TAXATION OF FOREIGN INDIVIDUAL REAL ESTATE TRANSACTIONS IN U.S.A.

KELLEY K. HASSON BLATNIK

Esq., J.D.
Admitted to Practice Before: U.S. Supreme Court, Florida State Court, Nevada State Court, Utah State Court, Florida Northern United States District Court, Florida Middle United States District Court, Florida Southern United States District Court, Utah United States District Court, Nevada United States District Court, Ninth United States Circuit Court of Appeals, & Eleventh United States Circuit Court of Appeals
E-mail: attorney@blatniklaw.com

Abstract - Brief analysis of taxation withholdings by foreign individuals as it relates to real estate transactions in U.S.A.

The United States of America ("America") typically allows foreign investment in the purchase of real property ("land") whereas other countries such as the Philippines and Romania allow foreigners to own the building but not the land, except under special circumstances. When a foreign entity invests in, purchase, or sales land in America, special taxation withholdings pursuant to 26 USC § 1445 apply.

The American congress passed 26 USC § 1445 commonly referred to as the Foreign Investment in Real Property Tax Act ("FIRPTA") which taxes foreign gains and losses upon real estate transactions differently than domestic profits and losses through real estate transactions. FIRPTA requires the withholding of a tax equal to fifteen percent (15%) of the "amount realized on the disposition [1]." Pursuant to Internal Revenue Service ("IRS") interpretation of "amount realized," the 15% is calculated as 15% of (1) the amount of cash paid (2) fair market value of the property or (3) amount of liability transferred. Examples of the above would include:

If a foreign individual purchased a house on land for $100,000 and the fair market value ("FMV") was $100,000, then the FIRPTA tax withholding would be $15,000, making the out of pocket price to the foreign individual $115,000. If the foreign individual sold the property for $100,000, assuming no encumbrances, the foreign individual would only receive $85,000 less closing costs at the conclusion of the sale.

If a foreign individual purchased a house on land for $85,000 but the local tax assessor deemed the property as a FMVof $100,000, the withholding amount would still be $15,000 despite the lesser $85,000 price. Therefore, the out of pocket price for the home would be $100,000. If the foreign individual sold the property for $85,000 and the FMV was $100,000, the selling foreign individual would only receive $70,000, less closing costs and realtor commissions.

If a foreign individual sold property for $50,000, the FMV of the property is $100,000, and the property is encumbered by $150,000 of liens, mortgages, or a Deed of Trust, and the selling foreign individual was liable for paying off the encumbrances, no withholding would be required as the sale was a loss, but 26 USC § 1445 requires reporting of the loss. If the foreign individual purchased the property for $50,000 and assumed the $100,000 mortgage on a property with $100,000 fair market value, no tax would be withheld as the liability assumed exceeded the FMV.

As with all laws, loopholes allow foreign individuals to escape the 15% tax in certain circumstances [2]. If the foreign individual resides in the home for no less than fifty percent (50%) of the first two twelve (12) month periods of ownership and the sale price is less than $300,000, no FIRPTA need be withheld. Assuming the sale date was December 31, 2017 for $300,000, if a foreign individual lived in the home from February 1, 2017 to July 31, 2017 and February 1, 2016 to July 31, 2016, no FIRPTA would be withheld. However, if the foreign entity lived in the home from January 1, 2016 to December 31, 2016, did not live in the home in 2017, and sold the home for $300,000 on December 31, 2017, the FIRPTA withholding would be 15% of the full $300,000 or $45,000. Because FIRPTA requires six months out of each of the last twelve- month periods, living in the home for one year in 2016 will not satisfy the six-month requirements for residence in 2017.

The time periods need not be continuous but must satisfy the six-month within the last two twelve-month periods. Therefore, living in the home every other month for two years would satisfy the 26 USC§ 1445(b)(5) exception.

If a foreign individual purchased the property for $300,000, intended to live in the property, and did live in the property for six (6) months of the following two twelve (12) month periods following the sale of the property, no FIRPTA would be withheld. If a foreign individual purchases the property for $350,000 and lives in the property for two(2) six months of two (2) twelve months periods after the sale, the FIRPTA withholding would be 15% of $50,000 or $7,500. If a foreign individual purchased the property for $350,000 but only lived in the property for five months and twenty-nine days of the twelve months following the sale, the FIRPTA withholding would be 15% of the entire purchase price or $52,500.

Pursuant to 26 USC§ 1445 (c)(1)(c), a foreign individual may seek refund of over-payment of FIRPTA withholdings against the foreign individual's total tax liability. Typically, the request for refund of withholdings of FIRPTA is done through the filing of a tax return by the foreign individual who may apply for a tax identification numbers from the IRS in order to file a tax return.

The IRS interpreted 26 USC §1445 (b)(5) to include the foreign individual's family. Pursuant to 26 USC§ 267 (c)(4), a family member includes "brothers and sisters (whether by the whole or half-blood), spouse, ancestors, and lineal descendants [3]." The code makes no provision for step-siblings or step-parents. Therefore, a foreign individual may escape FIRPTA withholding by facilitating a family member residing in the property for no less than six (6) months of each of the two (2) twelve-month periods preceding the property transaction for a sale or following a property transaction after a sale. This allows a brother, sister, mother, father, son, daughter, grandchild, great grandchild, grandparent, great grand-parent, or great-great grandparent to satisfy the residency requirements but prevents cousins, aunts, uncles, nieces, or nephews from satisfying the residency requirements. Therefore, a foreign individual seeking to avoid FIRPTA withholdings would be best served by purchasing a home for less than $300,000 and either residing in the property or facilitating a recognized family member residing in the property.

REFERENCES

[1] 26 USC §1445 (a)
[2] 26 USC § 1445 (b)(5)
[3] 26 USC§ 267 (c)(4)

Additional Useful Sources:

Statutes:
Foreign Investment in Real Property Tax Act of 1980 (FIRPTA)
26 USC§ 267 (c)(4)
26 USC§ 1445(b)(5)
26 USC § 1445 (c)(1)(c)

Publications:
IRS Pub. 515

Electronic Resources:
www.irs.gov/individuals/international-taxpayers/firpta-withholding

★★★