FIRPTA Explained[1]

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Enacted in 1980, the Foreign Investment in Real Property Tax Act (FIRPTA) requires foreign persons to pay U.S. income tax on gains they make from selling U.S. real estate. To explain FIRPTA comprehensively, we will discuss the following:

- The General Rule
- Exemptions to the General Rule
- Limitations on the Amount Required to be Withheld
- Some Special Rules
- Procedures for Withholding
- Delayed Reporting
- Liability of Agents and the Transferee
- FIRPTA and Title Insurance
- FIRPTA Checklist

The General Rule

The General Rule as set forth in FIRPTA is as follows:

> *Except as otherwise provided in this section, in the case of any disposition of a United States real property interest (as defined in section 897 (c)) by a foreign person, the transferee shall be required to deduct and withhold a tax equal to 15 percent of the amount realized on the disposition.*[2]

Let's pull out and define some of these terms:

- *United States real property interest* is an interest in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the Virgin Islands.[3]
- *Foreign person* means any person other than a United States person.[4]
- *Transferee* means the person acquiring the United States real property interest (*i.e.*, the purchaser).[5] More specifically, *transferee* includes any person, foreign or domestic, that acquires a U.S. real property interest by purchase, exchange, gift, or any other transfer.[6]

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[1] The information presented herein represent the views of the author only and not those of Old Republic National Title Insurance Company. This information is provided for educational use only and may not be relied upon for legal advice or tax advice. Please consult with an attorney or CPA.
[2] 26 USC § 1445(a).
[3] 26 USC § 897(c).
[4] 26 USC § 1445(f)(3).
[5] 26 USC § 1445(f)(2).
[6] 26 CFR § 1.1445-1(g)(4).

- *Amount realized* is the contract sales price, not the amount of sales proceeds.[7] The fact that the seller may have no proceeds at all is irrelevant.

Putting it all together, the General Rule can be restated simply as follows:

> *Unless an exemption applies, the purchaser must withhold 15% of the contract sales price if the seller is a foreign person.*

Of course, the General Rule is not so simple. There are exemptions, limitations, and some special rules to consider—to which we now turn.

Exemptions to the General Rule

The General Rule for withholding tax does not apply if any one of several exemptions applies, only three of which are relevant to real estate transactions: (1) the transferor furnishes a nonforeign affidavit; (2) the transferee receives a qualifying statement from the IRS; and (3) the real property is a residence where the amount realized does not exceed $300,000.

(1) The transferor furnishes a nonforeign affidavit.

This is the most common exemption and requires the greatest amount of discussion. Remember that FIRPTA tax applies only to *foreign persons*, so if the transferor (*i.e.*, the seller) is not a foreign person within the meaning of the statute, then no tax need be withheld.

To apply, *the transferor furnishes to the transferee an affidavit by the transferor stating, under penalty of perjury, the transferor's United States taxpayer identification number and that the transferor is not a foreign person.*[8] This affidavit is a safe harbor to prove that the transferor is not a foreign person. A transferee can rely on other means to prove that the transferor is not a

[7] 26 CFR § 1.1445-1(g)(6). The *amount realized* is a little curious. In one place in the regulations, *amount realized* is defined as having 3 components: (1) the *cash paid, or to be paid* (*i.e.*, the cash the purchaser brings to closing); (2) the *fair market value of other property transferred, or to be transferred* (this is atypical in a real estate transaction—the purchaser brings cash to pay for the property, not *other property* like cattle or cars); and (3) the *outstanding amount of any liability assumed by the transferee or to which the U.S. real property interest is subject immediately before and after the transfer* (*i.e.*, the loan). 26 CFR § 1.1445-1(g)(5). Put simply, the *amount realized* is the cash the purchaser brings to closing plus the loan amount. Because of the transactional costs incidental to the closing (*e.g.*, loan fees and settlement fees), the *amount realized* would be slightly higher than the contract sales price—if we looked solely at 26 CFR § 1.1445-1(g)(5). And yet the CFR states immediately thereafter the following: *The contract price of a U.S. real property interest is the sum that is agreed to by the transferee and transferor as the total amount of consideration to be paid for the property. That amount will generally be equal to the amount realized by the transferor* . . . . 26 CFR § 1.1445-1(g)(6). This makes sense. If it were not so, if we were to look solely to the prior section and it's 3 components, the purchaser, by selecting an expensive loan, could increase the amount of withholding tax a foreign seller is required to pay. Consequently, the settlement agent should rely on the contract sales price for determining the amount of tax to withhold.

[8] 26 USC § 1445(b)(2).

foreign person but may be subject to tax liability if he or she proves to be wrong.[9] For sample certifications provided by regulation[10] for both individual and entity transferors, see Appendix 1.

The idea that the affidavit is a safe harbor for a transferee should not be overlooked. The statute regulations are phrased to allow the transferee to take the seller at his or her word.[11] That is to say, *there is no statutory duty to verify the substance of the affidavit—either on the part of the transferee or (by extension) the settlement agent administering this transaction.*

What is the substance of this affidavit? The answer to that question depends on whether we are talking about the nonforeign affidavit for *individuals* or the nonforeign affidavit for *entities*. Let's discuss each in turn.

The Nonforeign Affidavit for Individuals

On this affidavit, the individual transferor makes 3 simple assertions:

1. I am not a nonresident alien for purposes of U.S. income taxation;

2. My U.S. taxpayer identifying number [Social Security number] is ___________; and

3. My home address is: ________________.

Remember, *there is no duty in FIRPTA or its regulations for the transferee or settlement agent to prove any of these affirmations.* The transferor need not furnish proof that he or she is *not a nonresident alien* any more than he or she needs to prove that the social security number or home address provided is correct.

And yet for whatever reason, some settlement agents (and sometimes transferees) persist in wanting proof that the transferor is speaking the truth in this affidavit. So, for argument's sake, how does one prove that he or she is *not a nonresident alien*? Understanding this phrase is tricky because of the double negative.

