ISSN 0008-5111
Price: $8.50

Printed in Canada
10.4M 3-85

January-February 1985
Vol. 33, No. 1

CANADIAN TAX JOURNAL

ARTICLES

EXPROPRIATIONS: THE INCOME TAX ASPECTS
—*Larissa V. Tkachenko*

TAX IMPLICATIONS OF MOVING FROM THE UNITED KINGDOM TO CANADA
—*Richard J. Horner*

FEDERAL SALES TAXATION: A SURVEY OF SIX DECADES OF EXPERIENCE, CRITIQUES, AND REFORM PROPOSALS
—*Malcolm Gillis*

FEATURES

CURRENT CASES—INTERNATIONAL TAX PLANNING—PERSONAL TAX PLANNING—THE TAXATION OF CORPORATE REORGANIZATIONS—SELECTED U.S. TAX DEVELOPMENTS—FISCAL FIGURES—CURRENT TAX READING—CHECKLIST—CORRESPONDENCE—IN THE LIBRARY

Canadian Tax Foundation
L'Association Canadienne d'Études Fiscales

borrower's interest deductions reduce income that is subject to tax in the United States at a 46 per cent rate, the risk of a 30 per cent withholding tax on interest payments may be worth running.[38] If, however, the U.S. corporation is generating losses without regard to any interest deductions, and the possibility of generating future income against which to apply any current losses is not assured, the risk of a 30 per cent U.S. withholding tax may not be worth taking.

If the withholding tax risk is not worth running, the back-to-back loan structure should be terminated (although the fact of the termination may give credence to an argument that the sole purpose of the structure was tax avoidance). For example, under the facts of Revenue Ruling 84-152, the Swiss parent corporation might transfer cash to its U.S. subsidiary as capital, which the subsidiary could use to pay off its indebtedness to the Netherlands Antilles subsidiary, which in turn could, if desirable, use the proceeds to pay off its loan from the Swiss parent. The termination might also be accomplished through transfers of the notes between the various corporations or possibly by way of cancellation of the notes, although the risks of dividend income, cancellation of indebtedness income,[39] and other adverse tax consequences would have to be considered.

CONCLUSION

At this early date, it is not possible to predict how broadly the IRS will seek to apply the principles of Revenue Rulings 84-152 and 84-153 in situations similar to those described in the rulings as well as in analogous areas of the tax law. It is understood, however, that the IRS is considering and shortly will issue guidance on this question. It is to be hoped that guidance will also be provided with respect to the proper tax treatment of the intermediary corporation and other ancillary questions raised by the rulings.

[38]In such a case, thought might also be given to terminating the loan *to* the Netherlands Antilles corporation but retaining the loan by the Netherlands Antilles corporation to the U.S. corporation. Presumably, the Netherlands Antilles corporation would no longer be viewed as a conduit and the Article VIII withholding exemption should apply to the interest payments to the Netherlands Antilles corporation. The Netherlands Antilles corporation, however, would pay tax in the Netherlands Antilles at the rate of 24 to 30 per cent on its net income, which would no longer reflect any deductions for interest expense.

[39]See IRC sections 108(e)(6), (7), (8), and (10).

BROAD FIRPTA WITHHOLDING RULES ARE BOUND TO AFFECT CANADIANS

Fred Feingold and Peter A. Glicklich

Canadian individuals, corporations, and other entities transacting business that involves direct or indirect dispositions of U.S. real estate must take into account new withholding rules that impose obligations on persons who acquire U.S. real property interests from non-U.S. persons. In other cases, the new rules require entities to withhold a tax upon such dispositions on the portion of the sales price attributable to foreign persons, whether or not any portion is distributed. The new rules apply to dispositions occurring on or after January 1, 1985, and they are currently in effect. This article briefly describes the new rules and how they are likely to affect common transactions involving Canadians.

The Deficit Reduction Act of 1984 retroactively repealed the elaborate Foreign Investment in Real Property Tax Act ("FIRPTA") reporting requirements, replacing them with a set of broad withholding rules that became effective on January 1, 1985.[1] Detailed Temporary and Proposed Regulations ("the regulations") promulgated under section 1445 were not published until December 31, 1984; they became effective the next day. The regulations generally clarify certain of the statutory withholding rules, but depart in several important respects from the provisions of the statute. They also set forth various procedural rules, including time, notice, filing, and record-keeping requirements. The withholding rules do not eliminate the requirement that foreign persons disposing of a U.S. real property interest ("USRPI")[2] file a tax return for the year of disposition, even if their full tax has been withheld.

[1]Pub. L. no. 98-369, section 129, added section 1445 to the Internal Revenue Code, as amended ("IRC"), and retroactively repealed the reporting requirements under former section 6039C. (Unless otherwise indicated, all references to sections are to the IRC.) See generally Fred Feingold and Peter A. Glicklich, "Onerous FIRPTA Reporting Requirements Replaced by New Broad Withholdings Rules" (November 1984), 61 *Journal of Taxation* 298-305. Under new section 6039C, future regulations may require reporting of the ownership of certain direct investments in U.S. real property interests by non-U.S. persons who were not engaged in a trade or business in the United States during the year. The IRS is currently not exercising the authority granted under section 6039C to require information reporting and has withdrawn the proposed and temporary regulations promulgated under former section 6039C. For a discussion of the previous FIRPTA reporting rules, see Sanford H. Goldberg and Michael Hirschfeld, "Reporting Requirements for Foreign Investment in U.S. Realty" (January-February 1983), 31 *Canadian Tax Journal* 95-107.

[2]The term "USRPI" is defined broadly for this purpose to include not only directly held real property "interests" and personal property "associated with" real property but also "interests" in a U.S. corporation if, at any time during the applicable test period (generally the five-year period preceding the date of the disposition of the stock in question, or such shorter period during which the foreign person held the stock), one-half in value of the corporation's business and real property assets consisted of USRPIs. Although stock of a foreign corporation (other than an electing foreign corporation, described below) cannot be a USRPI for purposes of imposing U.S. tax on its transfer; the stock may be treated as a USRPI for purposes of determining whether another entity is a USRPI. At least for now, an interest in a partnership, trust, or estate is not usually considered a USRPI, but certain interests owned by persons with large holdings in a publicly traded partnership or trust and similar interests held by shareholders in publicly traded corporations also constitute USRPIs. See IRC section 897(c); Treas. Reg. section 1.897-1(c) (certain final regulations under section 897 were promulgated on December 31, 1984). Compare Fred Feingold, "FIRPTA—An Overview of the New Proposed Regulations" (January-February 1984), 32 *Canadian Tax Journal* 147-74; Fred Feingold and Herbert H. Alpert, "Observations on the Foreign Investment in Real Property Tax Act of 1980"

(Continued on following page.)

