

FIRPTA

(Foreign Investment in Real Property Tax Act)

A Quick Overview

By DAVID S. VELEBER AND BRUCE A. ZAWODNIAK

What Is FIRPTA?

FIRPTA is the IRS acronym for the Foreign Investment in Real Property Tax Act, 26 USC Sect. 897. While there are no prohibitions on non-US citizens holding title to real property, when those owners sell, they are subject to the same capital gains taxes that US citizens pay. In order to ensure that any such gains are reported and any tax due is paid, the U.S. Congress legislated a withholding requirement at 26 USC Sect. 1445, and the IRS has implemented regulations regarding that requirement.

Why Do I Need to Worry about It?

If you represent the buyer from a non-US citizen who is subject to the tax and you fail to withhold the required amount, your client may be liable for the payment of any tax, interest, and penalties that are due if the seller fails to pay. Even if the seller pays the tax, the buyer may be liable for the interest and penalties for late payment or non-filing.

What Is Required?

In any *disposition* of a *US real property interest* by a *foreign person*, the *transferee* is required to withhold an amount equal to 10 percent or 15 percent (depending on the amount realized and the intended use by the transferee) of the *amount realized* from the *transferor's* proceeds and send it to the IRS along with the proper forms.

The italicized words in the above statement all have defined meanings under the IRS regulations, 26 CFR Sect. 1.1445-1 *et seq.* Note these important items regarding the definitions:

1. A “*foreign person*” includes a non-resident, non-US citizen, and non-US corporations (except those that have made a valid election under section 897(i) of the Internal Revenue Code to be treated as a domestic corporation), partnerships, trusts, estates, and limited liability companies.



This article is a brief overview of the nature and scope of, and requirements under, FIRPTA, and its impact on attorneys representing buyers and sellers. Learn more about this topic at the 2021 Connecticut Legal Conference in **RP03 FIRPTA (Foreign Investment in Real Property Tax Act)**. Register online at ctlegalconference.com.

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A non-US citizen who has resident status (“green card” status) is not a foreign person for FIRPTA purposes and is considered a lawful US resident. A person who meets the “substantial presence” test may also be considered a resident alien for tax purposes.

2. The “amount realized” is the purchase price or the consideration paid. It is not just the net proceeds.

The amount withheld must be remitted to the IRS along with Form 8288 and Form 8288-A. Both forms require that the transferee’s and transferor’s Taxpayer Identification Number (TIN) be provided. In the case of a foreign person who does not have a social security number or does not qualify for one, a Form W-7 must also be completed and submitted with the Forms 8288 and 8288-A. An Individual Taxpayer Identification Number (ITIN) will be assigned and can be used to file the subsequent tax return.

The tax on Form 8288 is due to the IRS by the 20th day after the date of transfer. An extension of the time to pay over the withholding is permitted if the taxpayer has filed an application for a certificate of waiver from the withholding requirement (a withholding certificate), and has not yet received a decision. Once the IRS makes a determination on the withholding certificate and on



what funds (if any) are due, the funds are due to the IRS within 20 days of that determination.

Are There Exceptions to the Filing Requirement?

Yes. If the transfer is a gift and no liabilities are being assumed, the amount realized is zero, and no withholding is required.

Also, if the transferor is not a foreign person within the definition set out in 26 CFR Sect. 1.1445-2(b)(2), no withholding or filing is required. This section allows the transferee to demand and to rely on a certification of non-foreign status (aka the non-foreign or FIRPTA affidavit) obtained from the transferor. The certification must be retained for five years.

There are four certification forms: Individual, Entity, Owner of Disregarded Entity—Individual, and Owner of Disregarded Entity—Other Entities.

A “disregarded entity” is defined in 26 CFR Sect. 1.1445-2(b)(2) (iii). The most common form of disregarded entity is the single member LLC where the member uses his/her own social security number for the entity tax identification number. The owner of the disregarded entity is treated as the transferor of property and must provide a certificate of non-foreign status to avoid withholding.

A further exemption from the requirement to withhold is found at 26 CFR 1.1445-2(d). This section applies when:

1. the amount realized by the transferor is not more than \$300,000; AND
2. at the date of the transfer, the transferee or member of the transferee’s family has definite plans to reside in the property for at least 50 percent of the time the property is occupied during each year of the two-year period following the transfer. The transferee must be an individual.

If you intend, as the buyer’s counsel, to rely on this exemption, you should obtain written confirmation from your clients of their present intent to occupy the property in the manner required by the regulations. Although the exemption may be available, the buyer does not need to proceed under the exemption and can still

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require the requisite amount to be withheld.

The Withholding Certificate—A Seller's Option

Foreign persons who are about to transfer title to real estate may avoid withholding under certain circumstances if they apply for and obtain a withholding certificate pursuant to 26 CFR Sect. 1.1445-3. Grounds for requesting a withholding certificate include the fact that the amount to be withheld exceeds the taxpayer's maximum tax liability, the reduced amount would not jeopardize collection, the transferor is exempt from the payment of US tax, or the transferor has entered into a separate agreement with the IRS for payment of the tax.

There are six categories of applications for a withholding certificate. IRS Publication 515 provides a good discussion of the six categories and the instructions for requesting the certificate. The most common situations would use a Form 8288-B to apply for the withholding certificate.

If the foreign person does not have a taxpayer identification number or an ITIN, an application to obtain the tax identification number (using Form W-7) must be submitted and an identification number obtained. Note that the IRS will not process a request for a withholding certificate without a taxpayer identification number or ITIN.

Processing such an application for a withholding certificate takes time. Applications should be made as soon as possible before closing.

Summary

FIRPTA should be a consideration in every closing you do. If you represent a buyer, you should obtain a certification of non-foreign status (if applicable) in every instance to protect your client. If withholding is in fact required, ensure that sufficient funds are withheld and processed correctly. If you represent a seller, you should determine early in the process whether the seller is a foreign person within the meaning of FIRPTA, and explore the withholding requirement. Early action will avoid a closing disruption. ■

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