

FOREIGN INVESTMENT IN U.S. FARMLAND—THE FACTS AND THE LAW

Reka Potgieter Hoff†

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I. INTRODUCTION

As of December 31, 1980 foreign persons¹ and United States corporations, owned 5% or more by foreign persons, owned 7.8 million acres or 0.6% of privately owned farmland,² forest land and other rural land. Fifty-two percent of all reported foreign-owned holdings is cropland, pastureland,

† Professor of Law and Economics University of Arizona; B.A. 1946, Wellesley College; LL.B. 1950, Yale Law School; LL.M. Taxation 1958, New York University Law School; Ph.D. Economics 1981, George Washington University.

1. The term "foreign person" as used in this Article includes nonresident alien individuals, foreign corporations, foreign partnerships, trusts and estates. It does not include resident alien individuals.

2. U.S. DEP'T OF AGRICULTURE, FOREIGN OWNERSHIP OF U.S. AGRICULTURAL LAND vii (1981) [hereinafter cited as FOREIGN OWNERSHIP followed by the appropriate date of the report if different]. As used in this Article the term "farmland" includes privately owned cropland, pastureland, vineyards and orchards. It does not include timberland and rural land put to nonfarm use.

orchards and vineyards.³ This is less than 0.3% of the total privately owned United States cropland, pastureland, orchards and vineyards. In 1980 foreign persons and United States corporations, owned 5% or more by foreign persons, spent \$2.5 billion to purchase United States agricultural land.⁴ Of the acres acquired, 64% were cropland and 28% pastureland.⁵ Individuals or entities from West Germany, the Netherlands-Antilles and United States corporations controlled by West German shareholders were the principal purchasers of United States cropland (247,455 acres or 44% of the total).⁶ Foreign persons from West Germany, the Netherlands-Antilles, the United Kingdom, Greece and Belgium were the principal purchasers of pastureland (384,300 acres or 69% of the total pastureland purchased).⁷

It is not clear whether the motivation for such foreign direct investment in United States farmland is the configuration of United States tax rules, the desirability of farmland as a store of value or the relative political stability of the United States and the security of property rights.⁸ Although there is no evidence that this share has had an aggregate impact on United States agriculture, the foreign presence has given rise to a widely held belief that foreign capital is outbidding United States citizen taxpayers in the farm real estate market.⁹

This Article surveys the data on foreign investment in United States farmland reported to the Secretary of Agriculture pursuant to section 5 of the Agricultural Foreign Investment Disclosure Act of 1978¹⁰ and relates this data to state law restrictions on alien investment in farmland and to the federal tax rules applicable to foreign ownership of United States farm real estate. The Article concludes that the state law restrictions have had little effect on foreign ownership of United States farmland. There is some evidence that the fact that residents of treaty countries can make an annual election to be taxed on United States source real property rental income on

3. *Id.* at 22.

4. *Id.* at 32.

5. *Id.* at 45, table 26.

6. *Id.* at 43.

7. *Id.*

8. For an analysis of the goals of foreign investors in Iowa farmland see Paulsen, *Goals and Characteristics of Foreign Purchases of Farmland in the United States*, reprinted in U.S. DEPT. OF COMMERCE, *FOREIGN DIRECT INVESTMENT IN THE UNITED STATES*, vol. 8 app. L, at L.-19 (1976) [hereinafter cited as *FOREIGN DIRECT INVESTMENT*]. For an analysis of the tax rules applicable to foreign investment in United States real property prior to enactment of the Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, 91 Stat. 2682 (1980) (current version at 26 U.S.C. § 1 (Supp. IV 1980)) see U.S. DEPT. OF THE TREASURY, *TAXATION OF FOREIGN INVESTMENT IN U.S. REAL ESTATE* (1979) [hereinafter cited as *TAXATION OF FOREIGN INVESTMENT*].

9. See *TAXATION OF FOREIGN INVESTMENT*, *supra* note 8, at 46-52, app. C; H.R. REP. No. 1216, 96th Cong., 2d Sess. 17-10 (1980).

10. Pub. L. No. 95-460, 92 Stat. 1263, 1265 (1978) (current version at 26 U.S.C. § 1 (Supp. II 1978)).

a net basis and that foreign investors generally can dispose of United States real property free of tax has been an inducement to foreign direct investment in United States agricultural land. Changes in the tax rules made by the Foreign Investment in Real Property Tax Act of 1980¹¹ remove these tax advantages and, in general, apply the same tax rules to United States and foreign investors in United States real property for dispositions occurring after June 18, 1980.

II. LEGISLATIVE BACKGROUND

In November 1974, President Ford signed the Foreign Investment Study Act of 1974¹² directing the Secretaries of Commerce and Treasury to conduct a comprehensive study of foreign direct and portfolio investment in the United States. Included in this directive was a requirement that these departments analyze the effects of foreign direct investment in United States real property holdings and the effects of federal, regional, state and local laws on such investment. The Commerce Department report, published in 1976,¹³ estimated that foreign persons owned 1 million acres or about 0.1% of the estimated 1.1 billion total acres of United States agricultural land in 1974.¹⁴ Despite the relatively small landholdings by foreign persons shown by the Department of Commerce survey, Congress continued to be concerned about the possibility that United States farmland resources as well as other natural resources might end up under foreign control and be operated in ways ultimately harmful to United States national interests.¹⁵ In response to the Department of Commerce finding that there did not then exist an adequate data base for assessing the extent of foreign ownership of United States farmland,¹⁶ Congress, in 1978, enacted the Agricultural Foreign Investment Disclosure Act (AFIDA).¹⁷ This Act establishes a nationwide system for monitoring foreign ownership and purchases of United States agricultural land.¹⁸ It requires any foreign person¹⁹ who acquires,

11. Pub. L. No. 96-499, 91 Stat. 2682 (1980) (current version at 26 U.S.C. § 1 (Supp. III 1980)).

12. Pub. L. No. 93-479, 88 Stat. 1450-54 (1974) (current version at 15 U.S.C. § 78(b) (1976)).

13. FOREIGN DIRECT INVESTMENT, *supra* note 8, vol. 1.

14. *Id.* at 184.