The new rules generally require any person who acquires a USRPI from a foreign person to "deduct and withhold" a tax in an amount equal to 10 per cent of the "amount realized" by the foreign transferor. In addition, certain entities and fiduciaries must withhold on amounts realized on the disposition of a USRPI that are attributable to foreign partners, beneficiaries, or shareholders; and corporations may be required to withhold on certain distributions. At present, no withholding is required in connection with transfers of interests in or distributions from partnerships, trusts, or estates regardless of whether such entities own USRPIs. It is expected, however, that the regulations will be modified in the future to require withholding in such cases.[3]

Foreign as well as U.S. persons are subject to these rules. Thus, for example, a Canadian individual purchasing a parcel of realty located in the United States for $1 million from another Canadian individual or a Canadian corporation must withhold $100,000 in the absence of an applicable exemption or other limitation.

If the required amount is not withheld and paid over, the transferee (usually the purchaser) becomes liable for the payment of the tax he has failed to withhold and for interest thereon, and he may be subject to certain civil and criminal penalties as well.[4] Payment of the tax due on the sale either by the seller or purchaser will, however, generally relieve the purchaser from the imposition of penalties for a failure to withhold the tax, but not from the imposition of interest.[5] Under general principles, the Internal Revenue Service ("IRS") may ultimately enforce its right to the tax, interest, and penalties by obtaining a lien on the real property if the liability is not paid within 10 days after a notice and demand is made therefor.[6]

Any person acquiring a USRPI from a *U.S.* person need not withhold under these rules. Since a transferee generally may rely on a certification of the transferor to the effect that the transferor is not a foreign person, U.S. transferors, partners, and trust beneficiaries may routinely be asked to certify that they are not foreign persons and therefore not subject to FIRPTA withholding.

In some instances, it may be inappropriate to require withholding at the 10 per cent statutory rate. In such cases, transferees of USRPIs and certain other potential taxpayers should be able to reduce the amount of tax otherwise required to be withheld by applying to the IRS for a "withholding certificate" (described below) at least 30 days before the transfer of a USRPI. If an application for a withholding certificate is not filed at least 30 days before the date of the transfer, the required amount must be paid to the IRS within 10 days after the date of the transfer,[7] and (new) Forms 8288 and 8288-A must be filed at the same time.[8] The IRS is required to stamp Form 8288-A and send it to the transferor or other taxpayer; the transferor must attach the Form 8288-A to any application to obtain an early refund or to his U.S. tax return to obtain a credit against his U.S. income tax. Under these and other procedures, many of the initially perceived problems with section 1445 should be avoidable in common transactions involving dispositions of USRPIs.

A brief summary of the more significant withholding rules is provided below, followed by a review of certain issues that may be of particular interest to Canadians. This article does not, however, attempt to deal with all the intricacies of the new rules.

---

[2]Continued . . .
(1981), 1 *Virginia Tax Review* 105-33. A foreign corporation and its shareholders that validly elect to have the corporation treated as if it were a U.S. corporation for purposes of the substantive FIRPTA rules and the related reporting provisions (an "electing foreign corporation") is treated by the statute as a *foreign* corporation for purposes of section 1445. Despite the statute and express language to that effect in the Conference Report accompanying section 1445, however, the regulations provide that an electing foreign corporation will be treated as a *domestic* corporation for purposes of the FIRPTA withholding rules as well as for purposes of the substantive and reporting rules of FIRPTA. See Temp. Reg. section 1.1445-7T. Compare section 897(i)(1); H.R. Rep. no. 98-861, 98th Cong., 2d Sess. 946-47 (1984). The reason given for departure from the literal terms of the statute is that it "is more consistent with the conferees' intent of simplifying the administration of section 1445." T.D. 8000 (December 31, 1984) (preamble to the regulations). For a discussion of the complexity created by treating an electing foreign corporation differently under sections 897 and 1445, see Feingold and Glicklich, supra footnote 1, at 300.

[3]The time for payment of the withheld funds may be suspended during the pendency of an application for a reduction or elimination of the amount required to be withheld, provided the application is made no later than 30 days before the transfer and is made in good faith. See infra footnote 8.

[4]See Temp. Reg. sections 1.1445-1T(e) and 1.1445-5T(b)(6).

[5]Section 1463. See also Rev. Rul. 58-577, 1958-2 CB 744, and the text discussion accompanying footnote 56 below.

[6]See section 6321. A notice and demand for payment must, of course, follow an assessment of the tax. Generally, before an assessment can be made, the IRS must provide the taxpayer with an opportunity to have a "day in court." This is accomplished through a statutory notice-of-deficiency procedure. See sections 6211-6215. Notwithstanding these general rules, the IRS may in certain cases accelerate an assessment if it is reasonable to conclude that delay will jeopardize assessment or collection. See section 6861.

[7]If these items are not sent by U.S. mail, they must be *received* by the IRS by the end of the tenth day after the date of the transfer. For a description of a permitted delay in reporting, see infra footnote 8.

[8]Although the IRS generally will respond to an application for a withholding certificate within 90 days, the regulations suspend the requirement that the transferee report and pay over withheld amounts to the IRS if, at least 30 days before the date of transfer, the transferee or transferor applies for a withholding certificate and the application was not made with "a principal purpose of delaying" the payment to the IRS. If a qualifying application is made, the required report and payment is due 10 days after the IRS's final determination. Under the section 1445(a) withholding rules (discussed below) only, a principal purpose of delay will be *presumed* if the *transferee* applies for a withholding certificate based on a determination of the transferor's maximum tax liability (explained below under the withholding certificate exemption) and if such liability is ultimately determined to be at least 90 per cent of the amount that otherwise would be required to be withheld. Compare the discussion in footnote 31 below.

GENERAL RULES

Persons and Transactions Generally Affected

In the absence of one of the applicable exemptions or limitations discussed below, a withholding obligation may arise under section 1445 in any of the following four situations:

1) a disposition of a USRPI by a foreign person in which an amount is realized by a foreign person;

2) a disposition of a USRPI by a domestic partnership, trust, or estate, that has any foreign partner or beneficiary;

3) a distribution of a USRPI by a foreign corporation to its shareholders; or

4) a distribution in liquidation or in redemption by a U.S. corporation or by an electing foreign corporation that is (or was, during the applicable measuring period) a so-called U.S. real property holding corporation.

Amount Required To Be Withheld Absent a Reduction or Exemption

Except as otherwise described below, the amount to be withheld is 10 per cent of the full amount realized by the transferor. The amount realized includes any liabilities assumed by the transferee or to which the property transferred is subject as well as the amount of cash and the value of any other property received by the transferor.[9] Accordingly, in the absence of an applicable limitation or exemption (which may require filing an application with the IRS), the withholding obligation applies to the total amount realized by the foreign person *regardless* of whether there are any proceeds from the disposition of the USRPI. Similarly, the gross purchase price of property sold on the instalment method is subject to immediate withholding, even where there are insufficient cash proceeds from which to withhold the required 10 per cent. The transferor or transferee may, however, in an appropriate circumstance apply to the IRS for a reduction in the amount required to be withheld (see below under the heading "Exemptions from Withholding" for a discussion of this and other exemptions). In addition, a limitation is provided in connection with certain foreclosures (but that limitation does *not* apply to transfers of a USRPI pursuant to a deed in lieu of foreclosure), and an exemption is provided in a limited class of nonrecognition transactions.[10]

[9]See H.R. Rep. no. 98-861, 98th Cong., 2d Sess. 942-43 (1984); *Crane v. Commissioner*, 331 U.S. 1 (1947). Apparently, the reasons for including the full amount realized in the general withholding computation under section 1445 relate to its simplicity. An analogous withholding problem might arise in the case of a net lease of real estate (see Rev. Rul. 73-522, 1973-2 CB 226), although a net lessor may obtain relief through a net election pursuant to sections 871(d) or 882(d) or an applicable treaty provision.

