for the account of customers; and
- (10) funds received from customers to cover currency transactions or as the result of currency transactions on behalf of customers.

### *Reciprocity*

Finally, Florida's international banking act establishes a reciprocity requirement. It prohibits the Department of Banking and Finance from issuing a banking license to a corporation unless that corporation is chartered in a country which permits Florida banks to maintain similar facilities or exercise similar powers. The regulations stipulate that there will be sufficiently similar conditions for admission if the conditions for admission to the foreign country, as a whole, are as favorable as those existing in Florida.

### REMOVAL OF THE UNITED KINGDOM'S EXCHANGE CONTROLS

Forty years ago, the United Kingdom (U.K.) enacted an exchange control statute.<sup>8</sup> The statute was designed to alleviate the balance of payments problem and to prevent capital transfers to other countries. On June 12, 1979, Sir Geoffrey Howe, Chancellor of the Exchequer, publicly declared the British intent to progressively dismantle these controls. Howe, in an address to the House of Commons on October 23, 1979, announced that the United Kingdom was removing all exchange controls, except those pertaining to Rhodesia, effective as of the next day.

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8. Exchange Control Act, 1947, 10 & 11 Geo. 6, c.14.

While eventual control removal could have been anticipated, the October 23 action was sudden and surprised many observers.<sup>9</sup> The removal of exchange controls is one further step in the Thatcher government's gradual dissolution of burdensome restraints on the British economy. These restraints have previously resulted in inefficient allocations of resources.<sup>10</sup> This discussion will address the labyrinth of controls that were imposed prior to removal, Howe's removal order, and the potential consequences of that order.

### *Controls that Existed Prior to Removal*

The Exchange Control Act of 1974 established the controls' basic regulatory framework. Some of the Act's major provisions include the following:

1. Persons in, or resident of, the United Kingdom may not purchase or borrow foreign currency or gold from, or sell or lend foreign currency or gold to, any person except a Treasury-authorized dealer.<sup>11</sup>

2. Persons in, or resident of, the United Kingdom who are permitted to sell foreign currency or gold must do so at the Treasury-authorized price, to an authorized dealer.<sup>12</sup>

3. No person may make payments in the United Kingdom to, or for the credit of, persons residing outside of the "scheduled territories".<sup>13</sup> The term "scheduled territories" includes the following countries: the United Kingdom, the Channel Islands, the Isle of Man, the Republic of Ireland, and Gibraltar.<sup>14</sup>

4. No U.K. resident may make payments to persons resident outside of the scheduled territories.<sup>15</sup>

5. Persons in the United Kingdom may issue U.K. registered securities only to scheduled territory residents.<sup>16</sup>

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9. World Business Weekly, Nov. 5, 1979, at 5.

10. Margaret Thatcher reportedly is heavily influenced by the ideas of Friedrich A. Hayek, a leading proponent of the Austrian school of economics. For an understanding of his views, see, e.g., F. HAYEK, *MONETARY NATIONALISM AND INTERNATIONAL STABILITY* (1971), and F. HAYEK, *INDIVIDUALISM AND ECONOMIC ORDER* (1948).

11. Exchange Control Act, 1947, 10 & 11 Geo. 6, c.14, §1.

12. *Id.* at § 2.

13. *Id.* at § 5.

14. STAT. INST. 1972 Nos. 386, 930, and 2040.

15. Exchange Control Act, 1947, 10 & 11 Geo. 6, c.14, § 6.

16. *Id.* at § 8.

6. U.K. registered securities may not be transferred unless both the transferor and the transferee are scheduled territory residents.<sup>17</sup>

7. Securities registered outside of the United Kingdom may not be transferred: (a) outside of the United Kingdom if either the transferor or the transferee is a U.K. resident; or (b) inside the United Kingdom unless both the transferor and transferee are scheduled territory residents.<sup>18</sup>

8. The following items may not be exported from the United Kingdom: notes which are legal tender in the United Kingdom, treasury bills, postal orders, gold, security title certificates, assurance policies, foreign currency-denominated bills of exchange or promissory notes, and travelers cheques.<sup>19</sup>

9. Notes which are legal tender in the United Kingdom, Treasury bills, and security title certificates may not be imported into the United Kingdom.<sup>20</sup>

10. Goods may not be exported from the United Kingdom to certain countries unless: (a) payment for the goods has been made to a U.K. resident or will be made no later than six months after the exportation date; and (b) the amount of the payment represents a sales price "satisfactory to the national interest."<sup>21</sup>

11. A U.K. resident may not cause a corporation controlled by U.K. residents to cease to be controlled by U.K. residents.<sup>22</sup>

12. U.K. residents investing in securities denominated in foreign currencies must purchase them with currency obtained from a foreign currency pool. This pool usually attracts a premium over the official market rate.<sup>23</sup>

13. The Treasury is permitted to grant exemptions from the exchange control restrictions.<sup>24</sup> It was this authority that Howe used to remove the exchange controls.