Let's start with the definition of *alien*. An *alien* is any individual who is not a U.S. citizen or U.S. national. There are two kinds of aliens: *resident aliens* and *nonresident aliens*. At a minimum, we know that we are dealing with a *resident alien* if that person passes the *green card test* or the *substantial presence test*. Conversely, a *nonresident alien* (which is the subject of the affidavit) is an alien who has not passed both tests.[12]

[9] 26 CFR § 1.1445-2(b)(1).
[10] 26 CFR § 1.1445-2(b)(2)(iv).
[11] Of course, this reliance does have limitations. The transferee and settlement agent cannot, for example, turn a blind eye when the affidavit is known to be fraudulent. But the point here is that neither the transferee or the settlement agent has an independent duty to verify the veracity of the transferor.
[12] *See generally* "Taxation of Nonresident Aliens" at www.irs.gov.

The *green card test* is simple. An individual passes the green card test if he or she has an alien registration card, Form I-551, also known as a *green card*. For more detailed information on this test, see Appendix 2.

The *substantial presence test* is not so simple. See Appendix 3 for details. (A review of these materials in Appendix 3 will reveal that those who hold a visa are likely NOT to meet the substantial presence test. Or, to put it another way, those that hold certain visas, do NOT typically qualify as a *resident* alien, but a *nonresident* alien, and therefore CANNOT sign the nonforeign affidavit.)

As a practical matter, for those who insist on finding support for a seller's nonforeign affidavit, obtaining a copy of a seller's green card is feasible, but determining whether that seller passes the substantial presence test is well beyond the expertise of a typical settlement agent. Perhaps a compromise worth considering is to require the seller's CPA or tax attorney to issue an opinion letter that the seller meets the requirements of the substantial presence test or otherwise meets the requirements of a resident alien or U.S. Citizen or U.S. National—or simply that no FIRPTA withholding is due.

When attempting to corroborate the seller's nonforeign affidavit, it is tempting to think that if the seller has a social security number, we are "good"—no FIRPTA tax need be withheld. This is a mistake. Social security numbers can be issued to foreign persons, both resident and nonresident.[13] Having a social security number is not determinative—whether the seller signs the nonforeign affidavit is determinative.

In conclusion, what has been said before bears repeating here: *this nonforeign affidavit is a safe harbor to conclusively prove that the transferor is not a foreign person, and the transferee is entitled to rely on it.* A transferee can choose to rely on other means to prove that the transferor is not a foreign person but may be subject to tax liability if he or she proves to be wrong.[14]

The Nonforeign Affidavit for Entities

Remember the nonforeign affidavit comes in two flavors: one for individual sellers and one for entity sellers. We now turn to the latter, whereby the entity transferor makes the following assertions:

> 1. [Name of transferor] is not a foreign corporation, foreign partnership, foreign trust, or foreign estate (as those terms are defined in the Internal Revenue Code and Income Tax Regulations);
>
> 2. [Name of transferor] is not a disregarded entity as defined in §1.1445-2(b)(2)(iii);

[13] See IRS Publication 519, which discusses (among other things) SSN's for aliens—both resident and nonresident.
[14] 26 CFR § 1.1445-2(b)(1).

3. [Name of transferor]'s U.S. employer identification number is ___; and

4. [Name of transferor]'s office address is _______.

The third and fourth assertions are straightforward and warrant no discussion. But the first and second assertions do.

With respect to the first assertion, note that *foreign* in this context means foreign to the United States. For example, if the seller is a corporation created in Canada, the seller cannot sign the nonforeign affidavit. The one exception to this rule is when a foreign corporation has made an election to be treated as a domestic corporation and attaches a copy of the acknowledgement of the election from the IRS to this affidavit.[15]

Note further that when it comes to these entities (corporations, partnerships, and trusts), if these entities are domestic entities (*i.e.*, created in the U.S.), *the citizenship status of the stockholders, partners, and beneficiaries, respectively, is irrelevant.* What makes an entity *foreign* is where the entity was created, not the citizenship status of the stockholders, partners, or beneficiaries of the entity. If the entity seller can certify the remaining elements of the nonforeign affidavit, the entity may sign the affidavit, and the transferee is entitled to rely upon it.

Notice, however, a popular entity is missing from the list in the first assertion: limited liability companies (LLCs). For that entity, we must turn our attention to the second assertion: *[Name of transferor] is not a disregarded entity as defined in §1.1445-2(b)(2)(iii).*

What is a *disregarded entity* within the meaning of this affidavit? At this point, the analysis becomes difficult. The regulation offered by the affidavit to define *disregarded entity* is a complex regulation which leads to 26 CFR § 301.7701-3, which is even more complex—and lengthy. For those that want to walk down the difficult road of this analysis, see Appendix 4. For those that just want the answer, it can be summarized as follows:

- If a domestic LLC is a single-member LLC, then inquiry must be made as to how it has elected to be treated for tax purposes. Either it has elected to be taxed like a domestic corporation, or it is considered a disregarded entity by default.
    - If the former, then the single-member LLC may sign the nonforeign affidavit for entities, provided it can affirm the remaining elements of the affidavit. It is not a disregarded entity. It is treated like a domestic corporation. The citizenship of the single member is irrelevant.
    - If the latter, we must look to the citizenship of the single owner to determine whether FIRPTA withholding is due. That owner might be an individual or another entity, which will determine which version of the nonforeign affidavit should be signed, if applicable.

[15] 26 CFR § 1.1445-2(b)(2)(iii).

- If a domestic LLC is a multi-member LLC, then inquiry must be made as to how it has elected to be treated for tax purposes. Either it has elected to be taxed like a domestic corporation, or it is considered a partnership entity by default.
    - If the former, then the multi-member LLC may sign the nonforeign affidavit for entities, provided it can affirm the remaining elements of the affidavit. It is treated like a domestic corporation. It is not a disregarded entity. The citizenship of the members is irrelevant. These members may be individuals or entities.
    - If the latter, then the multi-member LLC may sign the nonforeign affidavit for entities, provided it can affirm the remaining elements of the affidavit. It is treated like a domestic partnership. FIRPTA withholding is administered by the entity; there is no duty to withhold imposed on the transferee. (See Appendix 5). It is not a disregarded entity. The citizenship of the members is irrelevant. These members may be individuals or entities.

Who Gets the Affidavit?

