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PATH Act Makes Major Changes to FIRPTA

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The “PATH Act,” enacted December 18, 2015,[1] made permanent, or extended, most of the Code provisions that for many years have had built-in expiration dates (the “expiring provisions”). But it does more. Buried in subtitle B of title III of the PATH Act (which makes extensive changes to the treatment of real estate investment trusts (REITs)) are major changes to Code section 897 (the “Foreign Investment in Real Property Tax Act of 1980” or FIRPTA) and section 1445 (the withholding rules for enforcing FIRPTA), not all of which are limited to foreign shareholders of REITs. Because of the PATH Act:

- **Funds exempt from FIRPTA** - FIRPTA is now inapplicable to United States real property interests (USRPIs) held by “qualified foreign pension funds.”

- **Publicly traded REIT stock excluded from USRPI** - The percentage of publicly traded REIT stock that a person can hold without the stock being treated as a USRPI with respect to that person has been increased from five percent to 10 percent.

These changes have generally already taken effect, and it appears that they are estimated to lose the Treasury (relative to prior law) between $2 billion and $4 billion in revenue in the next 10 years.[2] The PATH Act also is estimated to *raise* about $0.5 billion in that period by making the following changes:

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[1] “PATH Act” is short for “Protecting Americans from Tax Hikes Act of 2015,” a small part (“Division Q”) of the “Consolidated Appropriations Act, 2016,” Pub. L. No. 114-113, the omnibus bill that allowed the Congress to end its 2015 session in 2015. The primary legislative history for the PATH Act appears to be Joint Committee on Taxation, *Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40)*, (JCX-144-15), December 17, 2015 (hereinafter, “JCT TE”).

[2] The qualified foreign pension fund provision listed above was estimated to cost the Treasury $1,953 million over 10 years, while the published Congressional revenue estimate of the PATH Act combined the cost of the publicly traded REIT stock provision listed above and a number of other revenue-losing provisions discussed below; in combination, they were estimated to cost $2,297 million over 10 years. *See* Joint Committee on Taxation, *Estimated Budget Effects of Division Q of Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40)*, (JCX-143-15), December 16, 2015, page 6. At this point, then, we only speculate on the separate estimated cost of the change in the treatment of publicly traded REIT stock.

- **Withholding rate increased** - The general withholding tax rate on the proceeds of dispositions and distributions of USRPIs (historically, 10 percent) will increase to 15 percent.

- **Cleansing rule repealed for REITs or RICs** - The holder of the stock of a corporation that is or has been a REIT or a regulated investment company (RIC) can no longer treat the stock as "cleansed" of its USRPI status once the REIT or RIC sells all of its USRPIs.

While the second of these changes has already taken effect, the increase in the withholding rate will only apply to dispositions after February 16 of this year.

The PATH Act also adds new rules and presumptions to the Code for determining whether a REIT or RIC is "domestically controlled" when its stock is publicly traded or is held by another REIT or RIC. Finally, the PATH Act provides a new exception from the definition of USRPI for REIT stock held by certain publicly traded *foreign* collective investment vehicles.

This alert provides a summary and preliminary observations on these FIRPTA-related changes and their practical consequences.

I. Overview

USRPI gains (which may include stock gains) are "effectively connected" income

With some exceptions, the United States generally taxes nonresident alien individuals and foreign corporations on their gains from sales or exchanges of property if and only if the gains are effectively connected with the conduct of a trade or business in the United States ("effectively connected income" or ECI). However, FIRPTA automatically deems the gains of such persons *from the disposition of USRPIs* to be ECI, regardless of whether the person actually engaged in any U.S. trade or business.

The term "USRPI" encompasses not only an interest (other than solely as a creditor) in real property located in the United States,[3] but also stock of a domestic corporation (or other interest in the corporation other than solely as a creditor), unless the taxpayer establishes that the corporation was not a U.S. real property holding corporation (USRPHC) at any time during the shorter of the five-year period ending on the date of disposition or the period during which the taxpayer held the stock of the corporation (the "relevant holding period").

