OLD REPUBLIC NATIONAL TITLE INSURANCE COMPANY

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Q2 2021 Webinar

FIRPTA Explained

Thursday, June 10

presented by…

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OVERVIEW

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

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GENERAL RULE

"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."

Except: exemptions are coming

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GENERAL RULE

"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."

disposition: includes sales and deeds without consideration

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GENERAL RULE

"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."

United States real property interest: any interest in property (subsurface, Virgin Islands)

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GENERAL RULE

"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."

foreign person: any person other than a United States person

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GENERAL RULE

"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."

transferee: "purchase, exchange, gift, or any other transfer"

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GENERAL RULE

"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."

amount realized : contract sales price

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GENERAL RULE IN PLAIN ENGLISH

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

But wait! There's more:

- Exemptions
- Limitations
- Special rules

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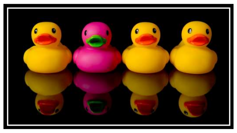
EXEMPTIONS

1. Transferor furnishes a nonforeign affidavit
2. Transferee receives a qualifying statement
3. Real property is a residence where amount realized does not exceed $300,000



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EXEMPTION 1: NONFOREIGN AFFIDAVIT

- Most common exemption
- Furnished by transferor to transferee
- States transferor's SSN (privacy concerns)
- States transferor is not a foreign person
- Affidavit is a safe harbor
- Transferee can rely on other means
- No statutory duty to verify
- Regulations provide sample forms for individuals and entities

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EXEMPTION 1: NONFOREIGN AFFIDAVIT (INDIVIDUAL)

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]

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EXEMPTION 1: NONFOREIGN AFFIDAVIT (INDIVIDUAL)

- **Alien: individual who is not a U.S. citizen or U.S. national.**
- **Nonresident Alien: Alien who has not passed green card test or the substantial presence test.**

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EXEMPTION 1: NONFOREIGN AFFIDAVIT (INDIVIDUAL)

- **Consider opinion letter from seller's CPA or tax attorney**
- **Having an SSN is not determinative**
- **Nonforeign affidavit is safe harbor**
- **Transferee is entitled to rely on it**

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EXEMPTION 1: NONFOREIGN AFFIDAVIT (ENTITY)

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);

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EXEMPTION 1: NONFOREIGN AFFIDAVIT (ENTITY)

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)]

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EXEMPTION 1: NONFOREIGN AFFIDAVIT (ENTITY)

- **"Foreign" means foreign to U.S. (e.g., Canadian corporation)**
- **Exception: election to be treated as a domestic entity**
- **If corporation, partnership or trust created in U.S., citizenship of stockholders, partners or beneficiaries is irrelevant**
- **Transferee is entitled to rely on affidavit**
- **Missing from the list: LLC**


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EXEMPTION 1: NONFOREIGN AFFIDAVIT (ENTITY)

- **"[Name of transferor] is not a disregarded entity as defined in §1.1445-2(b)(2)(iii)."**
- **Domestic, single-member LLC: treated like domestic corp.?**
  - Yes? LLC can sign affidavit
  - No? LLC is disregarded and we look to owner (individual or entity)
- **Domestic, multi-member LLC: treated like domestic corp.?**
  - Yes? LLC can sign affidavit
  - No? LLC is disregarded and treated like a domestic partnership—no duty on transferee to withhold

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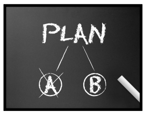
WHO GETS THE AFFIDAVIT?

- Transferor must furnish affidavit to transferee
- Affidavit has SSN or EIN
- Transferor may furnish affidavit to "qualified substitute" (i.e., settlement agent), who then furnishes transferee affidavit that he/she has received nonforeign affidavit from transferor



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EXEMPTION 2: QUALIFYING STATEMENT

- Statement from the IRS that no tax is due, etc.
- Also known as "withholding certificate"
- IRS must process request within 90 days
- Ideal when seller balks at FIRPTA withholding
- If not enough time, consider delayed reporting

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EXEMPTION 3: $300,000 OR LESS RESIDENCE

- Property must be acquired by transferee as a residence
- Amount realized (contract sales price) is not more than $300,000
- Transferee must be an individual ("used as residence")

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EXEMPTION 3: $300,000 OR LESS RESIDENCE

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 . . .

