

MEMORANDUM

TO: REF Review Attorneys

DATE: 6/4/85

FROM: Mary Sabatini DiStephan/Nancy Kramer *MSD*

RE: Re: Foreign Investment in Real Property Tax Act ("FIRPTA")

Section 1445 of the Internal Revenue Code requires the transferee of real property or an interest in an entity which owns real property to withhold 10% of the sales price if the transferor is a foreign (non U.S.) person. Failure to deduct and withhold the tax subjects the transferee to liability for the tax and penalty where tax is due and not paid by the transferor.

In appropriate plans (where the sponsor or holders of unsold shares as disclosed in the post closing amendment are "foreign") there should be the following disclosure:

- (1) Disclosure of Act and its requirements;
- (2) Liability of purchaser in certain instances;
- (3) Indemnification by sponsor/holder of unsold shares for tax liability of purchaser if there is a representation that transferee need not withhold tax under the facts of the instant transaction.
- (4) Form 8288 (U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests).

Attached please find a Chicago Title Insurance Company memorandum and an article in the New York State Real Property Law Section newsletter dealing with this law.

Please see Mary if you have any questions.

MSD/NK/bw

CHICAGO TITLE INSURANCE COMPANY

WOOLWORTH BUILDING, 233 BROADWAY, NEW YORK, NY 10279-0014 (212) 815-9371



To: Counsel

MICHAEL J. BEREY
ASSOCIATE REGIONAL COUNSEL

Subject: Foreign Investment In Real Property Tax Act (FIRPTA), as amended by the Deficit Reduction Act of 1984 (DRA)

Dated: January 29, 1985

A. Citations.

1. FIRPTA - 96 Stat. 2682
2. DRA - Sec. 129 of Tax Reform Act of 1984, Pub.L. 98-369
3. Withholding Provisions - 26 USCA Sec. 1445
4. IRS Regulations
 - a. Income Taxes: Taxation Of Foreign Investment In United Real Property Interests, 26 C.F.R. Sec. 1.1897-1, et seq., 49 F.R. 50689, et seq (Final Regulations).
 - b. Withholding Upon Disposition Of U.S. Real Property Interests By Foreign Persons, 26 C.F.R. Sec. 1.1445-1T, et seq., 49 F.R. 50667, et seq (Temporary Regulations).

B. Overview.

1. Effective January 1, 1985 the transferee of real property or an interest in an entity which owns real property is required to withhold 10 percent of the amount realized by the transferor (the sales price) and remit the same to the Internal Revenue Service Center, Philadelphia, PA. 19255 with IRS Forms 8288 and 8288-A (copies attached hereto) if:

- a. The transferor is a foreign person,
- b. The transferee is acquiring a United States Real Property Interest, and
- c. The transfer takes place on or after January 1, 1985.

2. In general, the transferee must report and pay over the tax withheld by the tenth day after the date of transfer, that being the first date on which consideration is paid or liability is assumed by the transferee. The payment of a contract down payment is not deemed to be the date of transfer.

A transferee that does not deduct and withhold tax when required is subject to liability for the amount of the tax, and to possible penalties where, in fact, tax is due and not paid by the transferor. Corporate officers may be subject to civil penalties equal to the amount that should have been withheld and paid over.

In certain entity transactions, as discussed herein, the transferor will withhold and remit the tax to the IRS.

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-2-

3. Ten percent of the amount realized must be withheld regardless of the cash involved in a transfer unless reduced withholding is authorized in advance by the IRS as discussed herein.

C. Transferor Is A Foreign Person.

1. Includes a nonresident alien individual, a foreign corporation (unless it elects to be taxed as a domestic corporation), foreign partnerships, foreign trusts and foreign estates.

2. A resident alien individual will be treated as a United States resident for tax purposes if he meets a "green card" or a "substantial presence" test. See "FIRPTA Withholding - Tax Rules - Lawyers", *Realty Brokers' Liability*, by Arthur Wittenstein and Suzanne Leonard, New York Law Journal, October 3, 1984, Page 1, Column 3.

D. United States Real Property Interest.

1. Regulations provide that local law will not be controlling for purposes of determining the meaning of the term real property.

2. Any interest other than an interest solely as a creditor in either

a. Real property located in the United States or the Virgin Islands -

1. Interests in real property itself, improvements and personal property associated with the use of real property.

2. Includes land and buildings, mines, wells and other unsecured natural deposits, time-sharing interests, condominium and cooperative units, life estates, options, contract rights, rights of first refusal, leaseholds, etc. Unclear as to whether the assignment and/or granting of ground leases and subleases are subject to withholding and how tax would be computed.

b. An interest in a domestic corporation unless the corporation was not a United States Real Property Holding Corporation within the past five years prior to the date of transfer or, if shorter, the period in which the interest was held by its present holder, and an interest in a partnership, estate or trust that owns a United States Real Property Interest.

