

FIRPTA 101: A Basic Overview of a Complex Tax Law

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What is FIRPTA?

The Foreign Investment in Real Property Act of 1980 (FIRPTA) is essentially a mechanism to capture capital gains from foreign investors when they sell property. Because there is generally not an enforcement mechanism available to the IRS in the event such taxes are not paid, FIRPTA shifts that obligation to the buyer.

Generally, the FIRPTA tax is due on the sale of an interest in real property from a foreign seller. Examples of an interest in real property include fee ownership, leaseholds, co-ownership (where one or more of the sellers, but not all sellers, are foreign), and fractional interests or timeshares.

Who has the liability to pay the FIRPTA tax?

FIRPTA imposes the liability on the buyer to collect and pay the FIRPTA tax. The buyer is regarded as the “withholding agent” for the collection of the FIRPTA tax and is required to withhold a percentage of the sales price (and not the net proceeds) paid to the seller. In practice, the funds are collected from the seller’s proceeds at closing and remitted by the closing company on behalf of the parties.

Buyers purchasing property from a foreign person may be obligated to withhold an amount from the seller’s proceeds (either 10 or 15%) to remit to the IRS along with Form 8288 within 20 days of their purchase.

Note that this withholding is not a final tax. The withholding amount is applied to the total tax due by the foreign seller/transferor and is not the tax itself. The IRS calculates the full tax due once the seller/transferor files a U.S. tax return. If the buyer/transferee fails to withhold and the foreign seller/transferor fails to satisfy its U.S. tax liability, both the buyer/transferee and the seller/transferor can be held liable for the tax, along with interest and penalties.

When does FIRPTA apply?

FIRPTA applies when the property being purchased is being sold by a “foreign person”. FIRPTA defines a “foreign person” as non-resident alien individuals who do not meet the substantial residency test, and foreign corporations, LLCs or partnerships.

FIRPTA defines a foreign person as:

A nonresident alien individual or foreign corporation that has not made an election to be treated as a domestic corporation, foreign partnership, foreign trust, or foreign estate.

A foreign person does not include a resident alien individual.

What is the IRS’s definition of substantial residency?

You will be considered a United States resident for tax purposes if you meet the substantial presence test for the calendar year. To meet this test, you must be physically present in the United States (U.S.) on at least:

1. 31 days during the current year, and
2. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
 - All the days you were present in the current year, and
 - 1/3 of the days you were present in the first year before the current year, and
 - 1/6 of the days you were present in the second year before the current year.

Example

You were physically present in the U.S. on 120 days in each of the years 2021, 2022 and 2023. To determine if you meet the substantial presence test for 2023, count the full 120 days of presence in 2023, 40 days in 2022 ($1/3$ of 120), and 20 days in 2021 ($1/6$ of 120). Since the total for the 3-year period is 180 days, you are not considered a resident under the substantial presence test: for 2023.

It's not the withholding agent's responsibility to determine if a transferor meets the necessary criteria of substantial residency. If a seller needs to determine their status, refer them to their CPA and the IRS website.

Determining withholding when FIRPTA does apply

Not all US properties being sold by a “foreign person” are subject to FIRPTA.

If the sale price is under \$300,000 and the buyer plans to occupy the property as their primary residence, they are not required to withhold anything under FIRPTA.

For all other scenarios:

