



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

4.61.12

JANUARY 10, 2025

EFFECTIVE DATE

(01-10-2025)

PURPOSE

- (1) This transmits revised IRM 4.61.12, International Program Audit Guidelines, Foreign Investment in Real Property Tax Act.

MATERIAL CHANGES

- (1) Revised IRM 4.61.12 throughout to update the renamed Wage and Investment (W&I) to Taxpayer Services (TS).
- (2) Updated internal links to new SharePoint sites with current formatting standard.

EFFECT ON OTHER DOCUMENTS

This IRM supersedes IRM 4.61.12, Foreign Investment in Real Property Tax Act, dated March 24, 2023.

AUDIENCE

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4.61.12

Foreign Investment in Real Property Tax Act

Table of Contents

4.61.12.1 Program Scope and Objectives

4.61.12.1.1 Background

4.61.12.1.2 Authority

4.61.12.1.3 Responsibilities

4.61.12.1.4 Program Management and Review

4.61.12.1.5 Program Controls

4.61.12.1.6 Acronyms

4.61.12.1.7 Related Resources

4.61.12.2 Introduction

4.61.12.3 Withholding Certificates

4.61.12.4 IRC 897(i) Election

4.61.12.5 USRPHC Status

4.61.12.6 Distributions by Foreign Corporations

4.61.12.7 Disposition of USRPI by Foreign Partners

4.61.12.8 Real Estate Investment Trusts

4.61.12.9 Examining Nonrecognition Transactions

4.61.12.10 Interests in Natural Resources

4.61.12.11 Loans Treated as USRPIs

4.61.12.12 Capitalization of Expenses

4.61.12.13 Guidance of Timeshare Issue

Exhibits

4.61.12-1 Withholding and Filing Requirements Under FIRPTA

4.61.12-2 Sources of FIRPTA Transactions

4.61.12-3 LB&I Guidance of Timeshare Issue

4.61.12-4 Definitions of Natural Resources Interest Types

4.61.12.1
(01-10-2025)
Program Scope and Objectives

- (1) **Purpose:** This IRM provides guidance and technical information for the Foreign Investment in Real Property Tax Act.
- (2) **Audience:** The primary users of this IRM are employees, management and executives of the WEIC Practice Area in LB&I.
- (3) **Policy Owner:** LB&I Policy under the Strategy, Policy and Governance office in the Assistant Deputy Commissioner Compliance Integration organization.
- (4) **Program Owner:** Director, Withholding Exchange & International Individual Compliance.
- (5) **Primary Stakeholders:** IRS examiners, Taxpayer Services (TS), Ogden Accounts Management.

4.61.12.1.1
(03-24-2023)
Background

- (1) This IRM was developed to provide guidance to WEIC personnel tasked with enforcing the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA).

4.61.12.1.2
(03-24-2023)
Authority

- (1) FIRPTA established IRC 897. FIRPTA was enacted to treat foreign and domestic investment in U.S. real property more comparably.
- (2) The development, implementation and oversight of the international individual compliance strategies and program initiatives are the prerogative of the WEIC director.

4.61.12.1.3
(03-24-2023)
Responsibilities

- (1) The Director, WEIC is responsible for the development, implementation and oversight of the withholding and international individual compliance strategies and program initiatives.
- (2) Ogden Accounts Management processes FIRPTA compliance. TS electronically stores FIRPTA compliance. IRS examiners audit FIRPTA-related cases.

4.61.12.1.4
(03-24-2023)
Program Management and Review

- (1) **Program Reports:** The Director, WEIC Practice Area prepares periodic briefing reports for the LB&I commissioner focusing on:
 - a. Significant accomplishments and opportunities for improvement
 - b. Changes in procedures that have been implemented
 - c. Operational, technical, and staffing updates
 - d. Any other key information
- (2) **Program Effectiveness:** The efficiency of the case procedures is measured through combined business results of the teams that make up the WEIC Practice Area.

4.61.12.1.5
(03-24-2023)
Program Controls

- (1) The Director, Field Operations (DFO), IIC monitors the activities of the territories and administers procedures and updates related to the territories.
- (2) The Director, WEIC identifies goals and objectives to be achieved by the organization, compiles periodic reports from the DFO, and reports to LB&I executive management on a continuous basis via the director's briefings.

4.61.12.1.6
(03-24-2023)
Acronyms

- (1) Commonly used acronyms are listed below.

Acronym	Definition
FIRPTA	Foreign Investment in Real Property Tax Act
FRPI	Foreign Real Property Interests (located outside the United States)
REIT	Real Estate Investment Trust
TS	Taxpayer Services
USRPHC	United States Real Property Holding Company
USRPI	United States Real Property Interest
WEIC	Withholding Exchange & International Individual Compliance

4.61.12.1.7
(03-24-2023)
Related Resources

- (1) For information regarding the LB&I examination process, see IRM 4.46, LB&I Examination Process.
- (2) For information regarding the basic procedures, guidelines and requirements for use by revenue agents and tax auditors in conducting income tax examinations, see IRM 4.10, Examination of Returns.
- (3) For additional information, see "Nonresident Alien FIRPTA Issues" On the International Knowledge Base site for *Individual Inbound - Withholding Individual*.

4.61.12.2
(03-24-2023)
Introduction

- (1) Foreign persons who dispose of U.S. real property interest after June 18, 1980 must treat any gain or loss from the disposition as if such gain or loss were income effectively connected with a U.S. trade or business [See IRC 897].
- (2) U.S. Real Property Interest (USRPI) includes:
- An interest in real property located in the United States or the Virgin Islands.
 - An interest in a domestic corporation unless the taxpayer establishes that the domestic corporation was not a U.S. real property holding corporation (USRPHC) for a certain period [See IRM 4.61.12.5 below].
- (3) USRPI includes any interest, except an interest solely as a creditor. USRPI also includes associated personal property. Below are examples of USRPI:
- Land and unsevered natural products of the land
 - Improvements and personal property associated with the use of real property
 - Standing timber
 - Growing crops
 - Mines
 - Wells and other natural deposits before extraction
 - Buildings
 - Swimming pools

- Fences
- Advertising displays
- Oil and gas pipelines
- Permanently installed telephone and television cables
- Leaseholds
- Options to acquire an USRPI

Note: USRPI does not include stock of a USRPHC which is regularly traded on an established securities market unless the foreign person held more than 5% of the stock generally within five years. Various attribution rules apply to determine whether the foreign person owned 5% of the stock.

