



What Foreign Buyers Need to Know When Buying or Selling Florida Real Estate

Citizenship/Residency, Federal Tax Requirements, FIRPTA, Tax Treaties

by:

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The Law Office of Kevin F. Jursinski and Associates often receives inquiries from foreign investors and local real estate agents asking for guidance in the purchase or sale of real estate in Florida. Due to our firm's background and extensive experience in real estate transactions, we are keenly aware of issues that face foreign investors in these situations.

Firm Background

The Law Office of Kevin F. Jursinski & Associates is a 35-year-old, AV-Preeminent Rated firm. Both Attorney Kara Jursinski Murphy and I are Florida Bar Board Certified in Real Estate Law, which means that the Florida Bar recognizes us as "specialists" and "experts" in this areas of law. I also hold two additional Board Certifications, Business Litigation and Construction Law.

Attorney Kara Jursinski Murphy also has a Masters of Law (LL.M.) in Real Estate Development, and Attorney Justin Mooney has a Master of Law (L.L.M.) in Taxation. In fact, Attorney Mooney wrote his Master's thesis on *International Tax Treaties entered into by the Unites States with Canada, Germany and Mexico as it relates to Real Estate Investing and Taxation*.

All three of us have assisted non-U.S. citizen clients who were interested in acquiring property in Florida and who faced challenges in that process. As you read this article, we hope that the points addressed will assist you in your particular situation.

Increasing interest in investment in Florida real estate, specifically in Southwest Florida

Both Lee County and Collier County are seeing rapid growth of population as more and more residents move to one of the most desirable areas in the country. For 2018, **U.S. News and World Report** (see link at the end of this article) identified Fort Myers, Florida as the second

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most desirable metro area for people to move to in the country. It was ranked number one in 2016 and 2017. Moreover, Fort Myers/Cape Coral has grown 14.6% over the last five years in net migration, which explains the major push to invest in Southwest Florida both for residential and commercial real estate investments.

Another reason that drives growth in our area is the elimination of write-offs by non-Florida residents of their local and state taxes from federal income tax, which has been eliminated by the recent Tax Act. Florida has no state or local income tax.

Along with the increasing interest in Florida real estate investments, is an increase in real estate purchases by non-U.S. citizens. A main reason they are buying here is because of the stability in this market over their other countries' economic markets.

However, along with the growth of foreign ownership of Florida real estate, whether as investors or part time residents, comes some issues for the Non-U.S. citizen. Many of these foreign investors, especially in Cape Coral, Fort Myers Beach and Bonita Springs, Florida, are purchasing waterfront properties for short term vacation rentals, which has its own attendant issues as far as state sales tax and local short term rental taxes ("Bed Tax"). It is important also to note that the IRS tax rules that apply to ownership and dispositions of U.S. real estate by foreign persons differ in certain aspects from the IRS rules that apply to U.S. citizens.

Looking for Guidance

Before we address the tax issue, it is imperative that other real estate fundamentals are addressed first. Since many of our real estate professional friends and clients have asked for some guidance on foreign investments, we have written and posted several articles on our website about this topic. For example, the article "**What Foreign Investors Need to Know when Buying, Selling or Leasing Florida Real Estate**" features information on purchasing Florida real estate for rental purposes, and it also addresses the local taxes on short term interim rentals as mentioned above. (See link at the end of this article)

Also on our website, we have an article titled "**Use of Business Entities and Acquisition of Real Estate Investments**"(see link at the end of this article) which recommends entities in which to hold real estate versus the foreign investor taking title in his/her individual name. The overarching theme in real estate investing is: Take title to the real property in an entity name when possible and *not* in your individual name.

The reason for this is because of *premises liability*. If there is an injury or death on the investment property and if it is held in the person's individual name, then that person is liable personally if there is a lawsuit and judgment that exceeds their insurance policy limits. That is fundamental real estate advice.

In this article, we will discuss the U.S. Federal Income Tax Rules that Florida real estate professionals must know in order to properly represent foreign investors acquiring real estate and to avoid certain personal liabilities for improper U.S. federal income tax compliance.

