

FIRPTA WITHHOLDING RULES

“UNDERSTANDING THE REQUIREMENTS AND THE EXCEPTIONS”



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Congress enacted the Foreign Investment in Real Property Tax Act of 1980 (“FIRPTA”) to impose a tax on foreign persons when they sold a U.S. real property interest. A foreign person includes a nonresident alien or foreign partnership, trust, estate or corporation that has not elected to be treated as a domestic corporation under IRC §897(i). For U.S. property dispositions subject to FIRPTA, the transferee (purchaser) is required to withhold and remit to the IRS 10% of the gross sales price to ensure that any taxable gain realized by the seller is actually paid. The withholding rate is computed differently for other foreign entities, such as foreign corporations and trusts, which are required to withhold 35% of the capital gain realized on the sale. For more information on FIRPTA, visit: www.irs.gov and download Publication 515: Withholding of Tax on Nonresident Aliens and Foreign Entities.

WHO IS A NON-RESIDENT ALIEN?

A non-U.S. citizen who does not pass the green card test or the substantial presence test is considered a “non-resident alien.” If a non-citizen currently has a green card or has had a green card in the past calendar year, they would pass the green card test and would be classified as a resident alien. If the individual has resided in the U.S. for more than 31 days in the current year and has resided in the U.S. for more than 183 days over a three-year period, including the current year, they would pass the substantial presence test and also be classified as a resident alien. For more on the definition of a non-resident alien, see [Topic 851, Resident and Non-Resident Aliens](#).

THREE EXCEPTIONS TO FIRPTA

1. Property to become buyer's personal residence. Section 1445 (b)(5) provides an exemption for property acquired by a transferee that will be used as the transferee's personal residence. To qualify for the exemption, a closer will generally require the transferee to sign an affidavit stating that the amount realized (generally sales price) is not more than \$300,000, and that transferee or a member of their family intend to use the property as a personal residence for at least 50% of the number of days the property is used by any person during each of the first two 12-month periods following the date of transfer.

2. Seller declaration of nonrecognition of gain or loss. The second exception to the FIRPTA withholding requirements is in the case of a simultaneous 1031 exchange and the transferee is not required to withhold if the “[t]he transferor gives written notice that no recognition of any gain or loss on the transfer is required because of a non-recognition provision in the Internal Revenue Code or a provision in a U.S. tax treaty.” Such a notice is called a “Declaration and Notice to Complete an Exchange” (“1031 Declaration and Notice”). A transferee can rely on a 1031 Declaration and Notice only if: (1) the foreign person completes a simultaneous exchange (i.e., the same day), and (2) the foreign person receives no cash or mortgage boot.

Also, if the property was seller's principal residence, where the sale of property exceeds \$300,000, a foreign seller's notice of nonrecognition of gain based on Section 121 may not be relied upon and an IRS withholding certificate is required even though the exclusion may reduce or even eliminate the amount to be withheld under Section 1445.

3. The third exception is for transactions in which the IRS has issued a withholding certificate (“Withholding Certificate”) to the foreign seller. The amount that must be withheld by a buyer can be reduced or eliminated pursuant to the Withholding Certificate. The transferee, the transferee's agent or the transferor may request a Withholding Certificate. The IRS will generally grant or deny an application for a Withholding Certificate within 90 days after its receipt of a completed Form 8288-B application .



A National IRC §1031 “Qualified Intermediary”

National Headquarters

800-282-1031

Eastern Region Office

866-394-1031

apiexchange.com

info@apiexchange.com

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IMPACT ON SIMULTANEOUS EXCHANGES

Under the foregoing rules, a buyer of U.S. property from a foreign person can rely on a 1031 Declaration and Notice only if the foreign person exchanges U.S. property for other U.S. property in a swap in which the foreign person receives no cash or mortgage boot. Since many exchanges can involve payment of some cash or debt reduction, the utility of a 1031 Withholding Certificate is substantially reduced.

IMPACT ON DELAYED EXCHANGES

To the extent that the 1031 exchange is not simultaneous, or if any cash or mortgage boot will be received by a foreign person with respect to the disposition of U.S. property, the buyer can only rely on a Withholding Certificate issued by the IRS to a foreign person. As a result, foreign persons desiring to engage in a delayed 1031 exchange should consult with a tax advisor and apply for a International Tax Identification Number (ITIN) and a 1031 Withholding Certificate well in advance of the anticipated disposition of U.S. property holdings. For more information, see [ITIN Guidance for Foreign Property Buyers/Sellers](#).

STEPS INVOLVED IN COMPLYING WITH FIRPTA IN AN EXCHANGE

- A. First, consult with your tax advisor and analyze if FIRPTA applies to you and your transaction and determine if you are considered a "Foreign Person" who is selling a U.S. real property interest.
- B. Next, explore if any exceptions to the FIRPTA withholding apply to your situation. For a more detailed explanation of these terms and exceptions, review [IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities](#) and [IRS Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests](#).
- C. If you are a Foreign Person, then you must obtain a U.S. Taxpayer Identification Number ("TIN") from the IRS as follows:
 - Individuals: To request a TIN, file [IRS Form W-7, Application for IRS Individual Identification Number](#).
 - Businesses: Obtain an Employer Identification Number ("EIN") by filing IRS Form SS-4, [Application for Employer Identification Number](#).
- D. The next step is to apply for a Withholding Certificate from the IRS.
 - File [IRS Form 8288-B, Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests](#). See the instructions to Form 8288 as it may be possible to attach Form 8288-B to Form W-7 when applying for both a TIN and a Withholding Certificate.
- E. Notify the buyer of your relinquished property that you have applied for a Withholding Certificate.
- F. Prior to closing on the sale of a relinquished property, contact Asset Preservation, a leading national Qualified Intermediary, to have all exchange documentation prepared and forwarded to the closing officer/attorney so the transaction can be closed as a 1031 exchange.
- G. The exchange begins when the relinquished property closes. The buyer must file IRS Forms 8288 and 8288-A to report and pay the amount withheld to the IRS by the 20th day after the date of the relinquished property closing.



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National Headquarters

800-282-1031

Eastern Region Office

866-394-1031

apiexchange.com

info@apiexchange.com

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