A corporation is a United States Real Property Holding Corporation if the fair market value of its United States Real Property Interests equals or exceeds 50 percent of the total fair market value of its United States

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-3-

Real Property Interests, interests in foreign real property and trade or business assets.

3. Interest Other Than Solely As A Creditor.

- a. If a person holds interests in a United States Real Property Interest or an entity owning a United States Real Property Interest as a creditor and otherwise the person will be considered as holding an interest solely as a creditor if the non-creditor interest did not arise for a principal purpose of avoiding tax.
- b. A lender's right to share in the appreciation or cash flow of a property is not an interest solely as a creditor.
- c. The right to a commission or brokerage fee will be other than an interest solely as a creditor if the total payment is contingent on appreciation or profit arising after the date of the transaction.
- d. The purchaser at a foreclosure sale is required to withhold the lesser of 10 percent of the amount realized by the debtor or the amount realized by the debtor in excess of the debts secured by the property at the time of the foreclosure. The transferee must provide a notice of foreclosure and remit the tax to the IRS by the tenth day after his acquisition of the property.

E. Distributions By Corporations, Partnerships, Trusts and Estates.

In the transactions below the transferor will withhold tax and remit the same to the IRS -

1. If a domestic partnership, trust or estate disposes of a United States Real Property Interest and any partner, beneficiary or substantial owner of the entity is a foreign person, the partnership or fiduciary must withhold a tax of ten percent of each foreign person's proportionate share.
2. A foreign corporation that distributes a United States Real Property Interest must generally withhold 28 percent of the corporation's recognized gain.
3. Any domestic corporation that distributes any property in redemption of stock or in a corporate liquidation to a foreign person that holds a United States Real Property Interest in the corporation must withhold 10 percent of the fair market value of the property distributed.
4. Withholding is not yet required on certain taxable distribution by domestic or foreign partnerships, trusts and estates under 26 USC Secs. 1445(e)(4) and (e)(5) pending further Treasury Department action.

Sample non-foreign person certifications for these situations are to be found at 49 F.R. 50674.

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-4-

F. Exemptions.

1. The transferor is an integral part of or a controlled entity of a foreign government or international organization and the subject property has not been used for commercial activity but for investment or diplomatic purposes.
2. The purchase of property by the transferee as a residence where the sales price does not exceed \$300,000.00. To claim the exemption the transferee must have definite plans for he or his family to reside at the property for at least 50 percent of the number of days that the property is in use during each of the first two twelve month periods following the date of transfer. If actual residence is not as intended the transferee will be liable for the tax, if due and unpaid, unless there was a change of circumstances that could not reasonably have been foreseen.
3. The transferee is not required to withhold if notified by the transferor in writing that it is not required to recognize any gain or loss for the transfer under a tax treaty or income tax regulations. By the tenth day after the date of transfer the transferee must provide a copy of that notice to the Director, Foreign Operations District, Washington, D. C.

The transferee is not entitled to rely on the notice if it is related to the transferor or has reason to know the statement is untrue.

4. The transferor furnishes to the transferee a certification executed by it under penalty of perjury stating that the transferor is not a foreign person. The certification need not be filed with the IRS but it must be retained for submission to the IRS on request until the end of the fifth taxable year after the date of the transfer.

The transferee may not rely on a certification if it has actual notice that the certification is false or it receives notice from a transferor's agent or transferee's agent that the certification is false. Notice received after the transfer will only require withholding as to consideration remaining to be paid.

Sample certifications are attached hereto.

5. Transfer of an interest in an entity by a foreign person.

- a. On the transfer of an interest in a non-publicly traded domestic corporation there will be no withholding required if the corporation furnishes to the transferee a certification that the interest being transferred is not a United States Real Property Interest (the corporation is not a United States Real Property Holding Corporation) and that the corporation has attached a statement that it is not a United States Real Property Holding Corporation to its tax return.

The corporation must respond in writing to a request for such a statement within thirty days of receiving the

CHICAGO TITLE INSURANCE COMPANY

-5-

request. A transferor - foreign person may rely on the statement for thirty days from its date of execution

Alternately, a foreign person may also establish that the interest being transferred is not a United States Real Property Interest by requesting and obtaining a determination to that effect from the Director, Foreign Operations Division, Washington, D.C.

- B. Also exempt is the transfer of a share or shares of stock in a domestic corporation that is regularly traded on an established securities market, except where the transferor of the stock has owned more than 5 percent of the class of stock being transferred during the shorter of five year period ending on the date of disposition of the stock or the period since June 18, 1980 (the effective date of FIRPTA). Publicly traded partnerships and trusts are subject to the same rules as publicly traded corporations.
6. The transferor receives a "withholding statement" from the IRS stating that the transferor either -
 - a. Has reached agreement with the IRS (or such agreement has been reached by the transferee) for payment of the tax with security being provided to ensure payment, or
 - b. Is exempt from payment of any tax on the disposition of the United States Real Property Interest being transferred, and
 - c. The transferor or transferee has satisfied any unsatisfied liability of the transferor relative to its acquisition of the property interest being disposed of or has provided adequate security to cover such liability.

