

Determining U.S. Real Property Holding Corporation Status

By Alicia Beyer and Victor Hollender

Alicia Beyer is an associate and Victor Hollender is a partner in the Chicago and New York offices, respectively, of Skadden, Arps, Slate, Meagher & Flom LLP.

Foreign investors face a variety of challenging decisions when investing in corporations in the United States, and the tax treatment of the investments often plays a significant role in making those decisions. Among those tax considerations, no single determination may be as important to foreign investors as whether a corporation is treated as a U.S. real property holding corporation (USRPHC). Therefore, making an accurate determination of USRPHC status is critical for both foreigners considering investing in the United States and for U.S. corporations seeking to attract foreign investment.

In this article, Beyer and Hollender provide an overview of the tests used to determine USRPHC status and discuss some of the more difficult legal considerations involved in making that determination.

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A. Introduction to FIRPTA

Foreign investors are generally exempt from U.S. taxation on the disposition of interests in U.S. corporations. They are subject to U.S. taxation on gains from those dispositions only if the gains are effectively connected with a U.S. trade or business.¹ However, under the Foreign Investment in Real Property Tax Act of 1980, gains from the disposition of interests in U.S. real property holding corporations (USRPHCs) are treated *as if* they are effectively

¹Sections 871(b) and 881(a).

connected with a U.S. trade or business, thereby subjecting them to U.S. tax at graduated income tax rates.²

Before the enactment of FIRPTA, foreign investors were not subject to U.S. taxation on the disposition of U.S. real property because the gains were generally not effectively connected with a U.S. trade or business.³ A stated policy goal of FIRPTA was to establish equal treatment of domestic and foreign investors disposing of interests in U.S. real property, by ensuring that foreign investors would be subject to taxation on that disposition just like their domestic counterparts.⁴ Under FIRPTA, and specifically section 897, gain or loss from the disposition of a “U.S. real property interest” (USRPI) is treated as effectively connected with a U.S. trade or business and subject to U.S. tax (regardless of whether the foreign person would otherwise be considered to be conducting a U.S. trade or business).⁵ Section 897 defines a USRPI to include interests in USRPHCs.⁶ Consequently, the sale of stock of a corporation by a foreign shareholder, though generally not subject to U.S. tax, is taxed under FIRPTA if that corporation is treated as a USRPHC. Under section 1445, in the case of a disposition of a USRPI by a foreign person, the transferee is required to withhold at a rate of 10 percent of the amount realized,⁷ and USRPHCs are also required to withhold at a rate of 10 percent on some distributions made to foreign shareholders.⁸

B. General USRPHC Status Test

Section 897(c) and the corresponding Treasury regulations define a USRPI to include an interest in real property located in the United States or the

²Sections 871(b) and 882.

³See Department of the Treasury, “Taxation of Foreign Investment in U.S. Real Estate,” May 8, 1979, at 30-31.

⁴Since its enactment, there have been a number of attempts at FIRPTA reform. The original author of the bill that enacted FIRPTA, Sen. Malcolm Wallop, later sought to repeal FIRPTA. The Senate passed a full repeal during the debate over tax reform in 1986, but it was later dropped during conference negotiations. More recently, in 2010 the House passed H.R. 5901, a bill containing a number of significant FIRPTA reform provisions, on a 402-11 vote.

⁵Section 897(a)(1).

⁶Section 897(c)(1)(A)(ii).

⁷Section 1445(a).

⁸Section 1445(e)(3).

