Primer on Foreign Investment Real Property Act (FIRPTA)
New Changes are Effective February 2016!

Synopsis: FIRPTA Withholding Rate Increasing to 15% effective for real estate settlements on or after February 17, 2016. The current 10% Rate will continue to apply for transactions in which the property is to be used by the Transferee (Buyer) as a residence, and the amount realized (generally the sales price) does not exceed $1,000,000 and the existing $300,000 “exemption” remains unaffected.

The recently-enacted Protecting American Taxpayers from Tax Hikes (PATH) Act (H.R. 2029, P.L. 114-113) includes two very positive FIRPTA provisions that are conservatively estimated to boost foreign investment in U.S. commercial real estate by $20-$30 billion per year involving REITS or Pension Funds without impacting the original intent of FIRPTA. However, as part of a package of tax changes to “pay for” the two provisions, Congress also included an increase in the FIRPTA withholding rate from 10% to 15%. It should be noted that residences purchased from foreign persons will not be affected by the higher withholding rate unless the purchase price exceeds $1 million. The PATH Act makes this change effective for dispositions after the date which is 60 days after the date of enactment. The legislation was signed into law by President Obama on December 18, 2015. The 60th day after this day is February 16, 2016. Thus, the new rate will apply to sales on or after February 17, 2016. To summarize, the new guidelines are:

- If the amount realized (generally the sales price) is $300,000 or less, AND the property will be used by the Transferee (Buyer) as a residence (as provided for in the current regulations), no sums need be withheld or remitted.
- If the amount realized exceeds $300,000 but does not exceed $1,000,000, AND the property will be used by the Transferee (Buyer) as a residence (there are no regulations that specifically address these changes but many are assuming you can follow the current regulations for the $300,000 exemption), then the withholding rate is 10% on the full amount realized.
- If the amount realized exceeds $1,000,000, then the withholding rate is 15% on the entire amount, regardless of use by the Transferee (Buyer).

It has been recommended to Transferee’s and their Tax Advisors to document the Transferee’s intent to use the property as a residence as best they can, and point out to the Transferee the risks of allowing the exemption to apply to their transaction. Under the law, the Transferee is the withholding agent and is responsible for withholding and remitting the proper amount to the IRS. Members should also be alert for situations where the foreign Transferor forces the Transferee to claim residence status merely to lower the withholding rate, since the Transferee could be liable for any additional withholding tax, penalty, and interest if their intent is ever challenged by the IRS.

Real Estate Brokers who address FIRPTA withholdings in their purchase-sale contracts might think about modifying the contract to change the potential rate of withholding up to 15% for closings to occur on or after February 17, 2016. As before if you are the broker for either the Seller or the Buyer have knowledge that a certificate or certificate application is false, you must notify the Buyer of this fact. Failure to do so could mean that you, as the broker, are liable for the tax that should have been withheld but was not.
If a potential FIRPTA withholding transaction involves a REIT or Foreign Pension Fund, please contact your tax advisor to discuss additional new rules that could positively apply to those situations.

**What is FIRPTA?**

**General Information Only -**

Enacted in 1980, The Foreign Investment Real Property Tax Act requires the transferee (Buyer) to deduct and withhold a tax equal to 10% of the amount realized when a foreign person disposes of a United States real property interest. The withholding obligation also applies to certain partnerships, corporations which are not domiciled in the U.S., and the fiduciary of certain trusts and estates. The “amount realized” includes cash paid or to be paid, the outstanding amount of any liability assumed by the transferee, the fair market value of other property transferred or to be transferred, and the amount of any liability assumed by the transferee or to which the U.S. real property interest is subject immediately before and after the transfer. The tax must be deducted from transferor’s proceeds, IRS forms 8288 and 8288A must be completed, the withheld tax must be paid, and the forms must be sent to the IRS by the 20th day following the date of transfer.

There are two special exemptions under the regulations. If the transferor provides the transferee with an affidavit stating, under penalties of perjury, that the seller is not a foreign person and by providing the seller’s U.S. taxpayer identification number, then withholding is not required and no personal liability of the transferee for the tax exists. The other exemption applies if (a) the transferee is acquiring a residence, (b) the transferee actually uses the property as his or her new residence, and (c) the sales price is $300,000 or less. An affidavit should be obtained from the transferee stating his or her intent to reside at the premises.

Foreign transferors who do not already meet the exemptions under the Act may apply to the IRS for a withholding certificate prior to the transfer. Withholding can be reduced or even eliminated when the IRS issues such a certificate. In this case, the transferee must still withhold the tax, but need not file the forms to remit the tax to the IRS until the 20th day after the IRS’ final determination regarding the application. The regulations require that the IRS act with respect to any such application within 90 days of receipt. The certificate may be relied upon unless it is known to be false. These certificates may be issued if the transferor is exempt from the tax, an agreement has been made for payment of the tax, or the transaction produces no taxable gain or an amount of gain which justifies reduced withholding.