MEMORANDUM

TO: REF Review Attorneys

FROM: Mary Sabatini DiStephan/Nancy Kramer

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.
To: 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

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.
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.


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

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  
   Number of Forms 8288-A attached  
   Amount realized on the transfer

   a. Withholding is at 10%  
   b. Withholding is of a reduced amount  
   (Check applicable box)  
   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  
   Number of Forms 8288-A attached

   a. Withholding is at 10% or 28%  
   b. Withholding is of a reduced amount  
   c. Large partnership or trust election to withhold at distribution  
   (Check all applicable bases)  
   Total amount withheld

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)
Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests

<table>
<thead>
<tr>
<th>Name and address of person subject to withholding</th>
<th>1 Date of transfer</th>
<th>2 Federal income tax withheld</th>
<th>3 Amount realized</th>
<th>4 Gain recognized by foreign corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Street address</td>
<td></td>
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<tr>
<td>City, state, and ZIP code (province, country, and postal zone)</td>
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<td></td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Name and address of person subject to withholding</th>
<th>5 Description of property transferred</th>
<th>6 Person subject to withholding is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Street address</td>
<td></td>
<td>An individual</td>
</tr>
<tr>
<td>City, state, and ZIP code (province, country, and postal zone)</td>
<td></td>
<td>Other than an individual</td>
</tr>
</tbody>
</table>

For Official Use Only

Copy A
For Internal Revenue Service Center

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.

Copy C
For Withholding Agent

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

____________________ 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. ____________________________ (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
(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, 

(Name of transferor) 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

   (Social Security Number)

3. My home address is

   

   (Address)

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)
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. These statutes are The International Investment Survey Act of 1976 (IISA), The Agricultural Foreign Disclosure Act of 1978 (AFIDA), and The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). 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-USRPHC affidavit" where the transferee of a non-publicly traded U.S. corporation receives an affidavit from the corporation, given under penalty of perjury, that it is not and has not been a U.S. real property holding corporation ("USRPHC") 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 to withholding.

(Continued on Page 2)
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 also 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
U.S. Disclosure (Continued from Page 2) persists, 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"; 94 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.


5 129 of H.R. 470, 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 U.S. 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,

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 ac-
  quired 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
regulated issued thereunder), a non-foreign affidavit, pro-
perly 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 in-
tends to file a U.S. income tax return with respect to the
sale of the Premises, and (v) granting Purchaser permis-
sion 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 pro-
erty contracts with closing dates on or after January
1, 1985:

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-
transferor’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 with-
hold 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 ac-
tion against the Internal Revenue Service for refund [under
Regulation Section 1.1464a(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.B.)

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 ex-
pected 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 for-
mula 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 con-
tact. 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 unam-
biguous.” (Geo. Backer Mgt. Corp. v. Acme Contracting 55
AD2d 535 [1976], aff’d 46 NY2d 211 [1976]).

However, the George Backer description of the clause
may be too generous, in the light of the later case of Avon
54 NY2d 637 [1981]), suggesting a penumbra area in apply-
ing the formula in relation to fringe benefits. Since such
Porter’s Wage Escalation clauses are bottomed on labor con-
tracts, 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)