

FIRPTA: The Basics and Beyond

1 hour CE (Ethics), 1 hour CLE (General), 1 hour Real Estate

Julie Lepore

President, Total FIRPTA, LLC





Julie Lepore
President, Total FIRPTA, LLC

Julie Lepore is the owner and President of Total FIRPTA, LLC, an accounting firm dedicated to FIRPTA related tax matters. She is a registered tax preparer and Certified Acceptance Agent for the IRS. Her background includes title insurance, mortgage lending, real estate, sales, and public speaking. Julie has trained thousands of real estate professionals, title agents, and attorneys across the nation, and delivered hundreds of seminars on FIRPTA over the last several years. She is committed to raising awareness regarding this often-misunderstood withholding tax and hopes to change the way our industry views FIRPTA.



OVERVIEW

Name of Provider: Total FIRPTA LLC

Name of Course: FIRPTA: The Basics and Beyond

Targeted audience: Florida Title Insurance Agents

Course Objectives:

The sale of real property by foreigners can be tricky. One small mistake can result in thousands of dollars in IRS penalties to the buyer or prevent the seller from getting their appropriate refund. It is critical for title agents to have a foundational understanding of FIRPTA to understand when FIRPTA applies, how the exceptions work, and when to seek expert advice.

Course Relevance:

This course will provide an overview of what FIRPTA is, when it applies, and how the different processing options can affect title agents. Agents will be taught how to identify foreign sellers more accurately, learn about some of the more popular exceptions, and understand the critical deadlines that can impact your bottom line. Agents will also be given the tools to develop effective operational protocols to handle FIRPTA transactions smoothly going forward.

Study Method: Classroom



OUTLINE

I. Introduction and Overview

5 minutes

II. Key Elements

50 minutes

A. What is FIRPTA?

B. Who is considered foreign for FIRPTA?

C. What are the options for handling FIRPTA?

D. What are the exceptions to FIRPTA?

E. What is the best way to manage FIRPTA transactions?

III. Questions and Answers

5 minutes

Total Time

60 Min



INTRODUCTION

The tax code relating to FIRPTA is vast and wide. It applies to many types of transactions, not just real estate. It is critical for title agents to have a foundational understanding of FIRPTA, for many reasons:

- The decisions we make in our offices can adversely affect buyers by creating IRS penalties.
- The way FIRPTA is handled can directly impact a seller's ability to get a refund.
- To save relationships, penalties are absorbed, which hurts your bottom line.
- Repeat offenses could impact your relationship with your underwriter.
- Conversely, knowing how to handle FIRPTA transactions well could be a factor in growing your business in a stagnant or declining market.

WHAT IS FIRPTA

FIRPTA is an acronym that stands for the Foreign Investment in Real Property Tax Act of 1980. It was designed to even the playing field between foreign and domestic investors.

FIRPTA requires that when a foreign seller (a "transferor") transfers U.S. real property, a certain percentage of the money realized by that transferor must be withheld and remitted to the Internal Revenue Service (IRS). This withholding serves to preemptively collect U.S. taxes that may be owed by the transferor, and withholding is the obligation of the buyer (the "transferee"). While withholding will not be required in every sale of U.S. real property by a foreign transferor, settlement agents should assume that FIRPTA applies to every transfer unless an exemption applies.

FIRPTA is a withholding tax, not a payable income tax, which means the excess tax is refundable:

INCOME TAX	WITHHOLDING TAX
<ul style="list-style-type: none">• Actual, permanent, nonrefundable• Paid by the receiver of the income (aka Seller)• You owe it, you pay it, it's gone forever!	<ul style="list-style-type: none">• Estimated, temporary, refundable• Paid by the payer of the income (aka Buyer)• You pay it, might not owe it, might get a refund.