If on the date of transfer an application for a withholding certificate is pending with the IRS, the transferee must nevertheless withhold 10 percent of the amount realized. If, however, the application was submitted not later than the thirtieth day prior to the date of transfer the amount withheld need not be reported and paid over to the IRS until the tenth day following the IRS determination on the application.

G. Agent Liability.

1. A transferor's or transferee's agent is a person who represents the transferor or transferee, as the case may be, in any negotiation with another person or another person's agent relative to the transaction or in settling the transaction.
2. If the transferee is furnished with a non-United States Real Property Interest Statement or a non-foreign certification that the transferor's agent or transferee's agent knows is false, the agent must so notify the transferee in writing as soon as possible. A transferee receiving such a notice that fails to withhold may be liable for tax found

CHICAGO TITLE INSURANCE COMPANY

-6-

to be due and unpaid. The agent is liable for the failure to provide notice up to the amount of consideration which the agent receives for the transaction.

There is no requirement that an agent make reasonable inquiry concerning the transferor's status.

3. If after the date of transfer the agent learns that the statement or certification is false, the agent must notify the transferee within three days from the date of discovery. The agent must also forward a copy of that notice to the IRS. The notice need not disclose the information on which the notice is based.

H. The Title Company.

1. The definition of transferor's agent or transferee's agent does not include a person solely performing one or more of the following: the receipt and disbursement of any portion of the consideration for a transaction, the recording of any document in connection with the transaction, or typing, copying or clerical tasks.
2. Company personnel must not give opinions or tax advice on the impact of FIRPTA. The tax or withholding obligation is not a lien on real property.

Do not prepare or execute FIRPTA withholding forms.



Michael J. Beley

MJB:am
enclosures

Form 8288
(December 1984)
Department of the Treasury
Internal Revenue Service

**U.S. Withholding Tax Return for
Dispositions by Foreign Persons of U.S.
Real Property Interests**

OMB No. 1545-0902
Expires 11-30-87

Complete Part I or Part II. Also complete Form(s) 8288-A.

Part I To Be Completed by the Buyer or Other Transferee Required to Withhold

1 Name of withholding agent (buyer or other transferee)

Identification number

Address (Number and street)

City, state, and Zip code

2 Description and location of property acquired

3 Date of transfer	4 Number of Forms 8288-A attached	5 Amount realized on the transfer
6 a Withholding is at 10% b Withholding is of a reduced amount	<input type="checkbox"/> (Check applicable box)	7 Amount withheld

Part II To Be Completed by a Corporation, Partnership, Trust, or Estate Subject to the Provisions of Section 1445(e)

1 Name of withholding agent (corporation, partnership, or fiduciary)

Identification number

Address (Number and street)

City, state, and Zip code

2 Description of U.S. real property interest transferred or distributed

3 Date of transfer	4 Number of Forms 8288-A attached	5 Total amount withheld
6 a Withholding is at 10% or 28% b Withholding is of a reduced amount c Large partnership or trust election to withhold at distribution	<input type="checkbox"/> (Check all applicable boxes)	

Under penalties of perjury, I declare that I have examined this return and accompanying attachments, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than withholding agent, partner, fiduciary, or corporate officer) is based on all information of which preparer has any knowledge.

Signature of withholding agent, partner, fiduciary, or corporate officer

Title

Date

Signature of preparer other than withholding agent, partner, fiduciary, or corporate officer

Address

Date

For Paperwork Reduction Act Notice, see Instructions.

(Attach additional same size sheets if you need more space.)

Form 8288 (12-84)

For Official Use Only

Withholding agent's name, street address, city, state, and ZIP code		1 Date of transfer	Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests OMB No. 1545-0902 Expires 11-30-87	
		2 Federal income tax withheld		
Withholding agent's Federal identification no.	Identification number of foreign person subject to withholding (If none, IRS will furnish.)	3 Amount realized	4 Gain recognized by foreign corporation	
Name and address of person subject to withholding		5 Description of property transferred		
Street address				
City, state, and ZIP code (province, country, and postal zone)		6 Person subject to withholding is: An individual <input type="checkbox"/> Other than an individual <input type="checkbox"/>		

Form 8288-A (12-84)

Attach to Form 8288.

Department of the Treasury - Internal Revenue Service

Copy A
For Internal Revenue Service Center

For Paperwork Reduction Act Notice, see the instructions for Form 8288.

