The Long-Awaited Game Changer For US Real Estate


Victor Hollender


Sarah Ralph


David Polster

Law360, New York (December 21, 2015, 4:18 PM ET) -- On Dec. 18, 2015, President Barack Obama signed into law a bill that will significantly reform the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). The Protecting Americans from Tax Hikes Act of 2015 will extend a number of tax relief provisions that expired at the end of calendar year 2014. The bill demonstrates continued legislative commitment to reforming FIRPTA and attracting additional foreign capital into the U.S. real estate market. The bipartisan FIRPTA reform efforts have been championed over the past six years by House Ways and Means Committee Chairman Kevin Brady, R-Texas, and Rep. Joseph Crowley, D-N.Y., in the House of Representatives, along with Sen. Mike Enzi, R-Wyo., and Sen. Bob Menendez, D-N.J., in the Senate.[1]

As described below, these reforms will constitute the most significant changes to FIRPTA since its enactment 35 years ago. The bill makes foreign capital investment in the U.S. real estate market more attractive by modernizing certain exemptions from FIRPTA and clarifying the application of certain FIRPTA provisions to real estate investment trusts and their shareholders.[2]

Foreign Pension Funds

The bill completely exempts "qualified foreign pension funds" and entities wholly owned by such funds from FIRPTA taxation, equalizing the tax treatment of domestic and foreign pension funds on the disposition of U.S. real property interests. A foreign pension fund is "qualified" if it is subject to government regulation and certain reporting requirements in its jurisdiction, is established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees, has no greater than 5 percent beneficiaries, and enjoys tax benefits on either contributions or investment income in its home jurisdiction. The new exemption applies to direct investments or investments through partnerships and private equity funds.

Threshold Increased From 5 to 10 Percent for Publicly Traded REIT Stock

For publicly traded REITs, the bill opens the door to substantial new foreign investment by expanding the FIRPTA exemption available to small foreign "portfolio investors." Under prior law, foreign investors owning 5 percent or less of a publicly traded REIT were not subject to FIRPTA taxation upon a sale of the REIT's stock or the receipt of a capital gain dividend from the REIT. The bill increases this ownership threshold from 5 to 10 percent, bringing the FIRPTA regime in line with the definition of a portfolio investor used in most U.S. tax treaties. The bill provides for the first time that the exemption for small foreign portfolio investors applies to interests in REITs held by certain widely held, publicly traded "qualified collective investment vehicles," including listed Australian property trusts that qualify under a comprehensive income tax treaty with the United States and certain foreign publicly traded partnerships.

Domestically Controlled Determination

The bill contains certain very important clarifying presumptions that will allow publicly traded REITs and their shareholders to rely with greater confidence on the domestically controlled exception to FIRPTA taxation. Currently, gain resulting from the sale or disposition of stock of a domestically controlled REIT (i.e., an REIT, 50 percent of the stock of which is held by U.S. persons) is not subject to FIRPTA. In the past, it has proven difficult for many publicly traded REITs to take advantage of this exception with any high degree of comfort because of the lack of information needed to determine the domestic or foreign status of their "small" shareholders (i.e., those holding less than 5 percent interest). The bill provides that a U.S. publicly traded REIT may presume that all less-than-5 percent shareholders are U.S. persons except where the REIT has actual knowledge to the contrary. Furthermore, stock in an REIT held by an upper-tier entity that is either a publicly traded REIT or a regulated investment company (RIC) meeting certain requirements will be treated as held by a foreign person unless the upper-tier REIT or RIC itself is domestically controlled. REIT stock held by any other type of upper-tier REIT or RIC will only be treated as domestically controlled to the extent that stock of the upper-tier REIT or RIC is held or is treated as held by a U.S. person.

Revenue-Raising Proposals

The budgetary impact of these FIRPTA reforms is offset, in part, by a few revenue-raising provisions that were contained in S. 915, passed unanimously by the Senate Finance Committee earlier this spring. First, the FIRPTA withholding rate imposed on the disposition or distribution of a U.S. real property interest (other than sales of residences where the amount realized is $1 million or less) is increased from 10 to 15 percent to ensure that FIRPTA withholding collects a sufficient portion of the actual tax owed. This proposal does not impose any new tax but, instead, is designed to collect FIRPTA taxes owed that currently go uncollected. Second, the bill codifies that the FIRPTA "cleansing rule" exception does not apply to REITs or RICs. Finally, dividends from REITs and RICs are no longer treated as dividends from domestic corporations for purposes of determining whether certain dividends from a foreign corporation, which are attributable to dividends from an 80 percent-owned domestic corporation, are eligible for a dividends-received deduction under Section 245 of the Internal Revenue Code.

Today, FIRPTA taxation substantially deters foreign investment in U.S. real estate by creating unintended economic distortions that drive foreign capital to invest in real estate opportunities abroad as opposed to in the United States. The FIRPTA reform provisions of the bill reduce some of these barriers to foreign investment and should increase foreign capital investment in U.S. real estate. And this is unlikely to be the final chapter in FIRPTA reform.

—By Pamela Lawrence Endreny, Edward E. Gonzalez, Victor Hollender, David F. Levy, Diana M. Lopo, David Polster, Sarah E. Ralph and John D. Rayis, Skadden Arps Slate Meagher & Flom LLP

Pamela Lawrence Endreny, Edward Gonzalez, Victor Hollender and Diana Lopo are partners in Skadden's New York office. David Levy, David Polster, Sarah Ralph and John Rayis are *partners in the firm's Chicago office.*

DISCLOSURE: A number of Skadden attorneys have been actively engaged in this legislative process over the past several years.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] The Bill's FIRPTA 5 to 10 provisions largely follow those included in previous bills, including H.R. 5901 (the Real Estate Jobs and Investment Act of 2010), which passed the House of Representatives in 2010 by a vote of 402-11, H.R. 2989 (the Real Estate Jobs and Investment Act of 2011), S. 1616 (the Real Estate Investment and Jobs Act of 2011), H.R. 2870 (the Real Estate Investment and Jobs Act of 2013), S. 1181 (the Real Estate Investment and Jobs Act of 2013), H.R. 5487 (the Real Estate Investment and Jobs Act of 2014), S. 915 (the Real Estate Investment and Jobs Act of 2015), H.R. 2128 (the Real Estate Investment and Jobs Act of 2015) and H.R. 34 (the Tax Increase Prevention and Real Estate Investment Act of 2015).

[2] For a discussion on the bill's significant REIT reforms see our alert titled "Extenders Bill Makes Important REIT Reforms and Closes Door on REIT Spinoffs" (Dec. 18, 2015), available here.