Effect of FIRPTA on foreign shareholders of REITs (and RICs)

In general, any distribution by a "qualified investment entity" (any REIT and certain RICs[4]) to a foreign person or another qualified investment entity (QIE) shall, to the extent attributable to gain from sale or exchange by the QIE of USRPIs, be treated as gain recognized by such foreign person or other QIE from the sale or exchange of USRPI. This rule does not apply, however, if any class of

[3] Interests in real property located in the U.S. Virgin Islands are also USRPIs. *See* section 897(c)(1)(A)(i).

[4] The treatment of certain RICs as qualified investment entities was generally an expiring provision, but it was made permanent effective January 1, 2015 by section 133 of the PATH Act.

stock of the QIE is regularly traded on an established securities market located in the United States and if the foreign person did not own more than five percent of such class of stock at any time during the one-year period ending on the date of such distribution.

The term USRPI does not include any interest in a "domestically controlled" QIE. This term refers to any QIE in which, at all times during the testing period[5] less than 50 percent in value of the stock was held directly or indirectly by foreign persons.

FIRPTA withholding

When a foreign person disposes of a USRPI, the transferee of the USRPI has generally been required by section 1445(a) to deduct and withhold a tax equal, until the PATH Act, to 10 percent of the amount realized on the disposition.[6]

II. PATH Act Changes

A. Exception for interests held by foreign retirement or pension funds

New Code section 897(l) provides that section 897 shall not apply to any USRPI held directly (or indirectly through one or more partnerships) by a "qualified foreign pension fund" (QFPF). Section 897 also does not apply to any distribution received by a QFPF from a REIT. Finally, section 897 does not apply to USRPIs held, and REIT distributions received, by any entity all of the interests of which are held by a QFPF. For purposes of the FIRPTA withholding rules, QFPFs and the QFPF-owned entities referred to above are not treated as "foreign persons." These provisions apply to dispositions and distributions after December 18, 2015.

A QFPF is any trust, corporation, or other organization or arrangement:

A) which is created or organized 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 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 its country in which it is established or operates, and

E) with respect to which, under the laws of the country in which it is

[5] The testing period generally means the shorter of the 5-year period ending on the date of the disposition or distribution, or the period during which the QIE was in existence. *See* section 897(h)(4)(D).

[6] Numerous exceptions may apply. Certain other transactions, such as a distribution of property by certain domestic corporations to foreign shareholders (section 1445(e)(3)), taxable distributions by partnerships, trusts or estates (section 1445(e)(4)), and dispositions of partnership interests (section 1445(e)(5)), also trigger the general obligation to withhold a tax equal to 10 percent of the amount realized on the transaction.

established or operates, either (i) contributions to it which would otherwise be to subject to tax under such laws are deductible, excluded from gross income or taxed at a reduced rate; or (ii) taxation of its investment income is deferred or such income is taxed at a reduced rate.

Observations: When the Obama Administration proposed a change along these lines in its last three budget proposals, it gave as its "Reason for Change" the fact that gain of a *U.S.* pension fund from the disposition of a USRPI generally is exempt from U.S. tax.[7] By exempting foreign pension funds' USRPI gains from FIRPTA, this provision seems to be intended to put QFPFs on a comparable footing with U.S. pension funds in order to encourage greater investment in real estate in the United States.[8] But the words used to codify the proposal implicate issues and pose questions that may warrant further guidance:

- It would appear that a foreign government's fund that provides pensions to persons who were never government employees, but are based in part on employment history (as does the U.S. Social Security system) might be QFPFs, if the benefits provided can be viewed as "in consideration for services rendered." Other situations may also warrant clarification of the definition of QFPF. For instance, certain public or government programs may provide coverage for citizens regardless of employment. Does the term QFPF encompass a foreign government's fund that provides old-age pensions regardless of the recipient's employment history? What about a fund that provides post-retirement pensions to self-employed persons who make contributions to the fund out of their self-employment earnings, so that the benefits are in consideration of services rendered not to a contributing or sponsoring employer, but only to the participants' customers or clients? Nowhere in section 897(l) does it say that a QFPF must be established "exclusively" for the benefit of employees or former employees, as are the pension trusts described in Treas. Reg. §1.892-2T(c)(1)(i); nor that a QFPF must be for the "exclusive" benefit of employees or their beneficiaries, as are the qualified plans described in section 401(a).