15. See H.R. REP. NO. 1216, 96th Cong., 2d Sess. — (1980).

16. FOREIGN DIRECT INVESTMENT, *supra* note 8, vol. 1 at 237.

17. Agricultural Investment Disclosure Act, Pub. L. No. 95-460, 92 Stat. 1263 (1978) (current version at 7 U.S.C. § 3504 (Supp. II 1978)) [hereinafter cited as AFIDA].

18. *Id.*, 92 Stat. at 1263-65 (current version at 7 U.S.C. § 3501 (Supp. II 1978)). For a discussion of the congressional intent and background of AFIDA, see Zagaris, *The Agricultural Foreign Investment Disclosure Act of 1978; How will It Affect the Market in U.S. Real Estate*, 8 REAL ESTATE L.J. 3 (1979).

19. AFIDA, section 5, defines "foreign" in terms of citizenship; an alien in the United States without permanent residence is a foreign person. AFIDA, *supra* note 17, at 1265-66 (cur-

transfers or holds an interest in agricultural land to report such interest to the Secretary of Agriculture.²⁰ The Secretary is directed to analyze the information derived from the reports and to determine the effects of such investments, in particular on family farms and rural communities.²¹ The Department of Agriculture has issued two reports under AFIDA, the first reporting foreign ownership of United States agricultural land for the period February 1, 1979 through February 1, 1980,²² the second reporting foreign ownership through December 31, 1980.²³

On the tax side, Congress was concerned that the tax-free status of United States capital gains derived by foreign persons was a factor in the competitive bidding for scarce farmland. In 1978 Congress considered legislation that would have required taxation of foreign investors' capital gains from United States agricultural property, in particular farmland.²⁴ In 1979 the concept was expanded to apply to all rural land, including land suitable for farming even though not used for that purpose, and interests in entities holding rural land.²⁵ The Treasury then submitted its own proposal to Congress that the tax be limited to gains derived from the sale or exchange of United States real estate and interests in foreign-controlled entities deriving the majority of their income from United States real estate or having assets consisting predominantly of United States real property interests.²⁶ None of these measures passed. Instead, Congress directed the Treasury to prepare a report on foreign investment in United States real estate.²⁷ The Treasury report was released in May 1979.²⁸ In December 1979, both the Senate Finance Committee and the House Ways and Means Committee reported out bills that would have taxed all foreign investor sales of United States real estate and taxed the sales of the shares of a foreign corporation investing in United States real estate.²⁹ The proposed legislation also would have imposed withholding responsibilities on purchasers and agents having access to

rent version at 7 U.S.C. § 3504 (Supp. II 1978)). Regulations under section 9 of the Act define a United States corporation owned 5% or more by nonresident aliens and all foreign corporations as "foreign persons" covered by the reporting requirements of the Act. 7 C.F.R. § 2.21(b)(34) (1981).

20. AFIDA, *supra* note 17, at 1263-65 (current version at 7 U.S.C. § 3501 (Supp. II 1978)).

21. *Id.*, 92 Stat. at 1265 (current version at 7 U.S.C. § 3504 (Supp. II 1978)).

22. FOREIGN OWNERSHIP, *supra* note 2 (1980).

23. FOREIGN OWNERSHIP, *supra* note 2.

24. S. 3414, 95th Cong., 2d Sess. — (1978).

25. S. 208, 96th Cong. 1st Sess. — (1979); H.R. 3106, 96th Cong. 1st Sess. — (1979).

26. *Hearings on S. 192 and S. 208 Before the Subcomm. on Taxation and Debt Management of the Senate Finance Committee*, 96th Cong., 1st Sess. — (1979) (statement of Donald C. Lublick, Assistant Treasury Secretary for Tax Policy).

27. See Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (1978) (current version at 26 U.S.C. § 1 (Supp. II 1978)).

28. See TAXATION OF FOREIGN INVESTMENT, *supra* note 8.

29. See H.R. 1212, H.R. 1319, H.R. 2297, H.R. 7652, S. 2939, 96th Cong., 1st Sess. — (1979).

any of the sales proceeds.³⁰ After many changes, the final legislation was enacted on December 5, 1980.³¹ Entitled the "Foreign Investment in Real Property Tax Act of 1980" (FIRPTA), the Act subjects to tax, gains realized by foreign persons from the disposition of investment in United States real estate.³² FIRPTA does not change the tax rules applicable to the operating income derived from such property.

