
NEW FIRPTA REFORMS BILL IS A GAME-CHANGER FOR U.S. REITS



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Last year ended on a favorable note for foreign investors interested in the U.S. real estate market. On December 18, 2015, President Obama signed a bill that dramatically reformed the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). The reforms mark the most significant changes to FIRPTA since its enactment 35 years ago.

The new bill, called Protecting Americans from Tax Hikes Act of 2015, dramatically reforms the taxation of real estate investment trusts (REITs). It also extends several tax relief provisions that had expired at the end of 2014.

According to attorneys at Skadden, Arps, Slate, Meagher & Flom LLP, a firm engaged in the legislation, the new bill shows the U.S.’s [continued legislative commitment](#) to bringing foreign capital to the domestic real estate market.

Critics of FIRPTA’s former taxation model say it created [unintended barriers](#) that drove foreign capital to real estate investment opportunities abroad instead of in the United States.

Efforts to reform FIRPTA [have been supported by](#) everyone from Chairman of the House Ways and Means Committee Kevin Brady, R-Texas, and Congressman Joseph Crowley, D-N.Y, in the House of Representatives, to Sen. Mike Enzi, R-Wyo., and Sen. Bob Menendez, D-N.J., in the Senate.

Some of the most notable changes include:

- Restricting companies’ ability to participate in REIT spin-offs. Until now, companies could spin-off their real estate assets into a REIT, tax-free. They could also elect REIT status on other spin-offs. The new bill says that unless the distributing corporation and the corporation being distributed are REITs directly after the distribution, the transaction will be taxed. If the companies are not REITs directly after the distribution, they can’t vie for REIT status for another 10 years after a tax-free spin-off. This move reduces the arsenal of activists who have fought for years to monetize corporate real estate assets. They will likely seek other ways to push for companies to declare the unrealized value of their real estate.
- The new bill imposes a tax on a REIT’s built-in gains realized during the recognition period. The gains will be taxed at the highest marginal rate, currently 35%. The bill also reduces the recognition period from ten to five years, a temporary rule that’s been in place for the past three years.

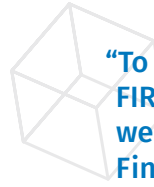
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- The bill paves the way for small foreign “portfolio investors” to participate in publicly traded REITs. Previously, foreign investors holding five percent or less of a publicly traded REIT were not subject to FIRPTA taxation. Now they can own up to ten percent.
- It is now assumed that all shareholders holding less than five percent are U.S. persons unless it is known otherwise. This enables publicly traded REITs to take advantage of the FIRPTA exception with greater confidence.

The bill also:

- Reduces the percentage of gross assets that a REIT can hold in securities of taxable REIT subsidiaries from 25 to 20 percent.
- Corrects the preferential dividend rule for publicly offered REITs. Until now, if a REIT did not distribute a dividend proportionally to all shareholders in a particular class, the dividend was a “preferential dividend”. It did not qualify for the dividends paid deduction. This also applies retroactively to 2015 distributions.
- Allows REITs to use a hedge to cancel out a prior qualifying hedge if the previous debt is repaid or if the asset was sold. This will enable REITs to better manage their interest rate exposure, without having to go before the IRS for a private ruling.

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They include increasing the FIRPTA withholding rate on the disposition or distribution of a U.S. real property interest from 10 to 15 percent. This doesn’t establish a new tax. Rather, it helps FIRPTA secure taxes that previously went uncollected.

Experts say this is unlikely the last round of changes expected in the FIRPTA reform process.

For a full list of the bill’s changes, [click here](#)

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