Virgin Islands,⁹ or an interest (other than an interest solely as a creditor) in any domestic corporation unless the taxpayer establishes that the corporation was never a USRPHC during the shorter of either the period after June 18, 1980, during which the taxpayer held the interest or the five-year period ending on the date of disposition of the interest. The shorter of those time periods is known as the testing period.¹⁰ Section 897(c) contains important exceptions whereby interests in domestic corporations will not be treated as USRPIs. First, if a class of stock of a corporation is regularly traded on an established securities market, stock of that class is not treated as a USRPI unless a person, at some point during the testing period described above, actually or constructively held more than 5 percent of that class of stock.¹¹ Second, under the so-called cleansing rule, an interest in a domestic corporation does not constitute a USRPI if, as of the date the interest is disposed of, that corporation did not hold any USRPIs and all of the USRPIs held by that corporation at any time during the testing period described above were disposed of in transactions in which the full amount of the gain was recognized or ceased to be USRPIs under the cleansing rule.¹² Section 897(h) provides a third important exception, under which interests in a “domestically controlled qualified investment entity” (QIE) are not treated as USRPIs.¹³ A QIE is defined as a real estate investment trust or, before January 1, 2014, a regulated investment company meeting specific requirements.¹⁴ A QIE is domestically controlled if less than 50 percent of the fair market value of the outstanding stock was directly or indirectly held by foreign persons during the shortest of: (1) the five-year period ending on the applicable determination date; (2) the period since June 18, 1980; or (3) the period during which the QIE existed.¹⁵ In practice it is sometimes difficult to determine if a QIE is domestically controlled because QIEs frequently

lack information about the identity of any of their shareholders holding a less than 5 percent interest. There is also uncertainty regarding when a QIE, the interests of which are held by another QIE, may qualify as domestically controlled.

Section 897(c)(2) defines a USRPHC as any corporation if the fair market value of its USRPIs equals or exceeds 50 percent of the FMV of its USRPIs, plus its interests in real property located outside the United States, plus any other of its assets that are used or held for use in a trade or business (Trade or Business Assets).¹⁶ In other words, a corporation is a USRPHC if:

$$\frac{\text{FMV (USRPI)}}{\text{FMV (USRPI + foreign real property + Trade or Business Assets)}} \geq 50\%$$

Reg. section 1.897-1(c)(1) defines a USRPI as (1) an interest “in real property” or (2) an interest in a USRPHC that is “other than solely as a creditor.”¹⁷ Reg. section 1.897-1(b) provides for three categories of real property: (1) land and unsevered natural products of the land, (2) improvements (which are defined to include buildings, inherently permanent structures, and the structural components of either), and (3) tangible personal property associated with the use of real property (such as mining equipment and farming equipment).¹⁸ Reg. section 1.897-1(d)(2) provides that:

an interest in real property other than an interest solely as a creditor includes a fee ownership, co-ownership, or leasehold interest in real property, a time sharing interest in real property, and a life estate, remainder, or reversionary interest in such property. The term also includes any direct or indirect right to share in the appreciation in the value, or in the gross or net proceeds or profits generated by, the real property.¹⁹

For an interest in real property to be treated as a USRPI for purposes of the USRPHC determination, the property must be located in the United States or the Virgin Islands — otherwise it will be treated as foreign real property.²⁰ In contrast, while only a U.S. corporation can be a USRPHC, the disposition of which is subject to FIRPTA tax,²¹ the regulations provide that an interest in a foreign corporation whose holdings qualify it for USRPHC status will be treated as a USRPI in determining whether another corporation holding its stock is itself a

⁹Section 897(c)(1)(A)(i).

¹⁰Section 897(c)(1)(A)(ii) and reg. section 1.897-1(c)(1). See also David F. Levy, “Nonrecognition Transactions Involving FIRPTA Companies,” *Tax Notes*, June 2, 2008, p. 933.

¹¹Section 897(c)(3) and reg. section 1.897-2(b)(1).

¹²Section 897(c)(1)(B) and reg. sections 1.897-1(c)(2)(ii) and 1.897-2(f)(2). Most practitioners do not believe the cleansing rule would apply to a real estate investment trust or regulated investment company.

¹³Section 897(h)(2). Further, distributions by a QIE for a class of stock that is regularly traded on an established securities market located in the U.S. are not treated as gain from the sale or exchange of a USRPI, except when the foreign investor held a greater than 5 percent interest in that class of stock at any time during the one-year period ending on the date of distribution. Section 897(h)(1).

¹⁴Section 897(h)(4).

¹⁵Section 897(h)(4)(B).

¹⁶Section 897(c)(2) and reg. section 1.897-1(c)(2)(iii).

¹⁷Reg. section 1.897-1(c)(1).

¹⁸Reg. section 1.897-1(b).

¹⁹Reg. section 1.897-1(d)(2).

²⁰Reg. section 1.897-1(c)(1)(i).

