



TAX SECTION

2013-2015 Executive Committee

DAVID H. SCHNABEL

Chair
Debevoise & Plimpton LLP
919 Third Avenue
New York, NY 10022-3904
212/909-6336

DAVID R. SICULAR

First Vice-Chair
212/373-3082

STEPHEN B. LAND

Second Vice-Chair
212/692-5991

MICHAEL S. FARBER

Secretary
212/450-4704

COMMITTEE CHAIRS:

Bankruptcy and Operating Losses

Stuart J. Goldring
Linda Z. Swartz

Compliance, Practice & Procedure

Elliot Pisem
Bryan C. Skarlatos

Complexity and Administrability

Edward E. Gonzalez
Joel Scharfstein

Consolidated Returns

Andrew H. Braiterman
Kathleen L. Ferrell

Corporations

Lawrence M. Garrett
Vadim Mahmoudov

Cross-Border Capital Markets

S. Douglas Borisky
Andrew Walker

Cross-Border M&A

Ansgar A. Simon
Yaron Z. Reich

Employee Benefits

Eric Hilfers
Andrew L. Oringer

Estates and Trusts

Alan S. Halperin
Laura M. Twomey

Financial Instruments

William L. McRae

"Inbound" U.S. Activities of Foreign

Taxpayers

Lee Allison
Peter J. Connors

Individuals

Sherry S. Kraus
Joseph Septimus

Investment Funds

Marcy G. Geller
Amanda Nussbaum

New York City Taxes

Maria T. Jones
Irwin M. Slomka

New York State Taxes

Paul R. Comeau
Arthur R. Rosen

"Outbound" Foreign Activities of

U.S. Taxpayers

Peter F.G. Schuur
Philip Wagman

Partnerships

John T. Lutz
Eric Sloan

Pass-Through Entities

James R. Brown
Matthew Lay

Real Property

Robert Cassanos
Elizabeth T. Kessenides

Reorganizations

Joshua Holmes
Eric Solomon

Securitizations and Structured

Finance

Jiyeon Lee-Lim
Lisa A. Levy

Spin Offs

Deborah L. Paul
Karen Gilbreath Sowell

Tax Exempt Entities

Stuart Rosow
Richard R. Upton

Treaties and Intergovernmental

Agreements

David R. Hardy
Andrew P. Solomon

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE

Janet A. Andolina
Robert E. Brown
Steven A. Dean
Charles I. Kingson

Robert J. Levinsohn
Charles M. Morgan
David M. Schizer
Stephen E. Shay

Jack Trachtenberg
Gordon Warnke

January 7, 2014

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report on Notice 2007-55 and Possible Administrative Guidance
Addressing Sections 897(h)(1) and 1445(e)(6)

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit this report providing recommendations as to how Treasury regulations could implement the positions expressed in Section 2 of Notice 2007-55 (the "Notice"), relating to how Sections 897(h)(1) and 1445(e)(6) of the Internal Revenue Code of 1986 (the "Code") apply to distributions made by a qualified investment entity (a "QIE").

By way of background, Section 897(h)(1) of the Code generally provides that any "distribution" by a QIE to a foreign person shall, to the extent attributable to gain from sales or exchanges by the QIE of United States real property interests, be treated as gain recognized by such person from the sale or exchange of a United States real property interest. The Notice provides, in relevant part, that:

FORMER CHAIRS OF SECTION:

John E. Morrissey, Jr.
Peter L. Faber
Hon. Renato Beghe
Alfred D. Youngwood
Gordon D. Henderson
David Sachs
J. Roger Mentz
Willard B. Taylor

Richard J. Hiegel
Dale S. Collinson
Richard G. Cohen
Donald Schapiro
Herbert L. Camp
William L. Burke
Arthur A. Feder
James M. Peaslee

John A. Corry
Peter C. Canellos
Michael L. Schler
Carolyn Joy Lee
Richard L. Reinhold
Richard O. Loengard
Steven C. Todrys
Harold R. Handler

Robert H. Scarborough
Robert A. Jacobs
Samuel J. Dimon
Andrew N. Berg
Lewis R. Steinberg
David P. Hariton
Kimberly S. Blanchard
Patrick C. Gallagher

