



# *FAQ: Foreigner's Tax Guide to Buying U.S. Real Estate*

*Structuring and Tax Considerations for  
Foreign Investors Acquiring U.S. Real Estate*

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# 1 *What is FIRPTA and how does it affect a foreign individual buying U.S. real estate?*

FIRPTA stands for “Foreign Investment in Real Property Tax Act.” Enacted in 1980, the law allows the United States to impose withholding income tax on foreign persons disposing of U.S. Real Property Interests. Per the Internal Revenue Service, a U.S. Real Property Interest (USRPI) is defined as “any interest, other than solely as a creditor, in real property located in the United States or the U.S. Virgin Islands, including leases and stock in U.S. Real Property Holding Corporations (US RPHC) as well as certain personal property that is associated with the use of real property (such as farming machinery or hotel furniture).”

In general, FIRPTA imposes a withholding requirement of 15% of the property’s gross consideration on any foreign person disposing of a USRPI. This amount is required to be withheld by the buyer of the property, who is generally the withholding agent, and sent to the Internal Revenue Service. The withheld tax is required to be paid within 20 days of the disposition. Exceptions for certain residence exist, where a 10% withholding rate applies versus the 15% rate.

## 2 *Are there any exemptions to FIRPTA?*

Yes, there are exemptions to avoid FIRPTA or to reduce the amount required to be withheld, including:

- *If the property being purchased is to be used as a residence and the purchase price is \$300,000 or less, FIRPTA would not apply.*
- *When the purchaser receives a certificate, under the penalty of perjury, from the seller stating that the seller is not a foreign person, FIRPTA does not apply.*
- *If the buyer receives a withholding certificate from the IRS, that certificate may excuse withholding or reduce the amount of withholding below the required 15% of the purchase price. Such an exemption, procured by the filing of Form 8288-B, must be addressed no later than the closing date of the sale.*
- *If the amount realized (i.e., sale price) does not exceed \$1 million, and the seller is acquiring property for his or her own use as a resident, withholding can be reduced to 10%.*



### **3 *Are real estate agents/ brokers liable and/or responsible for income tax withholding related to rental income collected on behalf of foreign real estate owners?***

Real estate agents and/or brokers frequently come across transactions involving foreign persons acquiring or renting U.S. property. Before agreeing to manage U.S. property for foreign investors, agents/brokers should become familiar with U.S. laws regarding the withholding of tax related





to disposing of or renting U.S. property (e.g., FIRPTA). Foreign individuals and Foreign Corporations may elect to have their passive rental income taxed as if it were “effectively connected” with the U.S. trade or business. Unless the foreign investor has properly informed the property manager that the rental income is to be treated as effectively connected income (by submitting a completed IRS Form W8-ECI), the property manager should withhold 30% of the gross rental receipts so as to avoid personal liability. Real estate agents and/or brokers should consult their Certified Public Accountant or tax advisor if they have any questions regarding withholding of taxes related to foreign persons investing in U.S. property.

## 4 *What type of expenses can a foreign person use to offset the rental income earned from investing in U.S. real estate?*

Expenses directly related to the rental activity will be deductible. For example, real estate taxes, depreciation, mortgage interest paid, condo maintenance fees, repairs, insurance, utilities, etc.

If the property is owned by a foreign individual or foreign entity, the owner may elect to treat the passive rental income as “effectively connected” with a U.S. trade or business. This election must be attached to a timely-filed income tax return when the real property is acquired or placed into service. If this election is not made, the investor will lose all current deductions related to the rental activity (unless the owner is actually engaged in a U.S. trade or business with such real estate).

## **5** *What happens if I use the property partly as a rental property and partly as a vacation home?*

If the property is used for 14 days or more as a vacation home and the rest of the time rented to others, the foreign investor must prorate expenses incurred and split the activity between personal and rental. The proration should count the number of days the property is used as a rental property separately from the number of days the property is used for personal use. The resulting percentage is then multiplied by the expenses incurred on the property. Expenses related to personal use are either limited or non-deductible.



## *What is the optimal structure for a foreign person buying a property in South Florida?*

Unfortunately, there is no “one size fits all” solution that addresses every client or investor’s needs. Every investor is different in terms of circumstances, goals, and priorities. For instance, estate taxes, which carry a high tax rate of 40% over an exemption amount of \$60,000, are a major consideration for most foreign investors. Treaties may provide a more favorable estate tax exemption. If a foreign individual wants to be shielded from estate tax, he or she may wish to implement a multi-level structure, perhaps anchored by a non-grantor trust or a foundation.

Some clients who are not overly concerned with estate taxes opt for a much simpler structure whereby the USRPI is owned by a multi-member LLC, which may not provide complete estate tax protection. Foreign persons buying property in the U.S. should consult with a tax professional as an integral part of the purchase process.





## **7** *Aside from the appropriate structure, are there other ways for foreign persons investing in a USRPI to protect themselves from estate taxes?*

Yes. Some investors wish to hold the real estate in their individual names (which leaves them liable to estate tax) but offset the tax through the purchase of a term life insurance policy (adjusted annually depending on fair market value fluctuation of all U.S.-based assets. The proceeds from the life insurance policy is used pay some or all of the estate tax.

# 8

***If a foreign individual has already purchased and titled a real estate investment under his or her personal name, can the individual still create a structure that will transfer the property ownership while protecting him or her from estate taxes?***

Yes. The Internal Revenue Code allows for certain non-recognition transfers of property from an individual to a business structure. However, each situation is different and several factors should be analyzed to determine whether the transfer will result in a favorable tax situation; certain transfers are taxable events. As with every business decision, it is important to consider the costs versus the benefit. If a foreign individual thinks he or she may have improperly structured the purchase of USRPI, he or she should seek the help of a tax professional to discuss the reorganization and the options available.







## 9 *Is it possible for a foreign person to defer the gain from the sale of a U.S. Real Property Interest (USRPI)?*

Yes. A foreign person who owns investment property may engage in a simultaneous like-kind exchange whereby the gain on the sale of the property is rolled into the purchase of another investment property.

A delayed like-kind exchange (as opposed to a simultaneous one) is a detailed process, requiring several tax forms to be filled out (and approved by the IRS). Time constraints are a factor as the new investment property (which the seller is purchasing) must be identified within 45 days of the closing of the original property and acquired within 180 days of the closing date of the original property. FIRPTA withholding is required in a delayed like-kind exchange.

Details on how to enter into an IRC Section 1031 exchange should be discussed with a real estate attorney or tax professional.







## 10 *Am I required to obtain an ITIN (Tax Identification Number)?*

Generally, a foreign individual will need an ITIN if he sells the USRPI and is required to file a tax return to either obtain a refund or to pay additional taxes owed. An ITIN will also be required for rental property or when the foreign person intends to transfer the property into a structure using a non-recognition provision (discussed in FAQ #8).



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