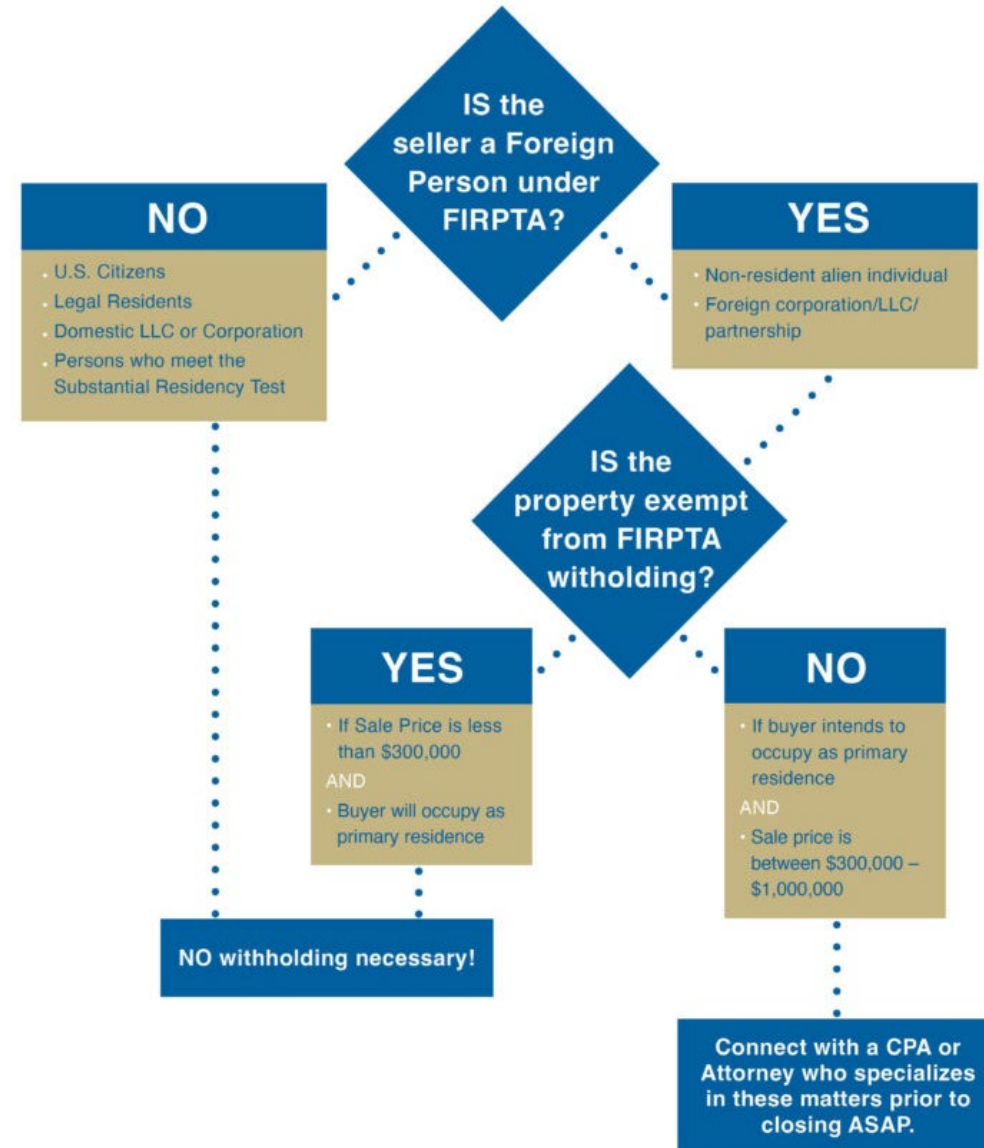
If the property price is \$300,000 or more, then there are two potential withholding rates depending on the situation.

1. For properties between \$300,000 and \$1,000,000 where the buyer intends to occupy the property as their primary residence, a 10% withholding rate applies.
2. For all other properties, a 15% withholding rate applies.