Note that with both affidavit (individual and entity), the seller must provide this affidavit to the purchaser, thereby disclosing his or her taxpayer/employer identification number. Understandably, sellers have legitimate privacy concerns with this requirement. Fortunately, there is a procedure to fulfill this requirement without compromising a seller's privacy. FIRPTA permits the transferor to furnish the nonforeign affidavit to a *qualified substitute*, who then *furnishes a statement to the transferee stating, under penalty of perjury, that the qualified substitute has such affidavit in his possession.*[16] A *qualified substitute* is defined as *(A) the person (including any attorney or title company) responsible for closing the transaction, other than the transferor's agent, and (B) the transferee's agent*.[17]

Having discussed at great length the first exemption to the General Rule, we now turn our attention to the remaining two.

(2) The transferee receives a qualifying statement from the IRS.

Put simply, a *qualifying statement* means a statement by the IRS that the transferor either: (i) reached an agreement with the IRS as to the payment of any tax due under this section; (ii) is exempt from such tax; OR (iii) such tax has been satisfied or adequate security has been provided to cover such liability.[18] The bases and procedures for obtaining such a qualifying statement from the IRS (also known as a *withholding certificate*) are set forth in 26 CFR § 1.445-3.[19] The IRS

[16] 26 USC § 1445(b)(9).
[17] 26 USC § 1445(f)(6).
[18] 26 USC § 1445(b)(4).
[19] *See also* 26 CFR § 1.1445-6.

must process a request for a qualifying statement within 90 days of receiving the request.[20] But there does not appear to be any recourse for the taxpayer if the IRS fails to meet this timeline.

Practically, this exemption becomes relevant for a transaction when a transferor balks at the idea of paying FIRPTA withholding—for whatever reason—or when the settlement agent is being put in the position of determining whether FIRPTA withholding is appropriate, which at times can be difficult or simply beyond the scope of the settlement agent's services or expertise. In such cases, why guess at the right answer? Simply request the IRS to determine whether FIRPTA withholding is due, and if so, how much.

While this seems like good advice—and it is—sometimes there is not enough time before closing to request such a certificate. In such cases, the parties may need to negotiate a later settlement date or agree to delayed reporting, discussed below.

(3) The real property is a residence where amount realized does not exceed $300,000.

This is the last of the exemptions. For this exemption to apply, two criteria must be met: (i) *the property is acquired by the transferee for use by him as a residence,* AND (ii) *the amount realized [i.e., the contract sales price] does not exceed $300,000.* [21] This exemption is only available when the transferee is an individual.[22]

With respect to the residency requirement, there is a common misunderstanding that the transferee must live in the property as his or her primary residence. This notion is false.

To establish the residency requirement, only one of several transferees need establish the subject property as his or her residence.[23] According to regulation, such transferee must have:

> *definite plans to reside at the property for at least 50 percent of the number of days that the property is used by any person during each of the first two 12-month periods following the date of the transfer. The number of days that the property will be vacant is not taken into account in determining the number of days such property is used by any person. A transferee shall be considered to reside at a property on any day on which a member of the transferee's family, as defined in section 267(c)(4), resides at the property. No form or other document need be filed with the Internal Revenue Service to establish a transferee's entitlement to rely upon [this] exception . . . .*[24]

[20] 26 USC § 1445(c)(3)(B).
[21] 26 USC § 1445(b)(5).
[22] 26 CFR § 1.1445-2(d).
[23] 26 CFR § 1.1445-2(d).
[24] 26 CFR § 1.1445-2(d).

The transferee's family includes brothers and sisters (whether by the whole or half-blood), spouse, ancestors, and lineal descendants.[25]

In plain English, the residency requirement is simply this: at the time of closing, the purchaser must intend that in Year 1 following the sale, the purchaser (or members of the purchaser's family) will reside in the property at least 50% of the time it is used by anyone. The purchaser must intend the same for Year 2 as well. There is no duty of the purchaser to document these intentions or file any such form with the IRS. Likewise, there is no duty for the settlement agent to document such intentions, although some settlement agents may find it desirable to do so to foreclose later allegations that the settlement agent was negligent in not withholding FIRPTA tax.

Limitations on the Amount Required to be Withheld

Recall that the General Rule requires 15% withholding of the amount realized (i.e., the contract sales price). But there are 2 ways this withholding can be limited.

First, certain transactions qualify for a reduced rate of 10% withholding. To qualify, ALL the following criteria must be met:

- The transferee must use the property as a personal residence;
- The amount realized does not exceed $1,000,000; AND
- The $300,000 exception does not apply.[26]

Second, the amount to be withheld is also reduced when the subject property is owned jointly by foreign and non-foreign transferors:

> *The amount subject to withholding . . . shall be determined by allocating the amount realized from the transfer between (or among) such transferors based upon the capital contribution of each transferor with respect to the property and by aggregating the amounts allocated to any foreign person (or persons). For this purpose, a husband and wife will each be deemed to have contributed 50 percent of the aggregate capital contributed by such husband and wife.*[27]

In short, FIRPTA tax that is due may be allocated according to capital contribution, so if some of the transferors are foreign and others are U.S. citizens/nationals, then the total FIRPTA tax is lessened by apportionment.

To illustrate these concepts, suppose Ted and George are brothers selling property held as joint tenants. Ted is a foreigner; George is a U.S. citizen. Sales price is $400,000. Purchaser is an individual who intends to use the property as her personal residence. No exemption applies. 10%

[25] 26 U.S.C. § 267(c)(4).
[26] 26 USC § 1445(c)(4); 26 CFR § 1.1445-1(b)(2).
[27] 26 CFR § 1.1445-1(b)(3). The phrase *will each be deemed* seems to imply that this presumption is irrebuttable.

(not 15%) withholding is appropriate as a starting point. That amount is $40,000. But only one of them is a foreigner. Capital contribution between them is presumed 50/50 because joint tenancy creates that presumption. 50% of $40,000 is $20,000, the amount that should be withheld and sent to the IRS.

But suppose further when you (the settlement agent) tell Ted and George about this proposed withholding, they affirm that George (the U.S. citizen) made all the capital contributions; therefore, no FIRPTA tax is due. In support, they offer you an affidavit that George made all the capital contributions, as well as receipts that trace certain expenditures to George's separate account. Furthermore, they instruct you that George will get all the proceeds from the closing wired into his separate account. Do you agree to remove the $20,000 FIRPTA tax line-item off the settlement statement or keep it on?

