

If you have any questions regarding overseas investment in New York real estate, or otherwise in the United States please see the Frequently Asked Questions below, and if you don't find the answers you need, please *Ask Mr. Samuel*

FAQ FOREIGN INVESTORS

WHAT IS FIRPTA?

Foreign Investment in Real Property Tax Act, a statute that requires that a seller who is a foreign person permit a withholding of a part of the selling price against the United States gains taxes that the foreign person will owe on capital gains earned by the sale of real United States real property.

WHAT CONSTITUTES A "FOREIGN PERSON" UNDER FIRPTA?

A foreign person for federal income tax purposes is generally any person who is not either a resident alien (i.e. a holder of a green card) or a United States citizen. If an owner of real property is an entity formed outside of the United States, it is also deemed a "foreign person" under the IR Code (example: British Virgin Islands or Channel Islands Corporations).

WHO HAS THE RESPONSIBILITY TO WITHHOLD?

The IRS gives buyer the obligation to withhold ten (10%) percent of the purchase price at closing and deliver it to the IRS when the seller of real property is a "foreign person"; a failure to withhold becomes the responsibility of the buyer to whom the IRS will look for payment in the event withholding is not made.

The seller must obtain a Tax ID Number in order to meet seller's obligations to the IRS (see W-7, attached)

WHAT FORMS NEED TO BE FILED FOR FIRPTA AND WHEN?

The buyer (who is designated the "withholding agent" by statute) is responsible for forwarding a check for the 10% together with completed and executed form 8288 (attached) and completed form 8288-a (the latter looking much like a multi part 1099) (attached) simultaneously with closing. A failure to timely file incurs interest and penalties against the withholding agent.

The IRS will sign off on part 2 of the multi part form 8288-a and return part 2 to the seller's address listed on the form which becomes the seller's proof that a payment has been made (referred to in this memo as the "Evidence of Receipt").

The foreign person, if believing that the 10% of the purchase price is far more than should be withheld, may apply for a “reduced” withholding. The form for this application is an 8288-b (attached) and it must be filed no later than closing, preferably well before closing with supporting documents justifying the reduced withholding. Where such an application is made the buyer’s attorney will typically hold 10% of the purchase price in escrow on and after closing pending a determination by the IRS of the proper amount of withholding pursuant to an escrow agreement duly executed at closing. Upon receiving the IRS determination of the amount to be withheld, buyer has 20 days to forward that sum together with the 8288 and 8288-a to the IRS. Failure to do so will incur interest and penalties for the withholding agent.

WHAT IF CAPITAL GAINS TAX IS MORE THAN FIRPTA WITHHOLDING?
WHAT IF CAPITAL GAINS TAX IS LESS THAN FIRPTA WITHHOLDING?

Remember that FIRPTA is a “withholding” statute and is not the seller’s payment of the required gains taxes for which the seller is absolutely liable.

By providing the 10%, the buyer has fulfilled all of buyer’s withholding requirements and has no further obligations in this regard irrespective of the correct amount of capital gains tax to be paid.

The seller is required to pay the actual gains tax against which he/she/it may credit the withholding made at closing. This is true whether the tax due is larger or smaller than the withheld amount, by filing a 1040NR (non-resident income tax return) or 1120F (foreign corporation) or other entity income tax return together with the Evidence of Receipt (see above), on or before April 15 of the year subsequent to the closing. If the withholding exceeds the tax due, seller will be entitled to a rebate of the difference between the tax due and the withholding. If the withholding is less than the tax due, the balance is to be paid with the filing of the 1040NR or the 1120F.

HOW SHOULD OVERSEAS INVESTORS TAKE TITLE?

Long term capital gains rates (reduced from ordinary income tax rates) are available for individuals or entities that are taxed as individuals (e.g. an individually owned LLC) after ownership of one (1) year. Corporations are taxed at the ordinary income rate irrespective of the length of ownership. Currently the long term capital gain rate is 15% (of the net gain, as defined below) and ordinary income rate varies but is approximately 35% of the net gain. Thus, in determining how best to take title, one must first determine the tax effect of the title taken. Also, if a corporation is the owner of the property, a foreign (including sister state) entity must pay NY State corporation franchise taxes and NY City general business taxes, irrespective of the place of incorporation (these taxes are business taxes and are NOT income taxes, which are treated separately).

