

FIRPTA WITHHOLDING RATE INCREASING TO 15%



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The recently-enacted Protecting American Taxpayers from Tax Hikes (PATH) Act (H.R. 2029, P.L. 114-113) includes two very positive FIRPTA provisions that are conservatively estimated to boost foreign investment in U.S. commercial real estate by \$20-\$30 billion per year.

However, as part of a package of tax changes to “pay for” the two provisions, Congress also included an increase in the FIRPTA withholding rate from 10% to 15%. It should be noted that residences purchased from foreign persons will not be affected by the higher withholding rate unless the purchase price exceeds \$1 million.

What is FIRPTA?

FIRPTA is the Foreign Investment in Real Property Tax Act of 1980. This legislation was enacted as a result of widespread concerns that foreign investors were purchasing U.S. real estate and then selling it at a profit without paying any tax to the United States. To solve the problem, FIRPTA established a general requirement on the purchaser of real estate interests owned by a foreign seller to withhold 10% of the purchase price and remit it to the Internal Revenue Service at the time of closing unless certain exceptions are met.

Usually, the settlement agent is the party that withholds and remits the funds to the IRS, but the buyer is legally responsible. In certain circumstances, the buyer’s agent can also be held liable (see reverse side).

Under the FIRPTA law, in the case of a sale of a residence that is intended for personal use by the buyer, there is no withholding requirement if the sales price does not exceed \$300,000.*

How Does the New Law Specifically Change the Withholding Requirement?

The provision increases the rate of withholding from 10% to 15% except in the case of sales of residences intended for personal use by the acquirer, if the purchase price does not exceed \$1 million. Thus, if the previous exception for personal residences (where the purchase price does not exceed \$300,000 – in which case no withholding is required) does not apply, the 10% withholding rate is retained so long as the purchase price does not exceed \$1 million. If the price is higher than \$1 million, the new 15% rate will apply.

In summary, here are some guidelines:

- If the amount realized (generally the sales price) is \$300,000 or less, AND the property will be used by the buyer as a residence, no sums need be withheld or remitted.
- If the amount realized exceeds \$300,000 but does not exceed \$1,000,000, AND the property will be used by the buyer as a residence, then the withholding rate is 10% on the full amount realized.
- If the amount realized exceeds \$1,000,000, then the withholding rate is 15% on the entire amount, regardless of use by the buyer.

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*For purposes of the exception from withholding for personal use residences, the buyer or a member of the buyer’s family must have definite plans to reside at the property for at least 50 percent 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 the transfer. Days the property is vacant do not count as days of use.

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When Does the New 15% Withholding Rate Become Effective?

The PATH Act makes this change effective for dispositions after the date which is 60 days after the date of enactment. The legislation was signed into law by President Obama on December 18, 2015. The 60th day after this day is February 16, 2016. Thus, the new rate will apply to sales on or after February 17, 2016.

What Beneficial Changes for FIRPTA Were Included in the PATH Act?

The new law makes two changes to the FIRPTA law, both of which are expected to make U.S. commercial property more attractive to foreign investors without substantially eroding the original purpose of the Act.

First, the law doubles the maximum amount of stock ownership that a foreign investor may have in a U.S. publicly-traded real estate investment trust (REIT) from the previous limit of 5% to 10%.

Second, the new law permits certain foreign pension funds to invest in real estate investment trusts (REITs) without having FIRPTA treatment apply.

Did the NAR support these changes?

Yes. NAR was part of a broad coalition of commercial real estate groups that advocated for the beneficial changes made in the PATH Act.

Do I have any obligations for FIRPTA withholding as a real estate agent or broker?

You very well might. If you represent either the buyer or a seller of real property that is subject to FIRPTA withholding, you could find yourself liable for the tax that should have been withheld by the buyer in certain circumstances.

- If the buyer of the real property receives a certificate from the seller that the seller is not a foreign person, and is therefore exempt from withholding, and you as the agent for either the seller or the buyer have knowledge that the certificate is false, you must notify the buyer of this fact. Failure to do so could mean that you, as the agent, are liable for the tax that should have been withheld but was not.

However, the agent's potential liability in this case is limited to the amount of commission he or she earns from the transaction.

- In addition, if you as an agent serve as a "withholding agent," you may be personally liable for the full amount of FIRPTA withholding tax required to be withheld, plus interest and penalties.

A "withholding agent" is any person having the control, receipt, custody, disposal, or payment of income that is subject to withholding. Generally, this is the person who pays an amount to the foreign person that is subject to withholding.

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