In response, a couple of thoughts may be helpful:

- Who gets the proceeds is irrelevant; who made the capital contributions is dispositive. With only a little imagination one could envision after such a closing, George giving to Ted his share of the proceeds, saying, "We sure fooled them, didn't we?"
- In the end, Ted and George may be telling the truth, or they could be lying to save themselves $20,000, or they could just be mistaken, not remembering that Ted in fact made some capital contributions 10 years ago. Neither you (the settlement agent) nor the purchaser (upon whom is placed the duty to withhold) will ever know for sure. But what we do know for sure is that if FIRPTA tax is not withheld when it is due, the purchaser may be liable for all of it. In the end, it should be purchaser's choice whether to proceed without withholding based on sellers' representation—although a prudent settlement agent would be wise to document this choice in writing.
- If a purchaser did not want to rely on sellers' representation, other choices are available, such as obtaining a qualifying statement from the IRS and delaying closing if need be, or (if settlement is impending) agreeing to delayed reporting, discussed below. Perhaps another option worth considering is a statement from sellers' CPA or tax attorney, certifying that no FIRPTA withholding is due.

Some Special Rules

Not everything fits well into categories when discussing all the ins and outs of FIRPTA. Now we turn to the junk drawer of weird stuff that doesn't have a home anywhere else.

(1) Special rules where transferor is a domestic partnership, domestic trust, or domestic estate

Whenever the seller is a domestic partnership, domestic trust, or domestic estate, no FIRPTA tax need be withheld by the transferee. The seller entity need only sign the nonforeign entity affidavit, and the transferee may rely on it. The citizenship of the partners, beneficiaries, devisees or heirs is irrelevant. FIRPTA tax may in fact be due, but FIRPTA places the burden of withholding on the selling entity, not the transferee. For the legal analysis supporting these conclusions, see Appendix 5.

(2) Special rules where transferee is a governmental body

No withholding is required when the purchaser is the United States, a state or possession of the United States, a political subdivision thereof, or the District of Columbia.[28]

(3) Special rules relating to foreclosures

Foreclosures are not exempt from the ordinary withholding requirements of FIRPTA if the debtor being foreclosed upon is a *foreign person* within the meaning of the statute.[29] However, special rules, if followed, allow for the payment of a lesser amount that would ordinarily be due. This lesser amount, called the *alternative amount*, takes into consideration that the debtor in a foreclosure sale is unlikely to have gain on the disposition of the subject property.

The *alternative amount* is any amount that the trustee determines to accrue to the debtor after outstanding balance of the loan and applicable fees and costs are paid.[30] If this amount is zero (as it usually is), then no withholding is due. If, however, there is such an amount, the appropriate withholding (10% or 15%) must be paid. In any event, even if there were such an amount to be paid, it is likely to be less than withholding based upon the amount realized (i.e., contract sales price). To take advantage of these rules, a transferee must comply with strict notice requirements to the trustee and the IRS.[31]

But one may well ask: How is a purchaser at a foreclosure sale to know whether the debtor being foreclosed upon is a foreign person as defined by FIRPTA so that these rules can be taken advantage of? The answer is: He doesn't. But a purchaser should be mindful that foreclosure sales are subject to FIRPTA withholding so that if FIRPTA withholding is in fact due and the purchaser fails to withhold, the purchaser may be liable for all of it—just like any other transaction. And so, as the saying goes, *caveat emptor*—let the buyer beware.

Perhaps a buyer at a foreclosure sale will recognize that it is unlikely that the debtor is a foreign person because the name of the buyer "sounds American"—whatever that may mean. And that will be enough. Foreclosures, after all, present a certain amount of risk above a routine sale transaction.

Perhaps a buyer at a foreclosure sale, seeking to address that risk, may ask the foreclosing lender to sign a nonforeign affidavit on behalf of the debtor, certifying that the debtor is *not a nonresident*.

[28] 26 CFR § 1.1445-2(d)(5).
[29] 26 CFR § 1.1445-2(d)(3)(i)(A).
[30] 26 CFR § 1.1445-2(d)(3)(i)(A)(2).
[31] 26 CFR § 1.1445-2(d)(3)(i)&(ii).

The foreclosing lender presumably would have access to the debtor's information and should be able to determine whether such individual is a foreigner subject to FIRPTA withholding.

Perhaps the *$300,000 or Less/Residence Exemption*, discussed above, applies. Perhaps, perhaps, perhaps—again, let the buyer beware.

(4) Special rules relating to deeds in lieu

Deeds in lieu of foreclosure are subject to the ordinary withholding rules. However, no withholding is required if:

- The transferee is the only person with a security interest in the property;
- No cash or other property (other than incidental fees incurred with respect to the transfer) is paid, directly or indirectly, to any person with respect to the transfer; AND
- The notice requirement of § 1.1445-2(d)(3) is satisfied.[32]

(5) Special rules relating to short sales

FIRPTA applies to short sales just like any other transaction. Remember that withholding is based not on the proceeds due to the seller but on the amount realized (*i.e.*, the contract sales price). Given the nature of a short sale (the sales price being below the loan amount), it is likely that the seller has no taxable gain—the value of the property as sold likely being lower than when purchased. The solution, therefore, is to recognize this situation early and request from the IRS a qualifying statement (withholding certificate) verifying that no FIRPTA withholding is due.

(6) Special rules relating to gift transfers

As stated above, when property is owned jointly by foreign and non-foreign transferors, withholding tax is collected based on the foreign person's capital contribution. Recall the example above with Ted (a foreigner) and George (a U.S. citizen) selling property. Suppose they propose that Ted conveys to George his interest in the property with a Deed of Gift prior to closing so that George is the only transferor at your closing. Does that strategy lawfully skirt FIRPTA so that no withholding need be made?

The short answer to this question is that gift transfers are subject to FIRPTA, and as such, FIRPTA withholding may be due when Ted conveys his interest to George—regardless of what Ted and George may believe. It is true that in the subsequent sale transaction, where George conveys to a purchaser for value, no FIRPTA withholding would be due because George is a U.S. Citizen. But if you are the settlement agent aware of such re-titling prior to the transaction, ask yourself whether what Ted and George are doing sounds like tax evasion. If so, do you think that turning a blind

[32] 26 CFR § 1.1445-2(d)(3)(i)(B).

eye to such an approach could be construed by the IRS as you being an accomplice to tax evasion?[33]

With so many other alternatives to addressing FIRPTA withholding issues, such as delayed reporting (discussed below), it seems prudent for the settlement agent to avoid strategies like the one suggested by Ted and George. For a more comprehensive analysis of gifts under FIRPTA, see Appendix 6.

