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IRS Announces Future Regulations Regarding Treatment of Intangible Infrastructure Assets Under FIRPTA

On December 1, 2008, the Internal Revenue Service ("IRS") announced plans to issue proposed regulations regarding the treatment of certain intangible infrastructure assets as interests in real property for purposes of the so-called "FIRPTA" rules in section 897 of the Internal Revenue Code.[1] Specifically, the future proposed regulations would address rights granted by a governmental unit, such as licenses, permits, franchises, or other similar rights ("Governmental Permits"), that are related to the lease, ownership, or use of toll roads, toll bridges, and certain other physical infrastructure.

The IRS and the Treasury Department are concerned that, in certain transactions, taxpayers may be taking a position with respect to the classification of Governmental Permits that is contrary to what is intended under the FIRPTA rules. In such a transaction, a domestic partnership (the "Infrastructure Partnership") leases or purchases from an unrelated party an infrastructure asset, such as a toll road or toll bridge, that is located in the United States. The Infrastructure Partnership's partners include domestic corporations that have foreign shareholders. Often, as a condition to operating the infrastructure asset and to collecting tolls for its use, the Infrastructure Partnership is required to obtain a Governmental Permit. The physical attributes of an infrastructure asset and the terms and conditions related to its operation mean that, in many cases, there may be no potential alternative commercial use for the infrastructure asset. Thus, a substantial portion of the value of infrastructure asset (or a leasehold interest in the asset) may derive from the right to charge and collect tolls.

FIRPTA addresses the treatment of gain or loss of a nonresident alien or foreign corporation from the disposition of a U.S. real property interest (a "USRPI"). Generally, a USRPI includes an interest in real property located in the United States and any interest in a domestic corporation unless a taxpayer shows that the corporation is not a U.S. real property holding company (a "USRPHC"). A USRPHC generally is defined as a corporation the fair market value of whose USRPIs equals or exceeds 50% of the fair market value of its worldwide interest in real property, including its USRPIs, plus its other assets which are used or held for use in a trade or business.

The IRS and the Treasury Department are aware that, in transactions similar to the one described above, some taxpayers take the position that the Governmental Permit

[1] Announcement 2008-115.

is not a USRPI and that a majority of the fair market value of the Infrastructure Partnership's assets is allocable to the Governmental Permit rather than to the tangible infrastructure asset, which generally is an USRPI. Accounting for the Governmental Permit in this manner for FIRPTA purposes reduces the likelihood that a domestic corporation that is a partner in the Infrastructure Partnership will be classified as a USRPHC. If the domestic corporation is not classified as a USRPHC, the sale of stock by the foreign shareholders generally would not be subject to U.S. tax.

However, the IRS and the Treasury Department are of the view that, in some of the transactions like the one described above, the Governmental Permit is properly characterized as a USRPI. Accordingly, the IRS and the Treasury Department are considering issuing proposed FIRPTA regulations that would address how Governmental Permits that are related to the use or ownership of an interest in real property should be taken into account when determining whether or not a domestic corporation is a USRPHC. It is anticipated that the new regulations would apply for transactions occurring on or after the date that they are published in final form.

In formulating the proposed regulations, the IRS and the Treasury Department will consider any written comments that are submitted by January 29, 2009.

A copy of Announcement 2008-115 is available at http://www.irs.gov/irb/2008-48_IRB/ar18.html. For further information, please contact David S. Lowman, Jr. at (202) 419-2070 or dlowman@hunton.com, or Cameron N. Cosby at (804) 788-8604 or ccosby@hunton.com.