F.I.R.P.T.A. REVISITED – THINGS TO REMEMBER WHEN NONRESIDENTS INVEST IN U.S. REAL PROPERTY

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INTRODUCTION

The year 2025 marks the 45th anniversary of the enactment of the Foreign Investors Real Property Tax Act. It is a good time to revisit issues that are faced by nonresident investors considering an acquisition of real property in the U.S.

For the private investor, many decision points must be addressed. Here are a few that come readily to mind:

- Will the investment generate passive or active income?
- Now and possibly in the future, will the investment be limited to one property or will there be multiple properties?
- Is it better to own the property directly or through a holding company?
- Should the holding company be formed in the U.S. or abroad there, or should there be holding companies in both places?
- Should the holding company be tax-transparent or tax-opaque?
- Will the structure prevent death duties from being imposed in the U.S.?
- If the initial holding structure produces suboptimal results, can the structure be revised, and if so, at what costs?
- Is it better to hold all U.S. properties through one U.S. holding company or is it better to hold each U.S. property through its own separate U.S. holding company?

The goal of this the article is to provide guidance to foreign investors and their home country advisers so that well-reasoned investment structures can be formulated at the front end that take into account U.S. tax rules , foreign tax rules, and preferences of the particular client.

F.I.R.P.T.A. BACKGROUND

Basic F.I.R.P.T.A. Rules

Non-U.S. persons are generally subject to U.S. income tax on two types of income: (i) income that is "effectively connected" with the conduct of a U.S. trade or business, known as "effectively connected income" or "E.C.I.," and (ii) U.S.-source income that is fixed, determinable, annual, or periodic ("F.D.A.P." income), which mostly refers to investment income, such as dividends and interest, but not capital gains.[1]

Gains derived by foreign persons from the disposition of U.S. real property are governed by a special set of rules enacted under the Foreign Investment in Real Property Tax Act ("F.I.R.P.T.A."), which treats such gains as E.C.I.[2] This means that foreign sellers of U.S. real estate must pay tax on a net basis and file U.S. tax returns reporting the sale.

Specifically, F.I.R.P.T.A. applies to dispositions of "U.S. Real Property Interests" ("U.S.R.P.I.'s). U.S.R.P.I.'s include[3]

- direct interests in U.S. real property, and
- shares in U.S. corporations that are viewed as "U.S. real property holding corporations" ("U.S.R.P.H.C.'s").

A U.S. corporation is a U.S.R.P.H.C. if the value of its U.S.R.P.I.'s is at least 50% of the aggregate value of all of its real property and all other assets used or held for use in a trade or business.[4]

Tax under F.I.R.P.T.A. is collected partly through the F.I.R.P.T.A. withholding tax. Under F.I.R.P.T.A. withholding rules, a buyer of a U.S.R.P.I. generally is required to withhold and remit to the I.R.S. an amount equal to 15% of the amount realized.[5] A limited set of exceptions exist to the obligation of the purchaser to withhold tax.[6]

Because F.I.R.P.T.A. tax liability and withholding differ with respect to both rate and tax base (gain for the former vs. amount realized for the latter), the tax withheld often does not match the seller's final tax liability. If the tax withheld exceeds the final tax liability, the seller is refunded the excess when it files a U.S. tax return. The tax previously withheld is claimed as a credit against the seller's U.S. tax liability.[7]

Nonrecognition

By default, F.I.R.P.T.A. overrides the nonrecognition provisions of the Code.[8] Therefore, unless a specific provision in the F.I.R.P.T.A. regulations allows for a taxpayer to make use of a nonrecognition provision, tax is due on would-be tax-free transactions. Among other requirements, a transaction must generally involve an exchange of one or more U.S.R.P.I.'s for one or more other U.S.R.P.I.'s to qualify for nonrecognition.

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1 Code §§881(a) for F.D.A.P. and 882(a)(1) for E.C.I.

2 Code §897(a).

3 Code §§897(c)(1)(A), (c)(4).

4 Code §§897(c)(1)(A), (c)(4).

5 Code §1445(a). A different withholding regime applies to distributions of U.S.R.P.I.'s by foreign corporations, under which the distributing corporation must withhold 21% of the gain. See Code §1445(e)(2).