14. The Treasury, authorized to delegate its powers under the Act, has delegated most of its powers to the Bank of England.<sup>25</sup>

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17. *Id.* at § 9.

18. *Id.*

19. *Id.* at § 22.

20. *Id.* at § 21.

21. *Id.* at § 23.

22. *Id.* at § 30.

23. [1978] 29th Annual Report: Exchange Restrictions 426 (International Monetary Fund).

24. Exchange Control Act, 1947, 10 & 11 Geo. 6, c.14, § 6.

25. *Id.* at § 37(4).

This statutory overview, while not intended to be comprehensive, demonstrates the regulatory complexity and pervasiveness of the prior law.

### *Removal of Controls*

The Chancellor of the Exchequer, in his October 23 address, removed all exchange controls, except for those pertaining to Rhodesia. He declared that he has

. . . decided to remove all the remaining exchange control restrictions as of midnight tonight. There will from tomorrow be full freedom to buy, retain and use foreign currency for travel, gifts and loans to non-residents, buying property overseas and investment in all foreign currency securities. Portfolio investment will be wholly freed and the foreign currency securities need no longer be deposited with an Authorized Depository. Foreign currency accounts can be held here or abroad. Passport marking for travel funds can be abolished. From tomorrow, we shall be meeting in full our Community obligations on the freedom of capital movements.<sup>26</sup>

Significantly, the Exchange Control Act remains on the books; it has no current effect because exemptions, which are embodied in "statutory instruments," have been granted.<sup>27</sup> Consequently, the necessary regulation exists in the event that the United Kingdom decides to reimpose the controls.

### *Results of the Controls' Removal<sup>28</sup>*

Some of the more important potential consequences of the exchange control removal are:

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26. Address by Sir Geoffrey Howe to the House of Commons (October 23, 1979).

27. A series of exemptions have been granted: (a) The Exchange Control (Gold and Foreign Currency) Exemption Order 1979; (b) The Exchange Control (Payments, etc.) (Exemption) Order 1979; (c) The Exchange Control (Securities, etc.) (Exemption) Order 1979; (d) The Exchange Control (Import and Export) Order 1979; (e) The Exchange Control (Exports) (Southern Rhodesia) Order 1979; (f) The Exchange Control (Settlements) (Exemption) Order 1979; (g) The Exchange Control (Bodies Corporate) (Exemption) Order 1979; and (h) The Exchange Control (Authorized Dealers and Depositories) (Amendment) (no. 4) Order 1979.

28. The author gratefully acknowledges the contributions of Gary and Genie Short in the preparation of this section.

1. The European Community's requirements concerning freedom of capital movements will be met.<sup>29</sup>

2. Downward pressure on the pound may result. This possibility induced British exporters to seek exchange control removal,<sup>30</sup> particularly in the wake of the pound's strength caused by the discovery and production of North Sea oil.<sup>31</sup>

3. There may be a net sterling outflow, particularly if the rate of return on investments is higher outside of the United Kingdom than inside.<sup>32</sup>

4. There may be an increasing use of the pound as a reserve currency.<sup>33</sup>

5. There will be a savings to the British of approximately 14.5 million pounds annually, which is the cost of the 775 employees presently enforcing the exchange controls who will no longer work in that capacity.<sup>34</sup>

6. Some information that the government formerly collected to enforce the controls will no longer have to be collected.

7. Overseas investment could increase the capital inflow into the United Kingdom through repatriation of profits.

8. Because control removal further integrates the British position in the international financial system, the United Kingdom money supply will be harder to control.<sup>35</sup>

In conclusion, Howe's actions are extremely important, but their full consequences will not be known for months or years to come.

#### PROPOSED BILLS TO TAX FOREIGNERS' GAINS FROM THE SALE OF UNITED STATES REAL ESTATE

##### *Introduction*

Foreigners are investing increasingly large amounts of money into United States real estate. They do so in order to: (1) diversify

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29. See Address by Sir Geoffrey Howe to the House of Commons (October 23, 1979).

30. *World Business Weekly*, Nov. 5, 1979, at 5.

31. *Id.*

32. *Id.* at 6.