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EXEMPTION 3: RESIDENCY REQUIREMENT DEFINED

- Transferee must have "definite plans"
- First 12 months: must live in property at least 50% of time it is used by anyone
- Second 12 months: same
- "Transferee" includes transferee's family, defined as "brothers and sisters (whether by the whole or half-blood), spouse, ancestors, and lineal descendants"
- No requirement to document, but perhaps it is wise to do so

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LIMITATIONS

- General Rule: must withhold 15% of contract sales price
- To qualify for 10% withholding:
  - Must use property as personal residence
  - Amount realized $1,000,000 or less; AND
  - $300,000 exception does not apply
- Owned by foreign/nonforeign transferors?
  - Base on capital contribution
  - Husband and wife: presume 50/50

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LIMITATIONS: EXAMPLES

- Ted & George = brothers
- Ted: foreigner; George: U.S. citizen
- Sales price: $400,000
- Purchaser intends to use it as personal residence
- No exemption applies
- 10% withholding (not 15%) applies ($40,000)
- Capital contribution is presumed 50/50 because joint tenancy
- FIRPTA withholding = $20,000

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LIMITATIONS: EXAMPLES

- What if Ted & George say George made all capital contributions so no FIRTPA withholding is due?
- They offer affidavits, receipts and instructions that all money goes into George's separate account
- Do you remove the FIRTPA $20,000 withholding?

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LIMITATIONS: EXAMPLES

- Who gets the proceeds is irrelevant
- Capital contributions are determinative
- You (settlement agent) or purchaser will never know for sure
- But purchaser is liable if FIRPTA withholding not made
- Consider: qualifying statement (Exemption No. 2)
- Consider: opinion from CPA or tax attorney

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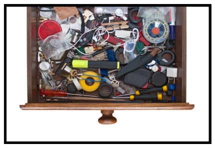
SPECIAL RULES

- Transferor is a domestic partnership, domestic trust, or domestic estate
- Transferee is a governmental body
- Foreclosures
- Deeds in lieu of foreclosure
- Short sales
- Gift transfers



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TRANSFEROR IS DOMESTIC PARTNERSHIP, ETC.

- No FIRPTA tax need be withheld by transferee
- Seller entity need only sign the nonforeign entity affidavit, and transferee may rely on it
- Citizenship of the partners, beneficiaries, devisees or heirs is irrelevant
- Burden of withholding on the selling entity, not the transferee

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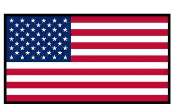
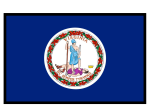
TRANSFEREE IS GOVERNMENTAL BODY

- No withholding 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





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FORECLOSURE

- Not exempt if foreclosed borrower is a foreign person
- Lesser amount ("alternative amount") is due
- Based on any amount due to debtor after loan and fees are paid
- If zero, then withholding is zero; if not, then 10% or 15%
- Strict notice requirements to trustee and IRS
- How is a purchaser (transferee) to know?
- Assume the risk? Ask for an affidavit? $300K exemption? Caveat emptor?

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DEED IN LIEU OF FORECLOSURE

- Transferee is only person with a security interest in property
- No cash or other property paid to any person
- Specific notice requirements must be met

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SHORT SALE

- Not exempt from FIRPTA
- Withholding not based on proceeds, but amount realized (contract sales price)
- Likely seller has no taxable gain
- Request withholding certificate?
- Letter from attorney/CPA?

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GIFT TRANSFER

- Jointly owned? Base FIRPTA on foreigner's capital contribution
- Recall Ted (foreigner) and George (U.S. citizen)
- Proposal: Ted gifts his interest to George prior to closing
- George is only seller
- FIRPTA avoided?
- Gift transfers are subject to FIRPTA
- Tax evasion?
- Consider alternatives

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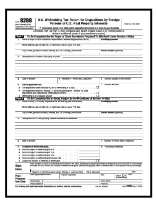
PROCEDURES FOR WITHHOLDING

- Transferee must report and pay over any tax withheld by the 20th day after the date of the transfer (settlement date)
- Forms 8288 and 8288-A
- Burden to withhold on transferee
- Practically: settlement agent



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DELAYED REPORTING

- Great solution when seller objects to FIRPTA withholding
- Prior to closing: transferor or transferee applies for withholding certificate
- If transferor, notice must be given to transferee
- No form: name, address, TIN of transferor, property description, date the application was submitted to IRS
- IRS has 90 days to respond
- Remittance of FIRPTA withholding 20 days after IRS sends letter

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DELAYED REPORTING

- Transferee may be liable for interest and penalties if IRS determines purpose was to delay payment
- Delay presumed if actual liability is 90% or more of maximum FIRPTA tax withheld
- Problem: buyer's consent
- Seller may apply for TIN if lacking

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LIABILITY OF SETTLEMENT AGENT AND TRANSFEREE

Liability of the agent:

- If transferor provides false nonforeign affidavit, agent must notify transferee and IRS
- Agent must still withhold tax
- Failure to do so may result in agent paying tax that should have been withheld, up to amount agent received as compensation

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LIABILITY OF SETTLEMENT AGENT AND TRANSFEREE

Liability of the transferee:

- Transferee has duty to withhold
- "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."
- Civil and criminal penalties may also apply.