Withholding agent's name, street address, city, state, and ZIP code		1 Date of transfer	Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests OMB No. 1545-0902 Expires 11-30-87	
		2 Federal income tax withheld		
Withholding agent's Federal identification no.	Identification number of foreign person subject to withholding (If none, IRS will furnish.)	3 Amount realized	4 Gain recognized by foreign corporation	
Name and address of person subject to withholding		5 Description of property transferred		
Street address				
City, state, and ZIP code (province, country, and postal zone)		6 Person subject to withholding is: An individual <input type="checkbox"/> Other than an individual <input type="checkbox"/>		

Form 8288-A (12-84)

Department of the Treasury - Internal Revenue Service

Copy B
Send to Internal Revenue Service Center—For Use by Person Subject to Withholding

This information is being furnished to the Internal Revenue Service.

Withholding agent's name, street address, city, state, and ZIP code		1 Date of transfer	Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests OMB No. 1545-0902 Expires 11-30-87	
		2 Federal income tax withheld		
Withholding agent's Federal identification no.	Identification number of foreign person subject to withholding (If none, IRS will furnish.)	3 Amount realized	4 Gain recognized by foreign corporation	
Name and address of person subject to withholding		5 Description of property transferred		
Street address				
City, state, and ZIP code (province, country, and postal zone)		6 Person subject to withholding is: An individual <input type="checkbox"/> Other than an individual <input type="checkbox"/>		

Copy C
For Withholding Agent

For Paperwork Reduction Act Notice, see the instructions for Form 8288.

Form 8288-A (12-84)

Department of the Treasury - Internal Revenue Service

CERTIFICATION OF NONFOREIGN STATUS

(Corporation, Partnership, Trust or Estate)

Section 1445 of the Internal Revenue Code provides that a transferee of a U.S. real property interest must withhold tax if the transferor is a foreign person. To inform the transferee that withholding of tax is not required upon the disposition of a U.S. real property interest by _____ (name of transferor), the undersigned hereby certifies the following on behalf of _____ (name of transferor):

1. _____ (Name of transferor) is not a foreign corporation, foreign partnership, foreign trust, or foreign estate (as those terms are defined in the Internal Revenue Code and Income Tax Regulations);
2. _____ (Name of transferor)'s U.S. employer identification number is _____, and
3. _____ (Name of transferor)'s office address is

_____(Name of transferor) understands that this certification may be disclosed to the Internal Revenue Service by transferee and that any false statement contained herein could be punished by fine, imprisonment, or both.

Under penalties of perjury I declare that I have examined this certification and to the best of my knowledge and belief it is true, correct and complete, and I further declare that I have authority to sign this document on behalf of _____ (Name of transferor).

Dated: _____

(Signature) _____

(Title) _____

CERTIFICATION OF NONFOREIGN STATUS

(Corporation, Partnership, Trust or Estate)

Section 1445 of the Internal Revenue Code provides that a transferee of a U.S. real property interest must withhold tax if the transferor is a foreign person. To inform the transferee that withholding of tax is not required upon the disposition of a U.S. real property interest by _____, (name of transferor) the undersigned hereby certifies the following on behalf of _____, (name of transferor):

1. _____ is not a foreign corporation, foreign partnership, foreign trust, or foreign estate (as those terms are defined in the Internal Revenue Code and Income Tax Regulations);
2. _____ 's U.S. employer identification number is _____, and
3. _____ 's office address is

_____, (Name of transferor) understands that this certification may be disclosed to the Internal Revenue Service by transferee and that any false statement contained herein could be punished by fine, imprisonment, or both.

Under penalties of perjury I declare that I have examined this certification and to the best of my knowledge and belief it is true, correct and complete, and I further declare that I have authority to sign this document on behalf of _____, (Name of transferor).

Dated: _____

(Signature) _____

(Title) _____

CERTIFICATION OF NONFOREIGN STATUS
(Individual)

Section 1445 of the Internal Revenue Code provides that a transferee (buyer) of a U.S. real property interest must withhold tax if the transferor (seller) is a foreign person. To inform the transferee (buyer) that withholding of tax is not required upon my disposition of a U.S. real property interest, I,

_____, hereby certify the following:

1. I am not a nonresident alien for purposes of U.S. income taxation
2. My U.S. taxpayer identifying number is _____; and
3. My home address is

I understand that this certification may be disclosed to the Internal Revenue Service by the transferee and that any false statement I have made here could be punished by fine, imprisonment, or both.

Under penalties of perjury I declare that I have examined this certification and to the best of my knowledge and belief it is true, correct, and complete.

Dated: _____

(Signature of Seller)

(Signature of Seller)

REAL PROPERTY LAW SECTION NEWSLETTER



NEW YORK STATE
BAR ASSOCIATION

Vol. 13, No. 1

January, 1985

U.S. Disclosure Requirements for Foreign Investors

By John E. Blyth, Esq.
Rochester, New York

Foreigners who invest in the United States, particularly in real property, face substantial disclosure requirements under at least three federal statutes.¹ Those statutes are The International Investment Survey Act of 1976 (IISA),² The Agricultural Foreign Disclosure Act of 1978 (AFIDA)³, and The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA).⁴ Although the three statutes are different in form and application, all of them work against the anonymity of the foreign investor and, in one way or another, require U.S. counselors to participate in the disclosure. In the case of FIRPTA, the purchaser becomes the agent of the United States for the collection of the withholding tax.

