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Selected US Tax Developments

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AVOIDING THE "COMMERCIAL ACTIVITY" TRAPS FOR FOREIGN SOVEREIGNS INVESTING IN US REAL ESTATE

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US tax laws include a favourable exemption for certain types of US income earned by foreign sovereigns and their controlled entities. Unfortunately, however, there are a number of traps relating to the conduct of commercial activities. The applicable rules are not always intuitive, or even rational, so careful planning is needed.

KEYWORDS: FOREIGN INVESTORS ■ REAL PROPERTY ■ US ■ TAXATION ■ SOVEREIGNS

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GENERAL RULES OF TAXATION OF FOREIGN PERSONS

Types of Income Taxed

As a general rule, foreign[1] persons are subject to US federal income tax

1. on a net basis, at the same rates applicable to domestic taxpayers, with respect to any income that is considered to be effectively connected with the conduct of a trade or business in the United States ("effectively connected income");[2] and
2. on a gross basis, at a 30 percent rate (unless an exemption or lower rate applies under a US income tax treaty or otherwise), on any US-source income that
   a. is not effectively connected income and
   b. is considered to be fixed or determinable annual or periodical.

The latter category of income includes, among other things, dividends paid by US corporations and rental income from property located in the United States.

FIRPTA

Pursuant to the Foreign Investment in Real Property Tax Act of 1980[3] (FIRPTA), special rules apply to foreign investors in US real estate. For example, section 897(a) of the Internal Revenue Code of 1986[4] provides that gain recognized by a foreign person from the sale of a "United States real property interest" (USRPI) is treated as effectively connected income, even if the US activities of such foreign person are passive and do not rise to the level of the conduct of a trade or business in the United States.

The FIRPTA rules apply not only to "dirt" but also to certain interests in entities. Pursuant to section 897(c)(1)(A), a USRPI generally includes

1. an interest in real property located in the United States or the Virgin Islands, and

1 With apologies to Canadian readers, for the purposes of this article the term "foreign" means non-US.

2 In the case of a foreign corporation, a branch profits tax may also apply at a 30 percent rate (unless an exemption or lower rate is available under a US income tax treaty). Note also that otherwise allowable deductions may be disallowed if an income tax return is not filed within a specified time period.

3 Foreign Investment in Real Property Tax Act of 1980, subtitle C of title XI of the Omnibus Reconciliation Act of 1980, Pub. L. no. 96-499, enacted on December 5, 1980.

4 Internal Revenue Code of 1986, as amended (herein referred to as "the Code"). Unless otherwise stated, statutory references in this article are to the Code.

2. an interest (other than solely as a creditor) in a domestic corporation if, at any time during a specified lookback period of up to five years, the corporation was a "United States real property holding corporation" (USRPHC).[5]

Pursuant to section 897(c)(2), a corporation is a USRPHC as of any point in time if, at such time, the fair market value of its USRPIs is at least 50 percent of the total fair market value of its USRPIs, plus its interests in real property located outside the United States, plus any other of its assets that are used in a trade or business.[6] For this purpose, section 897(c)(5) provides a lookthrough rule, pursuant to which stock of an at-least-50-percent-owned corporate subsidiary will be disregarded and the parent will instead be considered to own its proportionate interest in each asset owned by the subsidiary.

Novices (and even experienced US tax professionals) sometimes describe the USRPHC test as one in which USRPIs must represent at least 50 percent of the corporation's total assets, but this simplified description should be avoided since it misleadingly suggests that all of the corporation's assets are included in the fraction's denominator. For example, if a corporation owns $400x of USRPIs, $300x of foreign real property, and $300x of portfolio interests in publicly traded foreign stocks, the corporation is a USRPHC because USRPIs represent a majority of the relevant assets—that is, $400x/$700x.

There are some important exceptions to the foregoing rules. Pursuant to section 897(l), a qualified foreign pension fund is exempt from FIRPTA entirely.

Moreover, there are special exceptions to the generally applicable definition of a USRPI. For example, pursuant to a "cleansing rule" set forth in section 897(c)(1)(B), an interest in a corporation will not be considered a USRPI as of a particular date, even if the corporation was a USRPHC during the applicable lookback period, if

1. as of such date, the corporation owns no USRPIs;
2. all of the USRPIs owned during the lookback period either
   a. were disposed of in transactions in which all of the gains were recognized or
   b. ceased to be USRPIs by reason of the application of the cleansing exception to other corporations; and
3. neither the corporation nor any predecessor was a regulated investment company (RIC) or a real estate investment trust (REIT).

