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Tax Act puts onus on Americans to do the right thing

By Paul Bercovici, LL.B.
Principal, Marks Paneth

The United States has long been a prime choice for non-US people seeking to own real property outside of their home country.

The US is perceived by foreigners as being extremely stable politically and as having a robust and very strong economy. For all intents and purposes, the US imposes no real restrictions on the ownership of US real property by foreigners.

PAUL BERCOVICI

The *Foreign Investment in Real Property Tax Act of 1980* ("FIRPTA") was enacted to prevent foreign investors from circumventing, with relative ease, otherwise applicable US taxes on the sale of US real property.

FIRPTA imposes a federal withholding tax on gains realized by foreign persons from the sale of US real property. Because so much US real property is owned by foreign persons, it is important for US investors and developers to fully understand the potential impact of FIRPTA.

Role of the US Purchaser

While the financial impact of the FIRPTA tax falls solely on the foreign seller, the US purchaser bears the burden of withholding, reporting and remitting the tax obligation.

As a general rule, a buyer of US real property from a foreign person must withhold 15 percent of the total amount realized by the foreign person on the sale.

There are certain exceptions to the 15 percent FIRPTA withholding requirement, including a reduction in the withholding tax rate from 15 to 10 percent for the purchase of residences for less than $1 million. It is crucial to note that the amount to be withheld by the buyer is 15 percent of the amount realized by the seller, not 15 percent of the gain amount.

FIRPTA requires the purchaser to report and pay the withheld tax to the US Treasury by the 20th day after the date of transfer.

It is also important to note that the 15 percent tax withheld on the amount realized by the foreign seller of US real property is not the amount of US tax actually due from the seller in connection with the sale. The 15 percent amount withheld is merely an advance payment toward the foreign seller's final US federal tax obligation in connection with the sale of the US real property.

Withholding Certificates

The amount that must be withheld in connection with the sale of US real property by a foreign person can be decreased (or eliminated) pursuant to a withholding certificate issued by the IRS.

Withholding certificates, also referred to as reduced-rate certificates, are generally issued when the IRS determines that the amount required to be withheld under FIRPTA would be more than the foreign seller's maximum tax liability. The certificate authorizes the purchaser to withhold (and remit) an amount less than the 15% FIRPTA withholding tax.

A foreign seller is entitled to file for a tax refund in cases where a withholding certificate was not issued prior to the date of sale and it is determined that the ultimate tax liability associated with the sale of US real property is less than the FIRPTA tax amount withheld.

Planning for FIRPTA Compliance

The FIRPTA withholding provisions can be quite complex. Effective advanced planning can yield positive results for the buyer and seller alike, including:

1) Reduction or elimination of the withholding tax imposed by FIRPTA through the use, where appropriate, of withholding certificates and/or other tax planning techniques

2) Possible tax refund for foreign seller of US real property (if the seller's ultimate tax liability in connection with the sale is less than the amount required to be withheld under FIRPTA)

3) Timely and accurate compliance with reporting requirements imposed by FIRPTA

On the other hand, failure to plan ahead could lead to delays in closing the sale of the property and insufficient time to apply for a withholding certificate, among other complications.

It is always advisable to consult with your tax advisor to develop FIRPTA strategies prior to pursuing a deal to purchase real property from a non-US seller.