[10]The regulations set forth simple notification and filing procedures to be used in connection with certain nonrecognition provisions of the Code or a treaty. As discussed below in footnote 27, however, treaties rarely contain nonrecognition provisions.

Entity Withholding

Under section 1445(e), certain entities may be required to withhold even though they have not acquired a USRPI. Where an entity is required to withhold under section 1445(e), the transferee is not also required to withhold under section 1445(a); but where no withholding is required under section 1445(e) (for example, because one of the enumerated exemptions applies), withholding may still be required under the general rules of section 1445(a).[11]

Included in the category of entities required to withhold under section 1445(e) is a foreign corporation distributing a USRPI in a transaction in which gain is recognized.[12] Such a foreign corporation is required to "withhold" *its own tax at a rate of 28 per cent of the gain recognized on the distribution*.

In addition, any domestic (or electing foreign) corporation the shares of which qualify as a USRPI in the hands of a foreign person is obligated to withhold 10 per cent of the amount realized by any foreign shareholder in a liquidating or redemption transaction.[13]

Further, section 1445(e)(1) provides that a domestic partnership, trust, or estate must withhold 10 per cent of any amount *in its custody* that is attributable to the disposition (other than a distribution) by the entity of a USRPI

[11]Temp. Reg. section 1.1445-5T(b) provides that where both sets of rules apply and each requires at least some withholding, the rules under section 1445(e) take precedence over those under section 1445(a). *If an exemption applies under section 1445(e), however, withholding may still be required under the rules of section 1445(a)*. For example, if a U.S. corporation that is a U.S. real property holding corporation ("USRPHC") liquidates into a foreign corporation in a transaction qualifying for nonrecognition treatment under sections 332 and 336, the domestic corporation (as transferee of its own shares) or the foreign corporation (as transferor) would still have to apply for a withholding certificate from the IRS, since the foreign and U.S. corporations are related persons and cannot avail themselves of the nonrecognition exemption applicable to section 1445(a) withholding (described below). See infra footnote 29. The regulations further provide that where at least some tax is required to be withheld under the general withholding rules that apply to dividend distributions, under sections 1441 and 1442, no withholding is required under any of the provisions of section 1445. Although the heading of the regulation section implies that it is to deal with cases of double withholding, read literally, this provision would exempt from FIRPTA withholding a nonliquidating distribution of a USRPI by a foreign corporation where even $1 of the distribution was a dividend subject to section 1441 or 1442.

[12]Section 1445(e)(2) provides that withholding applies to the foreign corporation only if it is required to recognize gain as a result of section 897(d) or 897(e), but Temp. Reg. section 1.1445-5T(d) is not similarly limited. The regulations thus would expand the class of transactions (for example, where there is recapture in an otherwise tax-free liquidation or if gain is recognized as a result of section 311) in which withholding under section 1445(e)(2) is required.

[13]Section 1445(e)(3); Temp. Reg. section 1.1445-5T(e). The regulations provide that the amount withheld is to be 10 per cent of the *fair market value* of the property distributed to foreign shareholders (rather than of the amount realized by those shareholders). Treatment of a section 301(c)(3) distribution (that is, a nonliquidating, nondividend distribution in excess of the shareholder's tax basis in his stock, which is treated as gain from the sale or exchange of property under section 301) does not appear to be covered either by section 1445 or by the regulations.

and that is includible in the *distributive share* of a foreign partner or in the *income* of a foreign beneficiary of a domestic trust or estate. Contrary to the statute, however, the regulations provide that the partnership, trust, or estate must withhold 10 per cent of the full *amount realized* that is includible to each foreign person's income or distributive share.[14]

As noted above, in the case of a disposition of a USRPI by a U.S. trust or estate, the amount subject to withholding is the amount includible in the *income* of a beneficiary who is a foreign person. Although it appears possible to argue that the term "income" in the statute means gain (that is, the amount realized less the holder's tax basis) rather than the full amount realized, the regulations clearly state that the amount to be withheld is the appropriate share of the amount realized by the trust or estate equal to the foreign "beneficiary's share of the gain." That share of gain is the portion of the gain that the foreign beneficiary must include in his gross income under the rules relating to the income taxation of beneficiaries of trusts and estates.[15]

Potential problems may arise in connection with so-called complex trusts (that is, those not required to distribute all income currently). For example, if a domestic trust that disposes of a USRPI is not required to and does not distribute the gain currently, no amount is includible in the income of a beneficiary, and consequently no amount need be withheld by the trust. Furthermore, if the gain were long-term capital gain, a subsequent distribution of the gain would not be subject to withholding. To the extent that the gain were ordinary income, however, a later distribution would appear to be subject to withholding, but presumably only on the portion of the *initial* amount realized and in the same ratio as the ordinary income bears to the total gain realized; even though the beneficiary receives a credit that should cover the beneficiary's substantive tax liability, withholding under section 1445(e) seems to be required. Moreover, the trustee may not know at the time of the initial disposition of the USRPI whether the gain will be distributed currently or not, and this may pose timing problems under the withholding rule that ordinarily requires payment of the tax within 10 days after the date of the disposition.

A special rule is provided in the regulations for so-called large domestic partnerships or trusts (that is, those with *more than* 100 partners or beneficiaries). These entities may elect to withhold only on actual distributions to foreign partners or beneficiaries with respect to their share of *gains* realized by the partnership or trust on dispositions of USRPIs made *after* the date of the election.[16] Moreover, under this procedure, the amount required to be withheld is only 20 per cent of the gains in the case of noncorporate distributees and 28 per cent in the case of corporate distributees. Generally, this provision will be of use to large partnerships and simple trusts (if there are any with a sufficient number of beneficiaries). Complex trusts may also find the provision helpful, if only to deal with the timing problem noted above.

Without any apparent basis in the statute or legislative history, the regulations also subject real estate investment trusts ("REITs") to the distribution rules that a large partnership or trust may *elect* to apply.[17] This may result in a double tax on gains realized by REITs that are attributable to the REIT's foreign interest holders. It does not seem that such a double tax was intended, and regulations under section 897(h)(1) ought to address this potential problem.

In addition, under the statute, a partnership, trust, or estate (whether foreign or domestic) may be required to withhold 10 per cent of the *fair market value* of any USRPI distributed to a foreign person if the distribution would constitute a taxable distribution pursuant to (as yet unproposed) regulations to be promulgated under sections 897(e) and 897(g). The regulations provide, however, that this withholding obligation will be effective only after such regulations are promulgated.[18]

Similarly, although a person acquiring an interest in a partnership, trust, or estate may be required by future regulations to withhold, at least to the extent of USRPIs held by the entity, withholding obligations on these transactions will not arise until after the substantive regulations are promulgated.[19] For now, a person acquiring such an interest is *not* required to withhold under section 1445.