6 Code §1445(b).

7 Treas. Reg. §1.1445-1(f)(1).

8 Code §897(e)(1).

However, for certain types of nonrecognition transactions, the requirements are relaxed. For example, a corporation's contribution of property to its wholly owned subsidiary is typically nontaxable under Code §351. But a foreign corporation's contribution of its U.S.R.P.I. to its foreign subsidiary would fail the U.S.R.P.I.-for-U.S.R.P.I. requirement, as the parent would receive the subsidiary's stock, and foreign stock cannot be a U.S.R.P.I. However, the regulations allow certain foreign-to-foreign Code §351 contributions to qualify for nonrecognition if certain other requirements are met in lieu of the U.S.R.P.I.-for-U.S.R.P.I. requirement, namely that the transferred U.S.R.P.I. be stock in a U.S.R.P.H.C. (as opposed to a direct interest in U.S. real estate) and that the transferee corporation have the same owners as the U.S.R.P.I. did shortly before its transfer.[9]

Exceptions to Withholding

There are several situations in which a taxpayer is not subject to withholding. One situation is if the property transferred is determined to not be a U.S.R.P.I. This is particularly important for U.S.R.P.I.'s that are shares in U.S.R.P.H.C.'s. Formally, U.S. law presumes that any interest in a U.S. corporation is an interest in a U.S.R.P.H.C., unless either the corporation or the I.R.S. determines that it is not a U.S.R.P.H.C.[10] If the corporation makes the determination, it must also provide notice to the I.R.S. [11]Additionally, a U.S. corporation that is a U.S.R.P.H.C. at any time during the shorter of (i) the foreign shareholder's holding period or (ii) the five-year period preceding the date that the foreign shareholder disposes of the interest retains its U.S.R.P.H.C. status unless the corporation or I.R.S. establishes that this taint is cleansed.[12] The taint is generally cleansed if all U.S.R.P.I.'s are disposed of in taxable transactions.[13] If the corporation can establish that it is not a U.S.R.P.I., and the withholding agent receives a copy of the notice from either the foreign shareholder or the corporation, withholding is excused.[14]

"There are several situations in which a taxpayer is not subject to withholding."

If the transaction qualifies for nonrecognition under the rules described earlier, withholding is excused provided the seller furnishes a notice of nonrecognition to the buyer explaining the reason why the transaction is properly treated as a nonrecognition transaction.[15] Additionally, the buyer must send a copy of the notice to the I.R.S. within 20 days of the transaction.[16]

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9 Treas. Reg. §1.897-6T(b)(1)(iii). In Notice 2006-46, the I.R.S. announced its intention to revise the regulation in the context of to foreign-to-foreign Code §351 transactions and B-reorganizations, loosening some of the requirements for tax-free treatment. While the changes in the notice had immediate effect, the regulation has not been amended.

10 Treas. Reg. §1.897-2(g)(1)(i).

11 Treas. Reg. §1.897-2(h)(2). The corporation can also make the determination voluntarily, in the absence of a request from the shareholder, and provide notice to the I.R.S. (Treas. Reg. §1.897-2(h)(4)).

12 Code §897(c)(1)(A)(ii).

13 Code §897(c)(1)(B).

14 Code §1445(b)(3).

15 Treas. Reg. §1.1445-2(d)(2)(i)(A).

16 Treas. Reg. §1.1445-2(d)(2)(i)(B).

Alternatively, the buyer or seller can apply to the I.R.S. for a F.I.R.P.T.A. withholding certificate. A withholding certificate allows the buyer to reduce or eliminate the amount it must withhold.[17] Applications must fall into one of the following categories:[18]

- **Category 1:** Foreign person subject to withholding is entitled to nonrecognition or exemption from tax
- **Category 2:** Amount that would be withheld exceeds the maximum tax liability
- **Category 3:** Deferred payment or installment sales
- **Category 4:** Agreement to pay tax at a later date
- **Category 5:** Blanket withholding certificate for multiple dispositions of U.S.R.P.I.'s
- **Category 6:** Applications on any other basis