33. *Id.*

34. Address by Sir Geoffrey Howe to the House of Commons (October 23, 1979).

35. *World Business Weekly*, Nov. 5, 1979, at 64.

their portfolio mix; (2) remove assets from their home countries, which may be politically or economically unstable, and place them in a healthier environment; (3) take advantage of the recent decrease in value, as compared with other currencies, of the United States dollar; and (4) take advantage of United States tax laws.

As foreigners invest more heavily in United States real estate, many Americans have registered an alarm bordering on hysteria. In addition, there has been a greater concern over investment in agricultural lands than other types of real estate. To determine the nature and the extent of this problem, President Carter signed the Agricultural Foreign Investment Disclosure Act (AFIDA) in 1978. The Act requires foreigners to disclose their holdings, acquisitions, and dispositions of agricultural land. The Act also requires the Secretary of Agriculture to: (1) analyze information on foreign ownership of United States agricultural land; (2) determine the effect of foreign ownership, particularly on family farms and rural communities; and (3) determine the reporting requirement's effectiveness and efficiency.

### *AFIDA Report*

The Secretary of Agriculture's report was recently released. Foreign individuals and entities reported to the Secretary that they owned a total of 5.2 million acres of United States agricultural land, or less than 0.5% of all such land. Seventy-six percent of foreign-held land was owned indirectly through United States corporations. The South has been the focus of many foreign investors: Tennessee, Georgia, and South Carolina account for twenty-five percent of foreign-held United States agricultural land.

The report set out two significant findings:

- (1) Purchases by foreigners are likely to increase land values, *but not greater than new entries into the real estate market from domestic sources* (emphasis added); and
- (2) Foreign ownership is no more likely to foreclose farming opportunities than purchases by domestic sources.

The report also concluded that, at least in the short run, it is likely that local governments and communities will enjoy increased income as a result of these investments.

The report stated that the Agriculture Department is planning to make some administrative changes. These include: (1) redefining reportable agricultural land and increasing the minimum

amount of reportable acreage; (2) adjusting the percentage of foreign ownership to be required to report; and (3) clarifying ambiguities in the reporting form and instructions.

The report concludes that foreigners do *not* have an incentive to pay above the market price for land. These individuals have alternative investments available to them in the United States and approach land purchases from a national vantage point. Many American investors, on the other hand, purchase land only in or near their own community.

With constituents clamoring for protection from this foreign "invasion," several United States Congressmen have introduced bills which would tax the gains realized by foreigners on the sale of United States real estate. Of course, it is not merely a matter of hysteria that is prompting the new bills; foreigners do enjoy certain tax advantages in this area.

#### *Current Tax Treatment of Foreigners' Gains*<sup>36</sup>

A foreigner generally will not be taxed on his United States real estate gains if the gains are not effectively connected with a United States trade or business. To receive this treatment, he also must not be present in the United States for more than 183 days during the taxable year. The term "foreigner" includes nonresident aliens and foreign corporations.<sup>37</sup>

If a foreigner's gains are effectively connected with a United States trade or business, he still may avoid the capital gains tax.<sup>38</sup> This may be accomplished by utilizing one of the following five techniques:

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36. For general treatments of this subject, see Abrutyn, *United States: Investments in United States Real Estate by Nonresident Alien Individuals and Foreign Corporations*, TAX MANAGEMENT INT'L J. 9 (September 1977); J. FORRY, A PRACTICAL GUIDE TO FOREIGN INVESTMENT IN THE UNITED STATES (1979); Langer and Bittel, *How Foreigners Invest in U.S. Real Estate*, 15 U.S. TAXATION OF INTERNATIONAL OPERATIONS 581 (1977); R. POVELL & A. GRANWELL, FEDERAL TAXATION AND PLANNING FOR: THE NONRESIDENT ALIEN WHO BECOMES RESIDENT, THE RESIDENT ALIEN WHO BECOMES NONRESIDENT, AND THE CITIZEN WHO EXPATRIATES FOR TAX AVOIDANCE PURPOSES (PLI Handbook, No. 144, 1980); B. ZAGARIS, FOREIGN INVESTMENT IN THE UNITED STATES (1980).

37. A recent article analyzes the question of whether a person is a nonresident. See Packman and Rosenberg, *How Foreigners (Unintentionally) Become U.S. Residents*, Taxes Magazine, February 1979, at 85.

38. For an analysis of the "engaged in business" test, see J. GUTTENTAG, WHEN IS A FOREIGNER ENGAGED IN BUSINESS IN THE UNITED STATES?, Code And Treaty Rules (PLI Handbook, No. 118, 1978).