III. FOREIGN OWNERSHIP OF UNITED STATES FARMLAND

The typical foreign investor in United States farmland is an absentee landowner who either engages a property management firm to operate the farm or leases the property back either to the original owner-seller or to a neighboring farmer. Before enactment of AFIDA there was little reliable information on the identity of farmland ownership. In general, such data could only be obtained by checking county land records and interviewing local real estate dealers and tenant farm operators.³³ AFIDA requires all foreign persons holding agricultural land as of February 1, 1979 to file a report of such holdings with the Secretary of Agriculture.³⁴ It also requires all persons who acquire or disposed of agricultural land on or after February 2, 1979 to report such transactions within ninety days of the transfer.³⁵ In addition, if a foreign person holds land which subsequently is converted to agricultural use or if a person holding agricultural land subsequently becomes a foreign person, the person must file a report within ninety days of such change.³⁶ Failure to report can result in a fine of up to 25% of the fair market value of the interest in the real estate involved.³⁷ A domestic corporation is deemed to be a "foreign person" for purposes of the reporting requirement of the Act if "a significant interest or substantial control in such corporation is held directly or indirectly by foreign persons."³⁸ The regulations define "significant interest or substantial control" as at least a 5% interest.³⁹ The regulations exempt all land which is held in parcels of less than one acre; does not produce agricultural, forestry or timber products generating more than \$1,000 in annual gross sales; and produces products for per-

30. *Id.*

31. Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, 94 Stat. 2682 (1980) (current version at I.R.C. § 897) [hereinafter cited as FIRPTA].

32. *Id.*

33. This was the method used by the General Accounting Office in a sample of counties surveyed. REPORT BY THE COMPTROLLER GENERAL OF THE UNITED STATES, FOREIGN INVESTMENT IN U.S. AGRICULTURAL LAND—HOW IT SHAPES UP, July 30, 1979.

34. AFIDA, *supra* note 17, at 1264 (current version at 7 U.S.C. § 3501 (Supp. II 1978)).

35. *Id.*, 92 Stat. at 1263 (current version at 7 U.S.C. § 3501 (Supp. II 1978)).

36. *Id.*, 92 Stat. at 1264 (current version at 7 U.S.C. § 3501 (Supp. II 1978)).

37. *Id.*, 92 Stat. at 1265 (current version at 7 U.S.C. § 3502 (Supp. II 1978)).

38. *Id.*, 92 Stat. at 1266-67 (current version at 7 U.S.C. § 3508 (Supp. II 1978)).

39. 7 C.F.R. § 781.2(g)(4)(ii) (1981).

sonal use.⁴⁰ The completed report forms are available for public inspection in Washington, D.C. and also are transmitted to each state for foreign-owned agricultural land in that state.⁴¹

Data derived from 11,872 reports filed with the Secretary of Agriculture show that foreign persons including United States corporations, owned 5% or more by foreign persons, owned less than 0.5% of all privately held farmland in the United States as of February 1, 1979.⁴² There are approximately 879 million acres of privately owned farmland in the United States consisting of cropland, pastureland and other agricultural use, such as orchards and vineyards.⁴³ Foreign entities and individuals reported that they owned 658 thousand acres of cropland, 893 thousand acres of pasture and 176 thousand acres of other agricultural land.⁴⁴ United States corporations, owned 5% or more by foreign persons, reported owning 423 thousand acres of cropland, 944 thousand acres of pasture land and 393 thousand acres of other agricultural land.⁴⁵

Individuals or entities from the Netherlands-Antilles, not affiliated with a United States corporation, reported owning 16% of the reported cropland holdings.⁴⁶ Foreign owners with the next largest holdings of cropland were individuals or entities from West Germany (15%) and Canada (7%).⁴⁷ Individuals and entities from the Netherlands-Antilles also reported holding the largest pasture acreage, accounting for 159,480 acres or 8.7% of total foreign holdings of pastureland.⁴⁸ Individuals and entities from West Germany (8.3%) and Mexico (5.6%) reported the next largest holdings of pastureland.⁴⁹ Together, foreign individuals or entities from West Germany, Netherlands-Antilles and Mexico reported owning 415,857 acres or 22.6% of total foreign owned pastureland.⁵⁰ United States/West German, United States/Luxembourg and United States/United Kingdom corporations reported owning a total of 597,445 acres of pastureland or 32.5% of total foreign owned pastureland.⁵¹

IV. STATE LAW RESTRICTIONS ON FOREIGN INVESTMENT IN U.S. FARMLAND

Foreign ownership of United States farmland, as a percentage of total

40. 7 C.F.R. § 781.2(b) (1981).

41. AFIDA, *supra* note 17, at 1266 (current version at 7 U.S.C. § 3505 (Supp. II 1978)).

42. See table 1, *infra*.

43. *Id.*

44. FOREIGN OWNERSHIP, *supra* note 2, at 23.

45. *Id.* at 24.

46. *Id.* at 23.

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.* at 23-24.

51. *Id.* at 24.

privately owned farmland is concentrated in the nonagricultural states⁵² of Arizona (2.6%), California (1.5%), Florida (2.4%), Hawaii (6.1%), Nevada (3.6%), Utah (3.2%), and Vermont (3.0%).⁵³ In only two of the agricultural states, Hawaii and Arizona, were there state laws restricting foreign ownership of state real property during the period covered by the 11,872 reports.⁵⁴ In the agricultural states foreign ownership of farmland, as a percentage of total privately owned farmland, is less than 1% in all states except Delaware where the percentage is 1.02%.⁵⁵ In all of the agricultural states except Kansas, however, foreign owned farmland as a proportion of total foreign owned agricultural land is greater than it is for all privately owned farmland as a percentage of total privately owned agricultural land.⁵⁶ In the states of Delaware, Indiana, Iowa, Minnesota, Nebraska, North Dakota, Oklahoma, and South Dakota 100% of the reported foreign owned agricultural land located in the state is farmland.⁵⁷ Indiana, Iowa, Minnesota, Nebraska, and Oklahoma had state law restrictions on non-resident alien investment in United States farmland during the period covered by the reporting.⁵⁸ Iowa, Minnesota, Nebraska, North Dakota, Oklahoma and South Dakota have restrictions on corporate landholding.⁵⁹

Relating the data on foreign ownership of United States agricultural

52. A "nonagricultural state" is defined as a state in which the proportion of privately owned land to total area of the state is less than 50%. The agricultural states are, in order of concentration: Kansas, Iowa, Nebraska, North Dakota, Texas, Illinois, South Dakota, Indiana, Oklahoma, Missouri, Ohio, Minnesota, Delaware, Montana and Wisconsin. See table 2, *infra*.