- If a pension fund reports information about its beneficiaries to a government agency, but not to the "relevant tax authorities," it would apparently fail condition (D) above. If information *is* reported to the relevant tax authorities, does the requirement of annual reporting about beneficiaries refer to information for each individual beneficiary, or for beneficiaries as a group? If each individual beneficiary, then does the term "beneficiaries" in this context include participants who are not yet receiving pension payments, or only those actually receiving benefits currently?

- The exemption from FIRPTA applies to USRPIs held directly (or indirectly through one or more partnerships) by an entity *all* of the interests of which are held by *a* QFPF. The legislative history states that such an entity must

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[7] Department of the Treasury, General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals 123 (April 2013); Department of the Treasury, General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals 138 (March 2014); Department of the Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals 91 (February 2015).

[8] Joint Committee on Taxation, *Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2014 Budget Proposal* (JSC-4-13), December 2013, at 95.

be “wholly-owned” by “a” QFPF.[9] This seems to exclude entities that are collective investment vehicles exclusively for QFPFs, in contrast, for example, to the entities afforded “exempt beneficial owner” status by Treas. Reg. §1.1471-6T(f)(5) (“Investment vehicles exclusively for retirement funds”).

- Because the PATH Act excludes a QFPF (or QFPF-owned entity) from the term “foreign person” for purposes of section 1445 withholding, such QFPF or QFPF-owned entity need not be withheld upon when it transfers a USRPI. The regulations under section 1445 already provide an extensive set of rules for verifying that the transferor is a non-foreign person.[10] Thus, notwithstanding that a QFPF or QFPF-owned entity is, in the generic sense (as well as by the terms of the definition in the current regulations), “foreign,” and its U.S. EIN begins with “98-” (the prefix of EINs assigned to foreign persons[11]) it seems to be entitled to provide a non-foreign affidavit to its transferee in order to eliminate the latter’s obligation to withhold when the QFPF or QFPF-owned entity transfers USRPI generally, or stock in a domestic corporation.

- Treasury Reg. §1.1445-8(c)(2) generally imposes a 35-percent withholding obligation with respect to a capital gain dividend paid by a REIT to a foreign person. Questions may arise as to how a REIT should handle a situation where it designates *after* December 18, 2015, all or a portion of a *pre*-PATH Act distribution to a QFPF (or QFPF-owned entity) as a capital gain dividend distribution. Treasury Reg. §1.1445-8(c)(ii)(C) allows REITs to substitute “catch up” withholding on subsequent distributions for the withholding that would otherwise have been due on the distributions made before the designation. Now, however, a REIT must determine the obligation with respect to post-PATH Act distributions to a QFPF if the REIT designates a pre-December 18, 2015 distribution as a capital gain dividend distribution and the “catch up” withholding on the QFPF would, absent the PATH Act, be made from post-December 18, 2015 distributions.

Finally, although this change may have a major effect on the tax considerations surrounding U.S. investments by QFPFs, QFPFs and their foreign subsidiaries must nevertheless be aware that they are still subject to net-basis U.S. federal income tax on income that is treated, *apart from FIRPTA,* as effectively connected with a U.S. trade or business in which the QFPF (or other entity) is engaged—either directly, or vicariously through a partnership that is so engaged and in which the QFPF or subsidiary is a partner.