- (4) Dispositions of interests in pass-through entities are taxed to the extent the gains are attributable to USRPIs held by the entities [See IRC 897(a)]. These entities include partnerships, trusts, and estates. Gains or losses pass through to partners or beneficiaries.
- (5) Any transfer considered a “disposition” under any section of the code and regulations is considered a disposition under IRC 897. Under certain circumstances, transfers otherwise qualifying for nonrecognition treatment may be taxed under IRC 897. Dispositions may include the following:
 - a. Sales
 - b. Gifts in which the adjusted basis of property transferred is less than the liabilities transferred
 - c. Like-kind exchanges
 - d. Changes in an interest in a partnership, trust or estate
 - e. Corporate reorganizations, mergers or liquidations
 - f. Foreclosures
 - g. Involuntary conversions
- (6) A withholding obligation for dispositions of a USRPIs is required under IRC 1445 as of January 1, 1985. IRC 1461 makes the transferee liable for the tax that must be deducted and withheld under IRC 1445.

4.61.12.3
(03-24-2023)
Withholding Certificates

- (1) IRC 1445 and applicable regulations authorize the Service to reduce or eliminate the withholding amount. Rev. Proc. 2000-35 provides procedures for obtaining a withholding certificate to reduce or eliminate the withholding amount.
- (2) A withholding certificate only adjusts a withholding obligation to correspond with the probable tax liability arising from a transfer. It does not resolve substantive issues that may arise concerning the transfer.
- (3) If the application for a withholding certificate is submitted to the Service on or before the date of transfer, and the application is pending, the transferee need not pay over the amount required to be withheld immediately. Such a transferee must pay the withheld amount by the 20th day after the Service mails a copy of the withholding certificate or a denial.
- (4) Examiners should do the following when examining dispositions of USRPIs:
 - a. Request the taxpayer to provide withholding certificates relating to dispositions of USRPIs.
 - b. Review the transaction as reported on the application for the withholding certificate and as reported on the tax return. Verify that the two descrip-

tions match. If they do not match, determine whether a transferor's or a transferee's agent knew that a false affidavit was submitted to obtain a withholding certificate. In this case, the agent may be liable for the proper withholding amount to the extent of the agent's compensation. The transferor is also liable for the proper withholding amount.

- c. The FIRPTA database, a sub-application of the INTLWebApps system, is available for researching information related to Form 8288, Form 8288-A, and most filed withholding certificates claiming exemptions under category 1, 2, 3, or 5, whether filed on Form 8288-B or not. Examiners can request access to this system by selecting "PROD USER INTLWEBAPPS-READONLY (INTERNATIONAL WEB APPLICATIONS-INTLWEBAPPS)" in the Business Entitlement Access Request System (BEARS). For withholding certificates not included in the FIRPTA database, examiners can request assistance from a technical specialist on the *Withholding Individual Practice Network Contacts* list.

4.61.12.4
(05-01-2006)
IRC 897(i) Election

- (1) IRC 897(i) allows foreign corporations to be taxed as domestic corporations for FIRPTA purposes only. To make an IRC 897(i) election, a foreign corporation must:
 - a. Own a USRPI
 - b. Qualify as a USRPHC upon making the election
 - c. Be entitled to nondiscriminatory treatment of its USRPI under a tax treaty
 - d. Submit the election in proper form
- (2) Under IRC 897(i) the electing foreign corporation is treated as a USRPHC. Its stock is therefore a USRPI and subject to FIRPTA on its disposition.
- (3) While examining the Form 1120F (U.S. Income Tax Return of a Foreign Corporation), the examiner should do the following:
 - a. Request the official copy of the letter acknowledging the election, pursuant to IRC 897(i).
 - b. Verify that a treaty applies. If so, verify that the foreign corporation qualifies for nondiscriminatory treatment under the treaty.
 - c. Request a copy of the acknowledgment from the transferee.
 - d. Verify that nonrecognition transactions under Subchapter C were properly carried out. Review the closing documents. Interviews with individuals who were present at the closing may be conducted with proper approval.
- (4) The examiner should review the tax return for attachments required by Reg 1.897-5T(d)(1)(iii) and Notice 89-57. These attachments must include the following:
 - a. A statement that the distribution was subject to IRC 897
 - b. A description of the property
 - c. The distributor's adjusted basis in the USRPI
 - d. A statement providing the name, address and TIN of the distributee
 - e. A declaration by the distributee that it will be subject to tax on a subsequent disposition of the USRPI

4.61.12.5
(03-24-2023)
USRPHC Status

- (1) To decide if FIRPTA applies, the examiner should determine whether a domestic corporation is a USRPHC. If a domestic corporation is a USRPHC (or was one in the preceding five- year period), its stock is a USRPI.

- (2) A USRPHC is a domestic corporation whose USRPI percentage equaled 50 percent or more anytime within the preceding five-year period. In general, the formula is:

$$\text{USRPHC Percentage} = \frac{\text{Fair Market Value (FMV) of USRPIs}}{\text{FMV of USRPIs} + \text{FMV of FRPIs} + \text{FMV of Trade or Business Assets}}$$

Figure 4.61.12-1

- (3)

Note: Fair market value (FMV) of real property is the gross value reduced by the outstanding liability secured by property. Gross value (GV) is the price that a willing seller would charge a willing buyer.