53. See *id*.

54. See ARIZ. REV. STAT. ANN. §§ 33-1201-1207 (repealed 1978) (aliens not "eligible for citizenship" cannot hold real estate); ARIZ. REV. STAT. ANN. § 10-484(D) (repealed 1975) (foreign corporations cannot hold real estate); HAWAII REV. STAT. § 206-9(c)(1) (1976).

55. See table 2, *infra*.

56. See *id*.

57. See *id*.

58. See IND. CODE §§ 32-1-2-1 to -8-2 (repealed 1975) (aliens must dispose of Indiana land in excess of 320 acres within 5 years of acquisition); IOWA CODE § 567.1 (repealed 1979) (aliens may hold up to 640 acres of rural land). Effective January 1, 1980 nonresident aliens and foreign businesses cannot purchase or otherwise acquire Iowa agricultural land. IOWA CODE § 567.3 (1981). MINN. STAT. ANN. § 500.22(2) (1969) (current version at MINN. STAT. ANN. § 500.221 (1981)) (aliens may not purchase agricultural land—this restriction does not apply to land acquired by inheritance); NEB. REV. STAT. §§ 76-405 to -409, 4-107 (1976) (aliens can purchase rural land within three miles of a city limit); OKLA. STAT. tit. 60, § 121 (1971) (nonresident aliens may not hold land). In 1979, South Dakota enacted a statute limiting nonresident alien ownership of agricultural land to 160 acres. S.D. COMP. LAWS ANN. § 43-2A-5 (1979).

59. See, IOWA CODE § 567.3 (1981) (foreign corporations and domestic corporations owned by foreign persons may not hold title to Iowa real estate); MINN. STAT. §§ 500.221, .24 (1977) (foreign corporations may not purchase agricultural land and domestic corporations generally cannot purchase farmland); NEB. REV. STAT. §§ 76-402 to -414 (1976) (corporations owned by foreign persons may not hold Nebraska land); N.D. CODE 10-06-01 (1981) (corporations are prohibited from engaging in farming or agriculture); OKLA. STAT. tit. 18, § 951 (1978) (corporations generally may not engage in farming or ranching); S.D. COMP. LAWS ANN. § 47-9A (1974) (corporate ownership of farmland is restricted).

land to current state law restrictions, generally three types of legislation are relevant for the years covered by the reporting requirements of AFIDA: State law restrictions on the purchase of land by nonresident aliens, on the inheritance of land by aliens and on corporate ownership of agricultural land. The effect of these laws, if they were enforced, would be to prohibit individual alien investors living abroad and foreign corporations from purchasing real estate in their own names.⁶⁰ During the period ending December 31, 1980 there were major restrictions on the purchase of real estate by non-resident aliens in the states of Connecticut, Indiana, Iowa, Kentucky, Mississippi, New Hampshire and Oklahoma.⁶¹ Notwithstanding these restrictions, foreign persons reported owning farmland in each of these states with the exception of Connecticut: New Hampshire (3,000 acres), Indiana (93,000 acres), Iowa (27,408 acres), Kentucky (21,000 acres), Mississippi (69,000 acres), Oklahoma (25,000 acres).⁶² Eight states have or had laws restricting inheritance of real property by nonresident aliens.⁶³ Nonresident aliens reported owning farmland in all of these states: North Carolina (103,000 acres); Kentucky (21,000 acres); Nebraska (80,000 acres); Kansas (34,000 acres), Oklahoma (25,000 acres), Montana (272,000 acres), Wyoming (122,000 acres) and California (414,000 acres).⁶⁴

For reporting purposes the foreign organization category includes foreign corporations, United States corporations, 5% or more controlled by foreign persons and foreign estates and trusts.⁶⁵ In each of the nine states⁶⁶

60. In the United States, land law is basically state law. For a history of state law restrictions on foreign investment in United States real estate, see Fisch, *State Regulation of Alien Land Ownership*, 3 Mo. L. Rev. 407 (1978); Morrison, *Limitations on Alien Investment in American Real Estate*, 60 MINN. L. REV. 621 (1976); Sullivan, *Alien Land Laws: an Evaluation*, 36 TEMP. L.Q. 15 (1962); Weber, *Foreign Direct Investment in United States Real Estate: Xenophobic or Principled Reaction?*, 28 U. FLA. L. REV. 491 (1976).

61. See CONN. GEN. STAT. §§ 47-57 to -58 (1949) (nonresident aliens, citizens of France may hold real estate); IND. CODE §§ 32-1-8-1 to -2 (1976) (aliens restricted to 320 acres of land); IOWA CODE § 567.1 (1981) (aliens restricted to 640 acres of rural land during years covered by the reporting); KY. REV. STAT. § 381.300 (1970) (land escheats to state if alien does not become citizen within eight years of acquisition); MISS. CODE ANN. § 89-1-23 (1972) (nonresident aliens may not purchase or hold land except as security for debt; nonresident aliens, citizens of Syria and Lebanon can inherit land); N.H. REV. STAT. § 477.20 (1942); OKLA. STAT. tit. 60, §§ 121-123 (1971) (nonresident alien cannot purchase or hold land).

