

Drop-In Article

Tax Rules for Foreign Investors in U.S. Real Property

U.S. realtors and rental agents/property managers are encountering an increasing number of situations that involve foreign persons acquiring U.S. real estate. The tax rules governing ownership disposition of U.S. real estate by foreign persons vary in many ways from those that apply to U.S. persons. Understanding the tax laws is critical for real estate professionals to avoid personal liability for improper U.S. federal income tax compliance.

The disposition of a U.S. real property interest by a foreign person (transferor) is subject to the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) income tax withholding. FIRPTA authorized the United States for the first time to tax foreign persons on disposition of U.S. Real Property Interests (USRPI).

A USRPI includes sales of interests in parcels of real property, as well as sales of shares in certain U.S. corporations that are considered U.S. real property holding corporations. Any purchaser of a USRPI from a foreign seller must withhold ten percent (10%) of the gross purchase price and remit such amount to the IRS within 20 days of closing, using [Form 8288](#), and [Form 8288-A](#).

The purchaser (transferee) of the property must determine if the seller (transferor) is a foreign person. If the transferor is a foreign person and withholding does not take place in accordance with the law, the transferee and the agent or settlement officer may be held liable for the tax.

There are exceptions to the withholding requirements of Internal Revenue Code section 1445. One of the most common exceptions to FIRPTA withholding is that the transferee (purchaser/buyer) does not have to withhold in a situation where the buyer purchases real estate for use as a home and the purchase price is not more than \$300,000. However, the purchaser must reside in the home for a specific number of days following the date of transfer. For an explanation of this FIRPTA withholding exception and others, refer to [IRS Publication 515](#), *Withholding of Tax on Nonresident Aliens and Foreign Entities*, and at www.irs.gov, using “FIRPTA” as a key search word.

In certain situations, such as when the tax due on the transferor’s gain from the sale is less than the withholding, the foreign transferor (or the transferee) can request a reduction or elimination of withholding from the IRS. The [FIRPTA Withholding](#) pages on www.irs.gov have more information about reducing the withholding rate.

Withholding on Rental Income paid to a Foreign Person

If a foreign person owns U.S. rental property and receives rental/investment income not connected with a U.S. business, the renter must withhold a flat rate of 30% (without

deductions) of the rents, unless a tax treaty provides a lower rate or an exemption. Here are some basic rules regarding withholding on rent:

- IRC section 1441 provides for the withholding of tax paid by a withholding agent to a nonresident alien on various items of income, including rental income. The person paying rent, as well as the real property manager who collects rent on behalf of a foreign owner, is considered a withholding agent.
- The person making payment of U.S. source rents to a foreign person must withhold 30% unless the foreign person claims reduced withholding based on a tax treaty (W-8BEN) or makes an irrevocable election with the IRS to treat the income as effectively connected to a U.S. trade or business (W-8EIC).
- Withholding agents must use Form 1042 and 1042S to report the tax withheld.
- The requirement to withhold 30% extends to the manager of the rental property if the tenant has not done the 30% withholding. Property managers who do not comply with these rules will be held liable for 30% of gross rent, plus penalties and interest.

Additional Sources of Information:

[IRS Publication 515](#), *Withholding of Tax on Nonresident Aliens and Foreign Entities*

[Publication 519](#), *U.S. Tax Guide for Aliens*

[Form 8288](#), *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*

[Form 8288-A](#), *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*

Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding*

Instructions for Form W-8BEN

[Form W-8ECI](#), *Certificate of Foreign Person's Claim for Exemption From Withholding on Income Effectively Connected With the Conduct of a Trade or Business in the United States*

[Instructions for Form W-8ECI](#)

[Form 1042](#), *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*

[Form 1042-S](#), *Foreign Person's Source U.S. Income Subject to Withholding*

[Instructions for Form 1042-S](#)

The International section of www.irs.gov