Foreign Nationals
And
The New FIRPTA Compliance

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What is FIRPTA?

- The **F**oreign **I**nvestment in **R**eal **P**roperty **T**ax **A**ct is the Federal law governing the taxation & withholding by foreign persons selling U.S. real estate.
- Under the old FIRPTA Rules, the buyer was required to withhold 10% of the gross sales price.*
- Under the new FIRPTA, the withholding was increased to 15% of the gross sales price. In addition, there is a distinction for Buyers using the property as a "Personal Residence" with varying treatment at different sales prices.*

*Certain exceptions apply

FIRPTA Criteria

Foreign Person

- A "foreign person" is defined under FIRPTA as a nonresident alien individual, foreign corporation, partnership, trust or foreign estate.
- This is completely separate from Immigration Status.
- Green Card Holders are not Automatically exempt.
- Key question to ask Seller is what type of U.S. Tax Return they file. 1040 or 1040NR?

What is a Personal Residence?

What is a "Personal Residence" according to IRS?

- Buyer or members of Buyer's family (ancestors, siblings, spouse and lineal descendants) INTEND to use the property as a residence for at least ½ the time the property will be used by anyone as a residence during the first two 12-month periods following the purchase.
- If the Buyer is acquiring the property to use as a rental 100% of the time this is NOT a Personal Residence.

What is a Personal Residence?

In ENGLISH???

- Buyer or family intend to use the property.
- At least ½ of the time of the first two 12-month periods.
  - IT IS NOT CORRECT TO SAY FIRST 2 YEARS! The 12 month periods are examined separately.
- Time the property is vacant does not count against the personal use.
- Example: Buyer intends to use the property for 3 months. They can rent it out for a maximum of 3 months and it can sit vacant for 6 months.

What is a Personal Residence?

- If the total price of the property is more than $1,000,000.00, then 15% of the gross sale should be paid to the IRS.
- The 10% or 15% withholding the from gross proceeds are due to IRS within 20 days after closing when purchasing from a foreign seller.
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- A granted Application for a "Withholding Certificate" may allow lesser amount withheld at closing. Remit amount within 20 days of date of Certificate.

Why Withhold?

- The IRS requires the 15% withholding as a prepayment of the capital gains tax that could be due as a result of the sale.
- Because the Seller is foreign, the IRS wants to ensure that a tax return is filed and the capital gains tax is paid before the taxpayer leaves the country.
- 15% is the maximum long term capital gains tax rate and it is applied to the full sales price to ensure the maximum tax is remitted.

Withholding Thresholds

If Buyer is acquiring for use as a Residence, the following withholding schedule applies:

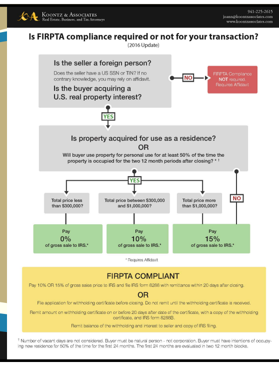
- 0% withholding - The sales price is $300,000 or less
- 10% withholding – The sales price is greater than $300,000 but not more than $1,000,000
- 15% withholding – The sales price is greater than $1,000,000

- Short Sales – withholding still required!

Exemptions

Withholding Certificate

- A Seller may apply for a withholding certificate (IRS Form 8288-B) allowing less than 10% or 15% withholding if the tax due from the sale will be less than the withholding AND the calculation is properly documented.
- IRS typically takes 90 days to issue from receipt of application.
- This application can be made as soon as the Seller goes under contract – a copy of the contract must be attached to the application.



What if…

If the Buyer is **NOT** acquiring the property for use as a Residence,

15% withholding applies at any price.

The After-PATH

- Section 203 of the Protecting Americans from Tax Hikes (PATH ACT) requires ITIN applicants residing outside the U.S. can only submit their W-7, Application for an Individual Taxpayer Identification Number, by:
  - mailing their completed W-7 application along with all required identification documents to the IRS address listed in the application

    OR
  - making an appointment at an IRS Taxpayer Assistance Center in lieu of mailing original identification documents, if the applicant(s) is physically in the United States.

