Foreign Investment in Real Property Tax Act (FIRPTA)

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FIRPTA was introduced in 1980 and imposes withholding of tax on dispositions of US Real Property Interests by foreign persons, defined to include non-resident alien individuals or foreign corporations, foreign partnerships, foreign trusts, or foreign estates. In addition, the gains on the sale of USRPI are subject to tax as "Effectively Connected Income" at rates applicable to US residents.

U.S. Real Property Interest (USRPI)

USRPIs are interests in real property located in the United States or the U.S. Virgin Islands, including land, buildings and options to purchase such property. It also means any interest in any domestic corporation that is a U.S. Real Property Holding Corporation (USRPHC), essentially a corporation where the value of its USRPI equals or exceeds 50% of its total assets.

Dispositions and Distributions

Disposition includes a sale or purchase, exchange, gift, liquidation, redemption, transfer, and distribution of USRPI, including disposals by an NRA of stock in a USRPHC. However, FIRPTA withholding does not apply when an NRA disposes of stock in a foreign corporation with USRPI as its only asset because such stock is not considered USRPI.

FIRPTA Withholding

Purchasers of USRPI from NRAs are required to withhold 15% of the amount realized by the seller. A US corporation must withhold 15% of the fair market value of any USRPI distributed to a foreign shareholder if distributed in redemption of stock or in liquidation of the corporation. By contrast, a foreign corporation that distributes a USRPI must withhold 21% of the gain on the distribution to its foreign shareholders. In most cases, the buyer is the withholding agent. US business entities that dispose of USRPI are the withholding agents.

Exceptions to FIRPTA withholding

Withholding is not required where: the seller certifies non-foreign status; the buyer acquires the property as a residence for less than $300,000**;** the NRA makes a gift and realizes no gain; the seller relies on a non-recognition provision in the tax code or a US tax treaty.

Proper Structuring

To avoid problems with FIRPTA, and US estate tax on us situs assets, such as US real estate, NRAs investing in US real estate should do so through foreign non-transparent entities.

Notice

This memo is for general information only, is not offered as legal or tax advice, should not be relied upon. Legal and tax advice should be obtained from qualified professionals.