62. FOREIGN OWNERSHIP, *supra* note 2 at —.

63. CAL. PROB. CODE § 259 (repealed 1974); KAN. STAT. ANN. § 59-511 (1976); KY. REV. STAT. §§ 381.290, .300 (1976); MONT. REV. CODE § 91-520 (repealed 1974); NEB. REV. STAT. §§ 76-405 to -409 (1976); N.C. GEN. STAT. § 64-3 (1959); OKLA. STAT. tit. 60, 123 (1971); WYO. STAT. § 24-15-101 (1977).

In the states of North Carolina, Kansas, Montana, Wyoming and California the right of inheritance is dependent on the existence of a reciprocal right for United States citizens in the country of the alien's citizenship.

64. FOREIGN OWNERSHIP, *supra* note 2, at —.

65. See note 66 *infra*.

66. See IOWA CODE § 567.1 (1979) (for years before 1980); KAN. STAT. ANN. § 17-5901

that restrict landholding by foreign corporations foreign organizations, as defined above, reported owning agricultural land:⁶⁷ Wisconsin (8,006 acres); Minnesota (21,494 acres), Iowa (14,472 acres); North Dakota (4,887 acres), South Dakota (12,710 acres), Nebraska (77,393 acres), Kansas (41,313 acres), Oklahoma (23,442 acres), Texas (319,614 acres).⁶⁸

The data on foreign ownership of United States agricultural land reported pursuant to AFIDA indicates that state-law restrictions on alien land ownership have been of limited significance and generally the rules have had little practical impact.

V. TAX LAW RULES APPLICABLE TO FOREIGN INVESTMENT IN UNITED STATES FARMLAND

This section focuses on the tax rules applicable to investment in United States real estate—in particular farm land—by “foreign persons” as defined by AFIDA.⁶⁹ The tax rules for foreign investment in United States real estate are different depending on whether the investor is a nonresident alien individual,⁷⁰ foreign corporation⁷¹ or other foreign organization, or a United States entity owned by foreign persons. The most common type of foreign owner is a nonresident alien individual.⁷² Corporations, on the other hand, reported owning the most acreage.⁷³ Nonresident alien individuals reported owning 423,790 acres of farmland in the United States.⁷⁴ One thousand two hundred and thirty-one corporate holders (both foreign corporations and United States corporations with foreign interests), reported owning more

(1973) (applicable all corporations); MINN. STAT. § 500.22 (1969); NEB. REV. STAT. § 76-402 (1976); N.D. CENT. CODE § 10-06-01 (1981); OKLA. STAT. tit. 18 § 951 (1978); S.D. COMP. LAWS ANN. § 47-9A (1974) (applicable to all corporations); TEX. STAT. ANN. § 1302-4.01 (Vernon 1977) (applicable to all corporations); WIS. STAT. § 710.01 (1971).

67. Six categories are covered by section 5 of AFIDA: Nonresident alien individuals; foreign corporations and United States corporations owned 5% or more by foreign persons; foreign partnerships and domestic partnerships where the partners are foreign persons; foreign trusts; estates; and, other foreign entities. See AFIDA, *supra* note 17, at 1285-87 (current version at 7 U.S.C. § 1304 (Supp. II 1978)). In the case of indirect holdings through a United States corporation, the indirect foreign owner may be at the end of a series of United States corporations, each of which is defined as “foreign” because owned at least 5% by the preceding United States corporation defined to be a foreign person. See 7 C.F.R. § 781.2(g)(4)(ii) (1981).

68. FOREIGN OWNERSHIP, *supra* note 2, at 11, table 3.

69. See note 63 *supra*.

70. The criteria for determining residence are set forth in Treasury Regulation section 1.871-2(b) (1981). In general, an alien present in the United States on a visitor's visa for less than one year is regarded as a nonresident for tax purposes.

71. A foreign corporation is any corporation incorporated outside the United States. See I.R.C. §§ 7701(a)(4), (5).

72. See FOREIGN OWNERSHIP, *supra* note 2, at 10 table 2 & 27 table 13.

73. *Id.*

74. *Id.*

than seven times the acreage held by individuals.⁷⁵ As of February 1, 1979, corporations reported owning 3,131,586 acres or 75% of the total acreage of foreign-owned farmland reported.⁷⁶ The remaining 1% of United States farmland reported was held by foreign estates, trusts, church groups and other foreign associations.⁷⁷

A. *Tax Rules Applicable to Real Property Income of Nonresident Alien Individuals and Foreign Corporations*

The Federal income tax rules applicable to the taxation of nonresident alien individuals and foreign corporations were completely revised in 1966 by the Foreign Investors' Tax Act (FITA).⁷⁸ The tax rules applicable to the taxation of real property capital gain income of a nonresident alien individual or foreign corporation were further revised in 1980 by the Foreign Investment in Real Property Tax Act (FIRPTA).⁷⁹ The FITA rules are set forth in sections 871 and 881 of the Internal Revenue Code. The FIRPTA rules are set forth in new section 897 of the Internal Revenue Code. These rules apply where there is no tax treaty or the applicable treaty does not modify the statutory rule.⁸⁰ The purpose of the FITA rules is to separate the tax treatment of investment income from the tax treatment of income "effectively connected" with the conduct of a trade or business.⁸¹ Investment income is taxed on a gross basis at the rate of 30% or lower treaty rate.⁸² The tax is withheld at the source.⁸³ Generally, effectively connected income is subject to tax at ordinary rates;⁸⁴ gain from the disposition of business assets is taxed as capital gain.⁸⁵ Neither FITA nor FIRPTA change the long established rule that mere ownership of United States real property does not cause the foreign investor to be engaged in a United States trade or business. There must be some level of active management⁸⁶ or an election to treat the operating income from real property as effectively connected in-

75. *Id.*

76. *Id.*

77. *Id.*

78. Foreign Investment Tax Act, Pub. L. No. 89-809, 80 Stat. 1539 (1966) (current version at I.R.C. § 896) [hereinafter cited as FITA]. For Committee Reports on Pub. L. No. 89-809 see 1966-2 C.B. 967, 1059, 1116.