FIRPTA: The Basics and Beyond

A classic paystub is a great example of how withholding tax works:

Abstract United		Jamaica, NY, 11433, USA		EARNINGS STATEMENTS		
Johnny Bravo					#12341231	
SSN	PAY PERIOD		PAY DATE		EMPLOYEE #	
***-**-5645	03/28/2018 - 04/03/2018		04/01/2018		3214	
INCOME	RATE	HOURS	CURRENT TOTAL	DEDUCTIONS	TOTAL	YTD TOTAL
GROSS EARNINGS	15	40	600.00	FICA - MEDICARE	8.70	121.80
				FICA - SOCIAL SECURITY	37.20	520.80
				FEDERAL TAX	75.10	1,051.41
				STATE TAX	30.00	420.00
YTD GROSS	YTD DEDUCTIONS	YTD NET PAY	TOTAL	DEDUCTIONS	NET PAY	
8,400.00	2,114.01	6,285.99	600.00	151.00	449.00	

In the paystub example, Johnny Bravo works 40 hours a week at \$15 per hour. After deductions, his net pay is \$449.00. Taxes are withheld from his pay weekly and submitted to the IRS by his employer. If the total paid withholding tax exceeds Johnny Bravo's actual tax liability, he is eligible for a refund.

Withholding has been a part of our tax system since the beginning. We do this because:

- The federal tax system is a "pay-as-you-go" tax system
- Tax is paid as the income is earned

FIRPTA requires the buyer to withhold up to 15% of the "amount realized" which is:

- The cash paid or to be paid;
- The fair market value of other property transferred or to be transferred; and
- The outstanding 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.

Note: For typical real estate transactions, the amount realized is the contract price (or gross sales price); it is NOT the transferor's proceeds.

Note: Withholding under IRC 1445 is applicable when a foreign person assigns their right to purchase a USRPI to another party. For example, if a foreign person signs a contract to buy a house from a builder for \$400,000 but assigns their right to purchase the house for \$30,000 to another individual, that individual is required to withhold \$4,500 (15% of the of \$30,000) on the amount realized by the foreign person.



FIRPTA: The Basics and Beyond

Note: The amount realized cannot be allocated entirely to one transferor when two or more transferors own the USRPI. If one or more foreign persons and one or more U.S. persons jointly transfer a U.S. real property interest, you must determine the amount subject to withholding in the following manner:

1. Allocate the amount realized from the transfer among the transferors based on their capital contribution to the property. For this purpose, a husband and wife are treated as having contributed 50% each.
2. Withhold on the total amount allocated to foreign transferors.
3. Credit the amount withheld among the foreign transferors as they mutually agree. The transferors must request that the withholding be credited as agreed upon by the 10th day after the date of transfer. If no agreement is reached, credit them equally.

FIRPTA applies to the sale of real property by foreign persons. A U.S. real property interest is an interest, other than as a creditor, in real property located in the United States or the U.S. Virgin Islands. Examples include but are not limited to:

- Single-family residences, condominiums, and townhouses, deeded parking spots, docks, boat slips, timeshares, co-ops, land, unsevered natural products of the land, commercial buildings, growing crops, standing timber, mines, wells, other natural deposits before extraction, swimming pools, fences, advertising displays, billboards, oil and gas pipelines, permanently installed telephone and television cables, options, and leaseholds.

WHO IS CONSIDERED FOREIGN FOR FIRPTA:

FIRPTA only applies when the seller is considered a foreign person. Since there are only two categories of taxpayers, it's important to know both:

United States Persons:

- A citizen of the United States
- A resident of the United States
- A domestic partnership
- A domestic corporation
- Any estate other than a foreign estate
- Any other person that is not a foreign person.

Foreign Person:

- Non-resident alien individual
- Foreign Corporation (no election)
- Foreign Partnership
- Foreign Trust
- Foreign Estate Any trust other than a foreign trust



FIRPTA: The Basics and Beyond

Note: A resident alien is not a Foreign Person. A resident alien is an individual who has a resident alien card (Form I-551-1, also known as a “green card”) or meets the “substantial presence” test.

Note: the “substantial presence” test involves a formula for calculating the individual’s physical presence in the United States; this calculation or determination should not be done by settlement agents.

Note: An individual who has a U.S. Social Security number is still considered a Foreign Person if he/she does not have a green card or does not meet the substantial presence test.