- (4) A foreign corporation is generally a USRPHC only for purposes of determining whether a corporation owning interests directly in the foreign corporation is a USRPHC [See Treas. Reg. 1.897-2(e)(1)].

- (5) Trade or business assets are assets other than USRPIs that are:

- a. Related to a trade or business
- b. Used in a trade or business
- c. Held for use in a trade or business

Note: Future trade or business needs are not relevant.

- (6) A corporation is presumed not to be a USRPHC when the book value of its USRPIs is 25 percent or less than the book value of its assets on the determination date. Book value is the value carried on the corporation's financial statements as determined by Generally Accepted Accounting Principles (GAAP).

- (7) Look-through rules apply to the determination of USRPHC status. They are as follows:

- a. The corporation is considered to own a proportionate share of assets held through the following: A domestic or foreign corporation in which it owns a controlling interest; A partnership; A trust; An estate.
- b. If the corporation owns stock in a foreign corporation, that stock is a USRPI only if the foreign corporation would qualify as a USRPHC if it were viewed as a domestic corporation.

- (8) Dates for determining USRPHC status are as follows:

- a. Last date of the taxable year
- b. Date a USRPI is acquired
- c. Disposal date of foreign real property
- d. Disposal date of a trade or business asset
- e. Date a lower tier entity performs an action described above

- (9) USRPHC status may be terminated by either of two ways.

- a. On a determination date in which the USRPHC status formula falls below 50 percent. However, the interests in the corporation will remain tainted for five years, or if

- b. The following two conditions are met: (1) No USRPI's are owned, and (2) all USRPIs owned directly or indirectly within the preceding five years were disposed of in transactions in which the full amount of the gain was recognized or ceased to be USRPI [See Treas. Reg. 1.897-2(f)(2)].
- (10) To avoid FIRPTA, a foreign person disposing of interest in a domestic corporation must establish the corporation's non-USRPHC status as of the disposition date. This is done by:
 - a. Obtaining a statement from the corporation that the interest disposed of was not a USRPI by the due date of the tax return. A signed copy must be sent to the Service by the corporation.
 - b. Obtaining a determination from the Service based on information contained in the Service's records that the interest was not a USRPI. This can be requested if the following occurs [See Treas. Reg. 1.897-2(g)]: (1) The foreign person requests a statement from the corporation as to the status of its interest no later than 90 days before the due date, including any extensions, of the tax return, and (2) The domestic corporation fails to respond to such request within 30 days of delivery.
 - c. Obtaining a determination from the Service based on information supplied by the foreign person.
- (11) FIRPTA may apply at the shareholder level to any distribution made by a domestic corporation that is a USRPHC. FIRPTA will apply at the corporate level to distributions of USRPIs by a foreign corporation.
- (12) Dividends received by foreign shareholders are subject to tax under other Code provisions, accordingly FIRPTA is not applicable. The effect of Code provisions may be modified by treaty and as modified are not altered by the corporation's USRPHC status.
- (13) A foreign shareholder may receive a nonliquidating capital gain distribution from a USRPHC if the value of the distribution exceeds the foreign shareholder's adjusted basis in its stock. The gain may be subject to FIRPTA tax unless the shares are regularly traded on an established securities market and the foreign person did not own more than 5% of the shares during the relevant period.
- (14) A foreign shareholder receiving a liquidating distribution from a USRPHC is deemed to have disposed of its stock. The resulting gain is subject to FIRPTA tax unless the foreign shareholder is a corporation, and the liquidation is an IRC 332(a) liquidation [See Treas. Reg. 1.897-5T(b)(3)(iv)(A)], or the shares are regularly traded on an established securities market and the foreign person did not own more than 5% of the shares during the relevant period.
- (15) The examiner should request all books and records relating to the determination of USRPHC status. This may include (but is not limited to) the following:
 - a. Listings and valuations of USRPI, other real property, and trade or business assets
 - b. Agreements relating to loans or notes secured by USRPIs and trade or business assets
 - c. USRPHC status computations made by the taxpayer on the required determination dates
 - d. Listings and valuations of assets owned by entities in which there is (was) a controlling interest

- e. All guidelines, questionnaires, performance studies, reports, analysis, memoranda and other similar documents
- f. All correspondence, emails, facsimiles, and other documents

(16) The examiner should remain aware of the five-year taint that USRPHC status may entail. Preceding years' USRPHC status may, therefore, affect the taxation of current distributions.

4.61.12.6
(03-24-2023)

Distributions by Foreign Corporations

- (1) When property distributed by a foreign corporation is a USRPI, FIRPTA applies to the foreign corporation, not to the shareholder.
- (2) If a foreign corporation disposes of a USRPI, the examiner should consider the importance of the following:
 - a. Contracts of sale
 - b. Closing documents
 - c. Description of all consideration received
 - d. Copies of any notes received as consideration
 - e. Names and addresses of shareholders
 - f. Number of shares of stock held by each shareholder
 - g. Application to the Service for reduced withholding certificate(s) including supporting documents
 - h. Copy(ies) of the issued reduced withholding certificate(s)
 - i. Documents sent to the Service relating to IRC 897(i) election
 - j. Copy of IRS acknowledgment of IRC 897(i) election
 - k. Affidavit of non-foreign status given to the buyer
 - l. Documents supporting the corporation's nontaxable treatment of the transaction
 - m. Names and addresses of all compensated agents involved with the transaction—these may include real estate brokers, lawyers, accountants and others
 - n. Documents substantiating basis
 - o. Settlement provider and local courthouse records relating to the transaction
 - p. Any other documents deemed necessary. (Also see items (e) and (f) of 4.61.12.5(15) above).
- (3) If a foreign corporation distributes a USRPI to its shareholders, it should recognize gain unless:
 - 1. The distributee is a foreign corporation.
 - 2. The distribution is a liquidating distribution under IRC 332(a). The gain is equal to the fair market value of the distributed USRPI minus the foreign corporation's basis in the USRPI [See Treas. Reg. 1.897-5T(c)(2)].
 - 3. For liquidating distributions under IRC 332, see generally Notice 2006-46.