Because the amendments made to FIRPTA in the summer of 1984 replace extensive disclosure with a 10% withholding tax and simplified disclosure and because those amendments are effective on January 1, 1985 this discussion of the three statutes will begin with FIRPTA.

I. The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA)

Under FIRPTA, foreign persons who dispose of U.S. real property interests ("USRPIs") as defined in Section 897(c) of the Internal Revenue Code (the "Code") are taxed on the gain realized on the disposition of those interests. The earlier version of FIRPTA provided for enforcement by elaborate reporting requirements. The new version imposes a 10% withholding tax and simplifies the disclosure requirements.

The Deficit Reduction Act of 1984 added new Section 1445 to the Code. That section imposes a withholding tax in the amount of 10% of the amount realized on the disposition and requires the buyer (transferee) to withhold the tax. As an alternative to the 10% withholding tax, a "maximum tax liability" of the transferor may be established under Section 1445(c) by agreement with the Secretary of Treasury.

Exempted from such withholding tax are (1) the disposition by a foreigner of a residence when the amount realized is less than \$300,000 and (2) the disposition by a foreigner of stock regularly traded on an established securities market.

If the seller gives the buyer one of two kinds of affidavits, the buyer is not required to withhold. Those affidavits are (1) a "non-foreign affidavit" given by the transferor under penalty of perjury providing (a) the seller's U.S. taxpayer identification number and (b) a statement that the transferor is not a foreign person, and (2) a "non-USRPNC affidavit" where the transferee of a non-publicly traded U.S. corporation receives an affidavit from the cor-

poration, given under penalty of perjury, that it is not and has not been a U.S. real property holding corporation ("USRPNC") during the applicable period under Section 897(c) of the Code. Without such an affidavit, the buyer of the corporate interest may be liable for withholding.

Neither affidavit exemption applies if the transferee has actual knowledge that the affidavit is false or if the transferee receives notice from either his agent or from the transferor's agent that the affidavit is false. An agent is any person who represents the transferor or transferee in the negotiations relating to the transaction in settling the transaction. The settlement officer who merely receives or disburses some part of the consideration or who records a document is not an agent.

Pursuant to regulations to be issued, withholding will be required upon the disposition of USRPIs to foreigners by a United States Real Property Holding Corporation (USRPHCo"), foreign corporation, domestic or foreign partnership, trust and estate. In the case of a distribution by a foreign corporation to a foreign shareholder, the withholding tax rate is raised to 28%. Dividend distributions are not covered here since they are already subject

(Continued on Page 2)

Inside

New Contract Provisions Required by FIRPTA	3
"Pay-First-Fight-Later" Clauses in Leases	4
Fire Insurance Proceeds Rights of Mortgagor and Mortgagee	5
An Analysis of the New Industrial Development Bond Rules	8
Committee Reports — Legislative Committee Report — Fall 1984	15
Report of Committee on Programs and Meetings	16
Recent Cases	17
Prejudgment Interest Computed From Time of Absolute Loss	17
Right of Life Tenancy	17
Mutual Mistake in Good Faith Not a Ground for Reformation	17

U.S. Disclosure (Continued from Page 1) to 30% withholding under Sections 1441 and 1442 of the Code. The application of those sections may, however, be limited by an income tax treaty.

A transferee may also avoid or reduce withholding if a "qualifying statement" is received from the Internal Revenue Service under Section 1445(b)(4). Such a statement means that agreement has been reached with respect to payment of the tax or that the transaction is exempt from tax and that adequate security has been provided to cover any tax liability.

Revised Section 6039 C of the Internal Revenue Code repealed earlier reporting requirements, retroactive to 1980, and substituted new, simplified reporting requirements. Now only "direct" investors in USRPIs will be required to disclose those investments. The former rules requiring disclosure up the chain of ownership have been eliminated.

When required, the foreign person must disclose his name, address and description of the USRPI if (1) the foreign person did not engage in trade or business in the United States in the calendar year and (2) the fair market value of the USRPI directly held was greater than \$50,000 during the year. Attribution rules apply if the USRPI is held by a partnership, trust or estate where the interest is deemed owned proportionately by the partners or by the beneficiaries and if the USRPI is held by a spouse or minor child where the interest is deemed owned by the individual.

II. The International Investment Survey Act of 1976 (IISA)

Under IISA, a report must be filed with the Bureau of Economic Analysis of the Department of Commerce with respect to every business enterprise subject to U.S. jurisdiction, including real estate, in which foreign persons after January 1, 1979 hold a pecuniary or voting interest of more than 10%. This statute reflects Congressional concern regarding the amount of foreign investment in the United States, particularly in U.S. farm land. The U.S. policy is not to restrain or deter foreign investment in the United States; rather, the United States wants to know the magnitude of the investment in the United States.