If you are not a U.S. Citizen, you are considered a nonresident alien **unless** you meet **one** of two tests:

Test #1 - The Green Card Test

You are a lawful permanent resident of the United States, at any time, if you have been given the privilege, according to the immigration laws, of residing permanently in the United States as an immigrant. You continue to have U.S. resident status, under this test, unless:

- You voluntarily renounce and abandon this status in writing to the USCIS,
- Your immigrant status is administratively terminated by the USCIS, or
- Your immigrant status is judicially terminated by a U.S. federal court.

Test #2 - The Substantial Presence Test (SPT)

You will be considered a United States resident for tax purposes if you meet the substantial presence test for the calendar year. To meet this test, you must be physically present in the United States (U.S.) On at least 31 days during the current year, and 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:

- All the days you were present in the current year, and
- 1/3 of the days you were present in the first year before the current year, and
- 1/6 of the days you were present in the second year before the current year.



FIRPTA: The Basics and Beyond

For the Substantial Presence Test, don't count:

1. Days you commute to work in the U.S. from a residence in Canada or Mexico if you regularly commute from Canada or Mexico.
2. Days you are in the U.S. for less than 24 hours, when you are in transit between two places outside the United States.
3. Days you are in the U.S. as a crew member of a foreign vessel.
4. Days you are unable to leave the U.S. because of a medical condition that develops while you are in the United States.
5. Days you are an exempt individual:
 - Foreign government-related individual under A (except A-3) or G (except G-5)
 - Teacher or trainee under J or Q visa (for first 2 years)
 - Student under an F, J, M, Q visa (for first 5 years)
 - Professional athlete temporarily in the U.S. for a charitable sports event.

In some cases, you are allowed to make elections that override the green card test and the substantial presence test:

- First-Year Choice To Be Treated as a Resident
- Nonresident Spouse Treated as a Resident
- Closer Connection To a Foreign Country (Form 8840)
- Tax Treaties

Also, you can be both a nonresident and a resident during the same year. This usually only happens during arrival and departure years. This is known as a dual-status alien.



FIRPTA: The Basics and Beyond

Note: Dual-status alien is not the same as dual citizen.

Limited Liability Companies:

SINGLE-MEMBER LLC Default classification is:	MULTI-MEMBER LLC Default classification:	LLC MADE AN ELECTION TO BE TREATED AS A C-CORP Now classified as:
Disregarded Entity	Partnership	C-Corporation
Look to the owner of the LLC	Look to the LLC itself	Look to the corporation itself
EIN not required	Usually has an EIN	Usually has an EIN
Files an individual return (1040 or 1040NR)	Files a partnership return (Form 1065)	Files a corporate return (Form 1120)
FIRPTA if owner is foreign**	No FIRPTA	No FIRPTA

Trusts - The tax status of a trust depends on two tests:

TEST #1 – The Court Test	TEST #2 – The Control Test
A court within the United States is able to exercise primary supervision over the administration of the trust.	One or more United States persons have the authority to control all substantial decisions of the trust with no other person having the power to veto any of the substantial decisions.

A trust that does not meet **both the court and control tests** is considered a **foreign trust**.



OPTIONS FOR HANDLING FIRPTA:

Sellers typically have two options when it comes to FIRPTA. Some options require the buyer's cooperation and/or approval.

OPTION #1 – NO WITHHOLDING CERTIFICATE

- The withholding (10% or 15%) is collected from the seller's proceeds and sent directly to the IRS after closing using only forms 8288 and 8288A.
- Seller will need to have a US tax ID number to get a "receipt" for the withholding.
- Seller will need to file a tax return and attach the receipt to claim a refund of overpaid withholding.
- On the check, reference the type of withholding, the accounting period, and the buyer's TIN. For example, if the closing took place July 6, 2023, and the buyer's SSN was 555-44-6666, you would write/type "8288/July 2023/555-44-6666" in the memo section on the face of the check.
- Funds must be remitted to the IRS within 20 days of the closing. After the 20th day, the following will apply:
 - Failure to Pay = Withholding Amount x .50% x number of months late
 - Failure to File = Withholding Amount x 4.5% x number of months late (5 max)
 - Interest = Withholding Amount + Penalties x Current Interest Rate (compounding daily)
- Once remitted, provide all parties with redacted copies of the forms, check (s), and the tracking number.