5 FIRPTA also includes a "lookthrough rule" for USRPIs held through partnerships. See section 897(g).

6 Investment assets (other than USRPIs) ordinarily are not taken into account, but there is one important exception. Pursuant to Treas. reg. section 1.897-1(f)(3)(ii), a corporation's investment assets qualify as "good" trade or business assets in the denominator of the fraction if the principal business of the entity is trading or investing for its own account, and this "principal business requirement" is presumed to be met if 90 percent or more of the entity's assets consist of cash, stock, securities, and certain similar investment assets.

In addition, section 897(c)(3) provides that if any class of stock of a corporation is regularly traded on an established securities market, stock of such class is considered a USRPI only in the case of a person who, during a specified lookback period of up to five years, held more than 5 percent (or, in the case of a REIT, 10 percent) of such class of stock.[7]

There are also certain exceptions for stock in a REIT that are best understood with some background regarding the tax rules applicable to REITs and their foreign investors.

Taxation of REITs and Foreign Investors

If a domestic entity qualifies as a REIT,[8] it is classified as a corporation for US federal tax purposes, but typically pays no tax because it receives a deduction for all dividends paid.[9] Ordinary REIT dividends paid to foreign shareholders are subject to withholding tax at a 30 percent rate, unless a US income tax treaty provides for a lower rate. In the case of REIT dividends, US treaty benefits are relatively hard to come by. For example, under article X(7)(c) of the US-Canada income tax treaty,[10] in the case of a dividend paid by a REIT to a resident of Canada, the 5 percent dividend withholding rate (otherwise available under article X(2)(a) to a Canadian corporation owning 10 percent of the voting stock of the US corporation) does not apply, and the 15 percent dividend withholding rate (otherwise available under article X(2)(b)) applies only in the case of an individual who owns a less-than-10 percent interest in the REIT. Since the REITs themselves will rarely pay US corporate tax, the relative stinginess in granting treaty benefits for REIT dividends is understandable.

Special rules apply if a REIT disposes of a USRPI at a gain and makes a distribution to a foreign shareholder that is attributable to such USRPI gain. Pursuant to the first sentence of section 897(h)(1), the general rule in such circumstances is that such distributions (attributable to the REIT's gains from dispositions of USRPIs) are treated as FIRPTA gain to the foreign shareholder.[11] Pursuant to the second sentence of section 897(h)(1) and section 897(k)(1)(B), an exception applies if

1. the distribution by the REIT is made with respect to a class of stock that is regularly traded on an established securities market in the United States and

7 See also section 897(k)(1)(A).

8 A discussion of the requirements for REIT status is beyond the scope of this article.

9 Section 561(a).

10 The Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007.

11 This rule applies to RICs as well.

2. the non-resident alien individual or foreign corporation that owns such REIT stock did not own more than 10 percent of such class of REIT stock at any time during the one-year period ending on the date of the distribution.[12]

Pursuant to another special rule, section 897(k)(2), stock of a REIT held by a "qualified shareholder" generally is treated as a non-USRPI, subject to certain exceptions. A description of the qualified shareholder rules is beyond the scope of this discussion.

Finally, section 897(h)(2) provides that stock of a REIT (or RIC) that is considered to be "domestically controlled" is also treated as a non-USRPI. In order for a REIT to be considered domestic controlled, foreign persons must own (directly and indirectly) less than 50 percent of the stock of the REIT at all times during a specified testing period of up to five years.

OVERVIEW OF SOVEREIGN EXEMPTION IN SECTION 892

Introduction

Section 892 provides a sovereign exemption for certain types of income from investments by "foreign governments." The types of income that may potentially qualify, and the requirements for availability of the exemption, are described below.