DOES A FOREIGN PERSON HAVE AN INCOME TAX OBLIGATION TO NEW YORK STATE?

Yes. New York State Law requires that any “non-resident” of the State of New York must file form and have a per-cent of the gain withheld at closing and paid to NY State before a deed can be filed IT-2663 (attached) or IT-2664 for cooperative apartments (attached). The % withheld varies, for 2008 the amount is 6.85% of the net gain.

HOW IS NET GAIN CALCULATED?

Total Selling Price minus

- a) price of property when purchased;
- b) cost of capital improvements over the life of the ownership (including capital improvements made by the condo or coop)
- c) the cost of the sale, such as broker’s commissions, transfer taxes and other expenses incurred by the seller by reason of the sale.

NOTE: If the seller is an investor and the ownership was not for personal use, a calculation of the amount amortized over the life of the ownership by the investor must be ADDED back to complete calculation of the net gain amount. For clarification please review with a tax advisor.

CAN OVERSEAS INVESTORS TAKE ADVANTAGE OF LIKE KIND TRANSFERS?

Yes. But the rules are slightly different. According to 1031Vest, a qualified intermediary: “Basically, because the exchangor is a foreign person or entity, a Notice of Non-Recognition Transfer needs to be delivered at the first closing, but only if the exchangor has already identified the replacement property. If the property has not been identified, the exchangor can apply to the IRS for a Withholding Certificate, which the IRS must act in within 90 days. While waiting for the IRS, the 10% withholding is held in escrow by the transferee, rather than being sent directly to the IRS within the usual timeline of 20 days after the closing.

Also, if the foreign exchangor is receiving ANY boot, the entire exchange will be disallowed, which is obviously very different from a domestic exchange.

IF A BUYER OR SELLER IS A OVERSEAS INVESTOR AND IS OUT OF THE COUNTRY CAN THE DEAL GO TO CLOSING AND IF SO WHAT IS NEEDED?

Yes. No one, whether an individual or entity, whether domestic, or out-of- towner or OVERSEAS INVESTOR is required to be personally at a closing of property which that person(s) or entity is purchasing or selling. Indeed, in my practice it is common that the client does not go to closing and from time to time, the client may actually never be in New York during the process. This is true even where financing is being undertaken. In my practice we commonly use a power of attorney that is specifically limited to the real

estate or cooperative apartment which the client is purchasing or selling. Where financing is taking place the lender often requires a specific reference to the loan in the power of attorney. The balance of a purchase price is usually wired into my attorney escrow account so that it is good cash no later than the close of business on the day before the actual closing and we take care of preparing all seller's checks at closing whether bank, certified or escrow.

ARE THERE ANY TIPS ON HELPING OVERSEAS INVESTORS GET FINANCING?

Yes. The first thing a person giving advice about financing should remember is that financing is a moving target. Which simply means: the rules for financing prevalent two years ago may be totally wrong today. If you have a relationship with a quality mortgage broker in New York, a quick telephone conversation can bring you up to date as to the likelihood of your client obtaining financing. It is usually not impossible for a person or entity to obtain a mortgage loan, even without a live person in the U.S. The key, however, is the willingness of the lending institution to provide a non-recourse* loan. In the past the MOST a lender would loan on a non-recourse loan is 65% LTV (loan amount compared with appraised value). That number may be lower today, although Manhattan properties have held their value. If a foreign person or entity has income or assets in the United States the non-recourse threshold might be modified. Alternatively, some of my pacific rim clients have in the past borrowed in their country, permitting the mortgage to be filed in New York. Recently the same occurred with a Scottish client, however in this case the Scottish bank had sufficient collateral without having to place a mortgage on the property.

*In the event of default lender can only look to the property for repayment (usually after foreclosure) and there is no further liability for the beneficial owner of the property.