OPTION #2 – WITHHOLDING CERTIFICATE APPLIED FOR

- The withholding (10% or 15%) is collected from the seller's proceeds and retained in escrow. The seller must notify the buyer in writing that they have applied for a withholding certificate.
- Only form 8288-B is used. This form (along with supporting documents) must be postmarked on or before the date of transfer.
- Shows a calculation of the seller's gain on the sale and potential tax owed.
- Can be applied for by the buyer or the seller.
- All parties will need to have or apply for a US tax ID number for the application to be approved.



FIRPTA: The Basics and Beyond

- When the IRS responds, only the reduced amount will need to be submitted. The balance of the escrow account can be released back to the seller.
- If funds are due, they must be remitted within 20 days of the date printed on the withholding certificate.
- It used to take 90 days for IRS processing – now it takes more than 12 months due to Covid.
- Withholding must be reduced by a minimum of 10% to be considered.
- If approved before closing – the buyer is only required to withhold the lower amount.
- If approved after closing – the funds can be placed in escrow and then disbursed once the certificate is received.
- Sellers are still required to file a tax return regardless of the outcome of the application.

Note: Be sure to use the most current version of form 8288 when submitting funds after a withholding certificate has been approved. Always include a copy of the certificate with the submission.

WHAT ARE THE EXCEPTIONS TO FIRPTA?

There are several exceptions to FIRPTA; some of the more common ones you encounter are:

1. Transferor is Not a Foreign Person: No withholding is required under section 1445 if the transferor of a U.S. real property interest is not a foreign person. The transferor can provide a Certification of Non-Foreign Status (CNFS) to inform the transferee that withholding is not required. To be valid, the CNFS must:
 - A. Be signed under penalties of perjury by the transferor,
 - B. State the transferor is not a Foreign Person,
 - C. Containing the transferor's name, address, and TIN

The CNFS may be relied upon unless the CNFS is known to be or is suspected of being false. Since this exemption to withholding applies only if the transferor is not a Foreign Person and a proper CNFS is provided, withholding (and applicable penalties and interest) will be owed if it is later determined that the transferor is a Foreign Person or that the CNFS was false or improper.

Every individual transferor, an authorized officer of a corporate transferor, a general partner of a partnership transferor, or the trustee, executor, or fiduciary of a trust or estate transferor, must sign the CNFS.



FIRPTA: The Basics and Beyond

A foreign corporation electing to be treated as a domestic corporation must also attach a copy of the IRS acknowledgment of such election (which must state that the information required by CFR Section 1.897-3 has been determined to be complete) to the CNFS; the CNFS cannot be relied upon if the IRS acknowledgment is not attached.

A “disregarded entity” may not, however, sign the CNFS since it is not treated as the taxpayer or transferor by the IRS for U.S. tax purposes. With a disregarded entity, the IRS instead looks directly to the individual owner (e.g., the single member of an LLC) as the actual taxpayer and transferor. When dealing with a disregarded entity, the owner of the disregarded entity is treated as the transferor of the property and assuming the owner is not a Foreign Person, must sign the CNFS. If the owner of a disregarded entity is a Foreign Person, this exemption does not apply.

Instead of delivering the CNFS to the transferee, the transferor may deliver it to a Qualified Substitute, such as a settlement agent. The Qualified Substitute will then provide the transferee with a Qualified Substitute statement (“QSS”), signed under penalties of perjury, indicating that the CNFS is in the Qualified Substitute’s possession. The QSS may also be relied upon unless the Qualified Substitute has reason to believe the CNFS is false.

The CNFS must be kept for a period of no less than 5 years.

2. Purchase of Residence for \$300,000 or Less: This exemption applies if the USRPI is being acquired as a transferee’s Residence, and the Amount Realized is \$300,000 or less. No form or other document is required to be filed with the IRS for this exemption but should be documented in the closing file. If not in fact used as a Residence, the IRS may subsequently assert that FIRPTA withholding was required. To utilize this exception:
 - A. Buyer must be an individual – not a trust, corporation, etc.
 - B. Buyer must have definite plans to reside at the property for at least 50 percent of the number of days that the property is used by any person during each of the first two 12- month periods following the date of the transfer.
 - C. Buyer’s family includes only his brothers and sisters (whole or half-blood) spouse, ancestors, and lineal descendants.