²¹*Supra* note 6 and reg. section 1.897-1(c)(1)(ii).

USRPHC.²² Therefore, in determining a corporation's USRPHC status, interests in both domestic and foreign USRPHCs will be taken into account as USRPIs.²³ The regulations indicate that this rule applies to tiered ownership structures.²⁴

The regulations under section 897 define Trade or Business Assets to include (1) inventory, depreciable property, and some livestock, provided those assets are not USRPIs; (2) specific intangibles used in the entity's trade or business; and (3) cash, securities, receivables, and specific options or contracts, but only to the extent that they are used for the corporation's trade or business and are not USRPIs.²⁵ Further, those assets must be "held for the principal purpose of promoting the present conduct of the trade or business" or held in the ordinary course of the business, or otherwise must have a direct relationship to the business and must be held to meet the current needs of the business (as opposed to being held in anticipation of future diversification or expansion).²⁶ A special safe harbor is provided for investment companies, under which cash, securities, receivables, and specific options or contracts will be presumed to constitute Trade or Business Assets for purposes of making the USRPHC determination.²⁷ But normally, for most operating corporations that are not investment companies, those liquid securities are not taken into account in determining USRPHC status.

If a corporation is a partner in a partnership or holds an interest in a partnership, trust, or estate (whether domestic or foreign), the corporation takes into account a share of the assets of the partnership, trust, or estate in proportion to the corporation's interest in that entity in determining its USRPHC status.²⁸ The corporation's interest in the partnership, trust, or estate itself is disregarded in determining USRPHC status.²⁹ Assets used or held by the partnership, trust, or estate in a trade or business are treated as so used by the partner or beneficiary corporation.³⁰ However, the regulations provide an exception under which assets that are

subject to the investment company safe harbor discussed above are not attributed to a partner or beneficiary of that investment company.³¹ Attribution of ownership applies upward through a chain of successive partnerships, trusts, or estates.³²

If a corporation holds a minority interest in a domestic or foreign USRPHC, the value of that interest is taken into account as a USRPI in determining whether the corporation holding that interest is itself a USRPHC.³³ A minority interest is defined as ownership of less than 50 percent of the FMV of all classes of the USRPHC's stock.³⁴ In contrast, if a corporation (the first corporation) holds a "controlling interest" in a second domestic or foreign corporation (the second corporation), a proportionate share of the second corporation's assets is deemed to be held directly by the first corporation in an amount equal to the percentage, by value, of the first corporation's ownership interest in the second corporation.³⁵ The value of the second corporation's stock held by the first corporation is not taken into account in determining the USRPHC status of the first corporation.³⁶ A controlling interest is defined as ownership of 50 percent or more of the FMV of all classes of the second corporation's stock.³⁷ As with the partnership, trust, and estate attribution rules, assets used or held by the second corporation in a trade or business are treated as so used by the first corporation,³⁸ but assets that are subject to the investment company safe harbor are not attributed upward.³⁹ Also like the partnership, trust, and estate rules, the ownership attribution rule applies successively upward through a chain of ownership.⁴⁰

C. Legal Considerations for USRPHC Status

1. The alternative accounting presumption. The regulations provide an alternative accounting presumption under which a corporation is presumed not to be a USRPHC if the book value of its USRPIs is 25 percent or less of the sum of the book value of its USRPIs, foreign real property, and Trade or

²²Reg. section 1.897-2(e)(1).

²³But if the corporation disposes of the stock in the foreign USRPHC, gains from that disposition will not be subject to FIRPTA taxation. Section 897(c)(1)(A)(ii) and reg. section 1.897-1(c)(1)(ii).

²⁴Reg. section 1.897-1(e)(1).

²⁵Reg. section 1.897-1(f)(1).

²⁶Reg. section 1.897-1(f)(2).

²⁷Reg. section 1.897-1(f)(3)(ii).

²⁸Section 897(c)(4)(B) and reg. section 1.897-2(e)(2).

²⁹Reg. section 1.897-2(e)(2).

³⁰Section 897(c)(4)(B) and reg. section 1.897-2(e)(2).

³¹Reg. section 1.897-2(e)(2).

³²Section 897(c)(4)(B) and reg. section 1.897-2(e)(2).

