

Foreign Investment in U.S. Real Estate

Non-U.S. persons who sell real property in the United States, or U.S. persons who buy U.S.-based real property from non-U.S. persons, are subject to the Foreign Investment in Real Property Tax Act (FIRPTA). Additionally, there are special reporting requirements if a foreign person buys U.S. real estate to rent it out.

What is FIRPTA?

FIRPTA stands for “Foreign Investment in Real Property Tax Act.” It was enacted in 1980 and has two primary components:

- ▶ Anyone buying a U.S.-located property interest from a foreign seller must deduct and withhold a tax equal to 10% of the sales price.
- ▶ The foreign seller is taxed as if they are engaged in a trade or business in the U.S.

To Whom and What Does FIRPTA Apply?

FIRPTA applies to a foreign person (individual or business) selling or disposing of a U.S. interest in real property. If the property is jointly owned, both owners are subject to FIRPTA.

When Does it Apply? What Forms Do I Use?

The withheld tax must be reported and remitted to the IRS by the 20th day after the date of the transfer (typically the closing date). Form 8288, “U.S. Withholding Tax Return for Dispositions by Foreign Persons of Real Property Interests,” and Form 8288-A, “Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests,” are used for this purpose.

What Are the Exceptions to the Withholding Requirement?

There are three common exceptions:

- ▶ The transaction is exempt from withholding if the seller furnishes a statement to the buyer that the seller is not a foreign person.
- ▶ The property is not sold but is transferred in a gift, inherited or transferred in certain other non-sale transactions.

- ▶ A U.S. buyer will use the property as a principal residence, and the sale price is less than \$300,000.

Who is Responsible for Withholding the Tax?

The buyer of the property is responsible for meeting the withholding tax requirements. Joint buyers of property are each responsible for meeting the requirements.

Are There Penalties if the Tax Was Not Withheld?

A person who is required to deduct and withhold tax but fails to do so may be held liable for the payment of the tax and any applicable penalties and interest.

How Can I Reduce or Eliminate the Withholding Tax?

The primary way to do this is to prove to the IRS that the tax on any gain from selling the property will be less than the 10% default withholding tax. This is done using a withholding certificate (Form 8288-B). An application for withholding certificate must be mailed to the IRS prior to the closing date of the sale.

Who Needs to File a Tax Return to Report the Sale?

Since the FIRPTA rules treat the property seller as being engaged in a U.S. trade or business, a tax return must be filed reporting the sale proceeds, less the seller’s cost basis in the property (including improvements) and any selling expenses. Any resulting gain will be taxed, and any withholding

Turn Page for Additional Information

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tax taken will be allowed as a refundable credit against tax assessed. It is important to note that large tax refunds may be obtained in the event 10% withholding tax was taken and the property sale resulted in a loss or a relatively small gain.

What Will the Level of Income Tax Be?

If property was held as a personal use home or as investment property, the gain usually will be taxed at rates currently ranging from 0% to 15%. If the property contained a rental operation, the gain usually will be taxed at rates currently ranging from 0% to 25%. It is important to note that sellers likely will use the assessed tax as a foreign tax credit on their country-of-residence tax return.

Are U.S. Taxpayer Identification Numbers Required?

Yes. To be properly credited with the withholding tax or to apply for reduction/elimination of withholding, the seller(s) must obtain U.S. tax identification numbers. These numbers are also required to report the gain or loss — as well as any withholding tax — on a U.S. income tax return.

What If I Intend to Purchase U.S. Real Estate Specifically to Rent It Out?

You have two options:

- 1) Obtain a U.S. tax identification number and file annual U.S. income tax returns. The benefit of filing is that it will allow you to obtain deductions (e.g., interest, insurance, depreciation, repairs) to offset the rental income.
- 2) If annual U.S. tax returns are not filed, you must pay a 30% tax on gross basis (i.e., without the allowance of any deductions connected with the earning of rent income) to the IRS, without possibility of refund.

What Are the Benefits of Filing a U.S. Tax Return if I Rent Out U.S. Real Estate

Filing a return allows any rental losses to be carried forward to offset any future rental net income or gains from selling the property. If you also have a personally run business in the U.S., rental losses may offset income from that business. Filing a U.S. tax return also permits proper use of foreign tax credits and minimization of tax on a worldwide basis.

The information provided in this document is not intended nor can it be used to avoid tax penalties levied by a taxing authority. Actions based on this information should not be taken without further consultation with a licensed tax professional.

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