Procedures for Withholding

The transferee must report and pay over any tax withheld by the 20th day after the *date of the transfer*.[34] In Virginia, the date of the transfer is the settlement date.[35] Use forms 8288 and 8288-A and the instructions thereto, all downloadable from the IRS website.[36]

When filling out these forms, it is important to remember that FIRPTA places the burden on the transferee (buyer) to be the withholding agent. But practically, the settlement agent will be holding the money and may act in accordance with the buyer's instructions.

Note on page 2 of the instructions *withholding agent* is defined as the buyer. Example 1 on page 6 is also instructive:

> ***Example 1.*** B, a corporation, purchases a U.S. real property interest from F, a foreign person. On settlement day, the settlement agent pays off existing loans, withholds 15% of the amount realized on the sale (after February 16, 2016), and disburses the remaining amount to F. B, not the agent, must complete Part I of Form 8288 and Form 8288-A.

See also instructions for Line 1:

> **Lines 1.** In Part I, enter the name, address, and identifying number of the buyer or other transferee responsible for withholding under section 1445(a). Do not enter the name, address, and identifying number of a title company, mortgage company, etc. unless it happens to be the actual buyer or transferee.

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[33] 26 USC § 7201 provides: *Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution*. According to 18 USC § 2(a): *Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.*

[34] 26 CFR § 1.1445-1(c)(1).

[35] According to page 3 of the instructions for filling out Form 8288, the *date of transfer* means the first date on which consideration is paid or a liability is assumed by the transferee. In Virginia, the buyer tenders money on the day of settlement and becomes liable for paying interest on the new loan on the day of settlement. Consequently, the date of transfer would be the day of settlement.

[36] 26 CFR § 1.1445-1(c).

It seems that the instructions require the information to be entirely the buyer's, not the buyer's title/settlement company or the seller's title/settlement company. As a practical matter, however, the buyer will not be holding the money. More likely, it will be the buyer's agent holding the money on behalf of the buyer.

Delayed Reporting

Delayed reporting is a great solution when the seller objects to remitting FIRPTA tax to the IRS and there is no time before closing to obtain a withholding certificate from the IRS to verify what, if any, FIRPTA tax is due.

Delayed reporting is possible if, prior to closing, either the transferor or the transferee applies for a withholding certificate (*i.e.*, a statement from the IRS that either no tax is due or some lesser tax is due).[37] If such application is made by the transferor, notice of the application must be furnished to the transferee.[38] *No particular form is required but the notice must set forth the name, address, and taxpayer identification number of the transferor, a brief description of the property which is the subject of the application, and the date the application was submitted to the [IRS]*.[39] The IRS has 90 days to respond to such a request after receipt thereof.[40] The transferee (or more practically, the settlement agent) has then 20 days from when the IRS sends the letter to report and pay over any tax that is due.[41]

A settlement agent should exercise caution, however, in utilizing this approach because if the IRS determines that this rule was used *for a principal purpose of delaying the transferee's payment to the IRS of the amount withheld*, then the transferee may be liable not only for the amount withheld, but also for interest and penalties as well.[42] *A principal purpose of delaying payment of the amount withheld shall be presumed if the transferee applies for a withholding certificate . . . based upon a determination of the transferor's maximum tax liability, and such liability is ultimately determined to be equal to 90 percent or more of the amount that was otherwise required to be withheld and paid over*.[43]

Sometimes, a practical problem arises with delayed reporting: the buyer's consent. A buyer may not want to take the risks that delayed reporting presents. For example, if the settlement agent (acting on behalf of the transferee) withholds the proper amount of tax but sends it to the IRS late, then the transferee will not be held liable for the tax, but may be held liable for the interest insofar

[37] 26 CFR § 1.1445-1(c)(2).
[38] 26 CFR § 1.1445-1(c)(3)(B).
[39] 26 CFR § 1.1445-1(c)(3)(B).
[40] 26 USC § 1445(c)(3)(B).
[41] 26 CFR § 1.1445-1(c)(2)(i).
[42] 26 CFR § 1.1445-1(c)(2)(ii).
[43] 26 CFR § 1.1445-1(c)(2)(ii)(B).

as the payment is late.[44] Understandably, a transferee may not want to take this risk and simply instruct you as the settlement agent to send the money immediately after closing, so getting the buyer's approval for delayed reporting seems like an appropriate thing to consider.

What if the seller does not have a social security number or other taxpayer identification number? Does that disqualify a seller from requesting a withholding certificate or delayed reporting? The short answer is *no*. If the seller does not have a taxpayer identification number, he can apply for one. The lack of such a number does not nullify the duty to pay the FIRPTA tax; the IRS simply cannot credit money back to the transferor without one.[45] The Instructions to these forms explain:

> *For a nonresident alien individual who is not eligible for an SSN, the identifying number is an IRS individual taxpayer identification number (ITIN). If the individual does not already have an ITIN, he or she should complete Forms 8288 and 8288-A and mail the forms along with any payment to the address shown under Where To File, earlier. In a separate package mail a completed Form W-7, Application for IRS Individual Taxpayer Identification Number, with supporting documentation and a copy of Forms 8288 and 8288-A to the IRS at the address given in the Form W-7 instructions.*

Liability of Agents and the Transferee

(1) Agents

If the transferor provides a false affidavit (*i.e.*, non-foreign certification), agents involved in the transaction may be liable for the withholding tax that should have been collected. This includes agents for the transferor, agents for the transferee, and the qualified substitute.[46] The settlement agent who closes the transaction falls within the scope of this rule. For purposes of this rule, an *agent* is any person who represents the transferor or transferee in any negotiation with another person (or another person's agent) relating to the transaction, or in settling the transaction. [47]

If any such agent has actual knowledge of the false affidavit, the requisite amount must still be withheld, and the agent must notify the transferee and the IRS that the affidavit is false.[48] This duty to notify extends after settlement has occurred.[49] If the agent fails to do so, the agent may be