Note: If the seller(s) does not already have an ITIN for 1099 reporting, they will not be able to apply for one if the buyer utilizes this exception.

Note: If the above applies but the sales price is \$300,001 - \$1M withholding is reduced to 10%.



FIRPTA: The Basics and Beyond

3. Government Buyer: The property is acquired by the United States, a U.S. State or possession, a political subdivision, or the District of Columbia.
4. No Consideration Paid: The Amount Realized by the transferor is zero (for example, the property is transferred as a gift and the recipient does not assume any liabilities or furnish any other consideration to the transferor).
5. Transferor's Non-Recognition of Gain or Loss: The transferee may receive a notice from the transferor signed under penalties of perjury stating that the transferor is not required to recognize gain or loss on the transfer because of a non-recognition provision of the Internal Revenue Code (e.g., Temporary Regulations Section 1.897-6T(a)(2)) or a provision in a U.S. tax treaty). The transferee may rely on the transferor's notice unless only part of the gain qualifies for non-recognition, or the transferee knows or has reason to know that the transferor is not entitled to the claimed non-recognition.

Note: There is a misconception that a 1031 Exchange falls under the non-recognition provisions mentioned above. However, the seller utilizing a 1031 Exchange does not automatically exempt the sale from FIRPTA. This type of exception does not apply to FIRPTA unless:

- The sale includes a simultaneous closing, and
- The 1031 exchange provides for a complete exchange - THERE CAN BE NO BOOT!

If a simultaneous 1031 exchange occurs, the seller must provide a detailed notice to the buyer explaining why there is no gain. Then by the 20th day after the date of transfer, the buyer must:

- Mail a copy of the seller's notice to the IRS, and
- Include a cover sheet that includes their name, tax ID number, and address.

Major Drawback: In most cases, sellers must come to the table with an extra 10% or 15% to cover the required FIRPTA withholding to maximize the tax efficiency of a 1031 exchange.

6. Withholding Certificate Issued by the IRS: An IRS withholding certificate may be relied upon to reduce or eliminate withholding under FIRPTA. The certificate may be issued if:
 - A. Reduced withholding is appropriate because the 10% or 15% withholding amount (as applicable) exceeds the transferor's maximum tax liability;
 - B. The transferor is exempt from U.S. tax, or non-recognition provisions apply; or
 - C. The transferee or transferor enters into an agreement with the IRS for the payment of the tax.



FIRPTA: The Basics and Beyond

What is the best way to manage FIRPTA transactions:

FIRPTA is a very complicated area and is best left to tax professionals. Here are some helpful tips for settlement agents:

DON'T:

1. Accept closing or other instructions that require you to determine whether FIRPTA applies, or to act as Withholding Agent, unless you understand those obligations;
2. Determine whether a seller meets the "substantial presence" test to be considered non- foreign;
3. Determine whether a buyer qualifies for the Residence exemption;
4. Sign any FIRPTA forms, including those being sent to the IRS, as "Withholding Agent" unless that is your intention and you understand the ramifications of acting in this capacity;
5. Rely on any documents you know or think may be false, misleading, or incomplete;
6. Attempt to explain any laws or regulations related to FIRPTA;
7. Agree to escrow withheld monies while waiting for the seller to provide documentation evidencing an exemption; or
8. Charge an additional or separate fee for FIRPTA-related matters.

DO:

1. Assume FIRPTA applies to every transaction involving a foreign seller and encourage the seller and buyer to seek professional FIRPTA advice;
2. If relying on a FIRPTA exemption, document your closing file with evidence supporting that exemption; and
3. If you've agreed to assist with the remittance of FIRPTA monies and forms to the IRS, including acting as a Qualified Substitute, make sure you understand your role and obligations and that monies and forms are properly remitted to the IRS no later than the 20th day after the closing.
4. Establish a standard operating procedure when dealing with FIRPTA transactions.
5. Encourage foreign sellers to work with a FIRPTA expert as early as possible.

