

FIRPTA Withholding Rules

Understanding the Requirements and the Exceptions

1031

Knowledge

Congress enacted the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) to impose a tax on foreign persons when they sell a U.S. real property interest. A “foreign person” includes a non-resident alien, foreign partnerships, trusts, estates and corporations which have not elected to be treated as a domestic corporation under IRC §897(i). For U.S. property dispositions subject to FIRPTA, the transferee (purchaser) is required to withhold and remit to the IRS 15% of the gross sales price to ensure that any taxable gain realized by the seller is actually paid. The withholding rate is computed differently for other foreign entities, such as foreign corporations and trusts, which are required to withhold 35% of the capital gain realized on the sale. The withholding tax rate on a partner’s share of income is 39.6% for non-corporate partners and 35% for corporate partners. For more information on FIRPTA, visit: www.irs.gov and download [IRS Publication 515: Withholding of Tax on Nonresident Aliens and Foreign Entities](#).

WHO IS A NON-RESIDENT ALIEN?

A non-U.S. citizen who does not pass the green card test or the substantial presence test is considered a “non-resident alien.” If a non-citizen currently has a green card or has had a green card in the past calendar year, they would pass the green card test and be classified as a resident alien. If the individual has resided in the U.S. for more than 31 days in the current year and has resided in the U.S. for more than 183 days over a three-year period, including the current year, they would pass the substantial presence test and be classified as a resident alien. For more on the definition of a non-resident alien, see [Topic 851, Resident and Non-Resident Aliens](#).

THREE EXCEPTIONS TO FIRPTA

1. Property to become buyer’s personal residence. Section 1445 (b)(5) provides an exemption for property acquired by a transferee that will be used as the transferee’s personal residence. To qualify for the exemption, a closing officer will generally require the transferee to sign an affidavit stating that the amount realized (generally sales price) is not more than \$300,000, and that the transferee or a member of their family intend to use the property as a personal residence for at least 50% of the number of days the property is used by any person during each of the first two 12-month periods following the date of transfer.
2. Seller declaration of non-recognition of gain or loss. The second exception to the FIRPTA withholding requirements is the simultaneous 1031 exchange. The transferee is not required to withhold if “[t]he transferor gives written notice that no recognition of any gain or loss on the transfer is required because of a non-recognition provision in the Internal Revenue Code or a provision in a U.S. tax treaty.” Such notice is called a “Declaration and Notice to Complete an Exchange” (1031 Declaration and Notice). A transferee can rely on a 1031 Declaration and Notice only if: (1) the foreign person completes a simultaneous exchange (i.e., the same day); and (2) the foreign person receives no cash or mortgage boot.

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Further, if the property was seller's principal residence, where the sale of property exceeds \$300,000, a foreign seller's notice of non-recognition of gain based on Section 121 may not be relied upon and an IRS withholding certificate is required even though the exclusion may reduce or even eliminate the amount to be withheld under Section 1445.

3. The third exception is for transactions in which the IRS has issued a withholding certificate (Withholding Certificate) to the foreign seller. The amount which must be withheld by a buyer can be reduced or eliminated pursuant to the Withholding Certificate. The transferee, the transferee's agent or the transferor may request a Withholding Certificate. The IRS will generally grant or deny an application for a Withholding Certificate within 90 days after its receipt of a completed [IRS Form 8288-B](#) application.

IMPACT ON SIMULTANEOUS EXCHANGES

Under the foregoing rules, a buyer of U.S. property from a foreign person can rely on a 1031 Declaration and Notice only if the foreign person exchanges U.S. property for other U.S. property in a swap in which the foreign person receives no cash or mortgage boot. Since many exchanges can involve payment of some cash or debt reduction, the utility of a 1031 Withholding Certificate is substantially reduced.

IMPACT ON DELAYED EXCHANGES

To the extent that the 1031 exchange is not simultaneous, or if any cash or mortgage boot will be received by a foreign person with respect to the disposition of U.S. property, the buyer can only rely on a Withholding Certificate issued by the IRS to a foreign person. As a result, foreign persons desiring to engage in a delayed 1031 exchange should consult with a tax advisor and apply for an International Tax Identification Number (ITIN) and a 1031 Withholding Certificate well in advance of the anticipated disposition of U.S. property holdings. For more information, see [ITIN Guidance for Foreign Property Buyers/Sellers](#).

STEPS INVOLVED IN COMPLYING WITH FIRPTA IN AN EXCHANGE

- A. First, consult with your tax advisor and analyze if FIRPTA applies to you and your transaction and determine if you are considered a "Foreign Person" who is selling a U.S. real property interest.
- B. Next, explore if any exceptions to the FIRPTA withholding apply to your situation. For a more detailed explanation of these terms and exceptions, review [IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities](#) and [IRS Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests](#).

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- C. If you are a Foreign Person, then you must obtain a U.S. Taxpayer Identification Number (TIN) from the IRS as follows:
- Individuals: To request a TIN, file [IRS Form W-7, Application for IRS Individual Identification Number](#).
 - Businesses: Obtain an Employer Identification Number (EIN) by filing IRS Form SS-4, [Application for Employer Identification Number](#).
- D. The next step is to apply for a Withholding Certificate from the IRS.
- File [IRS Form 8288-B, Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests](#). See the instructions to Form 8288 as it may be possible to attach Form 8288-B to Form W-7 when applying for both a TIN and a Withholding Certificate.
- E. Notify the buyer of your relinquished property that you have applied for a Withholding Certificate.
- F. Prior to closing on the sale of a relinquished property, contact a qualified intermediary to have the necessary exchange documentation prepared and forwarded to the closing officer so the transaction can be closed as a 1031 exchange.
- G. The exchange begins when the relinquished property closes. The buyer must file IRS Forms 8288 and 8288-A to report and pay the amount withheld to the IRS by the 20th day after the date of the relinquished property closing.

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