10 Most FAQ's of Foreign Buyers and Sellers of New York Real Estate

Michael J. Romer, Esq. & Pierre E. Debbas, Esq.
Romer Debbas, LLP
275 Madison Avenue – Suite 801
New York, NY 10016
212-888-3100
www.romerdebbas.com

Q1: Can a foreigner buy property in the U.S.?

A: A foreigner can buy property in the US. It is usually easier to purchase a condominium, rather than a cooperative. Cooperatives generally require all purchasers to be interviewed and they legally have the ability to reject a buyer without providing a reason. Cooperative boards also ask for extensive personal and financial information and do not cater to non-resident owners. Typically, condominiums have an easier review process which involves the condominium board waiving their right of first refusal to buy the apartment. Additionally, condominiums allow purchasers to buy in the form of a trust, domestic LLC or a foreign corporation. All three vehicles can provide liability protection and tax planning advantages to a foreign buyer.

Q2. When buying a property in New York City, what taxes does a foreigner need to pay?

A. A nonresident alien does not need to pay a specific tax due to their residence status when they purchase. All purchasers potentially have to pay the following taxes when purchasing a property in New York City:

1. Mansion tax of 1% of the purchase price, if the purchase price is over $1 million.
2. For certain purchases of a new development property, developers, or sponsors typically require the purchaser to pay the "transfer taxes." New York City transfer taxes for properties under $500,000 are 1% of the purchase price and for properties equal to or over $500,000 the transfer taxes are 1.425%. New York State transfer taxes are .4% of the purchase price regardless of the value of the property. If the property is not a new development, then the purchaser **will not be** responsible for transfer taxes.
3. A purchaser who obtains financing will have to pay a mortgage recording tax. The mortgage recording tax for properties under $500,000: 2.05%, of which

.25% is paid by the lender and for properties equal to or over $500,000: 2.175% of which .25% is paid by the lender.

Q3. When selling a property in New York City, what taxes does a foreigner need to pay?

A: A foreign person needs to pay gains tax and FIRTPA withholding tax. Federal capital gains tax is currently 20% of the net capital gain. Net capital gain is the amount of the gain on the property minus the original purchase price, closing costs, and capital improvements (renovations). Similarly, New York State charges an 8.82% non-resident gains tax on the net capital gain. A foreign seller is responsible for submitting a withholding named the Foreign Investment in Real Property Tax (FIRPTA). The FIRPTA withholding tax is discussed below.

Q4: **What is FIRPTA?**

A: FIRPTA is a withholding required of a foreign seller. The FIRPTA withholding tax amounts to 15% of the gross sales price (10% in certain circumstances). If the seller is current on all of their taxes owed to the IRS (i.e. income taxes, capital gains tax, etc.) then they should receive a refund of the 15% that was withheld at the sale.

Q5: What is the estate tax and do foreigners have to pay this?

A: Foreigners have to pay New York estate 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 maximum rate of 16%.

Foreign persons are also subject to Federal estate tax on property owned in the U.S. when they die. Currently, the federal estate tax rate can be as high as approximately 40%. U.S. citizens are given an individual exemption from the tax up to $5.43 million dollars. Married couples are currently exempt up to $10.86 million dollars ($5.43 million per person – both sums are periodically adjusted for inflation). However, non-U.S. citizens are not granted the exemption, unless a treaty exists with their country. See the discussion on treaties below. As a result, property valued above $60,000 is subject to estate tax. Discussed below are suggestions of vehicles that can be created to avoid Federal estate tax.

Q6: Can the use of an off-shore company mitigate the estate tax?

A: The most common mechanism that we structure in order to avoid the estate tax is the utilization of a New York limited liability company ("LLC") which will own the asset and then the formation of an off-shore company (a British Virgin Island company is the most common – "BVI") which acts as the sole member of the LLC. Under this structure, the foreign person can avoid estate tax on U.S. owned property. The reason is that at the time of death of the foreign national, their heirs overseas will be inheriting shares in a foreign corporation, not the actual asset in the U.S. As a result, the IRS views the ownership of the property as an intangible asset, which is not subject to estate tax.

Q7: What are the advantages and disadvantages of buying in the name of an individual?

A: Currently, long term capital gains tax rates are 20% for individuals. Federal corporate tax rates can be as high as approximately 40% (which are applicable under the LLC/BVI structure discussed above). What this means for the foreign buyer is a tax savings on the capital gains on the sale of the property if it is held individually as opposed to a standard corporation. However, these taxes can be avoided, and the foreign person can obtain the Federal capital gains tax rate of 20%, by creating an LLC and with the individual being the member(s) of the LLC as opposed to a corporation/BVI. LLCs allow individuals to be taxed at their own individual tax rate, instead of being subject to the high corporate tax rates of 40% if the individual is the member(s) of the LLC, due to the fact that the LLC is a disregarded entity and treated as a pass-through. As a result, there is not a significant advantage in tax treatment to a foreign buyer if they own a property individually versus in an LLC.

While there is not a significant difference in tax treatment between owning the property individually or through an LLC, there is a difference in liability protection. Owning a property individually can subject the foreign buyer to lawsuits in the U.S., whereas, an LLC can protect the foreign buyer's assets outside those owned by the LLC from liability. An LLC can also provide the foreign buyer with additional privacy protections, as purchasers of property in New York are required to register their ownership with the city and state and these registries are accessible to the public in online databases.

Q8: What are the advantages and disadvantages of buying in the name of a US corporation or LLC?

A: As noted above, owning a property through an LLC or US corporation can provide liability protection and additional privacy to the foreign buyer. Unlike a corporation, an LLC provides the foreign person the ability to be taxed at their individual rate, as opposed to corporate tax rates. However, owning the property through an LLC alone will not avoid estate tax. In order for a foreign person to avoid estate tax, they can create a foreign holding corporation such as a BVI as discussed above in addition to an LLC.

Q9: What is a tax treaty and how will that affect my tax liability?

A: 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 5.43 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. The IRS currently has copies of the tax treaties between the U.S. and foreign countries available on its website:

http://www.irs.gov/businesses/international/article/0,,id=96739,00.html

Q10: Can a foreign national utilize the I.R.C. 1031 for a tax deferred exchange?

A: A tax deferred exchange is referred to as a 1031 transaction. Upon the sale of an investment property ("Relinquished Property"), the investor can defer all gains taxes due if they use all of the net proceeds to purchase another investment property in the U.S. ("Replacement Property"). The investor will need to identify the Replacement Property (typically you identify three properties) within 45 days of the closing of the Relinquished Property and subsequently close on the Replacement Property within 180 days of the closing of the Relinquished Property. A foreign national can utilize a 1031 exchange and will avoid the FIRPTA withholding as well as defer the gains taxes discussed above.

Pierre E. Debbas, Esq. and Michael J. Romer, Esq. are partners at Romer Debbas LLP, who specialize in residential and commercial real estate transactions for international and domestic clients. Romer Debbas, LLP also specializes in structuring transactions in the most advantageous manner for foreign national investors and the firm also has an immigration practice, trust and estates practice as well as a tax practice. Pierre and Michael can be reached at +1-212-888-3100 - PDebbas@romerdebbas.com & MRomer@romerdebbas.com