³³Reg. section 1.897-2(d)(1) and (e)(1).

³⁴Section 897(c)(5)(B) and reg. section 1.897-2(e)(3).

³⁵Section 897(c)(5)(A) and reg. section 1.897-2(e)(3).

³⁶Section 897(c)(5)(A).

³⁷*Supra* note 34.

³⁸*Id.*

³⁹Reg. section 1.897-2(e)(3)(iii).

⁴⁰*Supra* note 35.

Business Assets.⁴¹ In other words, under the alternative accounting presumption, a corporation is presumed not to be a USRPHC if:

$$\frac{\text{book value (USRPI)}}{\text{book value (USRPI + foreign real property + Trade or Business Assets)}} \leq 25\%$$

This presumption relies on the book value of a corporation's assets, with book value defined as the value at which an item is carried on the financial accounting records of the corporation, if the value is determined in accordance with generally accepted accounting principles.⁴² The use of book value for this assessment appeals to many corporations because it allows them to rely on internal accounting valuations rather than having to make a more onerous FMV assessment.⁴³ Importantly, however, if the IRS determines, based on information about the FMV of a corporation's assets, that the presumption may not accurately reflect the corporation's USRPHC status, the corporation isn't allowed to rely on the presumption and must determine its USRPHC status under the general 50 percent test described above.⁴⁴ The regulations provide that a corporation that had previously relied upon the alternative accounting presumption, but that is determined to in fact be a USRPHC, will not be subject to penalties for any incorrect notice given regarding its USRPHC status, if the corporation had performed the necessary calculations enabling it to rely on the presumption and the corporation complies with the requirements for redetermination of its USRPHC status.⁴⁵ However, a corporation is nevertheless subject to any applicable penalties if, at the time it relied on the alternative accounting presumption, the corporation knew that the book value of its relevant assets was substantially higher or lower than the FMV and therefore had reason to believe that, under the general 50 percent test, it would probably be a USRPHC.⁴⁶

If a corporation's determination of USRPHC status under the alternative accounting presumption is found to be incorrect, any foreign person who previously sold an equity interest in that corporation and did not pay FIRPTA tax in reliance on

statements by the corporation that it was not a USRPHC will be required to file a U.S. tax return and pay any taxes and interest owed.⁴⁷ The foreign person's good-faith reliance on the corporation's statements will be taken into account in determining whether the person is subject to any penalties for the previous failure to file. But if the foreign person knew or had reason to know that the corporation's statements were incorrect, that person is not entitled to rely on those statements and will remain liable for penalties.⁴⁸ Thus, the alternative accounting presumption does not provide much of a safe harbor for foreign investors, because while they are protected from penalties if their reliance on the corporation's statements is in good faith, they are still liable for FIRPTA taxes and interest if the corporation's statements are found to be incorrect. Further, a determination that a corporation's statement regarding its USRPHC status is incorrect may result in an examination of whether the taxpayer's reliance on the statement was reasonable or whether the taxpayer "knew or had reason to know" that the statement was false. Ultimately, foreign investors intending to dispose of a substantial interest in a U.S. corporation may find it in their best interest to make their own assessment of whether the corporation is a USRPHC, or possibly even seek an alternative determination from the IRS commissioner.⁴⁹

Because of the composition of their assets, some corporations and publicly traded entities (such as master limited partnerships, infrastructure companies, and some RICs) may be unable to use the alternative accounting presumption, even if they are ultimately not determined to be USRPHCs. To the extent there is uncertainty about whether one of a corporation's most significant assets constitutes a USRPI, this presumption likely provides only minimal comfort, if any, and the legal merits of the arguments about potential USRPHC status will

⁴¹Reg. section 1.897-2(b)(2).

⁴²Reg. section 1.897-2(b)(2)(ii).

⁴³Michael J. Caballero, Suzanne C. Feese, and Michael H. Plowgian, "U.S. Taxation of Foreign Investment in U.S. Real Estate," *Tax Management Portfolio* 912-2, at A-34 (2009).

⁴⁴Reg. section 1.897-2(b)(2)(iii).

⁴⁵Reg. section 1.897-2(b)(2)(iv).

