

Breaking Down FIRPTA and its Changes in 2016

By Pierre E. Debbas, Esq.



FIRPTA is often thought of as a tax that is only imposed on foreign nationals when they sell real property. This is one of the biggest misconceptions about our tax code when it comes to foreign nationals. FIRPTA is actually not a tax, but simply a withholding. It stands for the Foreign Investment in Real Property Tax Act of 1980, which requires a withholding on the proceeds of the disposition of real property by a foreign investor.

When a non-U.S. citizen or non-green card sells real property, the buyer is required to withhold 15% (in some cases 10%) of the gross sales price. Essentially, the buyer releases 85% of the purchase price directly to the foreign seller and remits 15% directly to the IRS at the closing. The reason for this is that the seller may owe federal capital gains tax on the sale and potentially other income taxes. If the seller were to receive 100% of the sales proceeds and leave the country with the money, the IRS runs the risk of the seller never filing a tax return and paying taxes. Thus, the reason the onus is on the buyer to remit this sum, which prevents the seller from having control over all of the proceeds. The withholding sum in theory is supposed to be significantly greater than the likely gains/income tax on the sale and thus the seller would have a monetary incentive to file an income tax return and pay the taxes on the gain. Upon paying the tax, the seller receives a refund of the amount withheld.

As you can imagine, the FIRPTA withholding can be rather significant given the value of properties that are traded in New York. One can avoid the withholding by applying to the IRS for a Withholding Certificate. For the most part, a seller is only eligible for this if they are:

- 1) selling at a net loss;
- 2) filing the tax return early and paying the tax obligations in advance of the closing or;
- 3) engaging in a 1031 transaction in which both the relinquished and replacement properties close on the same day.

The FIRPTA withholding rules were amended on February 16th. Moving forward, the withholding will be increased to 15% from 10% in most transactions. The breakdown of the increase is as follows:

- 1) If the purchaser of the property will NOT occupy it as his/her primary residence, then the withholding will be based off of 15% of the gross sales price.
- 2) If the sales price is \$300,000 or less AND the purchaser will be using the property as a primary residence, then no withholding is due.
- 3) If the sales price is over \$300,000, but not greater than \$1,000,000 AND the property will be used as the purchaser's primary residence, then the withholding will be 10% of the gross sales price.
- 4) If the sales price of the property is more than \$1,000,000, then the withholding is 15% of the gross sales price whether or not the purchaser will occupy it as his/her primary residence.

A driving factor for the real estate boom in the previous decade and the current boom we have been experiencing; was the amount of money coming in from overseas. The government has been paying close attention to this and is monitoring any changes that are needed to our tax code. The increase in the FIRPTA withholding in most circumstances to 15% reduces the risk to the IRS that the taxes due will not be more than the withholding sum. Otherwise, the IRS would be running the risk of a foreign national electing not to file a tax return as they will save money if they simply do not receive a refund of the FIRPTA withholding in exchange for not paying their taxes.

While the 15% withholding is a substantial sum, it is not something that should have a detrimental impact on the foreign investor market. Foreign investors should consult with their lawyers and tax counsel when selling their properties, but it should be emphasized that the FIRPTA withholding is refunded to the investor once their taxes have been paid.

*Pierre E. Debbas, Esq.
Romer Debbas, LLP
275 Madison Avenue, Suite 801
New York, NY 10016
(P) (212) 888-3100
(C) (646) 599-6994
(F) (212) 888-3201
PDebbas@romerdebbas.com
www.romerdebbas.com*