---

[14]Compare section 1445(e)(1) to Temp. Reg. section 1.1445-5T(c)(1). The reason given for the position taken in the regulations is that it is consistent with the intent of Congress. See the preamble to the regulations. See also Staff of the Joint Committee on Taxation, "General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984" (hereinafter "General Explanation"), at 411-12 (1984) (this source is *not* technically part of the legislative history of section 1445). A technical correction of section 1445 may be required to resolve this issue.

The amount withheld is to be credited against the tax liabilities of the partners or beneficiaries.

[15]See Temp. Reg. section 1.1445-5T(c)(1)(iii). Under the general IRC provisions, a trust or estate is generally subject to tax on its income for the year, but is entitled to deduct income that is either required to be or actually is distributed currently. Such income is includible by the beneficiary. The remaining income is taxable to the trust or estate and is not includible in the income of a beneficiary, at least until a later distribution. Upon such a distribution of ordinary income accumulated in a prior year by a U.S. trust, a beneficiary generally must include the distribution in his income, but is given an appropriate credit reflecting tax already paid. In contrast, accumulation distributions of *long-term capital gain* by a U.S. trust and any accumulation distribution by an estate is *not* includible in the income of the recipient-beneficiary.

[16]Temp. Reg. section 1.1445-5T(c)(3)(iii). Note the potential timing problem where an election is not made at least one day prior to a disposition that is intended to be covered. The election is made by filing a notice with the IRS and can be revoked in a similar fashion. Query the effect on the credit mechanism of changes in the interests of partners and beneficiaries before and/or after an election is made. Also query the effect of this and the other rules of section 1445(e) on the U.S. shareholders, partners, and beneficiaries.

[17]Temp. Reg. section 1.1445-5T(c)(4).

[18]See the preamble to the regulations; Temp. Reg. sections 1.1445-5T(a), 1.1445-5T(b)(8)(iv), and 1.1445-5T(c)(2)(i). A technical correction to section 1445 may be required to coordinate the rules under sections 897(e)(2)(B)(ii) and 897(g) for purposes of withholding. See General Explanation, supra footnote 14, at 413, note 29.

[19]Temp. Reg. sections 1.1445-5T(a), 1.1445-5T(b)(8)(v), and 1.1445-5T(c)(2)(i).

Obligations of Agents

In certain cases, described in section 1445(d), a transferor's or transferee's agent also must withhold. For this purpose, the statute defines a transferor's or transferee's agent to include any person who represents the transferor or transferee in any negotiation related to the transaction or in settling the transaction. A person who merely receives or disburses funds in connection with the transaction, records any document relating thereto, or performs only clerical tasks, however, is excluded from the agent category. The regulations[20] expand the class of persons covered by providing that a transferor's agent includes any person who represents or advises an entity or fiduciary with respect to the planning, arrangement, or consummation of a transaction described in sections 1445(e)(1), (2), (3), or (4). As so defined, a tax practitioner who gives advice in connection with a sale of a USRPI by a U.S. partnership, trust, or estate, a distribution of a USRPI by a foreign corporation, or a nondividend distribution by a U.S. corporation clearly would be included in the class of agents. The regulations also expand the class of persons covered by providing that a transferee's agent includes any person who represents the holder of an interest in an entity involved in such a transaction.

For an agent to have any liability, however, the agent (1) must have been required to provide the transferee, or an entity or fiduciary, as well as the IRS, with notice that reliance either on a certificate of nonforeign status (explained below) or on a non-USRPI statement (explained below) would be misplaced, and (2) must not have given such notice. A transferor's or transferee's agent ordinarily is required to provide notice only if he has actual knowledge that the certificate or statement is false; but where the agent represents a foreign *corporate* transferor, the agent is deemed to have knowledge of the falsity of any certificate of nonforeign status of the corporation. In the event that the agent fails to provide the required notice, he will be liable as a withholding agent, but *in any event his liability cannot exceed the compensation he derived from the transaction.*

Exemptions from Withholding

The regulations provide two sets of exemptions to the withholding obligations set forth in section 1445: one set pertains to section 1445(a) withholding obligations and the other pertains to section 1445(e) withholding obligations.[21]

Exemptions to Section 1445(a) Withholding

The exemptions to section 1445(a) withholding are as follows:

1) No withholding is required if the transferor provides the transferee with a certification to the effect that the transferor is not a foreign person (a "certificate of nonforeign status").[22] The certificate must include the transferor's taxpayer identification number and must be signed by the transferor under penalties of perjury. The transferee must retain the certificate until the end of the fifth year following the year of the transfer. (See the discussion of an exception to this exemption in point (2) below.)

2) No withholding is required if a transferee receives an interest in a domestic corporation and a statement from the corporation, dated not more than 30 days before the date of the transfer, certifying that the interest is not then, and during the applicable five-year period (or such shorter period during which the transferor held the interest) was not, a USRPI (a "non-USRPI statement").[23]

A transferee will not be excused from withholding under this or the prior exemption if he has *actual knowledge* that the statements referred to above are false *or* if he has received a *notice* to that effect from the transferor's agent or his own agent. Where a transferee receives a notice *after* the date of the transfer that a certificate of nonforeign status was false, the transferee must attempt to withhold 10 per cent of the full amount realized by the transferor out of any subsequent payments made under the contract.[24]

3) No withholding is required upon the acquisition of an interest in a domestic corporation if any class of stock of the corporation is regularly traded on an established securities market.[25]

---

[20] Temp. Reg. section 1.1445-4T(f).

[21] As enacted, section 1445 did not clearly provide exemptions to withholding obligations arising under section 1445(e). See also supra footnote 11.

[22] Temp. Reg. section 1.1445-2T(b)(2). Compare section 1445(b)(2) (referring to a "nonforeign affidavit"). The preamble to the regulations states that the term "certification" is used in the regulations to remove any implication that the statement must be notarized. An electing foreign corporation can certify that it is not a foreign person for this purpose, but it must attach to its certificate a copy of the IRS acknowledgment of the election. See Temp. Reg. sections 1.1445-2T(b)(2)(ii) and 1.1445-7T(b)(1).

[23] Temp. Reg. section 1.1445-2T(c); Treas. Reg. section 1.897-2(h). A corporation may not provide such a statement based on its determination that the interest is "solely as a creditor." The regulations do not expressly provide that an electing foreign corporation may provide a non-USRPI statement. But compare Temp. Reg. section 1.1445-7T(b)(2). See also section 897(c)(1)(B), Treas. Reg. section 1.897-1(c)(2)(ii), and Temp. Reg. section 1.1445-5T(e)(2)(i) (corporation that has disposed of all of its USRPIs in taxable transactions is not a USRPHC).