A business enterprise with respect to which a report of investment must be filed is "any organization, association, branch or venture which exists for profit-making purposes or otherwise to secure economic advantage, and any ownership of any real estate". Residential real estate held for personal use (by an individual or corporation) is excluded and no report need be filed with respect to this activity.

A foreign person is a non-U.S. resident or a person subject to the jurisdiction of a country other than the United States. "Person" includes individuals, corporations, partnerships, associations, estates, trusts, organizations and any government. The concept also includes an affiliate (a business enterprise located in one country which is directly or indirectly owned or controlled to the extent of 10% or more by a foreign person) and a U.S. intermediary (trust or agent) for the benefit of a foreign owner. A foreign owner is the ultimate beneficial owner ("UBO"), that is, one who is not more than 50% owned or controlled by another person.

In addition to the residential exemption described above, there are two other exemptions: (1) a situation where the direct or indirect ownership or control by a

foreign person in the U.S. business enterprise is less than 10% and (2) a situation where the acquisition cost is less than \$1,000,000 and the acquisition does not involve more than 200 acres. If the acquisition involves more than 200 acres even though the cost is less than \$1,000,000, reporting is required. It is important to note, however, that, in order to obtain the exemption, a report must nevertheless be filed. A different form is used, and it contains only minimal information (Form BE-13 Supplement C).

The report must be filed by one or more of four categories of persons:

1. The U.S. business enterprise, business segment or operating unit that has been established or partially or totally acquired (Form BE-13).
2. The existing U.S. affiliate which establishes or acquires the U.S. business enterprise (Form BE-14).
3. Any U.S. person who assists or intervenes in the acquisition of a U.S. business enterprise by a foreign person, or who enters into a joint venture with a foreign person (Form BE-14), if that person knows of foreign involvement in the transaction or has reason to believe that the acquiring person may be a foreign person and that person does not have a reasonable basis to believe that the transaction is being reported on Form BE-13. This requirement includes an intermediary, real estate broker and CPA. As an intermediary who assists in the sale or purchase, a lender to the purchaser, engineer, and consultant to the purchaser, title insurance company and escrow agent may be included. While an attorney is included, the impact of the attorney-client privilege on this requirement is not clear. Perhaps an attorney or other advisor, to avoid the requirement of filing a Form BE-14, should see to it that a Form BE-13 is filed.

At least four different kinds of periodic reports are contemplated:

1. Transactional—whenever an acquisition or establishment of the U.S. business enterprise occurs (Form BE-13 or BE-14).
2. Benchmark survey—one was done in 1980. The next will be done in 1987 and thereafter every five years (Form BE-12).
3. Annual—by U.S. affiliates (Form BE-15) unless the affiliate did not own during the year 200 acres or more of U.S. land and each of the following was between negative \$10,000,000 and positive \$10,000,000 for the year (formerly \$5,000,000 in each case): (a) total assets, (b) net sales or gross operating revenues, exclusive of sales tax, and (c) net income after provision for U.S. income taxes.

4. Quarterly—the requirements here are the same as for the annual report under (3) above except the period is a quarter rather than a year (Forms BE-605 and BE-606 B).

The penalties for failure to file include a fine not to exceed \$10,000, injunctive relief, or imprisonment for up to one year.

The statute provides for confidential treatment of the information provided in that it will be generally available only to the U.S. government officials and employees performing functions under the IISA. Form BE-12, for instance, specifically states that the information shall be available only to officials and employees designated by the President to perform functions under the Act, but only for analytical and statistical purposes. Presumably a freedom of information request would not be honored. Fears

(Continued on Page 3)

U.S. Disclosure (Continued from Page 2) persist, however, that the information will not be treated confidentially but rather will be disclosed to other U.S. governmental agencies or to foreign governments pursuant to treaty commitments.

III. The Agricultural Foreign Disclosure Act of 1978 (AFIDA)

Under AFIDA, any foreign person who acquires or transfers an interest (other than a security interest) in U.S. agricultural land must file a report with the United States Secretary of Agriculture. While the report is made to the Secretary of Agriculture, it is filed locally, that is, at the office of the Agricultural Stabilization and Conservation Service (ASCS) where the tract of land is located or administered (Form ASCS-153). The report is due within 90 days of the acquisition of the land.

The purpose of AFIDA is to enable the United States to collect sufficient data to determine the extent of foreign investment in U.S. agricultural land and its effect on family farms and rural communities.

The definition of "any foreign person" includes an individual, corporation, partnership, estate, trust, institution, association or "other" organization which is (1) a non-U.S. citizen, or (2) a non-permanent resident or an individual not paroled into the United States under the Immigration and Nationality Act (e.g., a person residing in the United States on the basis of a treaty investor visa, treaty trader visa, or visitor's visa), or (3) an organization formed under foreign law or a U.S. organization whose principal place of business is outside the United States, or (4) a U.S. organization where more than 10% is controlled by foreigners.

