FIRPTA Overview

Description

Foreign Investment Real Property Tax Act (FIRPTA) became law in 1980 ensuring Foreign Sellerâ??s do not skip out on paying the IRS tax bill when selling U.S. real estate. We often see FIRPTA discovered in real estate transactions at the closing which is not the time for surprises. A FIRPTA surprise at closing often will cause a transaction to fall apart for two reasons. The first reason is Seller is being shorted 15% of the sale price for what Seller perceives is a hidden tax that discriminates against Seller because of foreign status. The second reason the transaction may fail is that the Buyer, upon learning of this obscure tax compliance requirement perceives IRS is going to pursue Buyer for the 15% and Buyerâ??s cost is now 15% greater than anticipated. Buyer and Seller both may also think this FIRPTA matter is somehow the Title Companyâ??s fault. The reality is that FIRPTA is not a tax, it is a deposit, Seller can recover the FIRPTA deposit net of any unsettled tax liabilities. Buyer has no risk of IRS pursuing Buyer so long as Sellerâ??s FIRPTA deposit is sent with tracking to IRS and postmarked within 20 days of closing. Also, some states have their own version of FIRPTA that applies to non-residents of the State. The sooner in a transaction that a foreign seller is identified, the smoother FIRPTA compliance will go.

VLTA Examiner

FIRPTA is a deposit withheld from Seller and is credited as a tax deposit on behalf of the Seller to cover any unsettled federal tax liabilities. The FIRPTA deposit can be used by IRS to cover any other unsettled federal debts such as tax on sale, delinquent student loans, delinquent child support, or federal tax debt. IRS uses the phrase â??disposition of real propertyâ?• to mean â??to dispose ofâ?• and is generally considered the sale of real estate, but could also be a 1031 like kind exchange, short sale, foreclosure, gift, or other transfer, etcâ?¦ FIRPTA applies anytime a foreign person disposes of U.S. real estate.

Tax on the sale is sorted out when the Sellers file a U.S. federal tax return. The FIRPTA deposit can be recovered net of tax owed. The Buyer of real property purchased from a foreign Seller is obligated to withhold 15% of the contract sale price and send the withheld funds postmarked to IRS no later than within 20 days of closing. IRS will pursue collection of the FIRPTA deposit plus interest and penalties from the Buyer and may also pursue the Agents (Realtors) for Buyer and Seller. In a real estate transaction, the Buyer is the Withholding Agent and responsible for holding the 15% back from Seller and depositing Sellerâ??s 15% with the IRS. FIRPTA is Sellerâ??s money, Buyer is responsible for ensuring the FIRPTA deposit is submitted to IRS within 20 days of closing.

Processing a FIRPTA transaction: The IRS treats every real estate transaction as a **FIRPTA** transaction until Buyer receives from Seller a â??certificate of non-foreign statusâ?•. Title Company Settlement Agents: It is a recommended practice to EITHER collect a certificate of non-foreign status from each Seller in every real estate transaction OR inform Buyer that the sale may be subject to FIRPTA withholding.

Who can be exempt from FIRPTA using a certificate of non-foreign status?

certificate of non-foreign status (any of the following qualify):

i. **U.S. Passport**
    1. **U.S. Birth certificate**
    1. **U.S. Certificate of Naturalization**
    1. **U.S. Permanent Resident Visa aka â??Green Cardâ?•**
    1. **Meet SPT (Substantial Presence Test)**

SPT is complex taking many factors into account. We recommend Buyer and Seller engage the services of an experienced competent qualified licensed professional. (CPA, Enrolled Agent, or Tax Attorney)

Note: there is no requirement for Buyer, Agent for Buyer (Realtor), Settlement Agent, Title Company, or Escrow Officer to audit, or otherwise examine Sellerâ??s certificate of non-foreign status. However, if there are conflicting facts, or the certificate appears on its face to be false, Buyer should be notified and Buyer should not accept the certificate.

If Seller cannot provide the certificate of non-foreign status i.e. Seller is foreign, then proceed with FIRPTA withholding:

VLTA Examiner

FIRPTA withholding compliance.

Generally, 15% of the of the contract sale price must be held back from Seller proceeds, and this becomes a line item on the closing disclosure settlement statement as a payment to the US Treasury.

The 15% can be reduced IF Buyer:

a. Intends to use the property as a primary residence for at least 50% of each year for the two years following closing. (Applies to Buyer or family member of Buyer).
b. Buyer signs an affidavit of intent to occupy the property as a primary residence and the affidavit includes an acknowledgement that if IRS determines the affidavit to be false, that IRS will go after Buyer for the 15% plus penalties and interest.
c. If the sale price is $300,000 or less, and Buyer signs an affidavit of intent to occupy then FIRPTA is eliminated. Add the affidavit to the file and you are done with FIRPTA.
d. If the sale price is $300,001 up to $1 million, then FIRPTA can be reduced to 10%
e. If the sale property is going to be used as a rental, second home, vacation home, commercial use, is raw land, or an entity other than an individual is purchasing, then FIRPTA is always 15%.