79. FIRPTA, *supra* note 31. For Committee Reports on Pub. L. No. 96-499 see 6 STAND. FED. TAX REP. (CCH) ¶ 4199E (1981).

80. The United States is a party to 26 double taxation conventions (treaties). "The conventions are applicable to 38 independent nations, and eight territories of other nations." U.S. DEP'T OF THE TREASURY, TAXATION OF FOREIGN INVESTMENTS IN U.S. REAL ESTATE 35 (1979).

81. See FITA, *supra* note 78, at 1541.

82. I.R.C. §§ 871, 881, 882.

83. *Id.* §§ 1441, 1442.

84. *Id.* §§ 871(b), 882.

85. *Id.* §§ 871(a)(2), 882(1).

86. Jan Casemer Lewenhaupt, 20 T.C. 151 (1953), *aff'd per curiam* 221 F.2d 227 (9th Cir. 1955).

come.⁸⁷ A net basis election, once made, remains in effect for all subsequent years unless revoked with the consent of the Commissioner.⁸⁸ Before amendment by FIRPTA, income from real property held for investment or ownership of property subject to a net lease was subject to the 30% withholding tax.⁸⁹ Gain on the disposition on such property received by a foreign corporation or non-resident alien not present in the United States for 183 days or more was exempt from tax⁹⁰ provided a net basis election had not been made.⁹¹ Noneffectively connected capital gain received by a nonresident alien present in the United States for 183 days or more was taxed at the 30% rate.⁹² For taxable years beginning in 1980, capital gain realized on the sale or other disposition of United States real property is taxable as effectively connected income⁹³ whether or not a net basis election was made or the seller was present in the United States for 183 days or more.⁹⁴ If the foreign person is a resident of a treaty country, the question is whether the agricultural investment activity constitutes a permanent establishment⁹⁵ in the United States. In principle, if the agricultural investment activity constitutes a trade or business, but is not conducted through a permanent establishment, the treaty would have the effect of exempting from United States tax income which otherwise would be subject to United States tax at ordinary rates and on a net basis.⁹⁶ If a foreign corporation or nonresident alien individual is engaged in trade or business in the United States by reason of

87. I.R.C. §§ 871(d), 882(d).

88. *Id.*

89. *See id.* §§ 871, 881.

90. *Id.* § 871(a)(2). In addition, there were a number of techniques available to a foreign investor engaged in a trade or business in the United States to avoid tax on capital gains. These techniques included a tax-free exchange for non-United States property, an installment sale where the gain would be reported in years when the foreign seller was not engaged in business in the United States and a sale pursuant to a section 337 liquidation of a corporation holding the real estate investment.

91. *Id.* §§ 871(d), 882(d).

92. *Id.* § 871(a)(2).

93. *Id.* § 897(a)(1).

94. *Id.* § 897. If real property is held for investment or as part of a trade or business (other than as inventory) capital gain will result except for depreciation recapture. *Id.* §§ 1245, 1250. If the property is held as inventory, gain will be taxed at ordinary income rates. For a discussion of FIRPTA see Feder and Parker, *The Foreign Investment in Real Property Tax Act of 1980*, 34 TAX LAWYER 545 (1980); Olsen, *Analysis of the Foreign Investment in Real Property Tax Act of 1980*, 7 INT'L TAX J. 262 (1981).

95. The "permanent establishment concept" is defined as a fixed place of business through which the business of an enterprise is carried on. In general, the treaty concept is synonymous with the statutory concept of carrying on a trade or business through an "office or other fixed place of business." I.R.C. § 864(c)(4). In the case of real estate, the statutory concept of having a trade or business and the treaty concept of permanent establishment are synonymous.

96. For an example of this situation, see U.S.-United Kingdom Income Tax Convention, January 1, 1945, United States-United Kingdom of Great Britain, Art. VII, 26 C.F.R. — (1981).

the ownership of agricultural property, he is allowed a foreign tax credit against the United States tax for any foreign income taxes paid or accrued to a foreign country with respect to the effectively connected real property income.⁹⁷

Most of the nonresident aliens and foreign corporations that invest directly in United States agricultural land are residents of treaty countries: 3,474 treaty country residents or 85% of the total of 4,082 foreign owners reporting, reported owning 2,500,525 acres or 79% of the total agricultural acreage owned by foreign persons.⁹⁸ The principal treaty country investors in United States, agricultural land are from Canada (2,047 owners, 1,236,603 acres), Germany (457 owners, 380,724 acres), Netherlands-Antilles (213 owners, 373,024 acres) and the United Kingdom (80 owners, 247,011 acres).⁹⁹ The tax treaties between these countries and the United States make them attractive places from which to make a direct investment in United States real estate. Treaties with each of these countries provide that the treaty resident can make a net basis election with respect to United States "rentals from real property" in the United States on a year by year basis.¹⁰⁰ Prior to FIRPTA, the result was that the foreign person could avoid tax on United States capital gains by selling the property in a year in which the election to be taxed on a net basis had been revoked. Under the treaties with Canada and the United Kingdom real property income is subject to tax withheld at source at the reduced rate of 15%;¹⁰¹ under treaties with Germany and the Netherlands-Antilles real property income is subject to tax withheld at source at the statutory rate of 30%.¹⁰²

B. Tax Rules Applicable to Real Estate Investment by Nonresident Aliens and Foreign Corporations through a United States Corporation