The concept of "acquires or transfers" includes a purchase, and probably also a gift and an inheritance. Excluded from the concept are security interests (mortgage or other debt securing instrument) and mineral interests (e.g., interests in oil and gas properties).

U.S. agricultural land includes timberland and cropland, idle lands if the last use within the last five years was agricultural, leaseholds of more than 10 years and

easements and rights of way unless they are used for non-agricultural purposes.

U.S. agricultural land does not include future interests nor land which is less than 10 acres (formerly one acre) in size from which the products generate less than \$1,000 in gross sales and are produced for the personal or household interest of the person holding the interest.

The information required to be disclosed is predictably complete and includes the identity of the foreign person, the type of interest, consideration given, purpose of the agricultural use, date of acquisition and legal description of the land including acreage.

The penalties for non-compliance with AFIDA can be formidable. For the knowing submission of a false or inaccurate report, the penalty is payment of 25% of the fair market value of the interest in the land. For a late filing, the penalty is payment of 1/10th of 1% of the fair market value of the interest in the land up to a maximum of 25% of the fair market value of the land.

Contrary to the stated purpose of IISA, the information gathered under AFIDA is not intended to be treated confidentially. It is available for public inspection and is also available to a treaty partner under a mutual assistance treaty or under an income tax treaty.

FOOTNOTES

1 Disclosure requirements may also arise under other statutes. See, for instance, the reporting requirements of the Currency and Foreign Transactions Reporting Act, sometimes called the "Bank Secrecy Act", 84 Stat. 1118, 31 U.S.C. 1051-1122 (1976), relating to bank transactions in excess of \$10,000 and to exports and imports of monetary instruments in excess of \$5,000. See also the Securities Act of 1933 (registration or exemption), the Securities Act of 1934 (anti-fraud rules), and blue sky restrictions such as the New York Real Estate Syndication Act.

2 Pub. L. No. 90-472, 90 Stat. 2059 (1976); 22 U.S.C. 3101-3108 (1983).

3 Pub. L. No. 95-460, 92 Stat. 1263, 1-10; 7 U.S.C. 3501-3508 (1983).

4 Pub. L. No. 96-499, 94 Stat. 2599 [codified at Code 86(a)(5), 897, 6039 C and 6652(g)] (1980).

5 129 of H.R. 4170, the Deficit Reduction Act of 1984, adding Code 1445 and substantially revising Code 6039 C.

New Contract Provisions Required by FIRPTA

By David Richards
New York City

In an attempt to close several 'loopholes' by which foreign investors could avoid United States capital gains tax when they dispose of interests in real property situated in the U.S. Congress in 1980 enacted the 'Foreign Investment in Real Property Tax Act of 1980' (FIRPTA), establishing new Internal Revenue code sections 897 and 6039C.

These provisions required that the name and address of a foreign investor holding a substantial interest (\$50,000 or more in fair-market-value) in US real property had to be disclosed to the Internal Revenue Service in an annually filed information return, no matter how indirectly the interest was held through tiers of domestic or foreign holding entities interposed between the property and the ultimate beneficial owner.

The FIRPTA temporary regulations issued by the Treasury elicited a firestorm of criticism leading first to new regulations, then to repeated postponement of the filing dates.

Now, instead of telling the taxman about foreign ownership of US realty, it is a case of telling the transferee. With the passage of the 'Deficit Reduction Act of 1984' (DRA) Congress substantially revised the taxing and reporting regime imposed by FIRPTA:

- previously-mandated reporting requirements have been repealed in their entirety (except for foreign persons having 'direct' substantial investments in U.S. realty) and, more dramatically,

(Continued on Page 4)

Editor's Note

Dear Readers: Please send contributions comments and suggestions for future newsletters to the Editor — Flora Schnall, Esq., 1 Chase Manhattan Plaza, New York, New York 10005.

New Contract

(Continued from Page 3)

- a withholding tax obligation will now be imposed on the transferee when a US real property interest is acquired from a foreign transferor, from and after January 1, 1985.

In certain circumstances withholding is also imposed on the transferee's agent, including his lawyer, up to the amount of the agent's compensation.

Details of the legislation are more fully discussed in Richards, "FIRPTA-the-Second: Disclosure and Withholding" in 58 TAXES INTERNATIONAL 15 (August, 1984), being reprinted as "Telling the Transferee" in the forthcoming Fall, 1984, REAL PROPERTY, PROBATE & TRUST JOURNAL.