B. Increase in percentage ownership of publicly traded REIT stock qualifying for exception from USRPI status

If a class of stock in a corporation is regularly traded on an established securities

[9] JCT TE at 190.

[10] Section 1445(b)(2), Treas. Reg. §1.1445-2(b), and Treas. Reg. §1.1445-5(b)(3).

[11] *See* IRM 21.7.13.3.2.7. *See also* Treas. Reg. §1.1441-1T(b)(3)(iii)(A) (under certain circumstances a withholding agent may presume that a payee is a foreign person and not a U.S. person if the payee’s EIN begins with the two digits “98”); Notice of proposed rulemaking, INTL-062-90, INTL-0032-93, INTL-52-86, and INTL-52-94, 61 Fed. Reg. 17614, 17618 (April 22, 1996) (“Over time, the IRS will issue EINs to foreign persons that begin with the two digits ‘98’ to permit instant recognition of foreign status”).

market, then stock of that class is not treated as a USRPI in the hands of a person who does not hold more than five percent of such class at any time during the relevant holding period.[12] Effective for dispositions on or after December 18, 2015, the PATH Act increases this five percent threshold to 10 percent, but only if the stock in question is *REIT* stock. Hence, foreign owners of a regularly traded class of REIT stock may now hold up to 10 percent of the outstanding shares in that class during the relevant holding period without being subject to FIRPTA on the disposition of the REIT stock.

The PATH Act similarly increases from five percent to 10 percent the ownership threshold above which a distribution to a foreign person with respect to publicly traded QIE stock that is attributable to gain from the disposition of a USRPI by the QIE, is taxed to the shareholder as if it were the shareholder's gain on the sale or exchange of a USRPI.[13] This change was effective for any distribution by a REIT on or after December 18, 2015 and deducted in a taxable year of the REIT ending after December 18, 2015.

Observations: The PATH Act and the legislative history are silent as to whether the increase from five percent to 10 percent will become applicable to non-regularly traded interests in a publicly traded REIT (including interests other than stock[14]). Since 1988, regulations have generally extended the publicly-traded exclusion from USRPI status to non-regularly traded interests held by a person, where such interests are of no greater value (generally, on date of acquisition) than five percent of the value of the least valuable class of the corporation's regularly traded stock. Treasury and IRS may wish to indicate an increase in the value of non-publicly traded interests in a REIT that can be excluded from USRPI by reference to their value relative to the REIT's publicly traded stock, commensurate with the statutory increase in the value of publicly traded stock that can be excluded.

C. New rules for determining whether a REIT or RIC is "domestically controlled"

Regardless whether REIT or RIC stock is or is not publicly traded, stock in a REIT (or a RIC that is a QIE) has never been a USRPI if the REIT or RIC is a "domestically controlled" QIE. The PATH Act made no change to this. "Domestically controlled" QIE was and remains defined as a QIE in which less than 50 percent in value of the stock was held directly or indirectly by foreign persons at all times during the "testing period."

[12] Section 897(c)(3).

[13] Attribution rules for determining whether the 10-percent threshold of publicly traded REIT stock ownership is exceeded are the same as those for determining whether the 5-percent threshold of publicly traded non-REIT stock ownership is exceeded.

[14] Pursuant to Treas. Reg. §1.897-1(d)(3), an interest, other than solely as a creditor, in a corporation, includes a direct or indirect right to share in the appreciation in value of an interest in the corporation or a direct or indirect right to share in the appreciation in value of assets of, or gross or net proceeds or profits derived by the corporation. Consequently, a foreign person may have an interest in a domestic corporation the gain on which can be taxed by reason of FIRPTA even where such foreign person does not own stock in such corporation.

The PATH Act added new “special ownership rules” to section 897(h)(4), effective December 18, 2015, for applying the “domestically controlled” definition to a QIE when stock in the QIE is either publicly traded, or owned by another QIE.[15]

- **Publicly traded QIE stock -** New Code section 897(h)(4)(E)(i) provides that, in the case of a QIE any class of stock of which is regularly traded on an established securities market in the United States, “a person holding less than 5 percent of such class of stock at all times during the testing period shall be treated as a United States person, unless the [QIE] has actual knowledge that such person is not a United States person.”