[24] A transferee receiving a belated notice may not obtain a withholding certificate to reduce the amount to be withheld; Temp. Reg. section 1.1445-2T(b)(4)(iv). Furthermore, in the event regulations are promulgated in the future to require a transferee to furnish a copy of such certificate or statement to the IRS and the transferee fails to do so, the exemption described here and in point (1) above will not apply; section 1445(b)(7)(B).

[25] Temp. Reg. section 1.1445-2T(c)(2). The "publicly traded" exemption does not, however, apply to certain acquisitions of large nonpublicly traded interests in such an entity. See Temp. Reg. sections 1.1445-2T(c)(2) and 1.1445-5T(b)(4)(ii); Treas. Reg. section 1.897-1(c)(2)(iii)(B). Generally, stock of a class in a corporation that is regularly traded on an established securities market is a USRPI only in the hands of a 5-per-cent-or-greater shareholder. See section 897(c)(3); Treas. Reg. section 1.897-1(c)(iii). See also Treas. Reg. section 1.897-1(c)(iv) (establishing a similar rule for large interests in certain publicly traded partnerships and trusts). The term USRPI currently does not otherwise include interests in partnerships or trusts, although future regulations may effectively provide otherwise; sections 897(e)(2)(B)(ii) and (g). Temp. Reg. sections 1.1445-2T(c)(2) and 1.1445-5T(b)(4)(ii) appear to exempt from withholding the acquisition of all but a large nonpublicly traded interest in a "publicly traded partnership or trust."

4) No withholding is required if the property is acquired by an individual for use by him as his residence, and the amount realized by the transferor in the transaction does not exceed $300,000. This exception applies whether or not the transferor used the property as his residence. Although the statute rather clearly did not include any requirement that the residence qualify as the transferee's principal residence, the regulations provide that the transferee will be held liable for a failure to withhold if the transferor does not pay the full tax due on any gain recognized on the transfer and the transferee (including members of his family) did not in fact reside at the property during 50 per cent or more of the number of days the property is in use during the 24 months after the date of the transfer.[26]

5) No withholding is required if the transferor certifies in a statement to the transferee that he is not required to recognize *any* gain or loss with respect to the transfer because of the application of a nonrecognition provision of the Code or a treaty provision,[27] and if the transferee provides the IRS with a copy of the statement within 10 days after the transfer. In addition, until regulations become effective under sections 897(d) and 897(e), those nonrecognition-limiting provisions will not be applied for this purpose.[28] Given its limitations (described below), this exemption will not apply in many common transactions. The regulations provide that this exemption will not be available if (a) the transferor qualifies for nonrecognition treatment with respect to only a *portion* of the gain realized by the transferor (for example, in a so-called like-kind exchange with "boot"), (b) the transferee knows or has reason to know that the transferor is not entitled to the nonrecognition treatment claimed, or (c) the transferor and transferee are "related persons" within the meaning of the regulations issued under section 897.[29]

6) No withholding is required where a USRPI is acquired by the United States, a state or possession of the United States, a political subdivision thereof, or the District of Columbia.[30] This exemption does not apply to foreign governmental transferees or to governmental agencies.

7) Where a transferee acquires a USRPI pursuant to a repossession or foreclosure and the transferee provides notice thereof to the IRS within 10 days after the acquisition, the amount of withholding is limited to the lesser of 10 per cent of the amount realized or the excess of the amount realized by the debtor-transferor over the debts secured by the property at the time of the foreclosure. This exemption does not, however, apply to transfers pursuant to the issuance of a deed in lieu of foreclosure or where a principal purpose of the transfer was avoiding the FIRPTA withholding requirements.[31]

8) No withholding is required, or a reduced amount may be withheld, if the transferee receives a "withholding certificate" from the IRS to that effect. Under the regulations, the IRS will issue a withholding certificate to the transferor or transferee in any of four circumstances: (a) where reduced withholding is shown to be appropriate (for example, based on a showing that the "transferor's maximum tax liability" [described below] is less than the amount otherwise required to be withheld); (b) where the transferor is exempt from U.S. taxation (either as a foreign-government-related enterprise or under a treaty[32]); (c) where the transferor or transferee agrees with the IRS to pay the tax and provides adequate security therefor[33]; or (d) where the IRS determines that permitting the transferee to withhold a reduced amount will not jeopardize the collection of tax.[34]

The "transferor's maximum tax liability" is the amount the transferor may be subject to pay under the Code as a result of the transfer in question plus the "transferor's unsatisfied withholding liability." The "transferor's

26Compare Temp. Reg. section 1.1445-2T(d)(1) with section 1445(b)(5). The regulations provide an exception to the use requirement where there has been an unanticipated change in circumstances after the transfer.

27Treaties often provide an *exemption* from tax; they rarely include a *nonrecognition provision*. For an example of that exceptional situation, see Canada-U.S. treaty, Article XIII(8).

28Temp. Reg. section 1.1445-2T(d)(2)(iv). Compare Temp. Reg. section 1.1445-5T(b)(2)(iii) (under the entity exemptions, the nonrecognition rule applies without regard to section 897(e) for now; however, section 897(d) is considered).

29Temp. Reg. section 1.1445-2T(d)(2)(ii). See Treas. Reg. section 1.897-1(i) for the applicable definition of related persons for this purpose. No similar exception applies to the similar nonrecognition exemption from the entity withholding rules of section 1445(e). See Temp. Reg. section 1.1445-5T(b)(2). Because of the related party exception, this exemption will not be available with respect to many such common transactions by foreign persons as the contribution of a USRPI to, or a nondividend distribution from, a corporation in exchange for stock, or contributions of a USRPI to, or a distribution from, a partnership in exchange for an interest therein. Query the effect of a contribution of a USRPI by a foreign shareholder to the capital of a corporation without receipt of stock in exchange; since there may be no amount realized, withholding may not be required at all, and it may be argued that the corporation need not rely on this particular exemption.

30Temp. Reg. sections 1.1445-2T(d)(5) and 1.1445-2T(d)(6)(ii).

31Temp. Reg. section 1.1445-2T(d)(3). Temp. Reg. section 1.1445-2T(d)(3)(iv) states that such a principal purpose will be *presumed* if the creditor's security interest in the property did not arise in connection with the debtor's acquisition, improvement, or maintenance of the property, and if the total amount of all debts secured by the property exceeds 90 per cent of the fair market value of the property. Compare the discussion in supra footnote 8. There is no similar exemption to section 1445(e) withholding on foreclosures or repossessions of USRPIs held by U.S. partnerships, trusts, or estates with foreign partners or beneficiaries.

32Temp. Reg. section 1.1445-3T(d)(2)(ii) states that the treaty exemption applies "subject to the [effective date] limitations" imposed by FIRPTA. In the case of the new (1980) Canada-U.S. treaty (discussed below), certain transitional provisions of the treaty are technically subject to this limitation, but it is understood that the treaty nevertheless may override FIRPTA, and presumably this regulatory restriction as well, for a limited time.

33Temp. Reg. section 1.1445-3T(e). The amount secured must be either 10 per cent of the amount realized by the transferor plus interest or the transferor's maximum tax liability plus 25 per cent of that amount. The regulations set forth detailed rules relating to the type of security that may be provided.