Applications under Categories 1, 2, or 3 are submitted using Form 8288-B (Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests).[19]

However, in recent practice, F.I.R.P.T.A. withholding certificates may not be a viable option due to extended processing times. Although the statute requires the I.R.S. to act on an application within 90 days after it is received,[20] I.R.S. agents have advised that withholding certificates currently take about 18 months to two years to be issued. In one recent matter, a taxpayer received a withholding certificate 14 months after submitting an application. As such, claiming a refund through filing a tax return may be a faster way for the seller to receive all the funds to which it is entitled.

INVESTMENT STRUCTURES

There are several different options for a foreign person to invest in U.S. real estate, depending on the number of properties involved and the foreign person's tax goals.

Investment in a Single Property Structure

Direct Investment by a Foreign Person

A foreign person can invest directly in U.S. real estate. The foreign person would be required to file a nonresident tax return on Form 1040-NR (U.S. Nonresident Alien Income Tax Return) for an individual or on Form 1120-F (U.S. Income Tax Return of a Foreign Corporation) for a corporation. Taxation of rental income would depend on whether the foreign investor is considered to be engaged in the conduct of a U.S. trade or business. If the investor is considered to be engaged in a U.S. trade

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17 Treas. Reg. §1.1445-3(a).

18 Rev. Proc. 2000-35 §4.05-4.10.

19 Rev. Proc. §4.04(5). Form 8288-B is not strictly required, but the I.R.S. advises that use of the form will expedite the application process.

20 Code §1445(c)(3)(B) (the I.R.S. "shall take action…within 90 days"). But note that Rev. Proc. 2000-35 §4.01 softens this requirement and states that the I.R.S. "ordinarily will act" on an application within 90 days.

or business (or elects to be treated as such), the rental income is subject to net taxation at individual or corporate tax rates that apply to U.S. persons. If the investor is not considered so engaged, the rental income is subject to gross-basis 30% withholding, or lower if a treaty applies. The investor may also make an election to treat the income as E.C.I.[21]

If the investor is a corporation, an additional tax known as branch profits tax may apply. Branch profits tax mimics the dividend tax that would have resulted if the foreign corporation set up a U.S. subsidiary to purchase the real estate instead of directly investing.[22] By default, branch profits tax is levied at 30%, although tax treaties may lower this rate.

Branch profits tax applies to after-tax earnings & profits that are connected with the conduct of a U.S. trade or business. The base against which after-tax profits are measured is referred to as the dividend equivalent amount ("D.E.A."). Note that for a branch that operates real estate in the U.S., depreciation for earnings & profits purposes typically is computed using a useful life that is longer than the useful life that is used for purposes of computing taxable income. As a result, the amount of D.E.A. may exceed the taxable income reported on the U.S. tax return filed by a foreign corporation.

The D.E.A. for a particular taxable year is reduced by an increase in the net equity of the U.S. branch as of the close of the preceding year.[23] On the other hand, the D.E.A. for a particular taxable year is increased by a decrease in the net equity as of the close of the preceding year.[24] For that reason, a reduction in the D.E.A. of a U.S. branch of a foreign corporation may turn out to be a deferral of branch profits tax rather than a permanent reduction of the tax.

In principal, there is no branch profits tax due in the year that a foreign corporation disposes of its U.S. assets.[25] This treatment equates to the treatment of a complete liquidation of a U.S. subsidiary by a foreign corporation. In that set of circumstances, a foreign corporation is not subject to dividend withholding tax when a liquidating dividend is received. Similarly, the non-previously taxed, accumulated effectively connected earnings and profits, as of the close of the taxable year of complete termination, are extinguished for purposes of the branch profits tax.

However, this favorable treatment applies only when a complete termination of the business exists. If a complete termination does not exist, the branch profits tax may be imposed on the non-previously taxed, accumulated effectively connected earnings and profits at such time as the net equity of the U.S. branch is reduced.