A nonresident alien individual or foreign corporation that invests in a United States corporation is not deemed to be engaged in trade or business

97. I.R.C. §§ 906, 901.

98. FOREIGN OWNERSHIP, *supra* note 2, at 15.

99. *Id.*

100. U.S.-Germany Income Tax Convention, July 22, 1954, United States-Germany, Art. IX(2), 26 C.F.R. § 503 (1981); U.S.-Netherlands Income Tax Convention, April 29, 1948, United States-Netherlands, Art. VII, 26 C.F.R. § 505 (1981); U.S.-United Kingdom Income Tax Convention, January 1, 1945, United States-United Kingdom of Great Britain, Art. VI, 26 C.F.R. § 507 (1981) (effective for years after January 1, 1945 and before April 25, 1980); U.S.-Canada Income Tax Convention, March 6, 1942, United States-Canada, Art. XIII, 26 C.F.R. § 519.1 (1981). Under FIRPTA section 1125(c) existing treaty provisions will not be overridden until December 31, 1984, except for a treaty negotiated before January 1, 1985. FIRPTA, *supra* note 31, at 2690-91. An override date may be specified which may be up to two years after signing. *Id.* at 2691.

101. See U.S.-Canada Income Tax Convention, March 6, 1942, United States-Canada, Art. XI(1); 7 C.F.R. § 507.5 (1981).

102. I.R.C. §§ 1441, 1442.

in the United States by reason of such stock ownership.¹⁰³ The income of the United States corporation is taxed in accordance with the normal rules applicable to all United States' corporations.¹⁰⁴ Dividends paid by the corporation to the nonresident alien individual or foreign corporation are subject to tax withheld at source at the 30% statutory or lower treaty rate.¹⁰⁵ Prior to amendment by FIRPTA, a nonresident alien individual not present in the United States or foreign corporation owning stock in a United States corporation that owned United States real property was not taxed on gain realized on the sale of the stock.¹⁰⁶ Under FIRPTA, if the domestic corporation qualifies as a United States real property holding organization, gain on disposition of the stock is subject to tax as effectively connected income.¹⁰⁷

Most of the foreign investments in United States agricultural land made through a United States corporation are made by residents of treaty countries: 572 treaty country residents or 79% of the total of 724 United States companies owned 5% or more by foreign persons, reported owning 3,218,534 acres or 92% of the total agricultural acreage owned by such companies.¹⁰⁸ The principal treaty country investors through United States corporate owners of United States agricultural land are: Germany (76 owners, 293,999 acres), Luxembourg (20 owners, 443,473 acres), Netherlands (34 owners, 300,742 acres), Netherlands-Antilles (52 owners, 168,619 acres) and the United Kingdom (46 owners, 1,259,868 acres).¹⁰⁹ Investors from these treaty countries are subject to United States tax on dividends at the reduced rate of 15%.¹¹⁰ Since, however, investors from all treaty countries except the treaty countries of Greece, Pakistan, South Africa, Trinidad and Tobago, Zaire and Zambia are entitled to the reduced 15% rate, it does not appear that the 15% reduced treaty rate has been a factor in foreign investment in United States agricultural land through a United States corporation.

C. Tax Rules Applicable to Real Estate Investment by Nonresident Aliens and Foreign Corporations through a United States Partnership

A direct investment in United States agricultural land may be made by a foreign person through either a domestic or a foreign partnership. Al-

103. *Id.* § 864(b)(2)(A).

104. *Id.* § 882(a).

105. *Id.* § 871(a)(1)(A).

106. *See id.* §§ 871, 881.

107. I.R.C. § 897(h).

108. FOREIGN OWNERSHIP, *supra* note 2, at 16.

109. *Id.*

110. *See* U.S.-Germany Income Tax Convention, July 22, 1954, United States-Germany, Art. VI, 26 C.F.R. § 503 (1981); U.S.-Netherlands Income Tax Convention, April 29, 1948, United States-Netherlands, Art. XII, 26 C.F.R. § 505 (1981); U.S.-United Kingdom Income Tax Convention, January 2, 1945, United States-United Kingdom of Great Britain, Art. VI, 26 C.F.R. § 507 (1981) (for taxable years after January 1, 1945 and before April 25, 1980).

though a partnership is not subject to United States tax, income is calculated and reported at the partnership level.¹¹¹ The partners account for their distributive share of the partnership income, gains and deductions, and report the distributive shares on their individual or corporate United States income tax returns, whether or not actually distributed by the partnership.¹¹² Normally, the character of the gain or loss is preserved as it passes through the partnership to the partner.¹¹³ Generally, a foreign person who is a partner in a United States partnership that is engaged in business in the United States is regarded also as engaged in business.¹¹⁴ This means that the nonresident alien or foreign corporation is taxed on a net basis at ordinary rates rather than on a gross basis at the 30% or lower treaty rate. A partnership may elect not to be covered by the partnership tax provisions with respect to ventures that are used for investment and not for the active conduct of a business.¹¹⁵ This election is commonly made by real estate investors who lease property under a net lease. If such an election is in effect, each partner is entitled to treat the ownership of the underlying property as if it were owned directly.¹¹⁶

Since a partnership is not a taxable entity, the tax treatment of either a domestic or a foreign partnership having United States source income depends on the tax status of the partners. The distributive share of partnership income of a nonresident alien individual or foreign corporation is generally taxed in the same manner as if it had been received directly. The determination, however, as to the source and type of income, is made at the partnership level.¹¹⁷ The rules for determining the tax effects of a sale of a partnership interest by a nonresident alien or foreign corporation are not clear. It may be that the sale of a partnership interest that takes place outside the United States is not subject to United States tax.