34Contrary to section 1445(c)(2), Temp. Reg. section 1.1445-3T(c)(4) implies that only the *transferor* may make an application on this basis. Section 1445(c)(2) provides that the tax referred to here is that imposed under section 871(b)(1) or 882(a)(1). No similar exemption exists under the section 1445(e) withholding rules.

unsatisfied withholding liability" is the amount of any tax the current transferor was required to (but did not) withhold and pay over under section 1445 upon the acquisition of the subject USRPI or a "predecessor interest." A "predecessor interest" is defined as an interest that was exchanged for the subject USRPI in a transaction in which the transferor was not required to recognize the full amount of the gain or loss realized upon the transfer.[35]

The regulations state that a withholding certificate obtained *prior* to a transfer notifies the transferee that a reduced amount, or no amount, may be withheld, and that a withholding certificate obtained *after* the transfer may permit the transferor to obtain a "quick refund," under the procedures set forth in the regulations, or an ordinary refund. The regulations do not clearly state whether an application for a withholding certificate will be granted if, for example, there has been a failure to withhold under circumstances in which an exemption to section 1445 withholding would have been available if certain procedural requirements had been met, but the regulations suggest that the IRS will consider such an application.[36]

The IRS generally will act on an application for a withholding certificate within 90 days after its receipt, although, as noted above, an application filed at least 30 days before the date of transfer suspends the time for filing and paying over the amount to be withheld until 10 days after the IRS's "final determination," unless the application was filed for a principal purpose of delaying payment to the IRS.[37] Where the IRS projects that it will be unable to provide a "final withholding certificate" within 90 days, the regulations provide that the IRS will notify the applicant within 45 days after submission of the application and will provide a target date for final action.

Exemptions from Withholding Otherwise Required by Entities

The exemptions from withholding otherwise required by entities are as follows. (Remember, however, that even if a transaction is exempt from withholding under one of these exemptions, withholding may nevertheless be required under the rules of section 1445(a).)

1) No withholding is required by a domestic corporation in connection with a liquidating or redemption distribution to a shareholder, or by a domestic partnership, trust, or estate on dispositions of USRPIs attributable to a foreign partner or beneficiary, *if* the shareholder, partner, or beneficiary provides the entity or fiduciary with a certificate of nonforeign status.[38] (See the discussion of an exception to this exemption in point (2) below.)

2) No withholding is required if a domestic partnership, trust, or estate disposes of an interest in a domestic corporation, or a foreign corporation distributes to shareholders an interest in a domestic corporation, *if* the entity or fiduciary receives a non-USRPI statement from the domestic corporation dated not more than 30 days before the date of the transfer.[39]

An entity or fiduciary will not be excused from withholding under this or the prior exemption if he has *actual knowledge* that the statements referred to above are false or he receives a notice to that effect from an agent of the transferor or transferee. Where a partnership or fiduciary learns *after* the transfer that an interest holder's certificate of nonforeign status or non-USRPI statement was false, it must pay over to the IRS the otherwise required amount (but only to the extent of the foreign partner's or beneficiary's remaining interest) within the next 10 days. Where a *domestic* corporation learns that a shareholder's certificate of nonforeign status was false *after* making a liquidation or redemption distribution to the shareholder, the corporation may rely on this statement only if the person providing the statement is or was less than a 10 per cent shareholder[40]; otherwise, the corporation must pay the required amount to the IRS within the next 60 days. Where a *foreign* corporation learns *after* the distribution of an interest in a domestic corporation that a non-USRPI statement was false, the corporation must in all cases pay to the IRS within the next 60 days the full amount otherwise required to be withheld.[41]

3) No withholding is required if the entity or fiduciary notifies the IRS within 10 days after a transfer that *no* gain or loss is required to be recognized by a foreign person by reason of a nonrecognition provision of the Code or a treaty provision.[42] Until regulations are promulgated under section 897(e), that provision will not be considered in determining nonrecognition treatment for this purpose, although section 897(d) will be con-

[35]Note that the transferor's unsatisfied withholding liability is not considered in determining the transferor's maximum tax liability if payment of any prior withholding liability is made along with the application for a withholding certificate or an agreement is entered into with the IRS for payment of that liability and sufficient security is provided therefor; Temp. Reg. section 1.1445-3T(c)(3)(i).

[36]Compare Temp. Reg. section 1.1445-2T(b)(4)(iv) with H.R. Rep. no. 98-861, 98th Cong., 2d Sess. 943 (1984).

[37]Temp. Reg. sections 1.1445-3T(a) and 1.1445-1T(c)(2) (the regulations provide that interest and penalties are payable in the event the "principal purpose" exists). See also supra footnote 8.

[38]Temp. Reg. section 1.1445-5T(b)(3). See also supra footnote 22. The regulations provide transitional rules that permit a partnership or trust-fiduciary that has more than 100 partners or beneficiaries to presume (in the absence of actual knowledge to the contrary) that a partner or beneficiary who has a mailing address in the United States is *not* a foreign person. Publicly traded partnerships or trusts may also temporarily presume that each interest holder of record is the beneficial owner of that interest. See also the description of the special rule for large partnerships to withhold only on distributions to partners, under Temp. Reg. section 1.1445-5T(c)(3)(iii), in the text discussion accompanying supra footnote 16.

[39]Temp. Reg. section 1.1445-5T(b)(4). See also supra footnote 23.

[40]Temp. Reg. section 1.1445-5T(e)(2)(iii)(B). Share ownership is determined based on the *value* of the outstanding stock of the corporation. (Outstanding when?)

[41]Temp. Reg. section 1.1445-5T(d)(2)(i)(B).

[42]Temp. Reg. section 1.1445-5T(b)(2). Query why there is not a similar rule where all the relevant foreign persons realize losses as a result of the transaction (for example, in a liquidation of a domestic corporation holding USRPIs). But consider the exemption relating to withholding certificates, discussed below.

sidered. This exemption is not available if nonrecognition treatment is accorded with respect to only *part of* the gain realized on the transfer, but the exemption may apply to transactions between related parties.[43]

4) No withholding is required by a partnership, trust, or estate on a transfer of an interest in a domestic corporation, or by a foreign corporation on a distribution of an interest in a domestic corporation, *if* any class of stock of the domestic corporation is regularly traded on an established securities market.[44]

5) No withholding is required, or the amount to be withheld may be reduced, if an entity, fiduciary, or "relevant taxpayer" applies for and obtains a withholding certificate from the IRS. A "relevant taxpayer" is defined for this purpose as any foreign person that will bear substantive income tax liability as a result of the substantive FIRPTA provisions with respect to a transaction as to which withholding is required under section 1445(e). A withholding certificate applied for by an entity or fiduciary may relate to all or less than all of the relevant taxpayers. Other rules, similar to those described above in connection with an application for a withholding certificate by a transferor or transferee, apply for this purpose.[45]

Other Aspects

Credit for Tax Withheld

Under sections 33 and 1462, any amount of tax withheld under section 1445 is creditable against the tax liability of the transferor or of a relevant taxpayer. Form 8288-A, which the IRS is directed to stamp, is to be sent by the IRS to the foreign interestholder, presumably for use in obtaining a tax credit or refund of amounts withheld under the section 1445(e)(1) rules.[46] The regulations also provide that if two or more foreign persons jointly transfer a USRPI, each is to be credited with the portion of the amount withheld that the transferors agree upon, but they do not provide what is to occur if the joint transferees cannot agree.[47]

Refunds

If the amount withheld in connection with the disposition of a USRPI exceeds the tax liability of the transferor or other relevant taxpayer, the taxpayer may file for a refund under the normal procedure for income tax refunds or pursuant to the new "quick refund" procedure set forth in the regulations. Quick refund applications are to be processed within 90 days and can be filed before the date prescribed for filing the tax return for the year of the transfer.[48]

[43]Compare the rule in the text discussion accompanying footnote 29.