1. If the foreigner is treated as engaged in a United States trade or business solely because of a treaty election, he may refrain from making the election in the year of sale.
2. The foreigner may sell the property on an installment (I.R.C. § 453) basis, and receive most of the payments in subsequent years when he is no longer engaged in a United States trade or business.
3. The foreigner may exchange his United States real estate for foreign real estate. This exchange is not taxable (I.R.C. § 1031). The subsequent sale of the foreign real estate is not taxed.
4. If a foreigner holds the real estate through a foreign corporation, he may sell the shares of stock.
5. If a foreign corporation holds the real estate, a foreigner may adopt a plan for its liquidation during a twelve month period. The corporate distribution of the property is not taxed (I.R.C. § 337).

### *Pending Bills*

With this background, then, various Congressmen began searching for methods to tax these gains. Some only wanted to tax gains from the sale of agricultural lands, while others wanted to tax all gains by foreigners. In 1978, Senator Malcolm Wallop and supporters attempted to amend the then-pending Revenue Act of 1978 by taxing the gain from the sale of United States *agricultural* land. The Revenue Act's final version, however, only required the Treasury Department to study the optimal tax treatment of gains by foreigners on the sale of United States real estate.

Prior to the issuance of the Treasury study, three significant bills were introduced into Congress. On January 23, 1979, Senator Dale Bumpers introduced S. 192, which would tax all United States source capital gains, whether from real or *personal* property. The bill would not override United States income tax treaty articles which provide to the contrary. Later in January 1979, Senator Malcolm Wallop introduced S. 208; a similar bill, H.R. 3106, was introduced by Representative Charles Grassley. These two bills would tax gains by foreigners on the sale of farmland or rural land, whether held directly by the individual or indirectly through certain foreign corporations. They also would impose tax withholding requirements on the buyer's payments to the seller. Although S. 208 would not override contrary

treaty provisions, H.R. 3106 would do so, beginning five years after the bill's enactment.

In May 1979, the Treasury Department issued the report that was required by the 1978 Revenue Act, and followed it with the presentation of its own proposal on the matter. Its proposal would tax gains by foreigners on sales of United States real estate—a broader approach than the Wallop and Grassley bills, but a narrower approach than the Bumpers bill. The proposal's definition of foreign corporations that could be taxed on these gains was complex. Foreign controlled United States "real property corporations" would be required to file annual information returns disclosing its foreign ownership. The proposal would also impose withholding tax requirements on the buyer. It would override contrary treaty provisions after a five year grace period.

Representative Fisher introduced H.R. 6007 on December 3, 1979. This bill closely reflects the Carter Administration's view. H.R. 6007's notable features are that it imposes estate and gift taxes on holders of real estate interests and that it contains extensive reporting requirements.

On December 6, 1979, H.R. 1212, H.R. 1319, and H.R. 2297 were passed by the Senate Finance Committee. These bills will be analyzed in detail, as it is likely that the final version of a bill which taxes foreigners' gains will strongly resemble these bills. The three bills are very similar, the major exception being that H.R. 2297 exempts from tax foreigners' interests from portfolio indebtedness of United States persons.

The bills impose, in effect, at least a twenty-eight percent tax on gains realized by foreigners on the sale or exchange of U.S. real estate, and from the sale or exchange of an interest in certain corporations, trusts, or partnerships which own U.S. real estate. The bills establish reporting and withholding requirements, and would become effective on January 1, 1980, if there is no treaty conflict, or on December 31, 1984, if there is a treaty conflict. They would establish new I.R.C. § 897 (tax on the disposition of real estate); § 1444 (withholding tax); § 6039(C) (reporting requirements); and, in the case of H.R. 2298, §§ 871(a)(3) and 881(c) (tax exemption from income of foreign individuals from portfolio debt).

## I.R.C. § 897: Tax on the Disposition of Real Estate

Section 897 imposes a tax of at least twenty-eight percent on the excess of gains over losses derived from the sale of "United States real property interests." The tax is the greater of twenty-eight percent or the amount that would result if the foreigner's gains were "effectively connected" with a United States trade or business, pursuant to §§ 871(b) or 882(a). Thus, dealers in real estate would be taxed at the higher of either the ordinary income rate or the twenty-eight percent rate. Sections 871 and 882, which otherwise might have taxed these gains, would not apply, unless the gains would escape the § 897 tax by reason of the *de minimus* rule. The *de minimus* rule exempts the excess gains from taxation if the excess gains do not exceed \$5,000. For the purposes of the *de minimus* provision, the total amount to be realized under an installment sales transaction (§ 453) is applied against the \$5,000 test.

