

# Understanding

# FIRPTA



When you start looking for a home, you're most often focused on how many bedrooms and bathrooms, the size of the garage, and the curb appeal. Sometimes, you'll also want to know a little information about the seller.

If the seller of your home is a foreign investor, it's important for you to know and understand more about a specific tax law called "FIRPTA" before making a move.

Like many tax laws, FIRPTA is complicated, and sometimes even the most seasoned real estate investors can get tripped up if they don't do their homework. Patten Title can help make sure you take the proper steps before closing on a deal that involves a foreign citizen.

## WHAT IS FIRPTA

FIRPTA is an acronym for "Foreign Investment in Real Property Tax." The law was established in 1980 to allow the government to collect taxes when the seller isn't a U.S. citizen. For instance, sellers from the United States must pay capital gains taxes for any profitable real estate investment in the country.

However, because a foreign investor isn't subject to the same tax laws as a United States citizen, the IRS shifts the obligation for collecting the tax to the buyer. FIRPTA was designed to even the tax playing field for U.S. investors.

It's always important to work with a title company that understands FIRPTA. While the seller is officially responsible for the FIRPTA tax, it's the buyer's job to make sure the money is set aside. According to the IRS, the buyer is what's known as the "withholding agent."

How much should you set aside? Typically, 15-21% of the price of the transaction should be carved out for tax, depending on the price of the property and if the seller is an individual or a corporation. A corporate buyer or business buying a property is subject to the same rules.



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# WHO IS CONSIDERED A FOREIGN INVESTOR

According to FIRPTA, a foreign person is a non-resident alien who doesn't meet the criteria for the **Substantial Present Test**. This test makes sure that foreign investors spend time on U.S. soil.

For tax purposes, a resident is someone who essentially spends more than 50% of the days that the property is used **as their primary residence**. So, if the seller spends more than half their time residing outside of the US, they most likely qualify as a foreigner, and are subject to the FIRPTA tax.

Because the buyer is responsible for the FIRPTA tax withholding, be sure to inquire early about the seller's residency and accumulate documentation early in case there are any questions along the way.

# WHAT TO DO IF YOU NEED A FIRPTA WITHHOLDING

When to prepare for a FIRPTA withholding depends on who is purchasing and who is selling the property. After establishing that the seller is a "foreigner," the criteria to determine the tax and its amount has several variables.

The FIRPTA tax can be avoided altogether if the price is **less than \$300,000** and the buyer plans to use the property as their primary residence. In this case, the buyer will need a signed affidavit explaining both that the purchase price was below \$300,000 and their intent to reside.

However, if the sale price is over \$300,000 or the property won't be used as a primary residence, the tax burden is 15%.

In cases where a **foreign corporation** is selling property, the tax is 21%. Keep in mind that FIRPTA **applies** to land, buildings, and permanent structures other than buildings like mines, wells and natural deposits, and growing crops and timber, as well as personal property that is associated with "real" property.

There are two **key terms** to understand with FIRPTA

1. **Disposition**, which means the purchase or sale of real estate by a foreigner to an American buyer.
2. **U.S. Property Interest**, which means any interest in property in the United States.

# UNDERSTANDING FIRPTA EXEMPTIONS

The good news is that there are some specific situations where exemptions apply.

**NONRECOGNITION:** The IRS's **nonrecognition provision** may exempt a property purchase from FIRPTA taxes. Nonrecognition means that the transaction was financially neutral or that no gain or loss was recognized. In this case, the buyer needs proof from the seller that the property falls into the nonrecognition category. Ultimately, the IRS bases its decision on the provided documentation. In nonrecognition cases, it's important for the buyer to take responsibility for providing the necessary paperwork to the IRS.

**ZERO FINANCIAL GAIN:** If a foreign seller makes no profit on a real estate sale, then there are no FIRPTA withholdings. Because FIRPTA is used in the same cases as capital gains, if the seller agrees to take a loss on the property, there would be no capital gains. As in all cases with FIRPTA, the buyer is responsible for ensuring the IRS has the necessary documentation showing the losses.

Because the FIRPTA exemptions are complicated, buyers should consider consulting a reputable lawyer, CPA or title company like Patten that understands any exemptions to FIRPTA withholdings.

# HOW PATTEN TITLE HELPS WITH FIRPTA

Though the buyer is responsible for securing FIRPTA paperwork, a trusted title company will make sure you've gathered the necessary documents and help you understand what needs to be submitted to the IRS.

For instance, the buyer may be designated as the **withholding agent** by the IRS. In that case, forms 8288 and 8288A must be filled out by the buyer.

Your title agent should start by helping you understand the questions that **define a FIRPTA transaction**.

- Is the buyer a foreign person or entity?
- Is the property a residence?
- Will the person buying the property live in it for 50% of its occupied time?
- Is the purchase price of the home under \$300,000?

For more detailed information about FIRPTA taxes for your immediate transaction, be sure to speak with your title company, attorney, and/or accountant.