

## FIRPTA: In a Nutshell â?? Part Two

### Description

Article by Kevin Pogoda. This is part two of [â??FIRPTA: In a Nutshell â?? Part Oneâ??](#).

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 below:

### Some Special Rules

Not everything fits well into categories when discussing all the ins and outs of FIRPTA. Now we turn to the junk drawer of weird stuff that doesn't have a home anywhere else:

1. **Domestic entities.** Whenever the seller is a domestic partnership, domestic trust, or domestic estate, no FIRPTA tax need be withheld by the transferee. The seller entity need only sign the nonforeign entity affidavit, and the transferee may rely on it. The citizenship of the partners, beneficiaries, devisees or heirs is irrelevant. FIRPTA tax may be due, but FIRPTA places the burden of withholding on the selling entity, not the transferee.
2. **Government entities.** No withholding is required when the purchaser is the United States, a state or possession of the United States, a political subdivision thereof, or the District of Columbia.<sup>[1]</sup>
3. **Foreclosures.** Foreclosures are not exempt from the ordinary withholding requirements of FIRPTA if the debtor being foreclosed upon is a *foreign person* within the meaning of the statute.<sup>[2]</sup> However, special rules, if followed, allow for the payment of a lesser amount that would ordinarily be due. This lesser amount, called the *alternative amount*, takes into consideration that the debtor in a foreclosure sale is unlikely to have gain on the disposition of the subject property. The *alternative amount* is any amount that the trustee determines to accrue to the debtor after outstanding balance of the loan and applicable fees and costs are paid.<sup>[3]</sup> If this amount is zero (as it usually is), then no withholding is due. If, however, there is such an amount, the appropriate withholding (10% or 15%) must be paid. In any event, even if there were such an amount to be paid, it is likely to be less than withholding based upon the amount realized (*i.e.*, contract sales price). To take advantage of these rules, a transferee must comply with strict notice requirements to the trustee and the IRS.<sup>[4]</sup>
4. **Deeds in lieu of foreclosure.** These deeds are subject to the ordinary withholding rules. However, no withholding is required if: (1) the transferee is the only person with a security interest in the property; (2) no cash or other property (other than incidental fees incurred with respect to the transfer) is paid, directly or indirectly, to any person with respect to the transfer; AND (3) the notice requirement of Â§ 1.1445-2(d)(3) is satisfied.<sup>[5]</sup>
5. **Short sales.** FIRPTA applies to short sales just like any other transaction. Remember that withholding is based not on the proceeds due to the seller but on the amount realized (*i.e.*, the contract sales price). Given the nature of a short sale (the sales price being below the loan amount), it is likely that the seller has no taxable gainâ??the value of the property as sold likely

being lower than when purchased. The solution, therefore, is to recognize this situation early and request from the IRS a qualifying statement (withholding certificate) verifying that no FIRPTA withholding is due.

6. **Gift transfers.** Gift transfers are subject to FIRPTA.<sup>[6]</sup> When a foreign co-owner attempts to avoid FIRPTA withholding by conveying his or interest by gift deed to the non-foreign owner before the "real" transaction, red flags should go off. It is true that in the subsequent sale transaction, no FIRPTA withholding would be due because the seller is non-foreign. But if you are the settlement agent aware of such re-titling prior to the transaction, ask yourself whether what the previous re-titling sounds like tax evasion. If so, do you think that turning a blind eye to such an approach could be construed by the IRS as you being an accomplice to tax evasion?<sup>[7]</sup>
7. **1031 Exchanges.** A 1031 Exchange allows the owner of real property to sell real property and defer the capital gains tax that would ordinarily be due upon the sale, and so one might question whether a foreign seller taking advantage of the 1031 exchange provisions would still be subject to FIRPTA withholding. The answer is clearly "yes" transactions that are part of a 1031 Exchange are still subject to FIRPTA withholding.<sup>[8]</sup> Part of the reason lies in the fact that at the time of sale by the foreign owner, the 1031 exchange is not yet complete. After the sale, the seller must purchase like-kind property within certain timeframes. If the seller does not meet these requirements, the seller will be liable for the capital gains tax. Therefore, the one who purchases from the foreign seller must withhold the appropriate FIRPTA tax. Perhaps an accommodation to the seller worth exploring here is requesting a qualifying certificate along with delayed reporting, allowing the seller to complete the 1031 exchange.
8. **Written Notice of No Gain or Loss.** In addition to the exemptions already noted, FIRPTA withholding is not required when the transferor gives the transferee written notice that no recognition of any gain or loss on the transfer is required because of a nonrecognition provision in the Internal Revenue Code or a provision in a U.S. tax treaty. The transferee must file a copy of the notice by the 20th day after the date of transfer with the Ogden Service Center, P.O. Box 409101, Ogden, UT 84409.<sup>[9]</sup> While this exemption certainly makes sense and is documented in the IRS website, it is beyond the normal expertise of the settlement agent or transferee (who is liable for the FIRPTA withholding) to determine whether the IRC Code section or Treaty cited in such a notification truly nullifies FIRPTA's withholding requirement. Perhaps a better course of action to consider in such a situation is to apply for a withholding certificate from the IRS and employ delayed reporting if necessary.