⁴⁶*Id.* A corporation is considered to "know" information regarding the FMV of its assets if the information is included on any books or records of the corporation or its agent, is known by the corporation's directors or officers, or is known by employees who had reason to know it in the course of their employment.

⁴⁷Reg. section 1.897-2(g)(1)(ii)(A).

⁴⁸*Id.* Interestingly, reg. section 1.897-2(b)(2)(v) previously provided a safe harbor for such foreign shareholders, under which they were not required to file a U.S. tax return and pay FIRPTA tax if it was shown that the corporation's determination of its USRPHC status under the alternative accounting presumption had been inaccurate. However, if a foreign shareholder knew or had reason to know that the corporation's reliance on the alternative accounting presumption was unreasonable, the shareholder was held liable for all taxes, interest, and penalties. Reg. section 1.897-2(b)(2)(v) was later amended, and the safe harbor was eliminated in 1987, because it was seen as inconsistent with reg. section 1.897-2(g)(1)(ii)(A) and 1.897-2(g)(2)(ii). See T.D. 8113 (Dec. 18, 1986).

⁴⁹Under reg. section 1.897-2(g)(1)(iii)(C), a foreign person may request that the IRS commissioner make a determination based on information supplied by the foreign person, such as annual reports, financial statements, and corporate records.

need to be carefully considered. Further, differences in financial accounting and tax accounting standards may make it difficult for some companies to rely on the alternative accounting presumption. Some joint venture partnerships or corporate subsidiaries may not be consolidated for financial accounting purposes, but for tax purposes their assets are included in the USRPHC determination because they are considered assets of the upper-tier corporation (under the rules discussed above). For example, assume corporation C has a wholly owned subsidiary S that owns a 50 percent interest in partnership P. For tax purposes, C's assets would include all the assets of S and 50 percent of the assets of P. However, for financial accounting purposes, C, S, and P may not be consolidated, so their assets may not all be taken into account under the alternative accounting presumption calculation regarding C's USRPHC status. Because of this difference, the alternative accounting presumption may not provide a sufficiently accurate indication of C's likely USRPHC status to be reasonably relied upon.

Some companies may be unable to rely on the presumption comfortably if the composition of their assets varies dramatically based on whether financial accounting or tax standards are used. For example, differences in the rules concerning the creation of goodwill for GAAP purposes versus for tax purposes may cause a company to pass the 25 percent alternative accounting presumption test but still possibly qualify for USRPHC status under the general test. Under reg. section 1.897-1(f)(1)(ii), goodwill is included in the category of Trade or Business Assets, and thus the more goodwill a corporation has, the less likely it is to be a USRPHC. To illustrate, assume a corporation acquires the stock of a second corporation, whose sole asset is a single building. GAAP accounting may provide that the difference between the amount paid for the corporation's stock and the depreciated replacement cost of the building will be treated as goodwill, but no such goodwill is created for tax purposes. Therefore, because the alternative accounting presumption relies on GAAP values, the corporation in this example would likely meet the 25 percent alternative accounting presumption threshold because the goodwill is a trade or business asset. But because no goodwill was created for tax purposes, under the general test the entire value of the acquired assets would be treated as a USRPI, increasing the likelihood of USRPHC status. In that situation, the acquiring corporation may be unable to rely on the alternative accounting presumption to determine its USRPHC status.

2. Determining FMV. For purposes of the general USRPHC determination, the regulations provide that the FMV of a corporation's assets is equal to

their gross value, reduced by the outstanding balance of some specified debts secured by those assets.⁵⁰ Gross value is defined generally as "the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the facts."⁵¹

Determining whether the gross value of a corporation's assets may be reduced by outstanding debts is governed by somewhat complex rules. Generally, the gross value of property is reduced by the outstanding balance of debts that are secured by a valid and enforceable mortgage or other security interest in the property and either (1) were incurred to acquire the property, or (2) were otherwise incurred in direct connection with the property, such as property tax liens upon real property or debts incurred to maintain or improve real property.⁵² If the debt is refinanced, the gross value of the property is reduced by the amount of the replacement debt, provided that: (1) the debt was refinanced for a valid business purpose, (2) the principal amount of the replacement debt does not exceed the outstanding balance of the original debt, and (3) the replacement debt is secured by the property.⁵³ Debts owed to a related person may be taken into account only if they constitute interests solely as a creditor (as defined in reg. section 1.897-1(d)(4)), and the related person has made similar loans to unrelated persons on similar terms and conditions.⁵⁴