Determining withholding when FIRPTA does apply

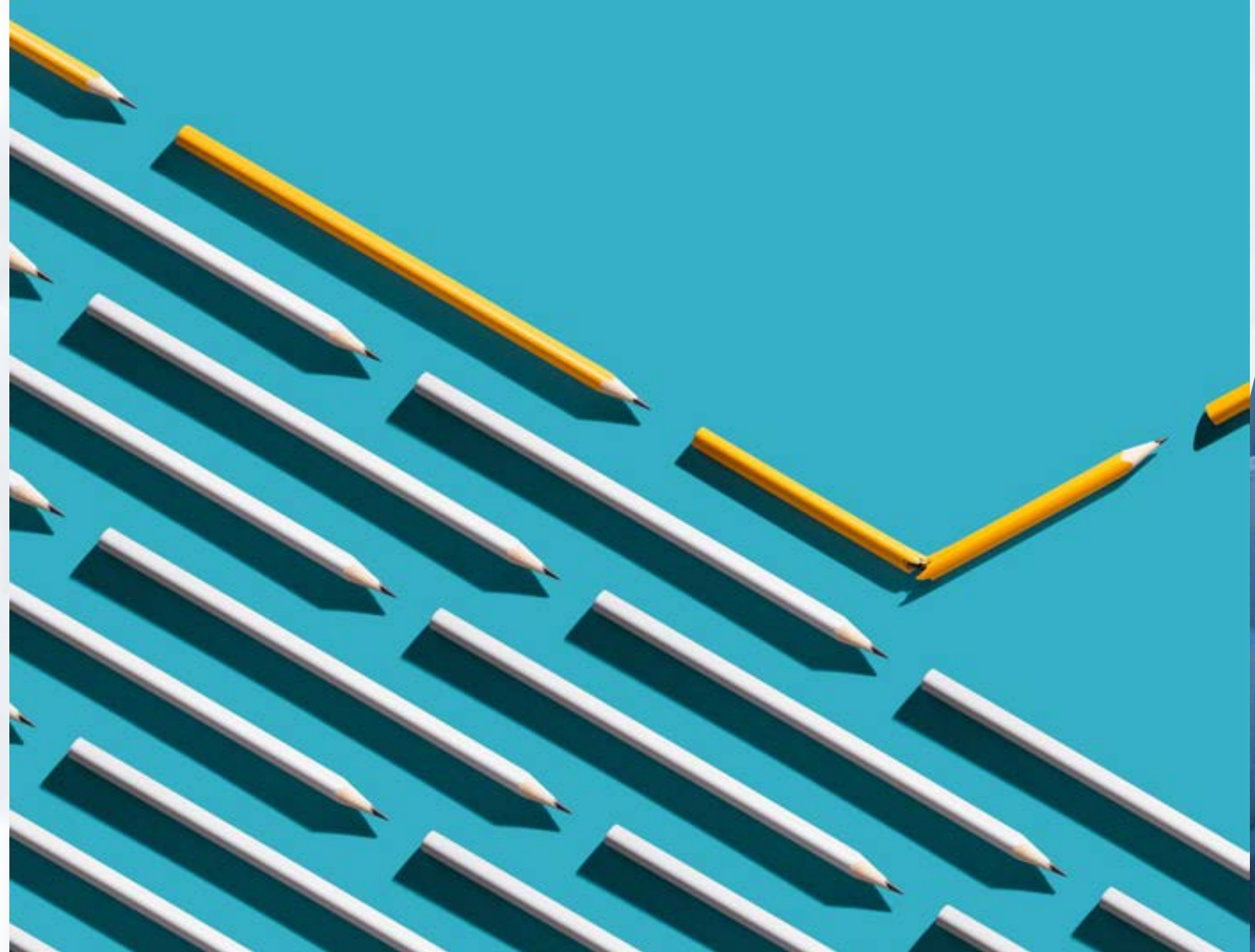
PROPERTY	AMOUNT REALIZED	WITHHOLDING RATE
Not acquired as buyer/transferee's residence	Any amount	15%
Acquired as buyer/transferee's residence	Up to \$300,000	0%
	Over \$300,000 and up to \$1,000,000	10%
	Over \$1,000,000	15%