For there to be a complete termination, several tests must be met.

- First, the foreign corporation must have no U.S. assets, or its shareholders must adopt an irrevocable resolution to completely liquidate and dissolve the corporation, and before the close of the immediately succeeding taxable

[21] Code §871(d) for a foreign individual and Code §882(d) for a foreign corporation.

[22] Code §884(a).

[23] Code §884(b)(1); Treas. Reg. 1.884-1(b)(2).

[24] Code §884(b)(2); Treas. Reg. §1.884-1(b)(3).

[25] Treas. Reg. §1.884-2T(a).

year, all assets in the U.S. must be distributed, used to pay creditors, or removed from the country.

- Second, for three years following the close of the year of complete termination, none of the U.S. assets of the terminated business, or property attributable to the sale of the business or to the U.S. earnings in the year of complete termination, can be used by the foreign corporation or by an affiliate in the conduct of a trade or business in the U.S.
- Third, the foreign corporation must not have any income that is, or is treated as, effectively connected with the conduct of a trade or business in the U.S. during the three-year period.
- Finally, the foreign corporation must extend the period of limitations on the assessment of the branch profits tax for the year of complete termination for not less than six taxable years.

As is generally the case under F.I.R.P.T.A., the sale of the property subjects the investor to U.S. tax as though the investor were engaged in a U.S. trade or business. Thus, if the seller is an individual, the gain on the sale would be taxed at the long-term capital gains rate of 20%, assuming the property was held for more than one year. To the extent the gain is attributable to a basis reduction based on the use of straight line depreciation, the tax rate is 25%. If the seller is a corporation, the gain would be taxed at the corporate rate of 21%. And in either case, the sale is also subject to withholding at 15% of the amount realized even if there is no gain.

Finally, if the investor is an individual, he or she also has potential estate tax exposure. With limited exception, nonresident, noncitizen ("N.R.N.C.") individuals are generally subject to estate tax only on property considered to be situated in the U.S. at the time of the decedent's passing, commonly referred to as "U.S.-situs property," which includes real estate located in the U.S.[26] As applied to foreign individuals, the estate tax is $345,800 on the first $1 million and 40% on the balance of the value of the taxable property. The amount subject to tax can be reduced if there is nonrecourse debt attached to the property. Additional deductions are available for administrative expenses of the estate and claims against the estate, but only if worldwide assets are reported on a true and accurate U.S. estate tax return, allowing only an apportioned amount of global (i) administrative expenses of the estate and (ii) claims against the estate to reduce the taxable value of the U.S. property.

Investment Through a Disregarded Entity ("D.R.E.")

As an alternative, the investor could form a single-member L.L.C. which would hold the U.S. real estate. By default, a single-member U.S. L.L.C. is treated as a disregarded entity ("D.R.E.") for U.S. tax purposes. A D.R.E. is not viewed as a separate entity for most U.S. tax purposes. Instead, a D.R.E.'s assets are considered held directly by its owner, and its income is considered realized directly by its owner.

This means that the same income tax consequences associated with the direct investment described above apply here. However, there is an argument that for purposes of estate and gift tax, the property subject to taxation is not the underlying

[26] Code §2103; Treas. Reg. §20.2104-1(a)(1).

property but rather the D.R.E. interest itself.[27] In principle, this means that a gift of the D.R.E. by a foreign individual is not subject to gift tax, as gifts of intangible property (such as equity interests in an entity) are not taxable when made by foreign persons. Additionally, this could open the door for a position that the D.R.E. interest is a foreign-situs asset and therefore also exempt from estate tax. But this is not a settled position, and those who rely on it should be prepared to take on a challenge by the I.R.S.

Investment Through a U.S. Partnership

Multiple investors can join together in a partnership that holds the property. For example, if the L.L.C. in the previous example has at least one other investor, the L.L.C.'s U.S. tax treatment defaults to that of a partnership.