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FIRPTA AND TITLE INSURANCE

<u>26 USC § 6321</u>: 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.

<u>Excluded by Policy</u>: Defects, liens, encumbrances, adverse claims, or other matters . . . attaching or created subsequent to Date of Policy.

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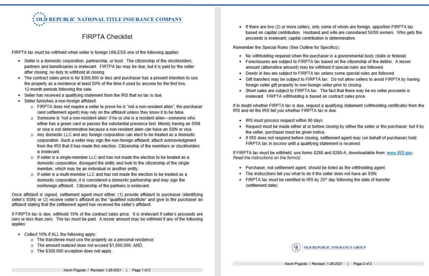
FIRPTA CHECKLIST



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FIRPTA Checklist

FIRPTA tax must be withheld when seller is foreign UNLESS one of the following applies:

- Seller is a domestic corporation, partnership, or trust. The citizenship of the stockholders, partners and beneficiaries is irrelevant. FIRTPA tax may be due, but it is paid by the seller after closing; no duty to withhold at closing.
- The contract sales price is for $300,000 or less and purchaser has a present intention to use the property as a residence at least 50% of the time it used by anyone for the first two, 12-month periods following the sale.
- Seller has received a qualifying statement from the IRS that no tax is due.
- Seller furnishes a non-foreign affidavit.
  - FIRPTA does not require a seller to prove he is "not a non-resident alien"; the purchaser (and settlement agent) may rely on the affidavit unless they know it to be false.
  - Someone is "not a non-resident alien" if he or she is a resident alien—someone who either has a green card or passes the substantial presence test. Merely having an SSN or visa is not determinative because a non-resident alien can have an SSN or visa.
  - Any domestic LLC and any foreign corporation can elect to be treated as a domestic corporation. Such a seller may sign the non-foreign affidavit; attach acknowledgment from the IRS that it has made this election. Citizenship of the members or stockholders is irrelevant.
  - If seller is a single-member LLC and has not made the election to be treated as a domestic corporation, disregard the entity and look to the citizenship of the single member, which may be an individual or another entity.
  - If seller is a multi-member LLC and has not made the election to be treated as a domestic corporation, it is considered a domestic partnership and may sign the nonforeign affidavit. Citizenship of the partners is irrelevant.

Once affidavit is signed, settlement agent must either: (1) provide affidavit to purchaser (identifying seller's SSN) or (2) receive seller's affidavit as the "qualified substitute" and give to the purchaser an affidavit stating that the settlement agent has received the seller's affidavit.

If FIRPTA tax is due, withhold 15% of the contract sales price. It is irrelevant if seller's proceeds are zero or less than zero. The tax must be paid. A lesser amount may be withheld if any of the following applies:

- Collect 10% if ALL the following apply:
  - 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.

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- If there are two (2) or more sellers, only some of whom are foreign, apportion FIRPTA tax based on capital contribution. Husband and wife are considered 50/50 owners. Who gets the proceeds is irrelevant; capital contribution is determinative.

Remember the Special Rules (See Outline for Specifics):

- No withholding required when the purchaser is a governmental body (state or federal)
- Foreclosures are subject to FIRPTA tax based on the citizenship of the debtor. A lesser amount (alternative amount) may be withheld if special rules are followed.
- Deeds in lieu are subject to FIRPTA tax unless some special rules are followed.
- Gift transfers may be subject to FIRPTA tax. Do not allow sellers to avoid FIRPTA by having foreign seller gift property to non-foreign seller prior to closing.
- Short sales are subject to FIRPTA tax. The fact that there may be no seller proceeds is irrelevant. FIRPTA withholding is based on contract sales price.

If in doubt whether FIRPTA tax is due, request a qualifying statement (withholding certificate) from the IRS and let the IRS tell you whether FIRPTA tax is due.

- IRS must process request within 90 days.
- Request must be made either at or before closing by either the seller or the purchaser; but if by the seller, purchaser must be given notice.
- If IRS does not respond before closing, settlement agent may (on behalf of purchaser) hold FIRPTA tax in escrow until a qualifying statement is received.

If FIRPTA tax must be withheld, use forms 8288 and 8288-A, downloadable from: www.IRS.gov. *Read the instructions on the form(s).*

- Purchaser, not settlement agent, should be listed as the withholding agent.
- The instructions tell you what to do if the seller does not have an SSN.
- FIRPTA tax must be remitted to IRS by 20th day following the date of transfer (settlement date).

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QUESTIONS

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Thank you!

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