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[44] How is lateness measured? Generally speaking, if FIRPTA tax was due at settlement and not paid timely, then the transferee is liable for the interest that accrues from the time from when it was due to when it was actually paid—either by the settlement agent or by the seller, such as when the seller pays the tax in his annual tax filing.
[45] 26 CFR § 1.1445(c)(1).
[46] 26 USC § 1445(d).
[47] 26 CFR § 1.1445-4(f). Settlement officers and clerical personnel are excluded if they perform one or more of the following activities: (1) the receipt and disbursement of any portion of the consideration for the transaction; (2) the recording of any document in connection with the transaction; (3) typing, copying, and other clerical tasks; or (4) or the transmission or delivery of documents between the parties.
[48] 26 USC § 1445(d); 26 CFR § 1.1445-4(c) & (e).
[49] 26 USC § 1445-4(c).

liable for the withholding tax, but in no event does the settlement agent's liability under FIRPTA exceed his or her compensation received for the subject transaction.[50]

(2) Transferee

Remember it is the *transferee* that has the duty to withhold the tax the transferor is liable to pay, according to the General Rule.[51] *A person that is required to deduct and withhold tax but fails to do so may be held liable for the payment of the tax and any applicable penalties and interest*.[52] In certain circumstances, civil and criminal penalties may also apply.[53]

FIRPTA and Title Insurance

As has been noted from the beginning of this article, if FIRPTA tax is not withheld, the IRS can demand payment of the withholding from the transferee. Ultimately, this could result in a federal tax lien on the property:

> *If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.*[54]

Such a demand (and resulting lien) could only occur after the transfer of the subject property. Consequently, there would be no coverage under a loan or owner's policy because Exclusion 3(d) of those policies exclude from coverage:

> *Defects, liens, encumbrances, adverse claims, or other matters . . . attaching or created subsequent to Date of Policy.*

FIRPTA Checklist

To make sure nothing gets overlooked, consider using a checklist. See attached.

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[50] 26 USC § 1445(d); 26 CFR § 1.1445-4(e).
[51] 26 USC § 1445(a).
[52] 26 CFR § 1.1445-1(e)(1).
[53] 26 CFR § 1.1445-1(e)(2).
[54] 26 USC § 6321.

APPENDIX 1

SAMPLE CERTIFICATION: INDIVIDUAL TRANSFEROR

Section 1445 of the Internal Revenue Code provides that a transferee (buyer) of a U.S. real property interest must withhold tax if the transferor (seller) is a foreign person. To inform the transferee (buyer) that withholding of tax is not required upon my disposition of a U.S. real property interest, I, [*name of transferor*], hereby certify the following:

1. I am not a nonresident alien for purposes of U.S. income taxation;

2. My U.S. taxpayer identifying number [Social Security number] is ____; and

3. My home address is:

I understand that this certification may be disclosed to the Internal Revenue Service by the transferee and that any false statement I have made here could be punished by fine, imprisonment, or both.

Under penalties of perjury I declare that I have examined this certification and to the best of my knowledge and belief it is true, correct, and complete.

[Signature and Date]

SAMPLE CERTIFICATION: ENTITY TRANSFEROR

Section 1445 of the Internal Revenue Code provides that a transferee of a U.S. real property interest must withhold tax if the transferor is a foreign person. For U.S. tax purposes (including section 1445), the owner of a disregarded entity (which has legal title to a U.S. real property interest under local law) will be the transferor of the property and not the disregarded entity. To inform the transferee that withholding of tax is not required upon the disposition of a U.S. real property interest by [name of transferor] , the undersigned hereby certifies the following on behalf of [name of the transferor]:

1. [Name of transferor] is not a foreign corporation, foreign partnership, foreign trust, or foreign estate (as those terms are defined in the Internal Revenue Code and Income Tax Regulations);

2. [Name of transferor] is not a disregarded entity as defined in §1.1445-2(b)(2)(iii);

3. [Name of transferor]'s U.S. employer identification number is ___; and

4. [Name of transferor]'s office address is _______.

[Name of transferor] understands that this certification may be disclosed to the Internal Revenue Service by transferee and that any false statement contained herein could be punished by fine, imprisonment, or both.

Under penalties of perjury I declare that I have examined this certification and to the best of my knowledge and belief it is true, correct, and complete, and I further declare that I have authority to sign this document on behalf of [name of transferor].

[Signature(s) and date]

[Title(s)]

APPENDIX 2

ALIEN RESIDENCY—GREEN CARD TEST

You are a resident, for U.S. federal tax purposes, if you are a lawful permanent resident of the United States at any time during the calendar year. This is known as the *green card test*.

You are a lawful permanent resident of the United States, at any time, if you have been given the privilege, according to the immigration laws, of residing permanently in the United States as an immigrant. You generally have this status if the U.S. Citizenship and Immigration Services (USCIS) issued you an alien registration card, Form I-551, also known as a *green card*.

You continue to have U.S. resident status, under this test, unless:

- You voluntarily renounce and abandon this status in writing to the USCIS,
- Your immigrant status is administratively terminated by the USCIS, or
- Your immigrant status is judicially terminated by a U.S. federal court.

If you meet the green card test at any time during the calendar year, but do not meet the substantial presence test for that year, your residency starting date is the first day on which you are present in the United States as a Lawful Permanent Resident.

APPENDIX 3

ALIEN RESIDENCY—SUBSTANTIAL PRESENCE TEST

You will be considered a United States resident for tax purposes if you meet the *substantial presence test* for the calendar year. To meet this test, you must be physically present in the United States (U.S.) on at least:

1. 31 days during the current year, and
2. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
    - All the days you were present in the current year, and
    - 1/3 of the days you were present in the first year before the current year, and
    - 1/6 of the days you were present in the second year before the current year.
3. **Example:**

You were physically present in the U.S. on 120 days in each of the years 2018, 2019 and 2020. To determine if you meet the substantial presence test for 2020, count the full 120 days of presence in 2020, 40 days in 2019 (1/3 of 120), and 20 days in 2018 (1/6 of 120). Since the total for the 3-year period is 180 days, you are not considered a resident under the substantial presence test: for 2020.

