

Real estate, FIRPTA and you

Be sure all parties are following the same rules **Interviewed by Steve Trusty**

Tax laws are different for foreign investors than they are for U.S. investors. The Foreign Investment in Real Property Tax Act (FIRPTA) of 1980 was enacted to encourage tax compliance when a foreign investor sells real estate. U.S. buyers, sellers and realtors who are parties to a real estate transaction involving a foreign investor all need to be aware of FIRPTA.

"It is imperative that you determine at the beginning of a real estate transaction if a foreign entity or investor is involved," says Monte S. Gordon, a partner at Coral Gables-based Berenfeld, Spritzer, Shechter & Sheer, LLP. "If a foreign investor is involved it is most helpful to consult with your CPA at the outset of the discussions to make sure that you are complying with all aspects of FIRPTA."

Smart Business talked with Gordon for more insight into what needs to be known concerning real estate transactions involving foreign investors and when it needs to be known.

What is the main FIRPTA compliance requirement?

FIRPTA puts the burden on the buyer to withhold a portion of the proceeds that they would normally give to the seller. The buyer must then file this withholding with the IRS as prepayment of the foreign seller's tax. Under most situations, this Act requires a mandatory withholding of 10 percent of the purchase price when a foreign investor sells a U.S. real property interest, which is broadly defined. This applies both to real estate and options to purchase, such as preconstruction contracts. The funds must be sent to the IRS within 20 days of the date of sale. If the seller is a foreign person and withholding does not take place in accordance with the law,



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the buyer and the agent may be held liable for the tax.

Are there exemptions to this withholding requirement?

Yes. One of the most common is where the real property is purchased for use as a personal residence and the purchase price is not more than \$300,000.

In certain situations the foreign seller may have lost money on the sale or only made a small profit and the 10 percent of the purchase price significantly exceeds the real tax the foreign seller would be required to pay. If this is the case, the seller can submit an application to the IRS requesting that the amount withheld by the buyer is for a lower amount. In order to submit this application for reduced withholding (Form 8288-B), both the buyer and seller must have a tax identification number (ITIN) or submit an application for an ITIN along with Form 8288-B. If you are going to submit an application for reduced withholding, you need to do this in advance of the sale because it can take the

IRS up to three months to approve it. Depending upon circumstances, the parties may want to delay the closing. Talk to your CPA and review IRS Publication 515 for more details on exemptions.

Does this law have any application to rental property?

No, but the foreign owner must annually file an income tax return and pay the tax. To assist the IRS with collecting money from the foreign landlord, the IRS has put the burden on the renter to withhold 30 percent (without deductions) of the rent, unless a tax treaty provides a lower rate or an exemption or the lessor provides the tenant with certain tax forms. This rule also applies to property managers. Those who do not comply with these rules will be held liable for 30 percent of gross rent, plus penalties and interest.

What considerations have to be made by the foreign investor when buying?

There are various options that the buyer has regarding how to take title of the property. It can be individually, through a flow-through entity, domestic corporation or foreign corporation. Foreign persons who die while owning U.S. real property are subject to estate tax and only have a \$60,000 exemption whereas a U.S. person would have a \$2 million exemption. The foreign buyer needs to be aware of the estate tax and income tax ramifications. It is essential that this decision is made prior to the purchase.

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