

FIRPTA: In a Nutshell â?? Part One

Description

In plain English, the Foreign Investment in Real Property Tax Act (FIRPTA) requires foreign persons (transferors) to pay U.S. income tax on gains they make from selling U.S. real estate. FIRPTA puts the burden on the purchaser (transferee) to withhold 15% of the contract sales price if the seller is a foreign personâ??unless one of three exemptions applies.^[1]

Exemption No. 1: The Non-foreign Affidavit

The *first exemption* is when the transferor furnishes to the transferee an affidavit by the transferor stating, under penalty of perjury, the transferorâ??s United States taxpayer identification number, forwarding address, and that the transferor is not a foreign person.^[2] This affidavit is a safe harbor to prove that the transferor is not a foreign person so that no FIRPTA withholding need be collected. A transferee can rely on other means to prove that the transferor is not a foreign person but may be subject to tax liability if he or she proves to be wrong.^[3] Regulations^[4] provide for individual and entity transferors sample certifications, which should be standard forms included in title and settlement agent software.

The idea that the affidavit is a safe harbor for a transferee should not be overlooked. The statute and regulations allow the transferee to take the seller at his or her word. That is to say, *there is no statutory duty to verify the substance of the affidavitâ??either on the part of the transferee or (by extension) the settlement agent administering this transaction.* The transferor need not prove that he or she is *not a nonresident alien* any more than he or she needs to prove that the social security number or home address provided is correct.

And yet for whatever reason, some settlement agents (and sometimes transferees) persist in wanting proof that the transferor is speaking the truth in this affidavit. So, for argumentâ??s sake, how does one prove that he or she is *not a nonresident alien*? There are two ways: the *green card test* or the *substantial presence test*.^[5]

The *green card test* is simple. An individual passes the green card test if he or she has an alien registration card, Form I-551, also known as a *green card*. The *substantial presence test* is not so simple. Determining whether the seller passes the substantial presence test is well beyond the expertise of a typical settlement agent. Perhaps a compromise worth considering is to require the sellerâ??s CPA or tax attorney to issue an opinion letter that the seller meets the requirements of the substantial presence test or otherwise meets the requirements of a resident alien or U.S. Citizen or U.S. Nationalâ??or simply that no FIRPTA withholding is due.

When attempting to corroborate the sellerâ??s nonforeign affidavit, it is tempting to think that if the seller has a social security number, we are â??goodâ??â??no FIRPTA tax need be withheld. This is a mistake. Social security numbers can be issued to foreign persons, both resident and nonresident.^[6] Having a social security number is not determinativeâ??*whether the seller signs the nonforeign affidavit is determinative.*

Remember the nonforeign affidavit comes in two flavors: one for *individual sellers* and one for *entity sellers*. If the entity seller (e.g., corporation, partnership, trust) is created in the U.S., the seller is not foreign and may sign the affidavit. No FIRPTA withholding is due. *The citizenship of the stockholders, partners, and beneficiaries, respectively, is irrelevant.* Furthermore, when a foreign corporation has made an election to be treated as a domestic corporation and attaches a copy of the acknowledgement of the election from the IRS to the nonforeign affidavit, no FIRPTA withholding is due.^[7]

Note that the entity affidavit is like the individual affidavit with one critical assertion: the selling entity must affirm that it is “not a disregarded entity as defined in Â§1.1445-2(b)(2)(iii).” Limited liability companies (LLCs) are “disregarded” within the meaning of this rule, so if the seller is an LLC, it cannot sign this affidavit.^[8] Instead, we must look to the member(s) of the LLC to determine if FIRPTA withholding is due.

If a domestic LLC is a *single-member* LLC, the citizenship of the single member determines whether FIRPTA withholding is due. That owner might be an individual or another entity, which will determine which version of the nonforeign affidavit should be signed, if applicable.

If a domestic LLC is a *multi-member* LLC, the FIRPTA analysis may stop. FIRPTA treats a multi-member LLC as a domestic corporation or domestic partnership.^[9] There is no duty on the purchaser to withhold FIRPTA for these entities. The duty to pay FIRPTA withholding, if any, is on the seller entity, not the purchaser, to be accomplished when the seller files taxes.^[10]

Wrapping up this first exemption, note that with both affidavits (individual and entity), the seller must provide this affidavit to the purchaser, thereby disclosing the seller’s taxpayer/employer identification number. Understandably, sellers have privacy concerns with this requirement. Fortunately, there is a procedure to fulfill this requirement without compromising a seller’s privacy. FIRPTA permits the transferor to furnish the nonforeign affidavit to a *qualified substitute*, who then *furnishes a statement to the transferee stating, under penalty of perjury, that the qualified substitute has such affidavit in his possession.*^[11] A *qualified substitute* is defined as (A) the person (including any attorney or title company) responsible for closing the transaction, other than the transferor’s agent, and (B) the transferee’s agent.^[12]

Having discussed the *first exemption* to FIRPTA withholding, we now turn our attention to the remaining two.

Exemption No. 2: IRS Qualifying Statement

The *second exemption* is when the transferee receives a qualifying statement from the IRS that the transferor either: (i) reached an agreement with the IRS as to the payment of any tax due under FIRPTA; (ii) is exempt from such tax; OR (iii) such tax has been satisfied or adequate security has been provided to cover such liability.^[13] The bases and procedures for obtaining such a qualifying statement from the IRS (also known as a *withholding certificate*) are set forth in 26 CFR Â§ 1.445-3.^[14] The IRS must process a request for a qualifying statement within 90 days of receiving the request.^[15] But there does not appear to be any recourse for the taxpayer if the IRS fails to meet this timeline.