4. **Days of Presence in the United States**

You are treated as present in the U.S. on any day you are physically present in the country, at any time during the day. However, there are exceptions to this rule. Do not count the following as days of presence in the U.S. for the substantial presence test:

- Days you commute to work in the U.S. from a residence in Canada or Mexico, if you regularly commute from Canada or Mexico.
- Days you are in the U.S. for less than 24 hours, when you are in transit between two places outside the United States.
- Days you are in the U.S. as a crew member of a foreign vessel.
- Days you are unable to leave the U.S. because of a medical condition that develops while you are in the United States.
- Days you are an exempt individual (see below).

For details on days excluded from the substantial presence test for other than exempt individuals, refer to Publication 519, U.S. Tax Guide for Aliens.

The term United States (U.S.) includes the following areas:

- All 50 states and the District of Columbia.
- The territorial waters of the United States.
- The seabed and subsoil of those submarine areas that are adjacent to U.S. territorial waters and over which the United States has exclusive rights under international law to explore and exploit natural resources.

The term does not include U.S. territories or U.S. airspace.

5. Exempt Individual

Do not count days for which you are an exempt individual. The term "exempt individual" does **not** refer to someone exempt from U.S. tax, but to anyone in the following categories:

- An individual temporarily present in the U.S. as a foreign government-related individual under an “A” or “G” visa, other than individuals holding “A-3” or “G-5” class visas.
- A teacher or trainee temporarily present in the U.S. under a "J" or "Q" visa, who substantially complies with the requirements of the visa.
- A student temporarily present in the U.S. under an "F," "J," "M," or "Q" visa, who substantially complies with the requirements of the visa.
- A professional athlete temporarily in the U.S. to compete in a charitable sports event.

If you exclude days of presence in the U.S. for purposes of the substantial presence test because you were an exempt individual or were unable to leave the U.S. because of a medical condition or medical problem, you must include Form 8843, Statement for Exempt Individuals and Individuals With a Medical Condition, with your income tax return. If you do not have to file an income tax return, send Form 8843 to the address indicated in the instructions for Form 8843 by the due date for filing an income tax return.

If you do not timely file Form 8843, you cannot exclude the days you were present in the U.S. as an exempt individual or because of a medical condition that arose while you were in the U.S. This does not apply if you can show, by clear and convincing evidence that you took reasonable actions to become aware of the filing requirements and significant steps to comply with those requirements.

6. Closer Connection Exception to the Substantial Presence Test

Even if you met the substantial presence test you can still be treated as a nonresident alien if you qualify for one of the following exceptions:

1. The closer connection exception available to all aliens. Please refer to Closer Connection Exemption to the Substantial Presence Test.

2. The closer connection exception available only to students. Please refer to The Closer Connection Exception to the Substantial Presence Test for Foreign Students.

APPENDIX 4

LIMITED LIABILITY COMPANIES (LLCs)

The applicability of FIRPTA to LLCs depends on several factors. To begin the analysis, remember that with entities, unless another exemption applies, a settlement agent should utilize the entity nonforeign affidavit, which contains the following affirmations:

> 1. [Name of transferor] is not a foreign corporation, foreign partnership, foreign trust, or foreign estate (as those terms are defined in the Internal Revenue Code and Income Tax Regulations);
>
> 2. [Name of transferor] is not a disregarded entity as defined in §1.1445-2(b)(2)(iii);
>
> 3. [Name of transferor]'s U.S. employer identification number is ___; and
>
> 4. [Name of transferor]'s office address is _______.

Notice that the entity seller must be able to affirm that it is not a *disregarded entity*, and the affidavit provides a definition in 26 CFR § 1.1445-2(b)(2)(iii):

> *Disregarded entities.* A disregarded entity may not certify that it is the transferor of a U.S. real property interest, as the disregarded entity is not the transferor for U.S. tax purposes, including sections 897 and 1445. Rather, *the owner of the disregarded entity is treated as the transferor of property and must provide a certificate of non-foreign status to avoid withholding under section 1445. A disregarded entity for these purposes means an entity that is disregarded as an entity separate from its owner under § 301.7701-3* of this chapter, a qualified REIT subsidiary as defined in section 856(i), or a qualified subchapter S subsidiary under section 1361(b)(3)(B). Any domestic entity must include in its certification of non-foreign status with respect to the transfer a certification that it is not a disregarded entity. This paragraph (b)(2)(iii) and the sample certification provided in paragraph (b)(2)(iv)(B) of this section (to the extent it addresses disregarded entities) is applicable for dispositions occurring September 4, 2003.

Admittedly, there is a lot going on in this paragraph. But there are two simple takeaways relevant to limited liability companies, emphasized in italics: (1) the owner of a disregarded entity is considered the transferor for FIRPTA analysis and must provide the nonforeign affidavit, and (2) a disregarded entity includes an entity that is disregarded under 26 CFR § 301.7701-3.

So let's turn our attention to 26 CFR § 301.7701-3. It is lengthy and complex. It states that if an entity is not otherwise classified as a corporation, it is an *eligible entity*.[55] An LLC is not otherwise classified as a corporation, so it is an *eligible entity*.

An eligible entity with at least two members can elect to be classified as a corporation or a partnership.[56] If it fails to make an election, it is considered a partnership by default.[57] An eligible entity with a single owner can elect to be classified as a corporation or to be disregarded as an entity separate from its owner.[58] If it fails to make an election, it is a disregarded entity by default, and we must look to the citizenship of its single owner, whether that single owner is an individual or another entity.[59]

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55 26 CFR § 301.7701-3(a).
56 *Id.*
57 26 CFR § 301.7701-3(a)&(b).
58 26 CFR § 301.7701-3(a).
59 26 CFR § 301.7701-3(a)&(b).

APPENDIX 5

SPECIAL RULES WHERE TRANSFEROR IS A DOMESTIC PARTNERSHIP, DOMESTIC TRUST OR DOMESTIC ESTATE

Put simply, when one of these enumerated entities is the seller, no FIRPTA tax need be withheld by the transferee. The seller entity need only sign the nonforeign entity affidavit, and the transferee may rely on it. The citizenship of the owners/members of such entities is irrelevant. FIRPTA tax may in fact be due, but FIRPTA places the burden of such reporting on the selling entity, not the transferee.