3. Treatment of certain intangibles. As described above, the regulations define a USRPI as "any interest, other than an interest solely as a creditor" in real property located in the United States or the Virgin Islands or in a USRPHC.⁵⁵ In other words, an "interest solely as a creditor in either real property or in a domestic corporation" does not constitute a USRPI.⁵⁶ This means that a foreign investor who holds solely a "straight" debt security of a U.S. corporation would not be subject to FIRPTA on the disposition of the security. The regulations' definition of an interest "other than solely as a creditor" excludes "any direct or indirect right to share in the appreciation in value, or in the gross or net proceeds or profits generated by" real property or a USRPHC,⁵⁷ meaning that an interest that includes those rights would be treated as a USRPI. Those provisions play an important role in the challenging

⁵⁰Reg. section 1.897-1(o)(2)(i).

⁵¹Reg. section 1.897-1(o)(2)(ii).

⁵²Reg. section 1.897-1(o)(2)(iii).

⁵³*Id.*

⁵⁴*Id.*

⁵⁵Reg. section 1.897-1(c).

⁵⁶Reg. section 1.897-1(d)(1).

⁵⁷Reg. sections 1.897-1(d)(2) and 1.897-1(d)(3).

determination of whether certain intangibles that are to some extent related to real property qualify as USRPIs.

An ongoing area of uncertainty in the treatment of intangibles as USRPIs concerns the proper classification of some government contracts and government-granted rights regarding the use of real property. For instance, in Announcement 2008-115, the IRS raised the issue of whether the government-granted right to charge and collect tolls from the use of roads, bridges, or other physical infrastructure should be treated as a USRPI.⁵⁸ The announcement states that taxpayers may be taking the position that the government permit is an “asset used or held in a trade or business” but that the IRS and Treasury believe that in some instances, “the governmental permit may properly be characterized as a USRPI,” and that they are considering issuing proposed regulations addressing the issue.⁵⁹ The announcement did not discuss what those instances might be. Ultimately, however, the announcement does not provide a definite conclusion regarding the appropriate treatment of these rights.⁶⁰ No regulations have been issued to date.⁶¹

The discussion of the USRPI status of toll rights in Announcement 2008-115 is just one example of the ambiguity regarding whether some intangibles such as licenses, franchises, or other rights whose exercise necessitates the use of real property constitute USRPIs under the FIRPTA regulations. For many of those assets, the government may need to determine their FIRPTA status on a case-by-case basis, which will likely only increase taxpayer uncertainty in this area.⁶² When those intangibles are among a corporation’s most valuable assets, their

⁵⁸Announcement 2008-115, 2008-2 CB 1228.

⁵⁹*Id.*

⁶⁰*Id.*

⁶¹See New York State Bar Association Tax Section, “Report on IRS Announcement 2008-115 on FIRPTA Treatment of Rights Granted by a Governmental Unit,” Report 1195 (Nov. 16, 2009), which provides an in-depth discussion of the announcement and argues that these toll rights are USRPIs.

⁶²At one end of the spectrum, intangibles such as the right to share in rental income from a leasehold interest clearly are a right to profits generated by real property and therefore a USRPI. At the other end, intangibles such as liquor licenses, taxi stands, and restaurant franchises all in some broad sense depend on the use of real property to generate income, but the ultimate source of value in these businesses is derived primarily from the services provided, not the use of property. Therefore they should not be USRPIs. Many other intangibles, such as toll rights, may fall somewhere in the middle of this spectrum, and a careful consideration of the facts and circumstances is required to ascertain their USRPI status. See Victor Hollender, “Privatizing Our Infrastructure: Taxing the Toll or Tolling the Tax,” *Tax Notes*, Mar. 23, 2009, p. 1479.

treatment as USRPIs may be a deciding factor in the determination of its USRPHC status.