  Observation: It seems unlikely that the QIE could know the 5-year history of a particular person’s percentage ownership in the QIE without having identified the person (and thus, whether the person is a United States person). However, the language of the statute would seem to make this necessary, as a shareholder that owns less than 5 percent in the current year may theoretically have owned 5 percent or more at some point within the five year testing period. If the QIE has identified each person who at any time in the last five years has owned its stock, and whose percentage ownership has not exceeded five percent, then it has done a fair amount (perhaps in some cases, a tremendous amount) of the work that might otherwise appear to be necessary even if there were no “special ownership rules” added by the PATH Act. The legislative history describes this rule differently than does the statute: a QIE “shall be permitted to presume that holders of less than five percent of a class of stock regularly traded on an established securities market in the United States are U.S. persons throughout the testing period.”[16] Under this language, it might appear to be sufficient for a REIT to identify its greater-than-five-percent owners as of the date of a particular shareholder’s disposition of its stock (or perhaps all days in the year of such disposition), and if there are none, to claim domestically controlled status (absent, of course, actual knowledge to the contrary). The difference in these two formulations may be a hint that future administrative guidance could add some additional clarification on the statutory language in section 897(h)(4)(E)(i).

- **QIE stock held by domestically controlled QIEs that are publicly traded or RICs that issue redeemable securities** - Any stock in a QIE that is held by a domestically controlled QIE, (i) any class of stock of which is regularly traded on an established securities market, or (ii) which is a RIC that issues redeemable securities, is treated as held by a *U.S.* person.

- **QIE stock held by non-domestically controlled QIEs that are publicly traded or RICs that issue redeemable securities** - Any stock in a QIE that is held by another QIE, (i) any class of stock of which is regularly traded on an established securities market, or (ii) which is a RIC that issues redeemable securities, is treated as held by a *foreign* person if the other QIE is *not* domestically controlled.

- **QIE stock held by other QIEs** - Any stock in a QIE held by another QIE not described above will be treated as held by a U.S. person in proportion

[15] Note that PLR 200933001 (February 26, 2009) dealt with the different question of how (for section 897(h)(4)(B) purposes) to treat ownership, by domestic corporations *neither* of which was “a REIT, RIC, hybrid entity, conduit, disregarded entity, or other flow-through or look-through entity,” of stock in a REIT.

[16] JCT TE at 190.

to the stock of the other QIE that is (or is treated as) held by a U.S. person.

Observation: The rules for QIE stock owned by a publicly traded QIE (or a RIC that issued redeemable securities) make the U.S.-vs.-foreign ownership question one with only two possible answers, eliminating the possibility that an infinite number of more graded determinations might otherwise have to be made in order to apply the basic “domestically controlled” definition to the lower-tier QIE. But if the upper-tier QIE is not publicly traded (and is not a RIC that issued redeemable securities), then for the purposes of determining whether a lower-tier REIT is domestically controlled, the PATH Act seems to require looking through to the owners of the upper-tier REIT.

D. Increased rate of withholding tax on amounts realized from USRPIs

Ever since the FIRPTA withholding rule, section 1445, was enacted in 1984, the rate of withholding has generally been 10 percent. That is, absent an exception, a transferee of a USRPI was generally required to deduct and withhold a tax equal to 10 percent of the amount realized by the transferor on the disposition if the transferor is a foreign person. The PATH Act increased the 10-percent rate to 15 percent, effective for dispositions that occur more than 60 days after enactment, or after February 16, 2016.[17]

However, the legislation makes an exception for property (i) which is acquired by the transferee for use as a residence and (ii) where the amount realized upon disposition is greater than $300,000 (the amount set by section 1445(b)(5) for exemption from FIRPTA withholding) but does not exceed $1,000,000. In these cases, FIRPTA withholding will remain at 10 percent.

