
TAX ASPECTS OF SELLING U.S. REAL ESTATE BY NON-U.S. PERSONS

This memorandum discusses the tax aspects of selling U.S. real estate by nonresident aliens and foreign corporations. It also discusses the new legislation (the Protecting Americans from Tax Hikes Act of 2015) signed into law by President Obama on December 18, 2015. The new legislation became effective February 17, 2016 relative to the 15% FIRPTA withholding.

When a non-U.S. person sells U.S. real estate, the U.S. tax authorities ("IRS") require that 15% of the gross sales price be withheld at closing and remitted as an estimated tax payment on behalf of the foreign seller. The 15% is merely a deposit against the seller's actual tax liability as shown on their income tax return for the year of sale. Failure to comply with this requirement can subject certain parties associated with the transaction to assessment by the IRS for the 15% tax plus penalties and interest.

There are three general ways of dealing with the 15% withholding:

- Having the 15% withheld and file an income tax return for a refund in the year following the sale.
- Apply for relief to the IRS, BEFORE THE SALE, from the 15% withholding (also referred to as a "Withholding Certificate").
- The seller is still required to file an income tax return.
- The buyer chooses to sign a statement avoiding the 15% withholding for certain residential property with a sales price of \$300,000 or less. The seller is still required to file a U.S. income tax return and pay any tax due, plus penalties for underpayment of estimated taxes.

WITHHOLDING THE 15% AND FILING AN INCOME TAX RETURN FOR A REFUND

When the 15% is withheld, the IRS issues a receipt to the non-U.S. seller and the seller may claim a refund when he or she files an income tax return for the year of sale. In this case the seller calculates the actual gain and related tax liability and receives a refund if the actual tax liability is less. The problem with this procedure is that it can take until the following year to obtain a refund. Also, because of the IRS reorganization there have been numerous instances when the payments have been incorrectly applied by the IRS, resulting in additional delays and additional costs to the foreign sellers in obtaining their refunds.

APPLYING TO THE IRS FOR RELIEF FROM THE 15% WITHHOLDING

A non-U.S. seller can apply for relief from the 15% withholding when the actual tax on the profit from the sale is less than 15% of the gross sales price. This procedure is commonly known as a Withholding Certificate. The benefit to the seller in applying for relief is that it can get part or all of the 15% to the seller in the shortest amount of time. ALL parties must have or apply for U.S. tax ID numbers or have Social Security numbers for the application to be accepted.

The application must be filed between the time the sales contract is signed and the date of closing. If the application is filed after the closing date (even by one day), the entire 15% must be remitted to the IRS and then the seller must wait until the following year to file an income tax return for a refund.

When the application for relief is timely filed, the 15% is held in escrow by the closing agent until the IRS processes the application and grants relief. At such time part or all of the escrowed funds are remitted to the seller. IRS instructions state that this normally takes about 90 days for the application to be processed. If a tax ID number has to be applied for it takes an additional four to six weeks, even for a short sale.

There has been a new development in issuing these certificates due to the present real estate market. Because of the depressed real estate market in the U.S. we have encountered many situations which qualify as "hardship sales". A hardship sale is one where there is a "short sale" or when the buyer has to bring money to the closing table to meet the 15% FIRPTA requirement. The IRS has been responsive to our firm in processing applications for relief in these situations. In most instances we have been fortunate to have these hardship cases processed on an expedited basis by the IRS within 4 weeks, rather than 120 days or more, unless a tax ID number is needed. Special procedures are required to accommodate these unfortunate situations. We have been able to deal with these situations effectively because of our extensive knowledge in this area and our positive working relationship with the IRS.



Each year our firm processes numerous applications for relief for non-U.S. sellers. The rules in this area are specialized and unique and should be handled only by someone experienced in dealing with international tax matters before the IRS. Please feel free to contact us if you would like to discuss the facts and determine the potential benefits in your situation.

THE BELOW EXCEPTION APPLIES WHEN THE BUYER CHOOSES TO PURCHASE PROPERTY PURSUANT TO THE RESIDENCY EXCEPTION, THEREFORE REDUCING THE 15% WITHHOLDING FOR CERTAIN RESIDENTIAL PROPERTY WITH A SALES PRICE OF \$1,000,000 OR LESS.

There is a misconceived idea that a buyer must sign a "Statement of Intent to Reside" in this situation. This is not true. The buyer has the sole discretion whether to rely on the following exception to the general rule.

One exception is that an "individual" buyer does not have to withhold the FULL 15% when the purchase price is less than \$1,000,000 if the buyer has plans to use the property as a residence – see below example. If the purchase price is 300,000 or less, the FIRPTA withholding is reduced from 15% to 0%. If the purchase price is greater than 300,000 but less than 1,000,000, the FIRPTA withholding is reduced from 15% to 10%. For example, a property selling for \$290,000 will require 0% withholding if the buyer is using the property as a residence and agrees to the commitments below. If the property sells for \$600,000, and the buyer agrees to use the property as a residence, the withholding would be \$60,000 rather than the full \$90,000.

The buyer must meet a certain time-use test to qualify for this exception. Failure to meet this test can subject the buyer to a penalty of 15% of the gross purchase price plus penalties and interest.

The problem with this exception is that most buyers do not want to rely on it (and are not required to – it is elective on their part). Even if they think they will satisfy the test, they basically will forfeit their right to change their mind to rent the property for a significant time during the first two years following the purchase if they rely on this exception. Also, most buyers will view this exception as a needless risk on their part especially when, in their mind, they are paying a fair price for the property.

Finally, the non-U.S. seller is still required to file a U.S. income tax return for the year of the sale to report the transaction and pay the correct amount of U.S. income tax. Their tax liability is going to be the same in the end whether or not there is withholding. The foreign seller also risks the imposition of underpayment of estimated tax penalties when the 15% is not withheld. Many foreign sellers who have not had the 15% withheld because of this exception have been unpleasantly surprised that they owe penalties in addition to the capital gains tax when they file their U.S. income tax return for the year of sale.

We have found that many non-U.S. sellers needlessly have missed good opportunities to sell their U.S. real estate because they have misunderstood this exception and have instructed their realtor not to accept an offer unless the buyer signs this exception. Our firm has a memorandum explaining this exception in detail. Call us for a copy of it.

CONCLUSION

We offer our service in minimizing the U.S. income tax consequences on the sale of Florida real estate. Our firm deals exclusively in assisting foreign nationals with U.S. tax matters. Please contact us at (727) 822-9393 for a free initial consultation.

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