Definition of Foreign Government

The statute does not define the term "foreign government." Pursuant to certain temporary regulations promulgated on June 27, 1988 ("the temporary regulations"),[13] the term "foreign government" includes the "integral parts" and "controlled entities" of a foreign sovereign.[14]

An integral part of a foreign sovereign is "any person, body of persons, organization, agency, bureau, fund, instrumentality, or other body, however designated, that constitutes a governing authority of a foreign country."[15]

12 In the case of a RIC, only a 5 percent interest is permitted during the one-year lookback period.

13 TD 8211, June 27, 1988. Note that, because such regulations were promulgated prior to the effective date of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. no. 100-647, enacted November 10, 1988, certain "sunset" provisions of section 7805(e)(2) (which normally cause temporary regulations to lose all force and effect after three years) do not apply to the temporary regulations issued under section 892.

14 Temp. Treas. reg. section 1.892-2T(a)(1).

15 Temp. Treas. reg. section 1.892-2T(a)(2). The regulation adds that "[t]he net earnings of the governing authority must be credited to its own account or to other accounts of the foreign sovereign, with no portion inuring to the benefit of any private person. An integral part does not include any individual who is a sovereign, official, or administrator acting in a private or personal capacity. Consideration of all the facts and circumstances will determine whether an individual is acting in a private or personal capacity."

A controlled entity of a foreign sovereign is defined as follows:

> (3) *Controlled entity*. The term "controlled entity" means an entity that is separate in form from a foreign sovereign or otherwise constitutes a separate juridical entity if it satisfies the following requirements:
>
> (i) It is wholly owned and controlled by a foreign sovereign directly or indirectly through one or more controlled entities;
>
> (ii) It is organized under the laws of the foreign sovereign by which owned;
>
> (iii) Its net earnings are credited to its own account or to other accounts of the foreign sovereign, with no portion of its income inuring to the benefit of any private person; and
>
> (iv) Its assets vest in the foreign sovereign upon dissolution.[16]

Categories of Exempt Income

The categories of income that may qualify for the sovereign exemption are set forth in section 892(a)(1). Under section 892(a)(1), the sovereign exemption may apply to income received by a foreign government from

> (A) investments in the United States in—
>
> (i) stock, bonds, or other domestic securities owned by such foreign governments, or
>
> (ii) financial instruments held in the execution of government or monetary policy, or
>
> (B) interest on deposits in banks in the United States of moneys belonging to such foreign governments.

The temporary regulations clarify that income from investments in stocks, bonds, or other securities includes gain from the disposition of such investments, as well as income earned from engaging in certain securities lending transactions.[17]

The temporary regulations provide that the exemption does not apply to "income earned from a U.S. real property interest described in section 897(c)(1)(A)(i)," "any gain derived from the disposition of a U.S. real property interest defined in section 897(c)(1)(A)(i)," or "[g]ain on the disposition of an interest in a partnership or a trust."[18] A US real property interest described (or defined) in section 897(c)(1)(A) is "an interest in real property located in the United States or the Virgin Islands," so income and gains with respect to "dirt" are not exempt.

16 Temp. Treas. reg. section 1.892-2T(a)(3). The regulation adds that "[a] controlled entity does not include partnerships or any other entity owned and controlled by more than one foreign sovereign. Thus, a foreign financial organization organized and wholly owned and controlled by several foreign sovereigns to foster economic, financial, and technical cooperation between various foreign nations is not a controlled entity for purposes of this section."

17 Temp. Treas. reg. section 1.892-3T(a)(2).

18 Temp. Treas. reg. sections 1.892-3T(a)(1) and (2).

The temporary regulations also elaborate on what constitutes a security for the purposes of the sovereign exemption:

> For purposes of paragraph (a) of this section, the term "other securities" includes any note or other evidence of indebtedness. Thus, an annuity contract, a mortgage, a banker's acceptance or a loan are securities for purposes of this section.
>
> However, the term "other securities" does not include partnership interests (with the exception of publicly traded partnerships within the meaning of section 7704) or trust interests. The term also does not include commodity forward or futures contracts and commodity options unless they constitute securities for purposes of section 864(b)(2)(A).[19]

Even if all other requirements are satisfied, the conduct of commercial activity can result in a loss of the sovereign exemption. In some cases, the impact of such activity may be surprising and exceedingly harsh. Accordingly, tax planners for foreign sovereigns spend much of their time worrying about commercial activity issues.

COMMERCIAL ACTIVITY DISQUALIFIERS

Overview

Pursuant to section 892(a)(2)(A), the sovereign exemption does not apply to any income

> (i) derived from the conduct of any commercial activity (whether within or outside the United States),
>
> (ii) received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity, or
>
> (iii) derived from the disposition of any interest in a controlled commercial entity.