[44]Temp. Reg. section 1.1445-5T(b)(4)(ii). See supra footnote 25.

[45]See supra footnotes 32 to 34 and the accompanying text discussion.

[46]Temp. Reg. sections 1.1445-1T(c)(1), 1.1445-1T(f), 1.1445-5T(b)(5), and 1.1445-5T(b)(7).

[47]See Temp. Reg. section 1.1445-1T(f).

[48]See section 1445(c)(1)(C); Temp. Reg. sections 1.1445-3T(f) and 1.1445-6T(f).

Section 6405(a) of the Code provides that no refund or credit of any income tax in excess of $200,000 shall be made before 30 days following the date on which a report, outlining the amount and circumstances of the refund or credit, is submitted to the Joint Committee on Taxation of Congress. The regulations promulgated under the Code provide that Joint Committee review is not required in connection with refunds of overpayments of certain timely paid taxes, and the IRS has ruled that no review is required in connection with amounts overwithheld from nonresident aliens and foreign corporations under the general foreign withholding provisions of the Code.[49] The IRS may therefore conclude that no such review is required for refunds of taxes timely paid under section 1445.

Statutes of Limitations

No special period of limitations is expressly provided in connection with the obligation to withhold under section 1445. The regulations do specify, however, that a certificate of nonforeign status is to be retained by a transferee until the end of the fifth taxable year following the taxable year in which the transfer takes place.[50] Similarly, the regulations provide that under the entity-withholding rules corresponding to section 1445(e), an entity may rely on a certificate of nonforeign status from an interest holder for two calendar years following the close of the calendar year in which the certification was given, and must retain the certificate for three calendar years after the last calendar year in which the entity relied on the certificate.[51]

In contrast, a tax may be assessed under the Code at any time within three years after the appropriate return is filed.[52] A six-year limitations period applies if the taxpayer omits from "gross income" an amount in excess of 25 per cent of the gross income stated in the return, and no limitations period applies if no tax return is filed or in the event of fraud.[53] (Note also that the time for *collection* of a tax after an assessment is made, which is normally six years after an assessment, is *suspended* for any period of at least six continuous months during which the taxpayer is outside the United States.[54])

Limitation on Liability of Withholding Agents

Under section 1463 of the Code and the regulations promulgated thereunder, if the tax required to be withheld is paid by either the recipient of the income (for example, a transferor of a USRPI) or the person required to withhold the tax, it will not be recollected from the other person; and if the tax is so paid, in the absence of fraud, neither the recipient nor the with-

[49]See Rev. Rul. 68-205, 1968-1 CB 556.

[50]Temp. Reg. section 1.1445-2T(b)(3).

[51]Temp. Reg. section 1.1445-5T(b)(3)(ii)(B).

[52]Section 6501(a).

[53]Sections 6501(c)(1) to 6501(c)(3) and 6501(e)(1).

[54]Sections 6502(a) and 6503(c).

holding agent will be subject to penalties for failure to return or pay the tax. Interest may be assessed, however.

Obligation to File Income Tax Return

As noted above, even if a foreign transferor's total U.S. income tax liability arising from the disposition of a USRPI is satisfied by withholding, the transferor must file a U.S. federal income tax return reflecting the disposition.

Interest

The regulations state that where an application for a withholding certificate is filed with a principal purpose of delaying payment of the tax, interest and penalties may be levied on the person required to withhold under section 1445 with respect to the period between the date the payment is due and the date payment is made or collected.[55] The IRS has ruled in an analogous situation, however, that interest runs against the withholding agent only until the *earlier* of the date the recipient of the income pays the tax or the date the recipient of the income is required to file his income tax return.[56] It appears that a similar rule should apply here as well.

ASPECTS OF WITHHOLDING RULES OF PARTICULAR INTEREST TO CANADIANS

Canadian Transferors

In the absence of an applicable treaty or other exemption, the transferee of a USRPI from a Canadian transferor is required to withhold and pay over to the IRS the amount of tax prescribed by section 1445. The Canadian transferor obtains a credit for amounts paid over but must still file a U.S. income tax return for the year of the disposition. It is important to note that, unlike the general withholding rules of sections 1441 and 1442, the FIRPTA withholding rules provide no exemption per se to withholding for Canadian or other foreign transferors who are otherwise engaged in trade or business in the United States, whether or not through a U.S. permanent establishment. It should be possible, however, for Canadian individuals or corporations with substantial assets in the United States to apply in a timely manner for a withholding certificate to permit their transferees of USRPIs to reduce or eliminate the amount they otherwise must withhold. The application may offer adequate security or request a determination that failure to withhold will not jeopardize collection of U.S. taxes.

The FIRPTA withholding rules require withholding only on dispositions of USRPIs by *foreign* persons. Accordingly, an individual Canadian transferor may determine under the new resident alien rules in section 7701(b),[57]

[55]See, for example, Temp. Reg. sections 1.1445-1T(c)(2)(iii) and 1.1445-5T(b)(5)(ii)(C).

[56]See Rev. Rul. 58-577, 1958-2 CB 744 (dealing with domestic wage and salary withholding).

[57]See Sidney I. Roberts and Marlene F. Schwartz, "New Statutory Definition of Resident Alien" (September-October 1984), 32 *Canadian Tax Journal* 969-82, for a discussion of the new U.S. resident alien rules.

or perhaps the "tie-breaker" residency rules in Article IV of the new Canada-U.S. treaty, that he would not be considered a foreign person for purposes of the withholding rules. In that case, the transferor should be able to provide a certificate of nonforeign status to the transferee to eliminate the transferee's withholding obligation under section 1445. Given the new quasi-objective residency rules of section 7701(b), for example, it may be possible for an individual Canadian transferor to plan his transactions so that at the time of closing, he can certify that he is not a foreign person.[58]

The transitional rules in the new Canada-U.S. treaty relating to the effective dates of Articles VI and XIII and the "fresh start" rules of Article XIII(9) may also be of particular interest to Canadian transferors.