The partnership is required to withhold on its foreign partners' share of the rental income.[28] The rate of withholding depends on whether the partnership is viewed to be engaged in a trade or business. If yes, the rent is considered E.C.I., and withholding applies at the highest possible tax rate applicable to the partner (20% for corporations and 37% for individuals).[29] If not, the rent is considered F.D.A.P. [30]which is subject to 30% withholding.[31] Additionally, the foreign partner is required to file a U.S. Federal income tax return and likely a state tax return if the rent is E.C.I. [32]

On a sale of a partnership interest, the foreign investor is subject to 15% withholding on the proceeds if two conditions are met.

- First, 50% of the partnership's gross assets are U.S.R.P.I.'s.
- Second, 90% of the partnership's gross assets consist of U.S.R.P.I.'s and cash.[33]

"There is a difference in certainty between the application of gift tax and estate tax when the property being transferred is a partnership interest."

A sale of the U.S.R.P.I. by the partnership subjects the investor to the withholding tax on E.C.I. described in the previous paragraph. In either scenario, the investor must file a U.S. tax return to report gain and pay tax or claim a refund, as the case may be.

There is a difference in certainty between the application of gift tax and estate tax when the property being transferred is a partnership interest. A gift of a partnership interest by a foreign individual is likely not subject to gift tax because gift tax does not apply to gifts of intangible property by foreign persons,[34] and a partnership interest is

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27 See *Pierre v. Commr*. (T.C. Memo. 2010-106), where the Tax Court held that for gift-tax purposes relating to a gift of a single-member L.L.C. that was taxed as a D.R.E., valuation was determined at the L.L.C. level rather than that of the underlying L.L.C. assets. Practitioners disagree on whether this applies only to the question of valuation or whether this more broadly means that a D.R.E. interest is "regarded" for transfer-tax purposes.

28 Treas. Reg. §1.1441-5(b)(2)(i)(A); Code §1446(a).

29 Code §1446(a).

30 Code §§871(a)(1)(A), 881(a)(1).

31 Code §§1441(a), 1442(a).

32 Code §875(1); Treas. Reg. §§1.6012-1(b)(1)(i), -2(g)(1)(i).

33 Code §1445(e)(5).

34 Code §2501(a)(2).

most likely to viewed as intangible property, notwithstanding the partnership's ownership of the underlying property.[35] In comparison, a transfer of a U.S. partnership interest at the death of an N.R.N.C. individual is subject to U.S. estate tax when the intangible is considered to be a U.S.-situs asset. The situs of a partnership interest has long been unsettled law. But in this scenario, where the partnership is formed in the U.S. and holds U.S.-situs assets, the partnership interest likely will be considered a U.S.-situs asset.[36]

Investment Through a Foreign Partnership

The foreign investor could be a member of a foreign partnership.[37] The results are similar. However, if the rent is F.D.A.P. and not E.C.I., the tenant and not the partnership is considered to be the withholding agent.[38] Provided the foreign partnership provides sufficient documentation (*i.e.*, its own Form W-8IMY, its foreign partners' Forms W-8BEN or W-8BEN-E, its domestic partners' Forms W-9, and a spread sheet showing the percentage interest of each partner), the withholding agent will withhold under F.D.A.P. only on the income allocated to foreign partners.

As with the U.S. partnership, the estate tax exposure related to a partnership interest is unclear. However, the use of a foreign partnership provides a stronger argument that the interest is not a U.S.-situs asset, based on inconsistent case law.[39]

Investment Through a Foreign Trust

A foreign investor could create a foreign trust and contribute cash, after which the trustee can purchase U.S. real estate. While the income tax consequences are largely similar, this option can provide better protection against estate tax. However, this requires the investor to relinquish control over and beneficial interests in the property.

Investment Through a Foreign Corporation

The tax treatment of a foreign corporation holding U.S. real estate is discussed in detail above and will not be repeated. As to the ultimate investor, dividends from the foreign corporation are not subject to withholding tax as long as branch profits tax

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35 See, *e.g.*, *Lehman v. Commr.*, 7 T.C. 1088 (1946).

36 But not all theories lead to U.S.-situs classification. For example, one theory would determine the situs of a partnership interest by reference to the domicile of the partner.