4.61.12.7
(03-24-2023)

Disposition of USRPI by Foreign Partners

- (1) Partnerships with foreign partners have three types of transactions that trigger FIRPTA consequences:
 - a. Dispositions of USRPIs by the partnership (see (2) below),
 - b. Dispositions of partnership interests by foreign partners, (see (3) below), and
 - c. Contributions to and distributions by the partnership (see (4) below).

- (2) Dispositions of USRPIs by the partnership—A foreign partner's share of gain or loss from a partnership disposition of a USRPI is treated as a direct disposition of the USRPI by the foreign partner.
- (3) Dispositions of partnership interests by foreign partners—
 - a. Under IRC 897(g), gain or loss is recognized on the disposition of an interest in a partnership to the extent attributable to a USRPI [See Notice 88-72, 1988-2 C.B. 383, and Treas. Reg. 1.897-7].
 - b. Treas. Reg. 1.897-7T, effective for transfers after June 6, 1988, treats certain partnership interests as USRPIs for purposes of IRC 1445. A partnership interest is a USRPI if it meets the "50/90" test, which means: directly or indirectly, 50 percent or more of the value of gross partnership assets consists of USRPIs; directly or indirectly, 90 percent or more of the value of gross partnership assets consists of the following: USRPIs or cash and cash equivalents.

Note: IRC 897(g) treats a partnership interest as a USRPI only to the extent the gain on the disposition is attributable to USRPI. IRC 897(g) does not treat a partnership interest as a USRPI to the extent the gain on the disposition is attributable to cash, cash equivalents or other property. However, FIRPTA may require withholding tax on the total amount realized.

- (4) Contributions to and distributions by a partnership— Contributions to and distributions by partnerships are normally not taxable events. Non-recognition may allow avoidance of IRC 897. IRC 897(e)(2) authorizes the Service to issue anti-avoidance regulations. Additionally, under IRC 897(g) if money or property is exchanged for "all or part" of a foreign partner's interest in a partnership gain or loss is recognized to the extent attributable to a USRPI. Under Treas. Reg. 1.897-6T, the exchange of a USRPI for an interest in a partnership will receive non-recognition treatment pursuant to Section 721 only to the extent that a disposition of the partnership interest will be subject to U.S. taxation under Section 897(g).
- (5) FIRPTA withholding rules in the partnership context.
 - a. IRC 1445(e) and regulations there under establish special withholding rules relating to the distributions by corporations, partnerships, trusts or estates.
 - b. If the foreign partner does not owe U.S. tax, an amount withheld under IRC 1445 may be refunded. If the domestic partnership fails to meet withholding tax obligations, the Service can do the following: assert withholding tax liability against the partnership, and charge interest on the delay.
 - c. IRC 1445 establishes five exemptions from withholding tax. Only the following two are likely to apply to dispositions by a partnership with foreign partners to non-partners: (1) The seller provides a non-foreign affidavit or (2) the seller receives a qualifying statement from the Service.
 - d. Withholding tax under IRC 1445 is reported on Form 8288 (U.S. Withholding Tax Return for Certain Dispositions by Foreign Persons).
- (6) Disposition of a partnership interest may result in the following consequences:
 - a. An IRC 1445 withholding tax based on the amount realized on the disposition [See IRC 1445(e)(5) and Treas. Reg. 1.1445-11T].

- b. An IRC 897 gain which is based on the extent the foreign partner's disposition of the interest is attributable to a USRPI [See Treas. Reg. 1.897-7T]. The IRC 1445 withholding tax, therefore, may be based on an amount in excess of the IRC 897(a) amount.

- (7) IRC 1446 imposes a withholding obligation on all partnerships (except those treated as corporations under IRC 7704) that have "effectively connected taxable income" allocable to a foreign partner. IRC 1446 requires withholding at the time the income is earned and regardless of whether distributions are actually made to foreign partners. "Effectively connected taxable income" includes gains or losses from dispositions of USRPIs [See Treas. Reg. 1.1446-2(b)(2)(ii)]. IRC 1446 withholding generally preempts the IRC 1445 withholding rules for domestic partnerships [See Treas. Reg. 1.1446-3(c)(2)(i)]. The tax is reported on Form 8804, Annual Return for Partnership Withholding Tax (Section 1446).
- (8) A foreign partnership is a foreign person for purposes of FIRPTA withholding. The buyer of a USRPI from a foreign partnership must withhold 15 percent of the amount realized. The foreign partnership is then allowed to credit the amount withheld under IRC 1445 against its IRC 1446 withholding liability for the year only to the extent such amount is allocable to foreign partners [See Treas. Reg. 1.1446-3(c)(2)(ii)].

4.61.12.8
(05-01-2006)
**Real Estate Investment
Trusts**

- (1) A real estate investment trust (REIT) is a conduit entity. In general, it is not taxed on ordinary income and capital gains distributed to its owners if it distributes 95 percent of such income. REIT is taxed at corporate rates. REIT is entitled to a dividend paid deduction. Shareholders treat a dividend from a REIT as either a capital gain or ordinary dividend, depending on the REIT's designation.
- (2) IRC 897(h) provides rules that apply to distributions made by REITs to foreign shareholders. Foreign shareholders must treat the distribution as an IRC 897 gain to the extent the distribution is attributable to gain realized by the REIT from the sale or exchange of a USRPI. Solely for purposes of IRC 1445 withholding, the largest amount of a post-March 7, 1991 distribution that could be designated as a capital gain dividend under IRC 857(b)(3)(c) will be treated as actually designated capital gain dividend.
- (3) Under IRC 897(c)(1), a REIT normally qualifies as a USRPHC, and an interest in a REIT is generally a USRPI, however, under IRC 897(h)(2) an interest in a domestically controlled REIT is not a USRPI. Therefore, a foreign shareholder disposing of REIT stock generally must recognize gain from the disposition of a non-domestically controlled REIT under IRC 897.
- (4) To determine whether IRC 897 and IRC 1445 apply to a distribution from a REIT, the examiner should review the following:
 - a. Form 1120 - REIT, U.S. Income Tax Return for Real Estate Investment Trusts
 - b. Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
 - c. Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding
 - d. The list of shareholders on the books of the REIT
 - e. Applicable information reporting forms sent to the REIT shareholders