Practically, this exemption becomes relevant for a transaction when a transferor balks at the idea of paying FIRPTA withholding—for whatever reason—or when the settlement agent is being put in the position of determining whether FIRPTA withholding is appropriate, which at times can be difficult or simply beyond the scope of the settlement agent’s services or expertise. In such cases, why guess

at the right answer? Simply request the IRS to determine whether FIRPTA withholding is due, and if so, how much. But sometimes there is not enough time before closing to request such a certificate. In such cases, the parties may need to negotiate a later settlement date or agree to delayed reporting, discussed below.

Exemption No. 3: \$300,000 or Less Residence

The third exemption is when (1) the contract sales price does not exceed \$300,000; AND (2) the property is acquired by the transferee for use by him as a residence.^[16] This exemption is only available when the transferee is an individual.^[17]

As to the first requirement, the IRS looks to the total amount realized, not the portion attributable to just one of several foreign transferors.^[18] As to the second requirement, there is a common misunderstanding that the transferee must live in the property as his or her *primary* residence. This notion is false.

To establish the residency requirement, only one of several transferees need establish the subject property as his or her residence.^[19] In plain English, the residency requirement is simply this: at the time of closing, the purchaser must intend that in Year 1 following the sale, the purchaser (or members of the purchaser's family) will reside in the property at least 50% of the time it is used by anyone. The purchaser must intend the same for Year 2 as well. The purchaser's family includes brothers and sisters (whether by the whole or half-blood), spouse, ancestors, and lineal descendants.^[20]

There is no duty of the purchaser to document these intentions or file any form with the IRS. Likewise, there is no duty for the settlement agent to document such intentions, although some settlement agents may find it desirable to do so to foreclose later allegations that the settlement agent was negligent in not withholding FIRPTA tax.

Reducing FIRPTA Withholding

If none of these three exemptions apply and the seller is "foreign," FIRPTA withholding must be collected. But some transactions may qualify for less withholding.

Certain transactions qualify for a reduced rate of 10% withholding. To qualify, ALL the following criteria must be met: (1) the transferee must use the property as a personal residence; (2) the amount realized (contract sales price) does not exceed \$1,000,000; AND (3) the \$300,000 exception does not apply.^[21]

Additionally, FIRPTA withholding may also be reduced when the property is owned jointly by foreign and non-foreign transferors.^[22] FIRPTA tax must be allocated according to capital contribution, so if some of the transferors are foreign and others are U.S. citizens/nationals, then the total FIRPTA tax is lessened by apportionment. The IRS does not allow the non-foreign transferor to report 100% of the amount realized to avoid paying FIRPTA tax; the amount realized cannot be allocated entirely to one transferor when two or more transferors own the property.^[23] A husband and wife will each be deemed to have contributed 50 percent of the aggregate capital contributed by such husband and wife.^[24]

Determining tax liability based on capital contribution is well beyond the expertise of the purchaser (who is liable for such withholding) or the settlement agent acting on the purchaser's behalf. Other options to consider: (1) sending the full amount of withholding to the IRS and letting the seller petition the IRS for a refund, or (2) delayed reporting, discussed in part two (coming June 2025).

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- [1] [26 USC Â§ 1445\(a\); 26 CFR Â§ 1.1445-1\(g\)\(6\).](#)
- [2] [26 USC Â§ 1445\(b\)\(2\).](#)
- [3] [26 CFR Â§ 1.1445-2\(b\)\(1\).](#)
- [4] [26 CFR Â§ 1.1445-2\(b\)\(2\)\(iv\).](#)
- [5] See generally [â??Taxation of Nonresident Aliensâ?•](#) at www.irs.gov.
- [6] See [IRS Publication 519](#), which discusses (among other things) SSNâ??s for aliensâ??both resident and nonresident.
- [7] [26 CFR Â§ 1.1445-2\(b\)\(2\)\(ii\).](#)
- [8] [26 CFR Â§ 301.7701-3\(a\)&\(b\).](#)
- [9] [26 CFR Â§ 301.7701-3\(a\)&\(b\).](#)
- [10] [26 USC Â§ 1445\(e\)\(1\).](#)
- [11] [26 USC Â§ 1445\(b\)\(9\).](#)
- [12] [26 USC Â§ 1445\(f\)\(6\).](#)
- [13] [26 USC Â§ 1445\(b\)\(4\).](#)
- [14] See also [26 CFR Â§ 1.1445-6.](#)
- [15] [26 USC Â§ 1445\(c\)\(3\)\(B\).](#)
- [16] [26 USC Â§ 1445\(b\)\(5\).](#)
- [17] [26 CFR Â§ 1.1445-2\(d\).](#)
- [18] See FAQ No. 17 of [FIRPTA Withholding](#) at <http://www.irs.gov>.
- [19] [26 CFR Â§ 1.1445-2\(d\).](#)
- [20] [26 U.S.C. Â§ 267\(c\)\(4\).](#)
- [21] [26 USC Â§ 1445\(c\)\(4\); 26 CFR Â§ 1.1445-1\(b\)\(2\).](#)
- [22] [26 CFR Â§ 1.1445-1\(b\)\(3\).](#)
- [23] See FAQ No. 1 of [FIRPTA Withholding](#) at <http://www.irs.gov>.
- [24] [26 CFR Â§ 1.1445-1\(b\)\(3\).](#)
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