Scope of Commercial Activity

As noted above, income derived from the conduct of any commercial activity is ineligible for the sovereign exemption. Unfortunately, the statutory language provides little guidance as to when the type or amount of activity will be sufficient to constitute commercial activity for the purposes of section 892. However, the statute does specify that such activity may be "within or outside the United States."

The temporary regulations generally provide that, unless a safe harbour applies, "all activities (whether conducted within or outside the United States) which are ordinarily conducted by the taxpayer or by other persons with a view towards the current or future production of income or gain are commercial activities."[20] The

19 Temp. Treas. reg. section 1.892-3T(a)(3).

20 Temp. Treas. reg. section 1.892-4T(b).

temporary regulations further provide that "[a]n activity may be considered a commercial activity even if such activity does not constitute the conduct of a trade or business in the United States under section 864(b)."[21]

The temporary regulations provide a safe harbour, however, pursuant to which the making of certain investments and certain trading activities are excluded from the scope of commercial activities.[22] For example, subject to certain exceptions (for dealers and investments made by a banking, financing, or similar business), exempt activities include[23]

- investments in stocks, bonds, and other securities;
- loans;
- investments in financial instruments held in the execution of governmental financial or monetary policy;
- the holding of net leases on real property or land that is not producing income (other than on sale or from net leases);
- the holding of bank deposits in banks;
- effecting transactions in stocks, securities, or commodities for a foreign government's own account, regardless of whether effected by the foreign government through its employees, or through a broker, commission agent, custodian, or other independent agent, and regardless of whether any such employee or agent has discretionary authority to make decisions in effecting the transactions.

However,

> investments (including loans) made by a banking, financing, or similar business constitute commercial activities, even if the income derived from such investments is not considered to be income effectively connected to the active conduct of a banking, financing, or similar business in the U.S. by reason of the application of § 1.864-4(c)(5).[24]

Thus, for example, foreign sovereigns are expressly permitted to make loans, but only if their lending activities do not rise to the level of a banking, financing, or similar business.

The temporary regulations also provide safe harbours for certain performances and exhibitions of amateur athletic events and events devoted to the promotion of the arts; non-profit activities; government functions; and the mere purchasing of goods.[25]

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21 Ibid.

22 Temp. Treas. reg. section 1.892-4T(c)(1).

23 Temp. Treas. reg. sections 1.892-4T(c)(1)(i) through (iii).

24 Temp. Treas. reg. section 1.892-4T(c)(1)(iii).

25 Temp. Treas. reg. sections 1.892-4T(c)(2) through (5).

Definition of Controlled Commercial Entity

As indicated above, sections 892(a)(2)(A)(ii) and (iii) provide that *any* income derived by or from a controlled commercial entity, or from the disposition of an interest in a controlled commercial entity, is ineligible for the sovereign exemption. For this purpose, section 892(a)(2)(B) defines a controlled commercial entity as follows:

> (B) Controlled commercial entity. For purposes of subparagraph (A), the term "controlled commercial entity" means any entity engaged in commercial activities (whether within or outside the United States) if the government—
>
> (i) holds (directly or indirectly) any interest in such entity which (by value or voting interest) is 50 percent or more of the total of such interests in such entity, or
>
> (ii) holds (directly or indirectly) any other interest in such entity which provides the foreign government with effective control of such entity.
>
> For purposes of the preceding sentence, a central bank of issue shall be treated as a controlled commercial entity only if engaged in commercial activities within the United States.

Notably, the above definition does not include any de minimis exception, and (except for central banks of issue) commercial activities outside the United States are just as toxic as commercial activities inside the United States.

"All or Nothing" Treatment for Controlled Entities

The consequences of engaging in commercial activity vary dramatically depending on whether the taxpayer is an integral part of a foreign sovereign or a controlled entity.

If an *integral part* of a foreign sovereign engages directly in commercial activity, the income derived from such commercial activity is ineligible for the sovereign exemption under section 892(a)(2)(A)(i). However, any income of such integral part that otherwise qualifies and is not derived from commercial activity remains eligible for the sovereign exemption.