## Procedures for Withholding

The transferee must report and pay over any tax withheld by the 20th day after the *date of the transfer*.<sup>[10]</sup> In Virginia, the date of the transfer is the settlement date. Use forms 8288 and 8288-A and the instructions thereto, all downloadable from the IRS website.<sup>[11]</sup>

When filling out these forms, it is important to remember that FIRPTA places the burden on the transferee (buyer) to be the withholding agent. But practically, the settlement agent will be holding the money and may act in accordance with the buyer's instructions.

## Delayed Reporting

Delayed reporting is a great solution when the seller objects to remitting FIRPTA tax to the IRS and there is no time before closing to obtain a withholding certificate from the IRS to verify what, if any, FIRPTA tax is due.

Delayed reporting is possible if, *prior to closing*, either the transferor or the transferee applies for a withholding certificate (*i.e.*, a statement from the IRS that either no tax is due or some lesser tax is due).<sup>[12]</sup> If such application is made by the transferor, notice of the application must be furnished to the transferee.<sup>[13]</sup> *No particular form is required but the notice must set forth the name, address, and taxpayer identification number of the transferor, a brief description of the property which is the subject of the application, and the date the application was submitted to the [IRS].*<sup>[14]</sup> The IRS has 90 days to respond to such a request after receipt thereof.<sup>[15]</sup> The transferee (or more practically, the settlement agent) has then 20 days from when the IRS sends the letter to report and pay over any tax that is due.<sup>[16]</sup>

Caution should be exercised, however, in utilizing this approach because if the IRS determines that this rule was used *for a principal purpose of delaying the transferee's payment to the IRS of the amount withheld*, then the transferee may be liable not only for the amount withheld, but also for interest and penalties as well.<sup>[17]</sup> *A principal purpose of delaying payment of the amount withheld shall be presumed if the transferee applies for a withholding certificate . . . based upon a determination of the transferor's maximum tax liability, and such liability is ultimately determined to be equal to 90 percent or more of the amount that was otherwise required to be withheld and paid over.*<sup>[18]</sup>

Sometimes, a practical problem arises with delayed reporting: the buyer's consent. A buyer may not want to take the risks that delayed reporting presents. For example, if the settlement agent (acting on behalf of the transferee) withholds the proper amount of tax but sends it to the IRS late, then the transferee will not be held liable for the tax, but may be held liable for the interest insofar as the payment is late. Understandably, a transferee may not want to take this risk and simply instruct you as the settlement agent to send the money immediately after closing, so getting the buyer's approval for delayed reporting seems like an appropriate thing to consider.

What if the seller does not have a Social Security number or other taxpayer identification number? Does that disqualify a seller from requesting a withholding certificate or delayed reporting? The short answer is *no*. If the seller does not have a taxpayer identification number, he can apply for one. The lack of such a number does not nullify the duty to pay the FIRPTA tax; the IRS simply cannot credit money back to the transferor without one.<sup>[19]</sup> The Instructions to these forms explain:

*For a nonresident alien individual who is not eligible for an SSN, the identifying number is an IRS individual taxpayer identification number (ITIN). If the individual does not already have an ITIN, he or she should complete Forms 8288 and 8288-A and mail the forms along with any payment to the address shown under Where To File, earlier. In a separate package mail a completed Form W-7, Application for IRS Individual Taxpayer Identification Number, with supporting documentation and a copy of Forms 8288 and 8288-A to the IRS at the address given in the Form W-7 instructions.*