Evaluating Whether FIRPTA Applies



Transactions with Special Rules

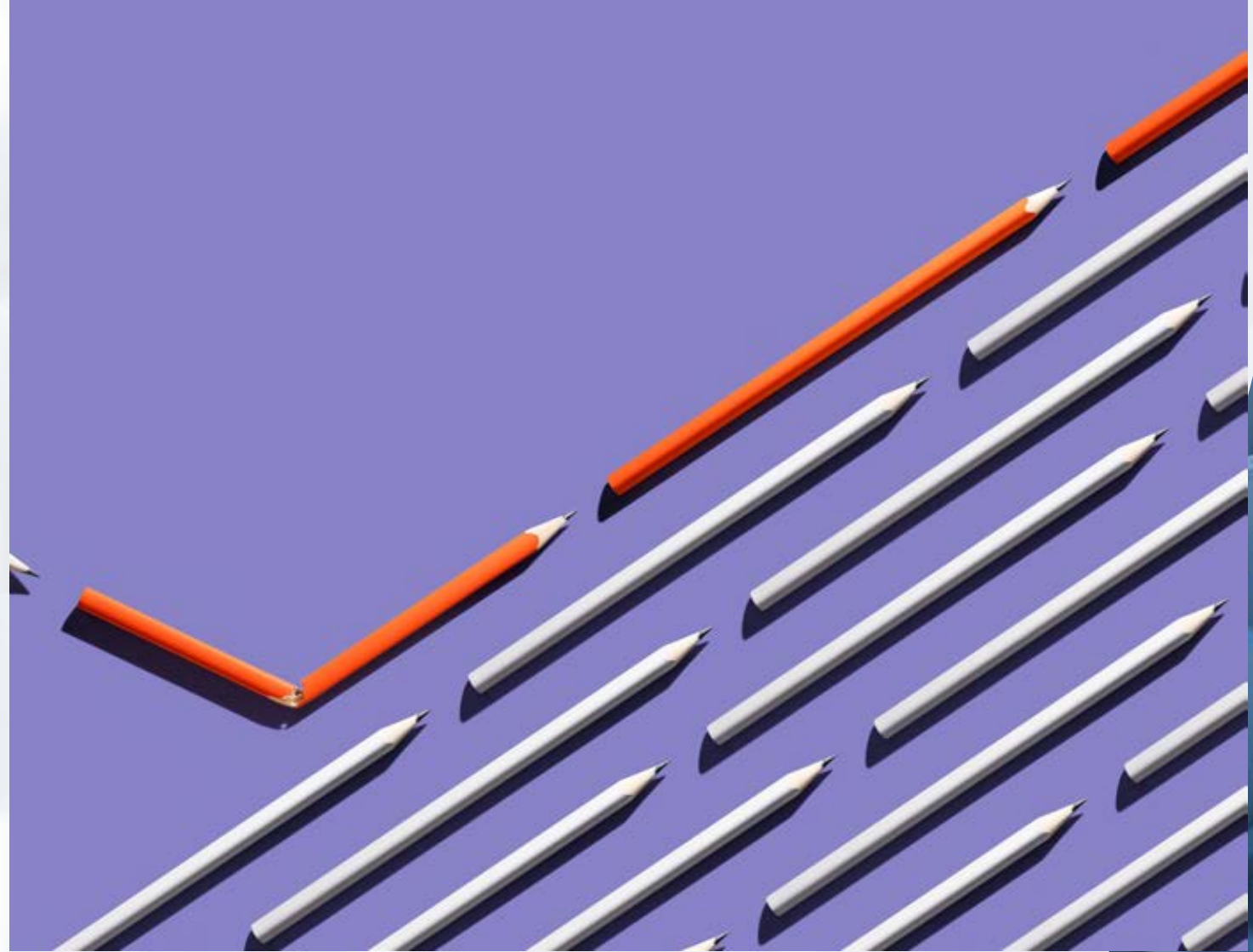
Some transactions, including the ones as follows, have special rules regarding FIRPTA requirements. It's imperative to consult with a tax professional to make sure they are understood.



Transactions with Special Rules

Seller/transferor is a domestic partnership, domestic trust or domestic estate:

If any partner or beneficiary of the partnership, trust or estate is a foreign person, a withholding as much as **35 percent** may be required. FIRPTA places the burden of the withholding on the partner, fiduciary or other representative of the domestic entity.