Alternatively, if a *controlled entity* engages in commercial activity, anywhere in the world, such that the controlled entity becomes a controlled commercial entity, then *all* income received by or from such entity (and all gain from the disposition of interests in such entity) is ineligible for the sovereign exemption. In light of this "all or nothing" rule, even a minor "foot-fault" that causes a controlled entity to be considered to be engaged in commercial activity can have devastating and disproportionate consequences.

For example, if a controlled entity earns US$100 million of income on US stocks with a value of US$1 billion, and also suffers a loss from the operation of a small crepe stand in Paris with a value of €50,000, the operation of the crepe stand will constitute the conduct of a commercial activity that causes the controlled entity to become a controlled commercial entity. The consequence of such controlled commercial entity status is that all benefits of the sovereign exemption will be lost.

Accordingly, controlled entities and their US tax advisers stay up at night worrying about crepe stand scenarios.

Certain proposed regulations issued in 2011, but not yet finalized, would provide an exception from such "all or nothing" rule for certain "inadvertent commercial activity." Commercial activity will be treated as inadvertent commercial activity only if

1. the failure to avoid conducting the commercial activity is reasonable;
2. the commercial activity is promptly cured; and
3. certain record maintenance requirements are met.

However, none of the income derived from such inadvertent commercial activity will qualify for exemption from tax under section 892.[26]

The preamble states that taxpayers may rely on the proposed regulations until final regulations are issued. Nevertheless, the exception for inadvertent commercial activity provides limited comfort at best.

Attribution Rules

The temporary regulations reiterate the provisions of the statute and, in addition, set forth a number of rules for when the commercial activities of an entity will or will not be attributed to another entity. These rules provide as follows:

- *No sibling attribution.* Commercial activities of a controlled entity are not attributed to such entity's "brother" or "sister" controlled entities.[27] Thus, for example, if Sub 1 and Sub 2 are sibling controlled entities, any commercial activities conducted by Sub 1 will *not* be attributed to Sub 2 and thus will not jeopardize Sub 2's entitlement to the sovereign exemption. From a planning perspective, this is critical. If the intention of the foreign sovereign is for Sub 2 to qualify for the sovereign exemption, one reasonable approach would be to ensure that all activities that may potentially constitute commercial activity are conducted by Sub 1.
- *No subsidiary-to-parent attribution.* Perhaps counterintuitively, commercial activities of a subsidiary controlled entity are *not* attributed to its parent.[28] Thus, for example, if Sub 1 and Sub 2 are controlled entities and Sub 1 owns Sub 2, any commercial activities conducted by Sub 2 would not be attributed to Sub 1. Therefore, one reasonable approach would be for Sub 1 to own all of the investments for which the sovereign exemption is sought, and for all activities that may potentially constitute commercial activities to be conducted by

26 Treas. reg. section 1.892-5(a)(2).

27 Temp. Treas. reg. section 1.892-5T(d)(1).

28 Temp. Treas. reg. section 1.892-5T(d)(2)(i).

Sub 2. Sub 2's commercial activities would not be attributed to Sub1, so Sub1 would not be at risk of becoming a controlled commercial entity.

- *Parent-to-subsidiary attribution.* Pursuant to another rule that may be counter-intuitive, commercial activities of a parent controlled entity *are* attributed to its subsidiary.[29] Thus, if a parent controlled entity has somehow become engaged in a commercial activity, thereby becoming disqualified from the benefits of the sovereign exemption as a controlled commercial entity, the same disqualifying taint would apply to its direct and indirect subsidiaries. Presumably the rationale for this "downstream" attribution rule is that a disqualified parent controlled entity should not be able to avoid the impact of its disqualification through the simple expedient of making its US investments through a subsidiary.
- *Partnership-to-partner attribution.* Commercial activities of a partnership (other than a publicly traded partnership) generally are attributed to its partners for the purposes of section 892.[30] Accordingly, controlled entities must take great care to ensure that the partnerships in which they invest will not engage in activities constituting the conduct of commercial activity.