David S. Miller
Erika W. Nijenhuis
Peter H. Blessing
Jodi J. Schwartz
Andrew W. Needham
Diana L. Wollman

Mr. Mazur  
Mr. Koskinen  
Mr. Wilkins  
January 7, 2014

Sections 897(h)(1) and 1445(e)(6) by their terms apply to all distributions to the extent attributable to gain from sales or exchanges by the qualified investment entity of a USRPI. Accordingly, the IRS will challenge under current statutory and regulatory provisions an assertion by any foreign taxpayer that section 897(h)(1) does not apply to distributions in complete liquidation under sections 331 and 332. In addition, regulations will clarify that the application of section 897(h)(1) and withholding under section 1445(e) is not limited to distributions by qualified investment entities that are subject to section 316. The regulations will clarify that the term “distribution,” as used in sections 897(h)(1) and 1445(e)(6), includes any distribution included under sections 301, 302, 331, and 332, where the distribution is attributable, in whole or in part, to gain from the sale or exchange of a USRPI by a qualified investment entity or other pass-through entity.

The Report addresses three primary questions: First, what type of corporate distributions does Section 897(h)(1) apply to? Second, how does one determine the amount of a distribution by a QIE that is “attributable to gain” from a sale or exchange of a USRPI by the QIE? Third, should Section 897(h)(1) be interpreted to impose FIRPTA tax on distributions that would not otherwise be treated as taxable income to the shareholder under general U.S. tax rules?

The Report concludes that guidance should provide that the phrase “any distribution” in Section 897(h)(1) means any distribution made to a shareholder in his capacity as such and is not limited to dividends which are, or could be, designated as capital gain dividends by a QIE.

The Report recommends a complex system for determining whether a distribution is “attributable to gain” from a sale or exchange of a USRPI by a QIE. Under that system, a QIE would be required to track (for each non-U.S. shareholder) several different types of FIRPTA gain and the extent to which the shareholder has received a distribution that is attributable to such type of gain. While the recommended system is complicated, it is designed to provide a fairer and more accurate measure of what portion of each distribution is attributable to FIRPTA gain by the QIE than the other, simpler systems which are discussed in the Report.

The Report concludes that guidance should not require that tax be paid on distributions that would not otherwise be treated as taxable income to the shareholder under general U.S. rules. Instead, guidance should require that the FIRPTA tax imposed by reason of Section 897(h)(1) be limited to the lesser of (x) the foreign shareholder’s share of the gains recognized by the QIE that are attributable to sales of USRPIs or (y) the shareholder’s actual economic gain from its investment in the QIE. In order to implement this limitation, the

Mr. Mazur  
Mr. Koskinen  
Mr. Wilkins  
January 7, 2014

Report recommends a foreign shareholder of a QIE be given the opportunity to limit the tax on distributions subject to Section 897(h)(1) to an amount of tax computed by reference to the actual income or gain recognized at the shareholder level with respect to such distribution. However, in order to apply that rule, the shareholder must agree to “catch up” and pay FIRPTA tax on any subsequent distribution or sale of the interest in the QIE to the extent the shareholder’s actual gain from the investment was greater than the gain recognized on the prior distribution(s). This “FIRPTA within gain” approach would be implemented through FIRPTA withholding certificates and/or agreements filed with the foreign shareholder’s tax return and would require as a prerequisite that the QIE voluntarily agree to withhold on a basis consistent with the FIRPTA within gain approach. Alternatively, the foreign shareholder could simply pay tax (and be subject to withholding on) a gross basis.

The Report thus recommends that guidance seek to balance competing interests by defining the scope of Section 897(h)(1) in an expansive manner, consistent with the Notice, but providing QIEs and their shareholders with a more accurate mechanism to match FIRPTA gain to QIE distributions and to ensure that the total amount of tax imposed by reason of Section 897(h)(1) is commensurate with the shareholder’s actual gain from its investment in the QIE.

We appreciate your consideration of our comments. Please let us know if you would like to discuss them or if we can assist you in any other way.

Respectfully submitted,



David H. Schnabel  
Chair