As stated in 26 USC § 1445(e)(1):

> ***(e) Special rules relating to distributions, etc., by corporations, partnerships, trusts, or estates***
>
> ***(1) Certain domestic partnerships, trusts, and estates*** *In the case of any disposition of a United States real property interest as defined in section 897(c) (other than a disposition described in paragraph (4) or (5)) by a domestic partnership, domestic trust, or domestic estate, such partnership, the trustee of such trust, or the executor of such estate (as the case may be) shall be required to deduct and withhold under subsection (a) a tax equal to 35 percent (or, to the extent provided in regulations, 20 percent) of the gain realized to the extent such gain—*
>
>> ***(A)*** *is allocable to a foreign person who is a partner or beneficiary of such partnership, trust, or estate, or*
>>
>> ***(B)*** *is allocable to a portion of the trust treated as owned by a foreign person under subpart E of part I of subchapter J.*

In order to determine that an interest holder in one of the above entities is not a foreign person, an entity or fiduciary may rely upon an affidavit of nonforeign status from the individual or entity interest holder. This is made clear by 26 CFR § 1.1445-5(c). This regulation is quite lengthy.

Remember that the general rule of FIRPTA places a burden on the *transferee* to withhold the applicable tax.[60] But when it comes to certain domestic partnerships, trusts, and estates, there is no burden on the transferee. Look at 26 USC § 1445(e)(1) above—the burden to withhold is on the partner, fiduciary or other representative of said domestic entity. This nuance is also articulated in 26 CFR § 1.1445-5(b)(1):

> *If tax is required to be withheld with respect to a* transfer of property *in accordance with the* rules *of this section, then no additional tax is required to be withheld by the* transferee

[60] 26 USC § 1445(a).

> *of the* property *with respect to that* transfer *pursuant to the* general rules *of section 1445(a) and § 1.1445-1.*

This makes sense. We impose FIRPTA tax due from a foreign seller on a purchaser because after closing the foreign seller can go back to his or her home country, making it difficult for the IRS to reach such a seller. But the IRS can reach the purchaser of a U.S. property interest. Likewise, the IRS can reach a domestic partnership, trust or estate. Even when one or more interest holders of such an entity is a foreign person, the entity itself is domestic and can be reached by the IRS, thus making it unnecessary to impost a burden of withholding on the transferee.

APPENDIX 6

FIRPTA AND GIFT TRANSFERS

Are gift transfers exempt from FIRPTA withholding? At first blush, it may seem that gift transfers are exempt from FIRPTA withholding, but a closer examination of pertinent regulations reveal that they are not.

Recall the General Rule with its references to *transferor* and *transferee*. The definition of *transferor* includes gift transfers, being defined as *any person, foreign or domestic, that disposes of a U.S. real property interest by sale, exchange, gift, or any other transfer*.[61] Similarly, the definition of *transferee* is defined as *any person, foreign or domestic, that acquires a U.S. real property interest by purchase, exchange, gift, or any other transfer*.[62] If this is so, then in following the General Rule we would expect to withhold 10% or 15% of the amount realized on gift transfers like ordinary sales. What is the *amount realized* in a gift transfer? Practically, the regulations define *amount realized* as cash paid by the transferee plus liability assumed.[63] For a gift transfer, this must be zero—no cash is paid, and no liability is assumed. And if that is so, then no withholding should be required because 10% or 15% of zero is zero.

This reasoning is sound. In fact, in discussing the duty to withhold generally, the regulations state this reasoning explicitly:

> *If two or more persons are joint transferees of a U.S. real property interest, each such person is subject to the obligation to withhold. That obligation is fulfilled with respect to each such person if any one of them withholds and pays over the required amount in accordance with the rules of this section. If the amount realized . . . by the transferor is zero, then no withholding is required. For example, if a real property interest is transferred as a gift (i.e., the recipient does not assume any liabilities or furnish any other consideration to the transferor) then no withholding is required.*[64]

But if this is all true, then why does the definition of *transferor* and *transferee* include gift transfers in the first place? Under what circumstances could gift transfers be subject to FIRPTA withholding? The answer is found in an example offered in a Treasury Regulation and a closer examination of how *amount realized* is defined.

To illustrate how FIRPTA withholding can be due on gift transfers, Treasury Regulation § 1.897-1(h) offers the following example:

[61] 26 CFR § 1.1445-1(g)(3).
[62] 26 CFR § 1.1445-1(g)(4).
[63] 26 CFR § 1.1445-1(g)(5).
[64] 26 CFR § 1.1445-1(b)(1).

> *Foreign individual C has an undivided fee interest in a parcel of real property located in the United States. The fair market value of C's interest is $70,000, and C's basis in such interest is $50,000. The only liability to which the real property is subject is the liability of $65,000 secured by a mortgage in the same amount. C transfers his fee interest in the property subject to the mortgage by gift to D. C realizes $15,000 of gain upon such transfer. As a transfer by gift constitutes a disposition for purposes of the Code, and as gain is realized upon that transfer, the gift is a disposition for purposes of sections 897, 1445, and 6039C and is subject to section 897(a) to the extent of the gain realized. However, section 897(a) would not be applicable to the transfer if the mortgage on the U.S. real property were equal to or less than C's $50,000 basis, since the transfer then would not give rise to the realization of gain or loss under the Internal Revenue Code.*[65]

This example is consistent with the definition of *amount realized*:

> *The amount realized by the transferor for the transfer of a U.S. real property interest is the sum of.*
>
> *(i) The cash paid, or to be paid.*
>
> *(ii) The fair market value of other property transferred, or to be transferred, and*
>
> *(iii) The outstanding amount of any liability assumed by the transferee <u>or to which the U.S. real property interest is subject immediately before and after the transfer</u>.*

It is the underlined portion of this definition that is the key to reconciling the statement, "*if a real property interest is transferred as a gift . . . then no withholding is required*" with the example in the Treasury regulation involving Foreign individual C who realized $15,000 in the process of gifting his real estate to D. Admittedly, the statement may be a bit misleading in light of the example. Perhaps a more gracious assessment is to say the statement is incomplete—it does not refer to a gift in which an outstanding liability is present both before and after the transfer. The example brings out this detail and illustrates why gift transfers can trigger withholding requirements under FIRPTA.

[65] 26 CFR § 1.897-1(h).