4.61.12.9
(03-24-2023)
**Examining
Nonrecognition
Transactions**

- (5) Some U.S. tax treaties provide specific rules for certain REIT distributions. In such circumstances, these will override any code provisions.
- (1) IRC 1001 provides rules for determining gain on the sale or other disposition of property. Gain is equal to the amount realized minus the adjusted basis of the property. The amount realized is the sum of the following:
 - a. Money received
 - b. Fair market value of property received
- (2) Gain on the disposition of property is fully taxable unless the Code provides an exception. The following are among the provisions of the Code that provide exceptions from gain recognition:
 - a. IRC 368 (reorganizations)
 - b. IRC 351 (transfers)
 - c. IRC 332 (liquidations)
 - d. IRC 355 (spin-offs, split-offs and split-ups)
 - e. IRC 1031 (like-kind exchanges)
 - f. IRC 1033 (involuntary conversions)
 - g. Former IRC 1034 (rollover of gain on the sale of a principal residence taking place before May 6, 1997)
- (3) IRC 897 provides additional requirements for nonrecognition treatment. IRC 897(d) provides that a foreign corporation must generally recognize gain on a distribution of a USRPI. This rule applies also to a distribution in liquidation or redemption. Gain need not be recognized if:
 - a. The distributee would be subject to U.S. taxation on a subsequent disposition of the USRPI, and the distributee receives no step-up in the basis of the USRPI, or
 - b. Regulation under IRC section 897(e)(2)(A) is applicable.
- (4) Under IRC 897(e), the non-recognition provisions generally apply to the sale or exchange of a USRPI only if it is exchanged for an interest that would be subject to the U.S. taxation [See Treas. Reg. 1.897-5T and 6T for implementing regulations].
- (5) Nonresident aliens are generally not subject to tax on U.S. source capital gains. Their capital gains are taxed only if the gains are effectively connected income or they have been present in the United States for 183 days or more during the taxable year in which the property is sold or exchanged. USRPIs are generally capital assets. Consequently, absent FIRPTA, the dispositions of USRPIs would generally not be subject to tax.
- (6) Absent anti-abuse rules, foreign corporations could avoid FIRPTA by exchanging USRPIs for non-USRPIs or stock. Subsequent exchanges would not be subject to tax unless the property received is:
 - a. Identified as a USRPI
 - b. Subject to FIRPTA rules
- (7) IRC 897(d) and IRC 897(e) are aimed at preventing foreign corporations from attempting to purge a USRPI's FIRPTA taint by exchanging a USRPI for non-USRPI.

- (8) Examiners should review tax returns for nonrecognition transactions. Generally, taxpayers must file information statements with the tax return when they claim nonrecognition treatment.
- (9) Many foreign corporations used nonrecognition provisions to domesticate in 1986 and 1987. This was motivated by unfavorable changes in tax laws that became effective after 1986. Examiners should check foreign-owned domestic corporations for previous reorganizations. Examiners should check domestic corporations owning real property for foreign ownership. Although the statute of limitations may have expired, tax attributes can still be adjusted. This includes the basis of property and net operating losses.
- (10) The nonrecognition provisions of Subchapter C are very stringent. Failure to meet requirements can result in gain recognition to the transferor. It can also result in withholding at the source. Nonrecognition transactions must also meet FIRPTA requirements to avoid gain recognition and withholding.
- (11) Reorganizations qualify for nonrecognition treatment only if they meet the following requirements:
 - a. Continuity of interest
 - b. Continuity of business enterprise
 - c. Business purpose
- (12) Distributions of property to persons not party to reorganizations do not qualify for nonrecognition treatment. Additionally, qualifying for nonrecognition treatment under FIRPTA requires the following:
 - a. A USRPI can only be exchanged for another USRPI
 - b. Taxability of subsequent distributions must be maintained
- (13) IRC 897(e)(1) applies to the exchange of a USRPI by a foreign corporation for stock of another foreign corporation pursuant to certain reorganizations. These reorganizations include reorganizations under IRC 368(a)(1)(B), (C), (D) or (F). These reorganizations are generally taxable under FIRPTA if the foreign corporation did not make an IRC 897(i) election. [See Treas. Reg. 1.897-6T for exceptions to gain recognition for certain foreign to foreign exchanges of a USRPI for a non USRPI.]
- (14) To qualify for nonrecognition treatment, Type A, B, C, D, F and G reorganizations must pass muster under both Subchapter C and FIRPTA.
- (15) IRC 351 transfers of USRPIs for foreign corporation stock generally do not qualify for nonrecognition treatment unless:
 - a. The foreign corporation makes an IRC 897(i) election
 - b. The transfer meets the requirements of Treas. Reg. 1.897-6T
- (16) IRC 351 transfers of USRPIs for domestic corporation stock qualify for nonrecognition treatment if:
 - a. There is no step-up in basis
 - b. The stock received by the foreign transferrer is a USRPI which would be subject to tax or disposition
 - c. The filing requirements of Treas. Reg. 1.897-5T(d)(iii) are met

4.61.12.10
(03-24-2023)
Interests in Natural Resources

- (1) Under FIRPTA, an interest in a “mine, well or other natural deposit” located in the United States is a USRPI. Examiners may encounter the following types of interests:
 - a. Oil and Gas Interests, including Mineral Fee Interests and Operating Interests
 - b. Non-operating Interests, including Landowner’s Royalty Interests and Overriding Royalty Interests
 - c. Net Profits Interests
 - d. Production Payment Interests

Note: See Exhibit 4.61.12-4 for definitions of natural resources interest types.