Pursuant to Article VIII of the former (1942) tax treaty, a Canadian investor was exempt from U.S. taxation on gains derived from the sale or exchange of capital assets in the United States, including gains realized from the disposition of USRPIs, as long as the investor did not have a U.S. permanent establishment. In contrast, Articles VI and XIII of the new treaty, which entered into force on August 16, 1984,[59] do *not* exempt Canadian investors from U.S. tax on gain derived from the alienation of USRPIs. Moreover, FIRPTA generally provides for the taxation of gains realized by nonresident aliens and foreign corporations on dispositions of USRPIs after December 31, 1984, overriding contrary treaty exemptions. Article XXX(5) of the new Canada-U.S. treaty, however, provides that

> [w]here any greater relief from tax would have been afforded by any provision of the 1942 Convention than under this Convention, any such provision shall continue to have effect for the first taxable year with respect to which the provisions of this Convention have effect. . . .

Although this treaty does not qualify for the transitional relief expressly provided for in FIRPTA, the United States has acknowledged that the treaty's effective date rules will apply to exempt gain realized in transactions that would have qualified for an exemption under Article VIII of the prior treaty until at least January 1, 1986 and perhaps until December 1, 1986, depending on the taxable year of the investor.[60]

Under the FIRPTA withholding rules, application of this treaty exemption will require the transferor, transferee, entity, fiduciary, or relevant taxpayer

[58]This may be somewhat problematical if at the time of the disposition the individual has not been present in the United States for a sufficient period to have become a resident, even though by the end of the year he will have been. Query whether a transferor could use the Code's resident alien rules to avoid withholding and FIRPTA liability and invoke the treaty tie-breaker rules to avoid liability under the general Code and/or substantive FIRPTA rules. Compare Peter A. Glicklich, "When Can a Nonresident or Foreign Corporation 'Pick and Choose' or 'Mix and Match' Different Treaty and Code Rules to Minimize U.S. Taxes?" (May-June 1984), 32 *Canadian Tax Journal* 611-16.

[59]See generally Nathan Boidman, "The New Canada-U.S. Income Tax Convention—The Effective Date Rules" (October 1984), 13 *Tax Management International Journal* 346-51.

[60]See S. Exec. Rep. no. 98-22, 98th Cong., 2d Sess. 10, 49 (1984); Joint Committee on Taxation, "Explanation of Proposed Income Tax Treaty (and Proposed Protocols) Between the United States and Canada" (April 25, 1984), at 7, 57.

to apply to the IRS for a withholding certificate (for example, following the procedure necessary to prove a zero or reduced transferor's maximum tax liability).

Similarly, under the fresh start rules of Article XIII(9) of the new treaty, a Canadian investor may not be subject to tax by the United States on any appreciation in a USRPI reflected in its value as of December 31, 1984 where the investor owned the USRPI since September 26, 1980 or where the investor acquired the USRPI in certain nonrecognition transactions. As in case of the Article XXX(5)-based exemption, a transferor, transferee, entity, fiduciary, or relevant taxpayer must apply to the IRS for a withholding certificate that permits withholding of a lesser amount than that otherwise required under section 1445.

Canadian Transferees

Canadian transferees, like all other transferees, are subject to the new FIRPTA withholding rules. As noted above, the regulations make it clear that if the appropriate procedures are followed, and if the IRS acts in a timely and reasonable fashion, no transferee needs to bear the burden of the FIRPTA withholding tax. Once fully informed, however, Canadian transferees can and should routinely act to minimize their liability under the FIRPTA withholding rules. For example, by adapting contracts to meet the requirements of these rules (for instance, to require at closing a certificate of nonforeign status from a U.S. resident who is selling a USRPI), a Canadian buyer can protect himself from unnecessary exposure to the FIRPTA withholding tax.

Other Canadians

Canadian partners or beneficiaries of a U.S. partnership, trust, or estate should also be aware of how the FIRPTA withholding rules work. If the partnership, trust, or estate, for example, is not otherwise well advised, it may fail to file timely for a withholding certificate or to recommend that its foreign interest holders do so.

CONCLUSION

No Canadian transacting business involving USRPIs can afford to ignore the FIRPTA withholding rules, which are already in effect. Assuming that the IRS acts in a timely and reasonable manner in response to what can be expected to be a large volume of applications for withholding certificates, however, perhaps the only significant burdens imposed by the new rules will be the familiarization process and related expenses. Yet problems in interpretation and administration are likely to arise under the new rules. It is to be hoped that the problems will be solved, the adjustment period will be short, and the withholding process will be relatively painless.

ADVISABILITY OF CONTEMPORANEOUS APPRAISALS

Jay I. Gordon

Delay in obtaining a valuation date appraisal could hinder a Canadian resident's ability to obtain certain benefits of the Canada-U.S. tax treaty pertaining to real property interests.

Under the 1942 convention between Canada and the United States, capital gains realized by a Canadian resident were exempt from tax in the United States provided the resident did not have a permanent establishment in the United States. However, the treaty recently negotiated between Canada and the United States, which entered into force on August 16, 1984, permits the United States to impose a tax on such gain for tax years beginning on or after January 1, 1985.[1] For this purpose, sales of U.S. real property may include sales of stock in a corporation holding U.S. real property interests ("USPRIS") or sales or other dispositions of an interest in a partnership, trust, or estate to the extent that any gain realized is attributable to USRPIS.[2]

In recognition of this change, the treaty contains a transitional rule that has the effect of exempting from tax any gain realized that is deemed at tributable to the period prior to December 21, 1984.[3] This transitional rule generally[4] will apply if the asset disposed of was owned by a Canadian resident on and after September 26, 1980, or if the asset disposed of was acquired by the Canadian resident from another Canadian resident who owned the asset on September 26, 1980 in a transaction qualifying as a nonrecognition transaction (for example, a like-kind exchange or reorganization) for purposes of U.S. taxation.[5] If the transitional rule is applicable, the taxable gain realized by a Canadian resident will be reduced by the portion of the gain attributable *on a monthly basis* to the period the property was held prior to December 31, 1984.[6] For example, if the resident acquired the prop-

[1]Canada-U.S. tax treaty, Articles XIII and XXX. Article XXX(5) of the treaty, however, provides a transitional rule to the effect that if any greater relief from U.S. tax would have been afforded by the provisions of the 1942 convention rather than the provisions of the new treaty (as will generally be the case with respect to the matter under discussion), then the provisions of the 1942 convention will continue to apply for the first taxable year during which the provisions of the new treaty are applicable. Hence the change in the treaty rules generally will become applicable to sales of USRPIs by Canadian residents beginning on January 1, 1986 if the resident uses a calendar tax year, or beginning on the day after the close of the fiscal year that began subsequent to January 1, 1985.

[2]Canada-U.S. treaty, Articles XIII(3)(a) and VI(2); U.S. Internal Revenue Code of 1954 ("IRC"), section 897(c).

[3]Canada-U.S. treaty, Article XIII(9).

[4]The transitional rule will not apply if the property formed part of the business property of a permanent establishment on September 26, 1980 or if it was owned by a non-Canadian resident after September 26, 1980; Canada-U.S. treaty, Articles XIII(9)(c) and (d).

[5]Canada-U.S. treaty, Articles XIII(9)(a) and (b).

[6]Ibid.