In the absence of clarifying regulations, the following contract provisions are strongly recommended for all real property contracts with closing dates on or after January 1, 1985:

Section 10. Seller's Closing Obligations

At the Closing, Seller shall deliver the following to Purchaser:

\$10.1[8] If Seller is not a "foreign person" (as defined in Internal Revenue Code Section 1445(f)(3) and the regulations issued thereunder), a non-foreign affidavit, properly executed and in recordable form, containing such information as shall be required by Internal Revenue Code Section 1445(b)(2) and the regulations issued thereunder. In the event that such regulations shall not have been issued by the Closing Date, the non-foreign affidavit shall be a sworn statement of Seller (i) stating that Seller is not a foreign person, (ii) stating that Seller is (as the case may be) a U.S. tax resident individual, or a U.S. corporation, or a U.S. partnership, or a U.S. trust, or a U.S. estate, (iii) setting forth Seller's taxpayer identification number (as identified in Schedule D hereto), (iv) stating that Seller intends to file a U.S. income tax return with respect to the sale of the Premises, and (v) granting Purchaser permission to furnish a copy of such affidavit to the Internal Revenue Service.

(N.B. A similar provision will be necessary in any House Contract form if the purchase price is in excess of \$300,000. A purchase price of \$300,000 or less for property acquired by the transferee for use by him as a residence, altogether constitutes another exemption to FIRPTA withholding by the purchaser which would avoid the need to secure a non-foreign affidavit to escape withholding liability, should the seller prove to be a foreign person.)

Section 2. Purchase Price...

2.06. In the event that Seller is a "foreign person" (as defined in Internal Revenue Code Section 1445(f)(3) and regulations issued thereunder, or in the event that Seller fails or refuses to deliver the nonforeign affidavit required in 10.1[8], or in the event that Purchaser receives notice from any Seller-transferor's agent or Purchaser-transferee's agent (each as defined in Internal Revenue Code Section 1445(d) and the regulations issued thereunder) that, or Purchaser has actual knowledge that, such affidavit is false, Purchaser shall deduct and withhold from the Purchase Price a tax equal to 10 percent thereof, as required by Internal Revenue Code Section 1445. In the event of any such withholding, to deliver title hereunder shall not be excused or otherwise affected. Purchaser shall remit such amount to and file the required form with the Internal Revenue Service, and Seller in the event of any

claimed over-withholding shall be limited solely to an action against the Internal Revenue Service for refund [under Regulation Section 1.14641(a)], and hereby waives any right of action against Purchaser on account of such withholding. The provisions of this 2.06 shall survive the Closing hereunder.

(N.8.

Some reviewers have suggested that this language is too Purchaser-favorable, in the sense that it suggests to an unscrupulous Purchaser how he might dishonestly claim such "actual knowledge" and threaten withholding at the closing, in a bald effort to reduce the purchase price to a Seller suddenly threatened by the prospect of expected proceeds being reduced by withholding. However, this language is descriptive of the probable course of events (in this writer's opinion), even in the absence of this language from the contract form, where the Purchaser comes into possession of actual knowledge, or notice from an agent in the transaction, which belies the affidavit.

Also, this language ignores a third exemption (besides the non-foreign affidavit and the residenceunder-\$300,000) which might be applicable to the foreign seller in a real estate (i.e., nonstock) transaction to reduce the amount withheld, namely the provision of a "qualifying statement" in which the Treasury has agreed that less than the full 10% should be withheld.)

If you find this entire procedure disruptive of the real estate industry, you may wish to support Senator Goldwater's efforts to repeal FIRPTA in its entirety, or at least to petition Secretary of the Treasury Donald Regan to postpone the effective date of the legislation (January 1, 1985) until further hearings might be held.

"Pay-First-Fight-Later" Clauses in Leases

By Bernard H. Goldstein

One may find that a clause of a lease, calling for a formula arrangement as the basis of what the tenant is to pay, may contain an arbitration clause allowing the tenant to have a dispute concerning payments resolved by arbitration. This may, of course, result in delaying what the tenant is to pay. The reliance of the landlord in this situation on the tenant's payments coming forward promptly as and when billed may be based on an illusory foundation.

The foregoing considerations are of significance in escalation clauses, for example, in the so-called "Porter's Wage Clause", common in the New York Metropolitan Area. In this clause, escalation is tied in with changes in the basic hourly rate of porters deriving from the governing union contract. The clause gives the appearance of a rigorous formula, and it may suggest that all that is required is a substitution of numbers for the symbols of an equation. It has been stated judicially that: "[The clause] may be complex, but it is unambiguous." (Geo. Backer Mgt. Corp. v. Acme Quilting 55 AD2d 535 [1976], aff'd 46 NY2d 211 [1978].

However, the George Backer description of the clause may be too generous, in the light of the later case of Avon Products v. Sollow (79 AD2d 53, 55 [1st Dept. 1981] aff'd 54 NY2d 637 [1981]), suggesting a penumbra area in applying the formula in relation to fringe benefits. Since such Porter's Wage Escalation clauses are bottomed on labor contracts, all the "black holes" of the latter as to fringe benefits will permeate the escalation clause. That these deficiencies in labor contracts are not a chimera can be seen from

(Continued on Page 5)