37 Note that a foreign equivalent of an L.L.C. may be treated as corporation for U.S. purposes under the default classification rules. In that situation the foreign L.L.C. would need to file an election to be treated as a partnership.

38 Treas. Reg. §1.1441-5(c).

39 Under Code §7701(a)(5), a partnership that is not a domestic partnership is considered to be a foreign partnership. The estate tax situs rule with regard to partnerships is based on case law and an old I.R.S. ruling that are not consistent. Moreover, Code §864(c)(8), which reversed the holding in Grecian Magnesite Mining, Industrial, & Shipping Co. v. Commr., 926 F.3d 819 (C.C. Cir. 2019), appears to apply specifically to income taxes covered by Subtitle A of the Internal Revenue Code. The estate tax appears in Subtitle B of the Internal Revenue Code.

applies.[40] If branch profits tax does not apply by reason of the provision of an income tax treaty, a treaty benefit will be available to the shareholder only if the foreign corporation and its shareholder are qualified residents of the treaty jurisdiction.[41]

No U.S. tax is due on the sale the foreign corporation's stock. Additionally, because shares in a foreign corporation are considered foreign-situs assets,[42] the investor should not be subject to estate tax with respect to shares held in the foreign corporation.

Investment Through a Foreign Corporation With a U.S. Subsidiary

Another option is to insert a U.S. subsidiary between the foreign parent corporation and the U.S. real estate. The U.S. corporation is subject to 21% corporate tax on both rental income and gain on the sale of real estate.

With respect to dividends paid to the foreign parent from its U.S. subsidiary, a 30% withholding tax will be imposed to the extent of the U.S. subsidiary's earnings & profits. The rate may be lower if a tax treaty applies.

To the extent a distribution exceeds earnings & profits but does not exceed the shareholder's basis in the shares of the U.S. subsidiary, the distribution is tax-free in principal. It is treated as a return of basis in a U.S.R.P.H.C. For that reason, a withholding certificate must be obtained from the I.R.S. in order to avoid the imposition of refundable F.I.R.P.T.A. withholding tax.

Once all U.S.R.P.I.'s are sold by the U.S. subsidiary and gain is fully recognized, the subsidiary can notify the I.R.S. of its early termination of U.S.R.P.H.C. status. At that point, a tax-free liquidating distribution can be made by the U.S. corporation.[43]

TRANSITIONING TO A MORE COMPLEX STRUCTURE

In some cases, a foreign investor may have acquired U.S. real estate before taking into account planning considerations. Upon consulting a tax adviser, the investor may wish to alter the already-created structure to one described above. But the investor may face obstacles in achieving the desired structure through a tax-free transaction.

Straightforward Two-Step Transfer

If the investor wishes to form a foreign blocker to hold U.S. real estate, the contribution of the real estate to the foreign blocker would trigger tax by default.[44] To avoid tax on the contribution, the investor could instead first form a U.S. corporation to which the real estate is contributed, after which the shares of the U.S. corporation would be contributed to the foreign corporation. In principle, the first contribution meets

40 Code §884(e)(3)(A).

41 Code §884(e)(3)(B) and (f)(3)(A) and (B). See also Code §861(a)(2)(B) for the characterization of the dividend as U.S. source income.

42 Treas. Reg. §20.2105-1(f).

43 Code §332(a).

44 As discussed earlier, F.I.R.P.T.A. by default turns off nonrecognition.

the U.S.R.P.I.-for-U.S.R.P.I. requirement for F.I.R.P.T.A. nonrecognition exchanges, since the newly formed U.S. corporation is a U.S.R.P.H.C. However, the immediate second contribution could cause problems for achieving the expected tax-free treatment of the first contribution. Under Code §351, the contributing shareholder must be in control of the transferee corporation "immediately after" the transfer, and it is unclear whether this is satisfied if the shares of the transferee corporation are immediately transferred to another taxpayer (*i.e.*, the foreign corporation).