- (2) All of the interests above are USRPIs except for the production payment interest. The production payment interest is a USRPI if it conveys a right to share in the appreciation in value of the property. Examiners should review the production payment interest to determine whether it is a USRPI. In doing so, examiners should inspect the following:
 - a. Purchase agreement contract
 - b. Partnership agreement
 - c. Trust agreement
 - d. Any other document(s) pertaining to this transaction
- (3) If a production payment interest is a USRPI, its disposition is subject to FIRPTA.

4.61.12.11
(05-01-2006)
Loans Treated as USRPIs

- (1) Examiners should review debt instruments held by foreign taxpayers. Debt instruments may have contingent interest features. These features may provide for interest if U.S. real property appreciates in value. Under FIRPTA, these types of debt instruments (called shared appreciation loans) qualify as USRPIs. Therefore, dispositions of these debt instruments are taxable under IRC 897 [See Treas. Reg. 1.897–1(d)].
- (2) Examiners should review debt instruments with contingent interest features. Taxpayers may attempt to use debt instruments with contingent interest features to avoid IRC 897. In such an arrangement, a foreign taxpayer makes a loan to a domestic borrower. It does so rather than obtain a direct interest in a USRPI. The USRPI is owned by a domestic borrower who is the debtor with respect to the shared appreciation loan. The domestic borrower realizes a gain on the sale of the property. Part of the gain is paid to the foreign lender as contingent interest in satisfaction of a debt instrument. The “contingent interest” received by the foreign taxpayer is gain subject to taxation under IRC 897(a) [See also IRC 871(h)(4) for the exclusion of contingent interest from portfolio debt exception].
- (3) Examiners should review the debt instrument and related documents for the following:
 - a. Contingent interest features
 - b. Connection with a USRPI
 - c. Terms of the debt instrument. Examiners should determine whether the terms would normally be negotiated at arm’s length.
- (4) Examiners should examine the relationships of the parties involved for any activities relating to the USRPI.

- (5) Examiners should determine how payments are made on the debt instrument and whether the payments are reported consistently from year to year.
- (6) Examiners should contact the Office of Associate Chief Counsel (International) if they encounter problems in this area.

4.61.12.12
(05-01-2006)
Capitalization of Expenses

- (1) Examiners should scrutinize the basis of USRPIs disposed of by foreign taxpayers.
- (2) Foreign taxpayers should reduce the basis of USRPIs by depreciation allowable, not depreciation taken.
- (3) Nonresident aliens or foreign corporations may earn gross income from the rental of U.S. real property. If not effectively connected to a U.S. trade or business, the income is subject to 30 percent tax. Under IRC 871(d), nonresident aliens who derive gross income from U.S. real property that is not “effectively connected income” may elect to treat such income as if it were “effectively connected income.” Likewise, under IRC 882(d), foreign corporations who derive gross income from U.S. real property that is not “effectively connected income” may elect to treat such income as if it were “effectively connected income.” This election allows deductions if and to the extent related to the “effectively connected income.”
- (4) Under IRC 874, nonresident aliens must file a return to take any deductions.
- (5) Foreign taxpayers who have made an election to treat income from real property as effectively connected income may receive a positive basis adjustment for carrying charges such as:
 - a. Real estate taxes
 - b. Mortgage interest
 - c. Capitalized under IRC 266. To be capitalized, the items must not have been deducted.
 - d. A nonresident alien must file a return to take any deductions under IRC 874.
- (6) Real estate taxes, mortgage interest or other carrying charges are generally not connected with “effectively connected income”, unless an election under IRC 874(d) or IRC 882(d) is made. Foreign persons cannot make IRC 871(d) or IRC 882(d) elections for a taxable year when no income is derived from the property. Consequently, foreign persons are not allowed deductions of expenses from U.S. real property that are not otherwise “effectively connected” for such taxable year. Because the expenses are not otherwise deductible, they cannot be capitalized [See Rev. Rul. 91–7].

4.61.12.13
(03-24-2023)
Guidance of Timeshare Issue

- (1) This guidance provides instructions with respect to managing issues under IRC 1445 related to certain timeshare arrangements. Specifically, this applies to examinations of LB&I taxpayers that failed to file Forms 8288, 8288-A or 8288-B for personal use timeshare “upgrade” transactions that result in no realized gain to nonresident alien individuals (“NRAs”). See Exhibit 4.61.12-3 below for details.

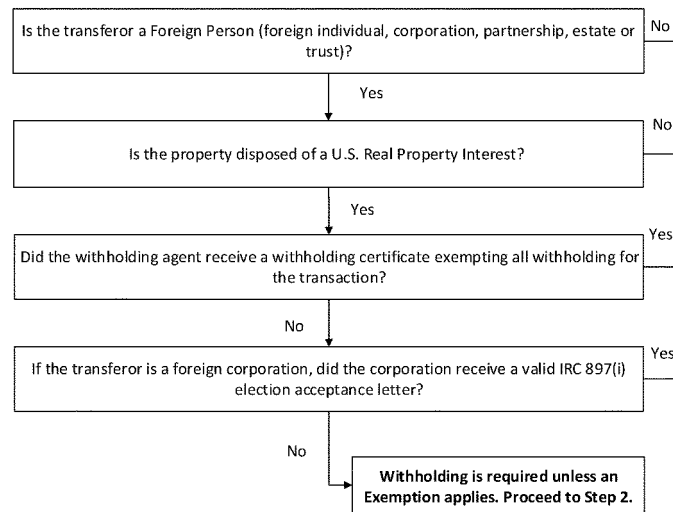
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Exhibit 4.61.12-1 (03-24-2023)

Withholding and Filing Requirements Under FIRPTA

Is Withholding and Filing Required Under the Foreign Investment in Real Property Tax Act (FIRPTA)?