Investment in United States farmland through the partnership form is not a significant percentage of the total foreign investment in United States farmland. Four hundred and eighty six partnerships reported owning 528,314 acres of farmland.¹¹⁸ This is 12.7% of the total farmland acreage owned by foreign persons.¹¹⁹

VI. CONCLUSION

Foreign investment in United States farmland is not, at present, a sig-

111. I.R.C. § 701.

112. I.R.C. § 702.

113. I.R.C. § 702(b).

114. I.R.C. § 875(1).

115. I.R.C. § 761(a); Treas. Reg. § 1.761-2 (1972).

116. *Id.*

117. I.R.C. § 701.

118. FOREIGN OWNERSHIP, *supra* note 2.

119. *See id.*

nificant percentage of total investment in privately owned farmland.

The reporting requirements of AFIDA establish a reliable data base on foreign investment in United States farmland. The states will be able to watch the trend in foreign acquisitions and to take corrective action if they perceive the level of absentee foreign ownership to be a threat either to United States control over its own food supply or to family farm ownership and rural communities. The changes in the tax laws made by FIRPTA to tax capital gain realized on the disposition of United States real estate removes this tax advantage as a competitive factor in the bidding for scarce farmland resources.

TABLE 1.

Proportion of Foreign Owned Farmland to Total Farmland¹
February 1, 1979

	Privately Owned Farmland ^a (1000 acres)	Foreign Owned Farmland ^a (1000 acres)	Proportion of Foreign Owned Farmland to Total Privately Owned Farmland	Proportion of Foreign Owned Agricultural Land To Total Privately Owned Agricultural Land ^a
Alabama	9,125	6	Neg	0.6%
Alaska	111	—	—	0.1
Arizona	9,953	155	2.60%	1.4
Arkansas	13,672	51	0.37	0.2
California	26,897	414	1.54	0.9
Colorado	29,443	230	0.78	0.6
Connecticut	569	—	—	Neg
Delaware	687	7	1.02	0.6
Florida	12,307	297	2.41	1.2
Georgia	9,749	113	1.16	1.0
Hawaii	791	48	6.07	2.4
Idaho	10,341	13	0.13	0.1
Illinois	28,830	109	0.38	0.3
Indiana	17,412	93	0.53	0.4
Iowa	32,547	27	0.08	0.1
Kansas	48,609	34	0.07	0.1
Kentucky	11,655	19	0.16	0.1
Louisiana	12,938	91	0.70	0.4
Maine	1,608	18	1.12	5.1
Maryland	2,785	23	0.83	0.4
Massachusetts	784	—	—	Neg
Michigan	13,843	10	0.07	0.2
Minnesota	28,097	28	0.10	0.1
Mississippi	11,469	59	9.60	0.3
Missouri	28,950	57	0.20	0.2
Montana	47,707	272	0.57	0.5
Nebraska	44,457	80	0.18	0.2
Nevada	4,313	156	3.62	2.1
New Hampshire	468	3	0.64	0.7
New Jersey	1,362	20	1.47	0.7
New Mexico	26,602	313	1.18	0.9
New York	10,219	37	0.36	0.9
North Carolina	9,389	103	1.10	0.6
North Dakota	39,329	18	0.05	Neg
Ohio	16,893	25	0.15	0.1
Oklahoma	31,101	25	0.08	0.1
Oregon	14,087	164	1.16	0.7
Pennsylvania	8,041	36	0.45	0.7
Rhode Island	71	—	—	—
S. Carolina	4,844	39	0.81	1.8
S. Dakota	38,008	19	0.05	Neg
Tennessee	11,183	9	0.08	1.3
Texas	134,364	426	0.32	0.8
Utah	6,888	223	3.24	2.1
Vermont	1,163	35	3.01	1.0
Virginia	7,313	29	0.40	0.3

Washington	13,109	95	0.72	0.4
West Virginia	3,279	1	0.03	0.2
Wisconsin	17,516	13	0.07	Neg
Wyoming	24,289	122	0.50	0.5
Total	879,167	4,175	0.47	

1. Farmland includes cropland, pastureland, vineyards and orchards.
2. Based on T. Frey, unpublished data, Econ. Stat. and Coop. Service, U.S. Dept. Agr., 1979.
3. Computed from Tables 1 and 11, Foreign Ownership of U.S. Agricultural Land, Econ. and Stat. Service, U.S. Dept. Agr., Bulletin No. 448
4. Agricultural land includes farmland as defined above plus forest land, range, and miscellaneous rural land. Column 4 is taken from column 4, Table 1, *supra* at 9.

TABLE 2.

Agricultural States

State	Proportion of Privately Owned Agricultural Land to Total Area of State	Proportion of Privately Owned Farmland to Total Privately Owned Agricultural Land	Proportion of Foreign Owned Farmland to Total Foreign Owned Agricultural Land	Proportion of Foreign Owned Farmland to Total Privately Owned Farmland
Kansas	92.86%	97.39%	77.27%	0.07%
Iowa	90.91	95.97	100	0.08
Nebraska	90.82	97.93	100	0.18
North Dakota	88.70	99.27	100	0.05
Texas	80.09	85.71	96.82	0.32
Illinois	80.80	80.19	99.09	0.38
South Dakota	78.19	99.39	100	0.05
Indiana	75.37	83.28	100	0.53
Oklahoma	70.65	80.00	100	0.08
Missouri	65.56	72.33	95	0.20
Ohio	64.42	73.51	96.15	0.15
Minnesota	55.37	77.61	100	0.10
Delaware	54.18	64.57	100	1.02
Montana	51.20	88.04	99.63	0.57
Wisconsin	50.25	63.38	92.86	0.07