4. USRPHC determination dates. The FIRPTA regulations provide two alternative approaches that a corporation may choose between to meet the requirements for determining its USRPHC status. Under the primary, transactional approach, a corporation must determine its USRPHC status: (1) on the last day of its tax year, (2) on the date it acquires any USRPI, (3) on the date it disposes of any interest in real property located outside the United States or disposes of Trade or Business Assets, and (4) on the date any entity that is controlled by the corporation and whose assets are included in the corporation’s USRPHC determination either acquires a USRPI or disposes of an interest in real property located outside the United States or disposes of a trade or business asset.⁶³ That general transactional rule is subject to several exceptions. First, the regulations provide a de minimis exception under which, based on a sliding scale that depends on the percent of the corporation’s total assets that were USRPIs as of the most recent determination date, a corporation may acquire a specific value of USRPIs or dispose of a specific value of Trade or Business Assets without triggering a USRPHC status determination.⁶⁴ Second, USRPHC status determinations need not be made on the date that a corporation (or a controlled entity of the corporation) disposes of inventory or livestock, receives payment on accounts receivable arising from the disposition of inventory or livestock or the performance of services, or pays out cash to meet the regular operating needs of the business.⁶⁵ Third, the regulations provide that a new corporation need not determine its USRPHC status until the 120th day after the later of either its date of incorporation or the date on which it acquires its first shareholder.⁶⁶ Finally, a corporation need not determine its USRPHC status during the 12-month period beginning on the date on which it adopts a plan of complete liquidation, provided that the corporation distributes all of its assets (other than assets retained to meet claims) during that 12-month period.

Under the alternative monthly USRPHC status determination method, a corporation must determine its USRPHC status: (1) at the end of each calendar month and (2) as of the date on which, under a single transaction (consisting of one or more transfers), either (A) USRPIs are acquired, or

⁶³Reg. section 1.897-2(c)(1).

⁶⁴Reg. section 1.897-2(c)(2)(iii).

⁶⁵Reg. section 1.897-2(c)(2)(i)(A)-(C).

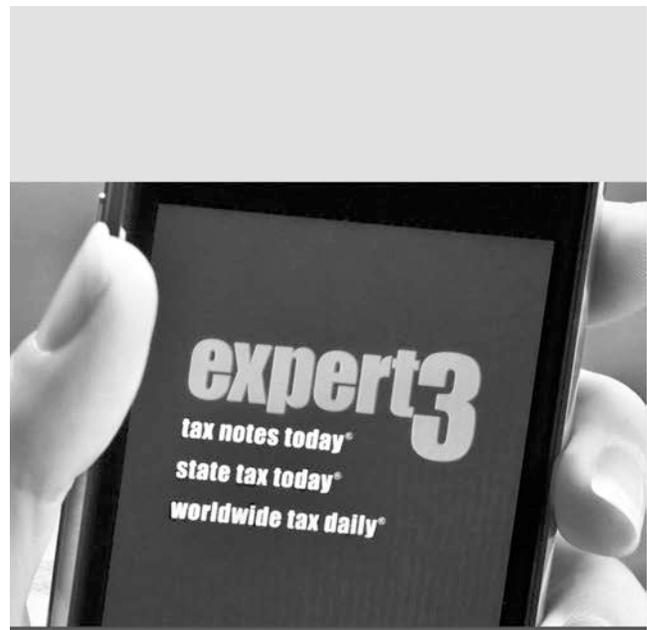
⁶⁶Reg. section 1.897-2(c)(1)(iv).

(B) foreign real property interest or Trade or Business Assets are disposed of, provided that the total FMV of the assets acquired or disposed of exceeds 5 percent of the sum of the FMVs of the USRPIs, foreign real property interests, and Trade or Business Assets held by the corporation.⁶⁷

D. Conclusion

Whether a corporation is a USRPHC is extremely important to foreign investors. U.S. corporations seeking to attract and retain those investors will often find it necessary to provide accurate information regarding their USRPHC status under FIRPTA. Determining a corporation's USRPHC status may often prove to be a challenging and difficult exercise, because of the complexity of the governing code sections and regulations. That is especially true because the treatment of certain types of assets as USRPIs is unclear, and existing law provides limited guidance.

⁶⁷Reg. section 1.897-2(c)(3).



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