Note: Buyer is never obligated to sign an affidavit of intent to occupy the property. Seller cannot force the Buyer to sign the affidavit of intent to occupy unless this was a special provision in the real estate sale contract. Seller is relying upon Buyerâ??s good will and cooperation to sign the affidavit of intent to occupy. Seller should never count on Buyer signing the affidavit of intent to occupy. Buyer may really intend to occupy the property, but the IRS acknowledgement clause often scares the Buyer into refusing to sign.

If FIRPTA funds are withheld, the appropriate forms need to be filled out, and signed by the Buyer. The completed Forms and withheld funds must be sent to the US treasury within 20 days of closing or penalties will apply and those go to the Withholding Agent (Buyer).

FIRPTA is not the responsibility of the Settlement Officer, Escrow Officer, Title Company, or Closing Attorney. FIRPTA responsibility rests with the Buyer and Agents for Buyer and Seller. According to the

Treasury regulations *settlement officers and clerical personnel are responsible for a FIRPTA compliance failure if work is limited to the following areas:*

(i) The receipt and disbursement of any portion of the consideration for the transaction;

(ii) The recording of any document in connection with the transaction;

(iii) Typing, copying, and other clerical tasks;

(iv) The obtaining of title insurance reports and reports concerning the condition of the real property that is the subject of the transaction; or

(v) The transmission or delivery of documents between the parties.

This means as a Settlement Officer, if you do not prepare FIRPTA documents and only advise Seller and Buyer to seek assistance with FIRPTA compliance from a competent qualified tax professional with experience in FIRPTA transactions, you are shielded from risk of IRS penalties regarding a FIRPTA compliance failure. From a customer service standpoint and underwriter standpoint, it is a good practice to inform the Buyer and Seller in writing to seek FIRPTA assistance from an experienced professional.

VLTA Examiner

These are a few common questions or misconceptions about **FIRPTA** withholding;

- **Seller has a U.S. Social Security number; FIRPTA does NOT apply.**
- **False**, having a U.S. SSN does **NOT** automatically exempt a seller from FIRPTA withholding, a Tax ID, State Driverâ??s License or U.S. Entry Visa do not determine U.S. tax residency, contact a tax professional for further verification.
- **Seller has an ITIN â?? FIRPTA withholding applies**;
  - **False**, if Seller has an ITIN, Seller **MAY** be exempt from FIRPTA using SPT.
- **Seller meets SPT, FIRPTA does NOT apply.**
- U.S. tax residency rules are complex and often misunderstood. Only take advice from a competent qualified tax professional experienced in FIRPTA transactions.
- **The foreign spouse of a married couple can allocate his/her share to the U.S. spouse to avoid FIRPTA.**
- **False**, the foreign spouse is subject to FIRPTA withholding on their allocated contributions (basis) of the property being sold.
- **The seller is a â??Domestic LLC.â?• FIRPTA does not apply.**
- **False** a single member limited liability company (SMLLC) is disregarded by the IRS meaning the IRS doesnâ??t care about the state level entity, **IRS ignores the LLC** and looks through to ultimate owner and **FIRPTA rules still apply.**

In many cases, a Seller can be considered exempt from FIRPTA once all the relevant facts and circumstances are considered. If Seller is foreign, then FIRPTA compliance is just another formality and should not fall on the Settlement Officer; FIRPTA is a matter for Buyer, Seller and the Realtors to sort out. The reality is that FIRPTA is simply a tax deposit of Sellerâ??s proceeds that is recoverable by the Seller. The unfortunate bit is that Buyer is ultimately responsible for ensuring the funds are withheld and sent to IRS. So, to ease the burden on the Buyer and Seller, having an experienced outside professional to refer the parties to is the simplest way to handle FIRPTA.


VLTA Examiner

Marc Enzi
Marc Enzi CFPÂ®, EA is an expert in FIRPTA transactions. Marc began his international tax career at PricewaterhouseCoopers, he went into private practice in 2009, Marc works with individuals to navigate the tricky road of the international tax. His firm Tax Solutions-FIRPTA Consulting specializes in the Foreign Investment in Real Property Tax Act (FIRPTA) and related tax controversy matters. Marc has an MBA from Boston University, he studied Financial Planning at Rice University and is a Certified Financial Plannerâ?¢, Certifying Acceptance Agent (CAA) and an National Tax Practice Institute fellow, he teaches tax courses annually at Texas Regional Practitioner Meetings, is active in the Houston Association Tax chapter of NAEA and he teaches the TREC FIRPTA for Realtors course.

Category

1. In the News
2. Legislative
3. Settlements
4. Uncategorized

VLTA Examiner

Date Created
2023/12/21
Author
vltaexaminer