

## What A Foreign Buyer Should Know Before Buying Property In New York

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The New York real estate market has a reputation for remaining somewhat insulated against the fluctuations in the domestic and foreign financial markets. As interest rates remain low and problems with the Euro compound, buying property in the New York market is becoming more attractive to the foreign buyer. Even though a foreign buyer can purchase in New York, without restriction, the foreign buyer should be warned against unnecessarily exposing themselves on the tax front.



The most significant tax burden for the foreign investor is presented by Federal and state estate tax. Foreigners have to pay New York death tax if they

own property in New York when they die. Any tangible or personal property located in the U.S. and valued over approximately \$60,000, requires the filing of a New York estate tax return when the foreign person dies. Currently, New York estate tax has a rate of 16%. Foreign persons are also subject to Federal estate tax on property owned in the U.S. when they die. Currently the estate tax rate can be as high as 35%. U.S. citizens are given an individual exemption from the tax up to five million dollars. Married couples are currently exempt up to ten million dollars. However, non U.S. citizens are not granted the exemption, unless a treaty exists with their country.

Before determining the estate tax liability the foreign person should be aware of the treaty between their country and the U.S. or lack thereof. The US has tax treaties with many foreign countries. Under these treaties, foreign residents are taxed at reduced rates, or are exempt from U.S. taxes on certain items of income. These reduced rates and exemptions vary from country to country. Many of these treaties also cover Federal estate tax and provide certain residents of foreign countries a pro-rated amount of the Federal Estate tax exemption of five million dollars for individuals.

If there is not a treaty between the buyer's country and the U.S., or if the treaty does not cover Federal estate tax, then a foreign person is subject to Federal estate tax on the value of the property over \$60,000 when they die. In order to avoid this tax, the foreign buyer should consider buying the property through an irrevocable trust or a foreign holding corporation.

One method a foreigner can use to avoid estate tax, is to create a New York LLC in addition to a foreign holding corporation such as a BVI, which is a corporation formed in the British Virgin Islands. Provided the BVI is the member of the New York LLC, the foreign person can avoid estate tax on US owned property. Under this structure, the IRS views the ownership of the property as an intangible asset, which is not subject to estate tax.

Other methods include buying the property through an irrevocable trust or taking out a life insurance policy to cover the amount of the

taxes. However, there is no set formula to determine appreciation values for New York properties, the future of applicable treaties, or US estate tax. As a result, the foreign buyer may be able to save money through setting up an irrevocable trust or a foreign holding corporation as opposed to purchasing a life insurance policy.

Another important consideration for the foreign buyer is whether to buy a cooperative or condominium. A foreigner who purchases a cooperative may be more vulnerable to estate tax liability. Cooperative boards have a stringent review process. Cooperatives require all purchasers to be interviewed and they legally have the ability to reject a buyer without providing a reason. They ask for extensive personal and financial information and do not cater to non-resident owners. In addition, it is not common practice for a cooperative board to allow a buyer, foreign, or otherwise, to purchase in the name of a trust or corporation. It is significantly easier for a foreign investor to purchase a condominium because the review process is more relaxed. In addition condominiums allow the foreign investor to purchase in the name of a trust or corporation.

Unfortunately, unlike the estate tax, no amount of careful planning will allow the foreign person to avoid Federal and state withholding tax or Federal Capital Gains tax. A foreign person needs to pay Foreign Investment in Real Property withholding tax (FIRPTA) when they sell their cooperative or condominium. The FIRPTA withholding tax amounts to roughly 10% of the gross sales price. If the seller is current on all of their other taxes owed to the IRS (i.e. income taxes, capital gains tax, etc.) then they should receive a refund of the 10% that was withheld at the sale. Similarly New York State charges an 8.82% non-resident gains tax on the net capital gain. This tax is due immediately after the property is sold as opposed to the following April 15<sup>th</sup>.

A foreign buyer will also be subject to Federal Capital Gains tax. Federal Gains tax is currently 15% of the net capital gain. Net capital gain is the amount of the gain on the property with the original purchase price, closing costs, and capital improvements (renovations), subtracted out. Federal Gains tax, unlike the estate tax is unavoidable for the foreign buyer. No amount of careful planning can alleviate this tax burden.

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