Special, and Inexplicable, USRPHC Trap[31]

The temporary regulations provide that "[a] United States real property holding corporation, as defined in section 897(c)(2) . . . shall be treated as engaged in commercial activity" and is therefore a controlled commercial entity if it is a controlled entity or otherwise controlled by a foreign sovereign.[32]

While this "USRPHC rule" may seem relatively benign at first blush, appearances can be deceiving. Assume that Fredonia, a foreign sovereign, owns a single controlled entity, Fco, and that Fco seeks to qualify for the sovereign exemption. Fco's only asset consists of 25 percent of the stock of a foreign-controlled REIT. Since stock ownership is a passive endeavour, it would seem that Fco is not engaged in any commercial activity. Unfortunately, however, the USRPHC rule applies here, even

29 Temp. Treas. reg. section 1.892-5T(d)(2)(ii).

30 Temp. Treas. reg. section 1.892-5T(d)(3). Proposed regulations issued by the US Treasury Department in 2011 would provide an exception for certain "limited partners" as that term is defined therein. Prop. Treas. reg. section 1.892-5(d)(5)(iii). The preamble states that taxpayers may rely on the proposed regulations until final regulations are issued. REG-146537-06, 2011-48 IRB 813.

31 For a more detailed discussion of this point, see Kimberly S. Blanchard, "Section 892 Controlled Commercial Entities: The USRPHC Trap" (2009) 38:7 *Tax Management International Journal* 451.

32 Temp. Treas. reg. section 1.892-5T(b)(1). The temporary regulations purport to apply the same treatment to "a foreign corporation that would be a United States real property holding corporation if it was a United States corporation," but this language is based on the misconception that a foreign corporation cannot be a USRPHC, and should therefore be ignored.

though it makes no sense whatsoever. Fco's only asset is a USRPI, so Fco is therefore a USRPHC, even though Fco does nothing more than passively own stock in the REIT. Consequently, Fco is deemed to be engaged in commercial activity and ineligible for the sovereign exemption.[33]

But not so fast, you say. The example may not be very realistic. In the real world, Fco may own substantial foreign assets. Suppose that Fco owns (1) 25 percent of the stock of a foreign-controlled REIT, which stock has a value of US$25 million, and (2) 25 percent of the stock of a foreign corporation that owns and operates foreign real estate, which stock has a value of US$75 million. In that event, it may be tempting to conclude that Fco is not a USRPHC, because only 25 percent of its assets consist of USRPIs. As discussed above, however, the only assets included in the denominator of the USRPHC fraction are USRPIs, foreign real estate, and assets used in a trade or business. There is a lookthrough rule, but the lookthrough rule only applies to subsidiaries that are at least 50 percent owned. Accordingly, even in this modified hypothetical, Fco continues to be a USRPHC, since 100 percent of the assets that are relevant to the determination of its status as a USRPHC or non-USRPHC are USRPIs.

OK, we'll try again. Suppose that, in addition to the foreign-controlled REIT stock, with a value of US$25 million, Fco directly owns foreign real estate with a value of US$75 million. Surely this must work to prevent Fco from being a USRPHC, right? The answer is yes, but now we have another problem. While the analysis is highly fact-dependent, Fco may now be engaged in the actual conduct of commercial activity, even without regard to the USRPHC rule.

So, what's the way out? With careful planning, Fco can avoid both the actual conduct of commercial activity and also the deemed conduct of commercial activity under the USRPHC rule. Suppose that, instead of owning the foreign real estate directly, Fco forms a wholly owned subsidiary, Fsub, to own the foreign real estate. For the purposes of determining Fco's status as a USRPHC or non-USRPHC, the foreign real estate owned by Fsub is attributed to Fco, so Fco qualifies as a non-USRPHC. However, as noted above, commercial activities conducted by a subsidiary are *not* attributed to the parent. Accordingly, any commercial activities conducted by Fsub in connection with its ownership or operation of the foreign real estate do not preclude Fco from claiming the sovereign exemption.

Another possible approach is for Fco to insist that the necessary steps be taken to ensure that the REIT will be domestically controlled, so that its REIT stock will not be a USRPI. This requires imposing commercial constraints on the other shareholders, and such constraints may potentially fail. Moreover, such constraints come at a cost. For example, if a controlled entity and a domestic investor team up to purchase a REIT, and the controlled entity asks the domestic investor to accept a restriction

33 For the purposes of this discussion, we shall assume the validity of the USRPHC rule, although this is far from a foregone conclusion.

that prevents the sale of its REIT stock to a foreign purchaser, the domestic investor is going to want something in return.

CONCLUSION

The rules with respect to commercial activity are exceedingly harsh and, in some cases, entirely nonsensical. In most cases, the traps can be avoided, but careful planning is needed.