Assuming that the risk can be addressed, the second contribution could qualify for the exception for foreign-to-foreign Code §351 exchanges discussed earlier. However, the second contribution would likely be characterized as an inversion transaction, *i.e.*, a transaction where a U.S. corporation is effectively redomiciled by means of a transfer to a foreign corporation.[45] Where the former shareholders of the transferred corporation directly or indirectly own at least 80% the new foreign parent, the foreign parent is treated as a U.S. corporation for all U.S. tax purposes,[46] thereby eliminating the estate tax benefits of including a foreign corporation in the structure.

One possible solution is for the foreign corporation to elect to be treated as a U.S. corporation for purposes of F.I.R.P.T.A., known as a "Code §897(i) Election."[47] This could eliminate the issues with contributing property to a foreign corporation, but the foreign status would be preserved for estate tax purposes. Note, however, that to make an 897(i) Election, a foreign corporation must be resident in a country that has an income tax treaty in effect with the U.S. that contains an adequate nondiscrimination provision. This means it must be viewed to be a qualified resident under the limitation-on-benefits article of the treaty. As a final point, the tax law of the treaty country must provide favorable tax treatment for (i) the receipt of dividends from the U.S. subsidiary, (ii) the recognition of gains from the disposition of the U.S. subsidiary, and (iii) the distribution of dividends to the shareholder.

Investment in Multiple Properties

When a foreign person invests in multiple properties in the U.S., additional considerations apply. On a disposition, the investor likely values the ability to sell a single property and distribute the proceeds with just one level of U.S. tax, *i.e.*, avoiding a second level of tax on the distribution. At the same time, the investor may wish to invest in multiple properties and allow operating losses realized in certain properties to offset taxable income from other properties.

Single U.S. Blocker

One option is to have a single U.S. corporation hold direct interests in the different pieces of U.S. real estate, either directly or through multiple single-member D.R.E.'s. For U.S. income tax purposes, there is only one taxpayer, the U.S. corporation that owns the D.R.E.'s. The U.S. corporation is subject to Federal corporate income tax at 21% on rental income, plus applicable state and local taxes. The upside of this

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45 See Code §7874.

46 Code §7874(b). Here, there would be 100% commonality because the investor would be the sole shareholder of both the U.S. corporation (pre-inversion) and the foreign corporation (post-inversion).

47 This election is only available if the foreign corporation was formed in a jurisdiction with an income tax treaty with the U.S. that broadly entitles the foreign corporation to be given the same rights as a U.S. corporation under the treaty.

arrangement is that losses from one property can be used to offset income from one or more profitable properties. The downside of this arrangement is that cash generated from sales cannot be distributed in many instances without the imposition of dividend withholding tax.

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Multiple U.S. Blockers

As mentioned, having a blocker for each property denies the ability to offset income from different properties. However, on a sale of a particular property, the proceeds can be distributed tax-free its foreign holding company as a tax-free liquidation, once an early termination of U.S.R.P.H.C. status is filed with the I.R.S. and a plan of liquidation is adopted and notice of the plan is furnished to the I.R.S. by filing Form 966 (Corporate Dissolution or Liquidation). If some or all of the liquidation proceeds are reinvested in a new U.S. corporation, the I.R.S. may treat the new corporation as if it were the old corporation under the liquidation-reincorporation theory, asserting that the liquidation distribution should be treated as a taxable dividend distribution.

CONCLUSION

It is not uncommon for a first-time investor in U.S. real property to evaluate an investment through a binary analysis, such as any of the following:

- Should I invest in property A or property B?
- Should I establish one foreign blocker corporation that holds shares in only one U.S. real property holding company or should it hold shares directly in several U.S. real property holding companies?
- Can I contribute my shares in a U.S. holding company to a foreign blocker because I now realize I face estate tax in the U.S. by reason of the decision I made initially?

This article demonstrates that the analysis of how to structure an investment is non-binary. Over time, many tax and non-tax factors come into play, and solutions to one part of the analysis may adversely affect tax and non-tax issues that need to be faced over time. The prudent investor and his or her foreign adviser should take all these factors and more into account when considering whether to make an investment in U.S. real property and how it should be structured.