Two types of interests qualify as "United States real property interests." The first type is an interest in real property located in the United States. The term "interest" includes leaseholds of land and improvements, and options to buy or rent land and improvements. The term "real property" includes mines, wells, and other natural deposits, in addition to personal property associated with the use of the real property, such as moveable walls and furnishings. The second type of "United States real property interest" is an interest, other than as creditor, in a "real property holding organization." To be a real property holding organization, the organization must have qualified as such during the shorter of the period the interest was held, or the five year period ending on the sale date of the interest. United States real property interests do not include interests in an entity which does not hold United States real property interests. The entity must have disposed of, in transactions in which gain or loss was recognized, all of the United States real property interests that it held during the shorter of the period the interest was held, or the five year period ending on the sale date of the interest.

The term "real property holding organization" includes an entity which meets two requirements. The first requirement is that no more than ten persons own at least fifty percent of the entity. Ownership by certain related parties will be attributed to the person in question. The second requirement is that United States real property interests constitute at least fifty percent of the fair market value of the entity's assets. To prevent the circumvention of this second requirement by

merely infusing liquid assets into the entity, the term "assets" is defined to exclude cash, accounts or notes receivable, or other marketable assets exceeding a "reasonable amount of working capital."

Sections 897 and 1444 override all Internal Revenue Code non-recognition provisions; this override, however, is much broader than necessary to achieve equal taxation of foreigners and U.S. persons. Although Treasury Regulations may be issued to permit the application of nonrecognition rules, this is an inadequate substitute for a statutory rule allowing nonrecognition treatment, and it may be several years before such regulations are issued.

#### I.R.C. § 1444: Withholding Tax

This section imposes extremely complex withholding requirements. Generally, every buyer of a United States real property interest from a foreigner must withhold tax from payments to the seller, in the smallest amount of: (1) twenty-eight percent of the amount realized from the transaction; (2) the tax liability that the Treasury Secretary determines is due as a result of the § 897 tax, plus any unsatisfied withholding liability from prior transfers of that interest; and (3) the sales proceeds which are in the withholding agent's control. The Senate Finance Committee report indicated that this should exclude assumption of mortgages and installment sales payments not yet made.

The Senate Finance Committee report further stated that in the event that a real property holding organization was liquidated, the liquidating entity is required to withhold tax, since it is deemed to be a purchaser of a United States real estate interest. The general withholding rule does not apply if: (1) the purchaser did not know that the seller was a foreigner and did not receive notice; or (2) the seller transmits a statement by the Treasury Secretary, as authorized by regulations to be issued, to the withholding agent that the tax may be withheld at a reduced rate or not withheld at all; or (3) the seller does not realize more than \$150,000 from the sale of a single family residence, which the purchaser buys for his "principal residence"; or (4) stock is transferred on an established securities exchange.

Notice requirements are also established. A foreign seller, and his agents, are required to notify the buyer that the seller is a foreigner, but only one notice is required to be given. "Agents" include the seller's nominee, broker, settlement attorney, and any other person holding sale proceeds, if they have reason to believe that the seller is a foreigner. If the seller's agent does not notify the purchaser as

required, the agent is required to withhold, and he must treat his compensation from the disposition as sale proceeds within the agent's control.

#### I.R.C. § 6039(C): Reporting Requirements

The new bill also imposes reporting requirements. Corporations, partnerships, and trusts must file information returns if at any time during the year: (1) at least one foreigner owned an interest in the entity; (2) less than eleven persons owned a controlling interest; and (3) over forty percent of the fair market value of the entity's assets were represented by United States real property interests.

An entity that is required to file this return must also furnish statements to any person who held an interest in the entity during the year, stating whether the entity was a real property holding organization at any time during the year. The penalty for failure to file a required return or statement is the greater of \$25 per day late filing (but not to exceed \$25,000), or the unpaid § 897 tax on transaction.

#### *Conclusion*

The above bills are to apply to transactions occurring after December 31, 1979. There is a possibility that the bills will be amended to extend the effective date, as the January 1, 1980, effective date is currently creating problems. For example, suppose that a person purchases United States real estate from a foreigner on February 1, 1980. Should the buyer withhold tax, even though the bill has not yet passed? What if the buyer does withhold, and the bills are not passed? Will the seller then have a cause of action against the buyer for wrongfully withholding the tax?

The bills would override contrary treaty provisions after December 31, 1984. This five year grace period is to allow time for the renegotiation of treaties. It must be emphasized that these bills only tax *dispositions* of real estate, and not their *operation*. In addition, only the Fisher bill affects estate and gift taxation.

This article reflects the legislative climate as of April 24, 1980. The reader is cautioned, however, that there is no assurance that the bills will pass in their present form.