1. Start below to Determine if Withholding under IRC 1445 is Required:



2. Determine if any Exemption from FIRPTA Withholdings Applies:

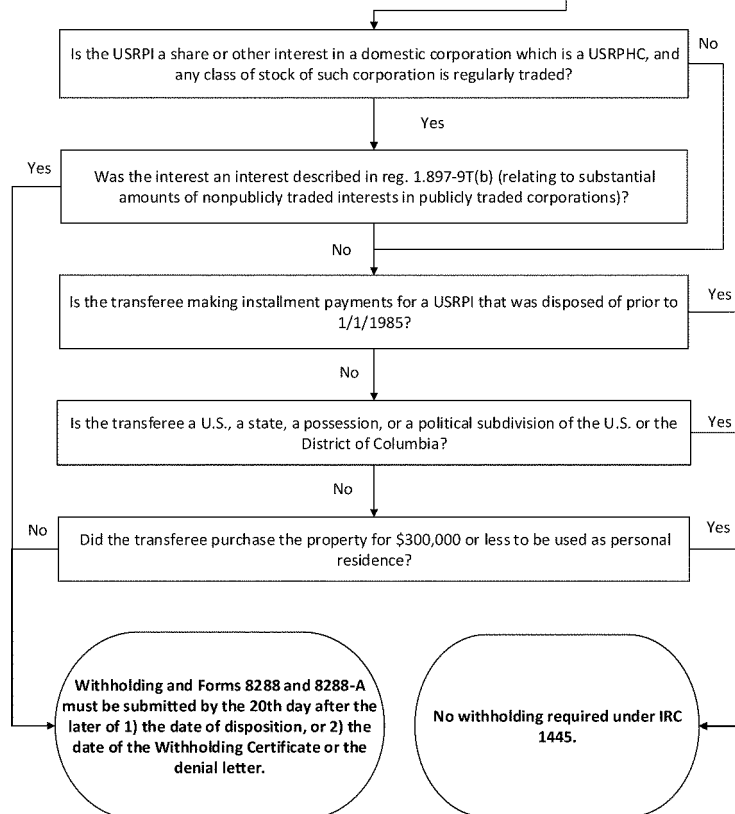


Exhibit 4.61.12-2 (03-24-2023)**Sources of FIRPTA Transactions****Application for Withholding Certificates and FIRPTA tax returns**

Form 8288, Form 8288-A, and withholding certificate applications are filed at the Ogden Service Center (OSC). Information related to these forms and most withholding certificate applications, including those filed on Form 8288-B, are kept in the FIRPTA database, a sub-application of the INTLWebApps system. Examiners can request read only access to the FIRPTA database [See IRM 3.21.25.12]. This database includes the following information:

- a. All information contained on Form 8288, U.S. Withholding Tax Return for Certain Dispositions by Foreign Persons
- b. All information contained on Form 8288–A, Statement of Withholding on Certain Dispositions by Foreign Persons
- c. Information contained on Form 8288–B, Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests. This includes the following information:
 1. Names, addresses, and taxpayer identification numbers (TINs) of transferors
 2. Names, addresses, and TINs of transferees
 3. Names, addresses, and TINs of withholding agents
 4. Amounts realized
 5. Amounts withheld
 6. Dates of transfer

Note: Some Form 8288-B applications are not included in the FIRPTA database. Examiners can request assistance for those not included in the database from a technical specialist on the *Withholding Individual Practice Network Contacts* list.

Accurint

Accurint provides helpful information in its “Assets” library. This library contains the following information:

1. Asset ownership
2. Property addresses
3. Individual's mailing address
4. Assessed valuations
5. Current market values
6. Recent property sales and deed transfers

State and Local Tax Authorities

States and counties maintain records of all real property transactions in their jurisdictions. These records are available to the public and accessible on state and county offices' websites. These records may include the following information:

1. Names and addresses of owners
2. Dates properties were sold
3. Names and addresses of sellers
4. Sales prices
5. Descriptions of properties

Exhibit 4.61.12-3 (03-24-2023)
LB&I Guidance of Timeshare Issue**Introduction**

This guidance provides instructions with respect to managing issues under IRC 1445 related to certain timeshare arrangements. Specifically, this guidance applies to examinations of LB&I taxpayers (that is, taxpayers with assets equal to or greater than \$10,000,000) that failed to file Forms 8288, 8288-A or 8288-B for personal use timeshare "upgrade" transactions, described in the Background section below, that result in no realized gain to nonresident alien individuals ("NRAs"). Transactions involving timeshares that are not described below, such as transfers where an NRA realizes gain, are not within the scope of this guidance.

Note 1: In general, there will not be realized gain in a fee simple personal use ownership situation because the owner's adjusted basis would not reflect a depreciation allowance. However, there may be realized gain in a fee simple ownership of property held in a trade or business, or property held for the production of income (generally, rental property) because the owner's adjusted basis may reflect a depreciation allowance. However, IRC 1031 may defer recognition of that gain. Also, see "Note 2" below.

This guidance is effective for all taxable years ending on or before December 31, 2017, and for subsequent taxable years until further notice.

Background

This guidance involves withholding agents engaged in the timeshare business in the United States ("Taxpayers"). Pursuant to this business, Taxpayers sell certain interests in vacation resort real property located in the United States ("timeshare interests") to U.S. tax residents and NRAs for their personal use. The timeshare interests constitute United States real property interests within the meaning of IRC 897(c).

