

CHANGES TO FIRPTA AFFECTING REAL ESTATE TRANSACTIONS

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Introduction

The Foreign Investment in Real Property Tax Act ("FIRPTA") is applicable to all transactions involving interests in real property where the Seller is a "foreign person" (this includes entities). According to the IRS, FIRPTA authorized the United States to tax foreign persons on dispositions of U.S. real property interests. A disposition means "disposition" for any purpose described in the Internal Revenue Code. This includes, but is not limited to a sale or exchange, liquidation, redemption, gift, transfers, etc. FIRPTA requires withholding of a portion of the amount realized (typically, the purchase price) by foreign persons at the time of disposition. FIRPTA was amended by Federal Law signed by the President on December 18, 2015. This article discusses the changes that have occurred and their effect on real estate transactions (dispositions) most commonly involving Realtors®, Buyers and Sellers.

When will the changes become effective? The changes occurring because of the amendment to FIRPTA become effective February 16, 2016 (60 days after becoming law). This means that the changes will affect all real estate transactions governed by FIRPTA that close (the date when settlement occurs) **on or after February 16, 2016**.

What changes were made to FIRPTA? The changes made are limited and you may have heard that the withholding amount has been changed, but a careful review of the changes is warranted. Previously, the withholding requirement was generally 10%, unless the transaction was exempt from withholding (where the BUYER executes a certificate establishing BUYER'S intention to use the Property as BUYER's residence in accordance with the Internal Revenue Code and all applicable regulations related to that exemption). The exemption has not changed. What did change was the withholding amount for transactions, which is now 15%, unless: (i) there is an exemption, or (ii) a reduced withholding amount is permitted. Therefore, unless there is an exemption or a reduced withholding amount is permitted, the new requirements are as follows:

0% withholding if the amount realized (typically, the purchase price) is not more than \$300,000.00 and BUYER executes a certificate establishing BUYER'S intention to use the Property as BUYER's residence in accordance with the Internal Revenue Code and all applicable regulations related to that exemption (this provision has not changed).

10% withholding if the amount realized (typically, the purchase price) is greater than \$300,000.00 but not more than \$1,000,000.00 and BUYER executes a certificate establishing BUYER'S intention to use the Property as BUYER's residence in accordance with the Internal Revenue Code and all applicable regulations related to this **reduced withholding rate**.

15% withholding on all other transfers of property by foreign persons.

Important note: Please note that the exceptions to withholding and certain provisions of FIRPTA that permit a reduced withholding amount have not changed. Additionally, there are other types of distributions, such as a distribution by a foreign corporation to its shareholders, where the rate of withholding can be 35%. Such dispositions, and dispositions other than real estate transactions most commonly involving Realtors®, Buyers and Sellers, are beyond the scope of this article.

Who is responsible to withhold? FIRPTA requires that persons purchasing U.S. real property interests (transferees) from foreign persons, certain purchasers' agents, and settlement officers are required to correctly withhold from the amount realized on the disposition.

Foreign Sellers, and Buyers from foreign Sellers, are advised to seek legal/accounting assistance in determining the appropriate withholding requirements. The impact of withholding requirements can often be limited by application to the IRS for a reduced withholding certificate. The earlier that these advisors are engaged to assist – the better the chance that the impact can be handled as efficiently as possible.