## Liability of Agents and the Transferee

If the transferor provides a false affidavit (*i.e.*, non-foreign certification), agents involved in the transaction may be liable for the withholding tax that should have been collected. This includes agents for the transferor, agents for the transferee, and the qualified substitute.<sup>[20]</sup> The settlement agent who closes the transaction falls within the scope of this rule. For purposes of this rule, an *agent* is any person who represents the transferor or transferee in any negotiation with another person (or another person's agent) relating to the transaction, or in settling the transaction.<sup>[21]</sup>

If any such agent has actual knowledge of the false affidavit, the requisite amount must still be withheld, and the agent must notify the transferee and the IRS that the affidavit is false.<sup>[22]</sup> This duty to notify extends after settlement has occurred.<sup>[23]</sup> If the agent fails to do so, the agent may be liable for the withholding tax, but in no event does the settlement agent's liability under FIRPTA exceed his or her compensation received for the subject transaction.<sup>[24]</sup>

Remember it is the *transferee* that has the duty to withhold the tax the transferor is liable to pay.<sup>[25]</sup> *A person that is required to deduct and withhold tax but fails to do so may be held liable for the payment of the tax and any applicable penalties and interest.*<sup>[26]</sup> Civil and criminal penalties may also apply.<sup>[27]</sup>

## FIRPTA and Title Insurance

If FIRPTA tax is not withheld, the IRS can demand payment of the withholding from the transferee. Ultimately, this could result in a federal tax lien on the property:

*If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.*<sup>[28]</sup>

Such a demand (and resulting lien) could only occur after the transfer of the subject property. Consequently, there would be no coverage under a loan or owner's policy because Exclusion 3(d) of those policies exclude from coverage:

*Defects, liens, encumbrances, adverse claims, or other matters . . . attaching or created subsequent to Date of Policy.*

In conclusion, title insurance cannot be a substitute fallback position or a replacement for knowing how to competently administer the provisions of FIRPTA.

[1] [26 CFR Â§ 1.1445-2\(d\)\(5\).](#)

[2] [26 CFR Â§ 1.1445-2\(d\)\(3\)\(i\)\(A\).](#)

[3] [26 CFR Â§ 1.1445-2\(d\)\(3\)\(i\)\(A\)\(2\).](#)

[4] [26 CFR Â§ 1.1445-2\(d\)\(3\)\(i\)&\(ii\).](#)

[5] [26 CFR Â§ 1.1445-2\(d\)\(3\)\(i\)\(B\).](#)

[6] [26 CFR Â§ 1.1445-1\(g\)\(4\).](#)

[7] [26 USC Â§ 7201](#) provides: *Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.* According to [18 USC Â§ 2\(a\)](#): *Whoever commits an offense against the United States or*

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*aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.*

[8] See [Internal Revenue Manual 21.8.5.4.6.1 \(10-01-2018\)](#).

[9] See Exceptions from [FIRPTA Withholding](#) at [www.irs.gov](http://www.irs.gov).

[10] [26 CFR Â§ 1.1445-1\(c\)\(1\)](#).

[11] [26 CFR Â§ 1.1445-1\(c\)](#).

[12] [26 CFR Â§ 1.1445-1\(c\)\(2\)](#).

[13] [26 CFR Â§ 1.1445-1\(c\)\(3\)\(B\)](#).

[14] [26 CFR Â§ 1.1445-1\(c\)\(3\)\(B\)](#).

[15] [26 USC Â§ 1445\(c\)\(3\)\(B\)](#).

[16] [26 CFR Â§ 1.1445-1\(c\)\(2\)\(i\)](#).

[17] [26 CFR Â§ 1.1445-1\(c\)\(2\)\(ii\)](#).

[18] [26 CFR Â§ 1.1445-1\(c\)\(2\)\(ii\)\(B\)](#).

[19] [26 CFR Â§ 1.1445\(c\)\(1\)](#).

[20] [26 USC Â§ 1445\(d\)](#).

[21] [26 CFR Â§ 1.1445-4\(f\)](#).

[22] [26 USC Â§ 1445\(d\)](#); [26 CFR Â§ 1.1445-4\(c\) & \(e\)](#).

[23] [26 USC Â§ 1445-4\(c\)](#).

[24] [26 USC Â§ 1445\(d\)](#); [26 CFR Â§ 1.1445-4\(e\)](#).

[25] [26 USC Â§ 1445\(a\)](#).

[26] [26 CFR Â§ 1.1445-1\(e\)\(1\)](#).

[27] [26 CFR Â§ 1.1445-1\(e\)\(2\)](#).

[28] [26 USC Â§ 6321](#).

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