Under the timeshare agreement with the Taxpayer, a timeshare owner may exchange his or her personal use timeshare interest for a different personal use timeshare interest ("upgrade transaction"). In an upgrade transaction, the timeshare owner disposes of one timeshare interest to the Taxpayer at a loss (or no gain), and acquires another timeshare interest from the Taxpayer with a greater value. For example, a timeshare owner that holds a timeshare interest ("Unit 1") may exchange his or her timeshare interest for another timeshare interest with a better view ("Unit 2"). In such a transaction, Taxpayer requires the timeshare owner to provide additional consideration (typically cash) to the Taxpayer equal to the difference between the purchase price of Unit 2 and the original purchase price of Unit 1. However, if the fair market value of Unit 1 at the time of the upgrade transaction is lower than its original purchase price, then the timeshare owner must provide additional consideration to the Taxpayer equal to the difference between the fair market value of Unit 1 and the purchase price of Unit 2.

For purposes of IRC 897 and IRC 1445, an upgrade transaction consists of two transfers. The first transfer is a disposition of a timeshare interest by the owner to the Taxpayer. The second transfer is an acquisition of a new timeshare interest by the same person from the Taxpayer. If the owner is an NRA, the first transfer is a disposition of a U.S. real property interest under IRC 897(a) by a foreign person. As a result, the Taxpayer, as the purchaser (or transferee), would be required to withhold under IRC 1445 on the amount realized.

Note 2: In the case of property held for investment, IRC 1031 of the Code may apply to defer realized gain or loss. In general, for exchanges completed after December 31, 2017, IRC 1031 applies only to exchanges of real property for real property. Section 13303 of P.L. 115-97. We do not express an opinion concerning whether a fee interest in a timeshare held for investment is real property under IRC 1031 as amended by P.L. 115-97.

In the upgrade transaction, the upgrading NRA timeshare owner does not realize any gain on the first transfer. A timeshare owner that is upgrading to a higher value timeshare interest is assigned value for the first timeshare interest that does not exceed its original purchase price. Except in cases where the timeshare owner purchases the timeshare interest for investment, the NRA timeshare owner's basis in the transferred timeshare interest is

Exhibit 4.61.12-3 (Cont. 1) (03-24-2023)**LB&I Guidance of Timeshare Issue**

generally equal to its original purchase price. Accordingly, the amount realized by the NRA timeshare owner will ordinarily not be higher than the NRA's basis in such interest. Thus, no gain is realized by the NRA timeshare owner on the first transfer. See "Note 1" above.

This guidance only applies to an upgrade transaction if the NRA originally purchased the timeshare interest being disposed of from the Taxpayer.

Planning and Examination Guidance Related to Scope

If an examiner determines it is necessary to verify whether a transfer is within the scope of this guidance, the examiner should request that the Taxpayer provide the following information regarding the transfer:

1. Name and home address of timeshare owner.
2. Unit number/address of the disposed timeshare interest.
3. Date of the purchase of the disposed timeshare interest.
4. Purchase price of disposed timeshare interest.
5. Date of the upgrade transaction.
6. Fair market value of the disposed timeshare interest.
7. Value of the disposed timeshare interest credited to the NRA.
8. Purchase price of the newly purchased timeshare interest.
9. Unit number/address of the newly purchased timeshare interest, as well as the description (and amount) of any other consideration (for example, credits or points) exchanged in the upgrade transaction.

Recommendation

To efficiently and effectively use resources, examiners should not examine the failure to file Forms 8288, 8288-A, and/or 8288-B with respect to upgrade transactions involving NRAs described in the Background section of this guidance because the upgrade transactions are not expected to result in realized gain to the NRA. Examiners should treat such taxpayers as having filed Forms 8288, 8288-A, and/or 8288-B and having fulfilled their withholding obligations under IRC 1445 and the regulations thereunder.

Contact Information and Limitations on Use

If you have any questions, please contact the Withholding Individual Practice Network for assistance.

This guidance is not an official pronouncement of the law or the position of the Service and cannot be used, cited or relied upon as such. In addition, nothing in this guidance should be construed as affecting the operation of any other provision of the Code, regulations or guidance thereunder. These instructions are intended for internal decision making only.

Exhibit 4.61.12-4 (03-24-2023)**Definitions of Natural Resources Interest Types*****Oil and Gas Interest:***

- a. ***Mineral Fee Interest.*** Mineral fee interests are direct interests in oil and gas underlying particular tracts of land. They are frequently severed from the rights to the surface of the land. In these situations, mineral fee interest owners have implied rights to use the surface of the land to develop and produce the underlying oil and gas.
- b. ***Operating Interest.*** Operating or working interests are also direct ownership interests in the oil and gas. Operating or working interests are burdened with the cost of developing and operating the property.

Non-operating Interest:

- a. ***Landowner's Royalty Interest.*** A landowner's royalty interest: (1) Entitles the owner to a specified fraction of the property's total production; (2) Is not burdened with the cost of developing and operating the property; (3) Is created by the mineral fee owner's assigning or reserving the interest.
- b. ***Overriding Royalty Interest.*** An overriding royalty interest: (1) Is a right relating to oil and gas in place; (2) Entitles the owner to a specified fraction of the property's total production; (3) Does not burden the owner with the cost of developing and operating the property; (4) Is created out of an operating interest and ends with the operating interest.

Net Profits Interest. A net profits interest is a right relating to oil and gas in place. It entitles the owner to a share of the property's total production. This share is measured by a specified percentage of the net profits from the property [See Rev. Rul. 75-182]. The interest is burdened by specified development and operating expenses. This expense burden is limited to its share of the net profits. The owner is not required to pay, advance, or otherwise be liable for such expenses. A net profits interest is created out of an operating interest. Thus, its term usually ends with that of the operating interest to which it relates.

Production Payment. A production payment is a right with respect to oil and gas in place that entitles the owner to a specified fraction, in kind or in value, of the total production from the property, free of development and operating expenses. The interest is for a limited period of time or until a specified sum of money (either set forth precisely or determined by a formula) or a specified amount of oil and gas has been received. A production payment secured by a mortgage is not an economic interest in oil and gas in place.