The After-PATH

- You will have to have your appointment for the ITIN PRIOR to the closing date. I would suggest we obtain an appointment earlier in the week of closing in case there are any issues.
- The only other alternative would be to NOT file the Withholding Certificate application, allow IRS to hold the full 15% ($450,000 x 15% = $67,500) until after January 2018 when you could file a US tax return to receive a refund of your deposit. That would still require you to come here and have the appointment at IRS before you could do so.

Recap

- 15% of the gross sale price <u>must</u> be paid to the IRS,

  <u>UNLESS</u>:
  - Buyer signs the Personal Use Affidavit AND sales price is under $300,000 (0%) or under $1,000,000 (10%).

    <u>OR</u>
  - A "Withholding Certificate" Application has been submitted and approved allowing reduced amount withheld at closing.

Case Study 1

- Seller is selling property to Buyer for the purchase price of $250,000. Buyer intends to occupy the property for 6 months and rent it out 2 months for the first two 12 month periods. Buyer is willing to sign the appropriate affidavit at closing. How much is withheld?

Answer:

No withholding is required since the purchase price is $300,000 or less, and Buyer will occupy the property for 6 out of the 8 months that the property is occupied for the first two 12-month periods, thus satisfying the withholding exemption.

Case Study 2

- What if the same set of facts but the Buyer is Eli Manning Development Corporation, Inc., a New York corporation? How much is withheld?

Answer:

15% of the gross sales price is withheld at closing since the Buyer must be an individual for the withholding exemption to apply.

Case Study 3

- What if the same set of facts as #1, but the Buyer has a change in family circumstances and is unable to occupy the property as intended? What happens?

Answer:

No impact as a result of the change in circumstances. The test is the Buyer's intention at the time of closing. Provided the intent to occupy as described in #1 was there, then there is no issue with signing the affidavit.

Case Study 4

- Seller is selling property to Buyer for the purchase price of $650,000. The Buyer intends to occupy the property as his primary residence and is willing to sign the appropriate affidavit at closing. How much is withheld?

Answer:

10% of the gross sales price is withheld at closing.

Case Study 5

- What if the same set of facts as #4, but Buyer refuses to sign the affidavit at closing? How much is withheld?

Answer:

15% of the gross sales price.

Case Study 6

- Seller is selling property for the purchase price of $4,000,000. The Buyer intends to occupy the property as their primary residence and will sign anything that helps the Seller avoid the withholding, as they have become friendly during the pendency of this transaction. How much is withheld?

Answer:

15% of the gross sales price is withheld for any sales price exceeding $1,000,000 regardless of the Buyers intended use.

Case Study 7

- John Lennon Development, LLC, a single member New Jersey limited liability company (owned solely by a Non-US tax resident) is selling property for the purchase price of $250,000. Buyer intends to use the property as a rental property 100% of the time it is in use, because it is so desirable. How much is withheld?

Answer:

15% of the gross sales price.

Case Study 8

- What if the same set of facts as #7, but the Seller is a Multi Member LLC that is considered a partnership with foreign partners? How much is withheld?

Answer:

FIRPTA doesn't apply at closing.

What happens is:

- Partnership prepares a tax return and reports capital gain from disposition.

- Partnership with foreign partners requires to file Forms 8804/8805 and that's where the calculation comes in.
  - Anytime there is income in the partnership, the partnership is required to send a check with Form 8804 based on approximate calculation of tax impact on that income. Capital gains are subject to a 40% rate. This essentially becomes the withholding and the partnership remits the 40% x Capital Gain with Form 8804 when filing partnership tax return (Due March 15 or September 15 on extension).

- The partners in turn can file their own 1040NRs and show their respective shares of the capital gain and tax calculated on it. Most of the time the tax on capital gain calculated at personal level is much less than 40% tax applied at partnership level, so the partners are then able to get a refund of excess withholding when they file their own 1040NR.

Case Study 9

- What is the same set of facts as #7, but the Seller is a Multi Member LLC or Single Member LLC that has elected to be taxed as a C Corporation?

Answer:

The withholding applies at closing, in the same way as it applies to the individual.

Questions?

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