

Foreign Investment Real Property Tax Act (FIRPTA)

Q What is the Foreign Investment in Real Property Tax Act (FIRPTA) and what does it have to do with title insurance?

A. The Foreign Investment in Real Property Tax Act (FIRPTA) is a provision of the Internal Revenue Code [Section 1445] which requires the buyer of real estate to withhold 10% of the 'amount realized' from the sale of the real property where the seller is a 'foreign person.'

The Act places the responsibility to withhold the 10% on the buyer of real property or his agent. If he/she fails to withhold the proper amount, he/she may be held liable for the payment of the tax plus penalties and interest.

There are several exceptions to the 10% withholding requirement. The following two are most relevant to residential real estate closings:

- (1) An individual *buyer* is acquiring real property for use as a residence and the 'amount realized' is \$300,000 or less. The seller's use of the property is not relevant. This exemption does not apply if the actual transferee (usually the grantee in the deed) is not an individual, even if the property is acquired for use by an individual. As proof of the exclusion from FIRPTA withholding, a buyer's exemption affidavit setting forth the sales price and that the property is being acquired for residential use is necessary.
- (2) The seller is not a 'foreign person.' Withholding will be exempted if the transferor furnishes a Non-Foreign Status Affidavit (NFSA) which sets forth the seller's taxpayer identification number (i.e. social security number or identification number for business entity) and contains a statement that the transferor is not a 'foreign person.' The NFSA can be executed by a US citizen, a US green card holder, a proper corporate officer of a foreign corporation, a general partner of a foreign partnership or fiduciary of a foreign trust or estate. A transferee is not permitted to rely upon a NFSA if he or she has actual knowledge that it is false. He or she must then comply with FIRPTA withholding, unless another exemption applies.

The forms and instructions for FIRPTA withholding may be accessed on the Internal Revenue Service's website – www.irs.gov – by choosing form number 8288.

Settlement agents must be careful not to exceed the boundaries of their responsibilities in closing transactions. While one should be aware of the

existence of this law, a settlement agent should not provide any advice concerning legal and tax ramifications of a transaction and should not prepare or determine the necessity of obtaining any of the affidavits discussed herein. Generally, it is the buyer's responsibility to determine the seller's status and to withhold the tax

OR April 2013

UPDATE

Year-end Tax Bill Increases FIRPTA Withholding Rate to 15%

Starting February 16, 2016, title settlement agents will need to start holding back more proceeds from the sale of property by foreign nationals due to recent changes to the Foreign Investment in Real Property Tax Act (FIRPTA). The changes were part of the year-end tax extension legislation signed into law by President Obama on Dec. 18, 2015. (Reference: The legislation is H.R. R. 2029, now known as Public Law 114-113. See Section 324 for text of changes.)

FIRPTA is a tax law passed in 1981 requiring foreign persons to pay U.S. income tax on the gains they make from selling U.S. real estate. The duty is on the U.S. national buyer to deduct and withhold a portion of the sales price and report the sale to the IRS. In most cases, the settlement agent is the party that actually remits the funds to the IRS, but the buyer is held legally responsible. Additionally, until the tax is paid in full, the government obtains a security interest in the real property.

Under the changes, the withholding rate for sales by foreign nationals will increase to 15% of the total sales price (up from the current 10%). The changes do not impact the current FIRPTA exemptions including the exemptions for sales under \$300,000 for the sale of primary residence or vacant land. Additionally, the current 10% withholding amount still applies to sales of primary residences where the sales price is less than \$1 million.

Cheat Sheet:

- If the amount realized (generally the sales price) is \$300,000 or less, AND the property will be used by the buyer as a primary residence, the withholding rate is 0%.
- If the amount realized exceeds \$300,000 but does not exceed \$1 million, AND the property will be used by the buyer as a primary residence, the withholding rate is 10% on the full amount realized.
- If the amount realized exceeds \$1 million, then the withholding rate is 15% on the entire amount, regardless of use by the buyer.

Title and settlement companies will want to review their FIRPTA procedures before the effective date. It is a good assumption that the risks associated with using the \$300,000 exemption will continue and expand to the new rate for transactions under \$1 million.

Real estate contracts containing language referring to a 10% FIRPTA withholding will need to be updated.

FIRSTAM 01/27/16