Transactions with Special Rules

Purchaser/transferee is a government body:

No withholding is required when the buyer/transferee is the United States government, a state or possession of the United States, a political subdivision thereof, or the District of Columbia.



Transactions with Special Rules

Foreclosures:

If the borrower being foreclosed upon is a foreign person, the transaction may still be subject to the FIRPTA withholding. However, special rules allow for an “alternative amount” that is less than the standard withholding. The amount is determined by the court or trustee and is generally calculated from any surplus of proceeds from the foreclosure sale after the foreclosing loan has been paid in full.



Transactions with Special Rules

Deeds in lieu of foreclosure:

Transactions with deeds in lieu of foreclosure are subject to the ordinary withholding rules, except if one of the following occur: (1) the buyer/transferee is the only person with a security interest in the property; (2) no cash or other property is paid to any person with respect to the transfer of the property; and (3) applicable notice requirements are met.



Best Practices

Most standard sale contracts include a clause where the seller must confirm if FIRPTA applies or not. The best practice for seller's agents, however, is to have their client retain a CPA and file Form 8288-B (Application for Withholding Certificate) prior to closing. This can be provided to the buyer to help reduce or even eliminate FIRPTA withholding requirements.

If the seller/transferor applies for a certificate, notification must be provided to the buyer/transferee in writing on the day of, or prior to, the transfer of the property. Once an application is submitted, the IRS generally processes the application within 90 days of receipt.

Best Practices

The IRS may issue a withholding certificate under the following circumstances:

1. The withholding is more than the seller/transferor's maximum tax liability, or reducing the withholding does not impede the ability to collect the tax. For instance, the foreign seller/transferor receives no gains because the property was sold at a price lower than originally purchased;
2. The seller/transferor is exempt from U.S. tax on the gain realized from the transfer of the property, such as a qualifying 1031 exchange; or
3. There is an agreement for payment of the tax that provides security for the tax liability by either the buyer/transferee or the seller/transferor.

The Role of the Closing Agent

During the closing process, the closing agent should have Transferors execute a FIRPTA certification wherein they affirm if they are considered a “foreign person.” In this certification the transferor will state, under penalty of perjury, that they are not a foreign person. Further, the certification must include:

1. The seller/transferor’s name
2. U.S. taxpayer identification number
3. Home address (or office address, in the case of an entity)

A copy of the executed certification should be circulated to Buyer, Seller and Real Estate Agents at the close of escrow for all parties’ records

The Role of the Closing Agent - Continued

Lastly, during a FIRPTA transaction, the buyer/transferee and foreign seller/transferor may instruct the closing agent to gather the applicable tax forms, deduct the withholding from the seller/transferor's proceeds and remit the funds to the IRS on behalf of the buyer/transferee.

As previously mentioned, because the IRS shifts the obligation to buyers, if FIRPTA applies, the required forms (8288 and 8288-A) must be completed and submitted along with the applicable withholding amount to the Internal Revenue Service within 20 days of closing. Copies of the completed forms, a copy of the check and the method of delivery should be provided to the buyer and seller for their records. Failure to submit the applicable forms and withholding could result in a tax liability for the BUYER!

The closing agent is generally not licensed or authorized to prepare any of the FIRPTA tax forms, provide advice regarding the FIRPTA withholding, or offer any legal advice.

Conclusion

Accordingly, it's imperative to determine if FIRPTA applies as quickly as possible in a transaction, to ensure all parties have sufficient time, to seek appropriate tax advice, get forms properly completed and apply for a withholding certificate if seller elects to do so.

This falls back to proactive communication. As we all know, it won't eliminate all the fire drills in a real estate transaction (because no matter how well prepared, they're still a bit of a goat rodeo!), but it will allow you to avoid a last-minute closing crisis regarding FIRPTA withholding.

Thank you. Questions?

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