E. Exclusion of RICs and REITs from recourse to the cleansing rule

Generally, a taxpayer’s interest in a domestic corporation is not treated as a USRPI held by the taxpayer if the corporation (i) had no USRPI on the date of the taxpayer’s disposition of the interest, and (ii) all of the USRPI held by the corporation during the shorter of the taxpayer’s holding period, or the five-year period preceding the date of taxpayer’s disposition of the interest, was disposed of by the corporation in a transaction in which gain (if any) was fully recognized (or such USRPIs ceased to be USRPIs by reason of the rule described in this sentence). This exception to the definition of USRPI is commonly referred to as the “cleansing rule.” Prior to the PATH Act, this rule applied equally to RICs, REITs, and other corporations.

The PATH Act makes the cleansing rule inapplicable, effective for dispositions made on or after December 18, 2015, where the corporation, or any predecessor to the corporation, was a RIC or REIT at any time during the shorter of (i) the period during which the taxpayer held the relevant interest in the corporation, or (ii) the five-year period ending on the date of the taxpayer’s disposition of the interest.

F. REIT Stock held by qualified collective investment vehicles not treated

[17] The rate increase also applies to a distribution of property by certain domestic corporations to foreign shareholders; taxable distributions by domestic or foreign partnerships, trusts or estates; and dispositions of interests in partnerships, trusts or estates.

as USRPI

The PATH Act added another exception from USRPI status for REIT stock, whether publicly traded or not, when the REIT stock is held by a publicly traded *foreign* collective investment vehicle. This new exception, found in new Code section 897(k), applies only to the extent that the investors in the publicly traded foreign entity are not themselves greater-than-10-percent shareholders (directly or indirectly, including through the publicly traded foreign entity) in the REIT. (Such greater-than-10-percent investors are called "applicable investors.")

- **"Qualified shareholders"** - The name given to a publicly traded foreign collective investment vehicle that can exclude some or all of its REIT stock from USRPI under this new rule is "qualified shareholder." To be a qualified shareholder, an entity must either be a "recognized exchange"-traded treaty resident, or a U.S.-exchange-traded foreign limited partnership. Either way, the entity must be exchange-traded; the difference is that along with treaty residence goes a greater range of exchanges that will "count" toward qualification.

- **"Qualified collective investment vehicles"** - To be a qualified shareholder, the entity also must satisfy the definition of a "qualified collective investment vehicle" (QCIV). If the entity is a treaty-country resident, it may achieve QCIV status if it is eligible for a reduced rate of U.S. tax on dividends under the relevant U.S. tax treaty when the entity holds more than 10 percent of the stock of the REIT in question. If the entity is a publicly traded partnership, it may achieve QCIV status if it is a "withholding foreign partnership"[18] and would have been a USRPHC in the five-year period preceding its disposition of its interests in a REIT (or distribution with respect to the partnership's interests in a REIT) if it were a domestic corporation. Finally, if the entity is fiscally transparent, or is required to include dividends in its gross income but is entitled to a deduction for distributions to its investors, then the Secretary of the Treasury has the authority simply to designate it as a QCIV.

  No collective investment vehicle, whether or not it meets one of the foregoing criteria, will be treated as a "qualified shareholder" unless it maintains records on the identity of each person who, at any time during its taxable year, is the direct owner of five percent or more of the class of its interests that is regularly traded on the relevant exchange.

- **Exclusion of qualified shareholder's REIT stock from USRPI, and of REIT distributions to qualified shareholders from gain on the sale or exchange of USRPI -** Effective for any disposition on or after December 18, 2015, and for any distribution by a REIT on or after December 18, 2015 (and which is treated as a deduction for a taxable year of the REIT ending after such date), a qualified shareholder will exclude all or a portion of its REIT stock from USRPI (and a portion of its REIT stock gains, and its REIT distributions attributable to USRPI gains, from its own USRPI gains).

