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Tax Alert

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The PATH Act and FIRPTA Tax

On December 18, 2015, President Obama signed the Protecting Americans from Tax Hikes Act of 2015 (the “PATH Act”) into law.

Among others, these provisions make it easier for real estate investment trusts (REITs) to comply with certain REIT qualification requirements and limit the application of the Foreign Investment in Real Property Tax Act (FIRPTA) to non-US investors. The Act also provided non-US investors with more opportunities to invest in US real estate without being subject to US tax and withholding.

Under FIRPTA, gain from the sale of a US real property interest (USRPI) is taxed as effectively connected income, on a net basis at the graduated rates generally applicable to US taxpayers (FIRPTA Tax). USRPIs include direct interest in US real estate as well as the stock of US real property holding corporations (USRPHCs).

Increase in Exempt Publicly Traded REIT Ownership

Under pre-PATH Act law, a non-US shareholder holding 5% or less of a publicly traded REIT is exempt from FIRPTA Tax on any gain from the disposition of such REIT or capital gain dividend paid by such REIT. Under the PATH Act, the 5% ownership threshold has been increased to 10% allowing non-US investors a larger ownership in such REITs without being subject to FIRPTA Tax.

Exemption for Qualified Shareholders

Subject to certain restrictions, the PATH Act further provides a general exemption from FIRPTA Tax for REIT stock held by, and certain distributions made to, a “qualified shareholder” except to the extent that an investor in the qualified shareholder (other than an investor that itself is a qualified shareholder) actually or constructively holds more than 10% of the REIT stock.

A qualified shareholder includes certain foreign entities that are publicly traded, are eligible for the benefits of a comprehensive U.S. tax treaty and are treated as partnerships for U.S. federal income tax purposes. In addition, a qualified shareholder would be treated as USRPHCs if they were domestic corporations, and satisfy certain additional requirements. The new legislation provides the Secretary with authority to expand the class of eligible qualified shareholders to include certain other types of entities.

Increased Rate of FIRPTA Withholding

The PATH Act generally increases the withholding rate on a disposition of a USRPI (“FIRPTA Withholding”) from 10% to 15%.

Expanded Determination of Domestically Controlled REIT

A USRPI does not include any interest in a domestically controlled regulated investment company (RIC) or REIT (collectively, “qualified investment entities” or “QIEs”). A QIE is domestically controlled if foreign persons directly or indirectly own less than 50% of the value of the entity’s stock. It often is difficult, however, for QIEs to determine with certainty the US or foreign status of all of their direct and indirect investors, particularly in the context of publicly traded entities.

The PATH Act provides three new rules and presumptions for purposes of determining whether a QIE is domestically controlled. First, a publicly traded QIE is permitted to presume (absent actual knowledge to the contrary) that a person that holds less than 5% of a class of publicly traded stock is a US person. Second, any stock in a QIE that is held by a publicly traded QIE (or a RIC that issues redeemable securities) is treated as held by a foreign person, unless the other QIE is domestically controlled, in which case the stock is treated as held by a US person. Lastly, stock in a QIE that is held by any other QIE not described above is treated as held by a US person only to the extent the stock of the other QIE is (or is treated as) held by a US person.

The new rules and presumptions could benefit existing investors in publicly traded QIEs as well as private REITs. The changes will make it easier for both publicly traded QIEs and private REITs to attain Domestically Controlled REIT status, making them attractive options for FIRPTA tax planning for non-US investors.

Exemption from FIRPTA for Qualified Foreign Pension Funds

The PATH Act adds Code subsection 897(l), which provides that the FIRPTA Tax shall not apply to any USRPI held directly (or indirectly through one or more partnerships) by, or to any distribution received from, a REIT by a qualified foreign pension fund (QFPF) or any entity of the interests of which are held by a QFPF. The PATH Act also exempts QFPFs from FIRPTA Withholding under section 1445 by amending the definition of "foreign person" in section 1445(f)(3) to exclude an entity described in new section 897(l).

A QFPF means any trust, corporation, or other organisation or arrangement:

a) which is created or organised under the law of a country other than the United States,
b) which is established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees (or persons designated by such employees) of one or more employers in consideration for services rendered,
c) which does not have a single participant or beneficiary with a right to more than five percent (5%) of its assets or income,
d) which is subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which it is established or operates, and
e) with respect to which, under the laws of the country in which it is established or operates, (i) contributions to such organisation or arrangement that would otherwise be subject to tax under such laws are deductible or excluded from the gross income of such entity or taxed at a reduced rate, or (ii) taxation of any investment income of such organisation or arrangement is deferred or such income is taxed at a reduced rate.

The legislation directs the Treasury to prescribe such regulations as may be necessary or appropriate for carrying out the purposes of this provision. The provision is effective for dispositions and distributions after the date of enactment of the law.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

About Tax Alert

KPMG's Tax Alerts highlight the latest tax developments, impending change to laws or regulations, current practices and potential problem areas that may impact your company. As certain issues discussed herein are time sensitive it is advisable to make plans accordingly.

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