  Generally, the portion (if any) of the qualified shareholder's REIT stock that will continue to be treated as USRPI is determined by reference to the ratio of (a) the value of the interests in the qualified shareholder treated as

[18] *See, e.g.,* Treas. Reg. §1.1441-5T(c)(2)(ii).

held (directly or indirectly) by “applicable investors” to (b) the value of all interests in the qualified shareholder. If the qualified shareholder is a partnership, then the applicable investor’s interest in the partnership for this purpose generally is based on the highest share of the partnership’s income or gain that such investor may receive during the period in which the applicable investor is a partner in the partnership.

If a distribution by a REIT is treated as a sale or exchange of stock under section 301(c)(3), 302, or 331 with respect to a qualified shareholder, the portion of the REIT distribution that is excluded from the qualified shareholder’s USRPI gain thanks to new section 897(k) is treated as a dividend subject to the 30-percent U.S. gross-basis tax under sections 871(a), 881, 1441, and 1442 even if the distribution would have been a capital gain distribution under the REIT rules.[19]

Observations: In contrast to the U.S. securities exchange laws, the laws of many other countries do not require the maintenance of records with respect to five-percent-or-more owners of publicly traded entities; this may limit the number of entities whose interests are not regularly traded on a U.S. exchange but that, under current practices, still satisfy the “qualified shareholder” definition. In addition, in most of its treaties in which the dividend articles have been revised since 1988, the United States has reserved the right to impose full internal-law (30-percent) tax on REIT dividends received by a resident of the other country that holds more than 10 percent of the stock of the REIT paying the dividends. (The U.S.-Australia treaty provides an exception to some extent for dividends paid by a REIT to a “listed Australian property trust,” and the U.S.-Netherlands treaty provides an exception for dividends paid by a REIT and beneficially owned by a “beleggingsinstelling.”[20]) Practically speaking, then, it may be a narrowly limited class of entities that satisfy the QCIV definition without being withholding foreign partnerships, or being designated as QCIVs by the Secretary.

III. Conclusion

For the most part, the PATH Act seems to represent a significant simplification for foreign investors in REIT stock and RIC stock, as well as provide a significant benefit for qualified foreign pension funds owning U.S. real property interests of all kinds. There are, however, plenty of new questions raised by the words added to the Code by the PATH Act. For this reason, we expect the definition of “qualified foreign pension fund,” and some of the other contours of the PATH Act, to be clarified as taxpayers and the IRS grapple with these new provisions. In addition, it is unclear if and how the ranks of “qualified shareholders” will fill out as some foreign collective investment vehicles fit themselves into the self-executing

[19] This provision partially overrides one of the conclusions in AM 2008-003, which found that a liquidating distribution by a publicly traded REIT to a foreign shareholder, which did not own more than five percent of the REIT stock during the one-year period preceding the date of the distribution, was not a dividend, and therefore was not subject to taxation as an ordinary dividend even though it was also exempt from taxation as a gain thanks to the exception from FIRPTA taxation for foreign shareholders of small blocks of publicly traded stock. If the REIT shareholder is not a “qualified shareholder,” the conclusion in AM 2008-003 appears not to be affected by the PATH Act.

[20] In addition to the U.S.-Australia treaty and the U.S.-Netherlands treaty, the current U.S. tax treaties with China, Cyprus, Egypt, Hungary, Indonesia, Jamaica, South Korea, Morocco, Norway, Philippines, Poland, and Romania may allow in some cases for a reduced U.S. tax rate on dividends paid by a REIT to a resident of the other country even where the resident holds a greater-than-10-percent interest in the REIT paying the dividend.

parts of the definition, and/or the Treasury Secretary expands the definition, via future designations, to cover collective investment vehicles that would otherwise fail the self-executing definition of "qualified shareholder" in the PATH Act.