The first part of this article covers the rules that determine whether an individual or entity is to be treated as U.S. citizen/entity or foreign person or entity and what types of incomes are reportable to the I.R.S. The second part discusses federal tax filing requirements. The third part is the compliance with the Foreign Investment in Real Property Tax Act (“FIRPTA”) for sales by foreign persons of U.S. real property interests (“USRPI”), and the fourth part provides a synopsis of U.S. federal income estate and gift tax considerations.

I. TAX RULES GOVERNING RESIDENCY

A. U.S. Citizen/Resident versus Foreign Person

Generally, U.S. citizens and residents are subject to the same tax rules which include taxation of their worldwide income. Fortunately, the Internal Revenue Code (the “Code”) provides a different set of tax rules for non-resident, non-U.S. citizens. Under the Code, a non-resident alien is defined as an individual who is neither a U.S. citizen nor a resident. *See* IRC § 7701(b)(1)(B). If an individual is not a U.S. citizen, the next step is to determine whether they meet the residency requirement. The Code provides three avenues for a person to be treated as a resident: The Green Card Test, The Substantial Presence Test and Election.

1. The “Green Card” Test

If an alien has been admitted for U.S. permanent residence (i.e., has a green card) at any time during the calendar year, the alien is a resident of the United States and is taxed on his or her worldwide income, the same as a U.S. citizen.

Otherwise, U.S. immigration status generally is not controlling or relevant for U.S. federal tax purposes. In this respect, the U.S. differs from many foreign countries, in which immigration and tax status are integrated, a difference that frequently causes confusion.

2. The “Substantial Presence” Test

The U.S. does not subject foreign visitors to the comprehensive tax regime for citizens unless they spend significant time here. The threshold is outlined in the substantial presence test. IRC § 7701(b)(3). The two test questions ask:

- a. Did the individual spent at least 31 days in the U.S. during the calendar year?
- b. What is the total number of days the person spent in the U.S. this year and the prior 2 years?

If the answer is “YES” to the first question and “183 or more” to the second question, the person meets the substantial presence test, and are thus taxed like a U.S. citizen.

Please note that the number of days in the current year is counted at a 1:1 ratio while the preceding years’ days are reduced (1/3 and 1/6, respectively). For example:

John Schmidt was in the U.S. for all 366 days in 2016, 0 days in 2017, and 31 days in 2018. The days in 2016 are only counted as 61 ($366/6 = 61$). While Mr. Schmidt was a resident in 2016, his absence in 2017 and limited time in the U.S. during 2018 are not sufficient to reach the 183-day threshold.

Under the Code, there are exceptions to avoid resident treatment if the 183-day threshold is met, and exceptions to those exceptions. *See IRC § 7701(b)(3)(B)-(D)*. For example, if you are in the U.S. for 182 days and become hospitalized and unable to leave the country, the days accruing after such incident are not counted. *IRC § 7701(b)(3)(D)*.

3. Election

The Code provides an option for certain individuals to elect to be treated as U.S. residents. *IRC § 7701(b)(4)*. The individual may elect if he/she:

- a. Does not possess a green card;
- b. Was not a resident in the previous year;
- c. Will not meet the substantial presence test in the current year;
- d. Will meet the substantial presence test in the following year; and
- e. The person has been in the U.S. for at least 31 consecutive days.

If all elements are met, the individual may elect to be treated as a resident in the present year.

B. Foreign Corporations

A foreign corporation is a corporation that is not incorporated in the United States. The rules for other types of entities are more complex. The treatment of an eligible foreign entity for U.S. federal income tax treatment may be treated differently, depending upon the type of entity.

Example: A foreign corporation with a single owner may elect to be disregarded for U.S. federal tax purposes, or elect to be treated as a partnership if it has more than one owner. In either case, the resulting U.S. taxpayer is the owner or owners, who themselves may be foreign or domestic for U.S. federal tax purposes. Similarly, a foreign unincorporated entity might elect to be taxed as a foreign corporation for U.S. federal tax purposes.

II. FILING REQUIREMENTS

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A. Federal Taxpayer Identification Numbers and Reporting Requirements

If a non-resident is engaged in a U.S. trade or business, a tax return must be filed for that year. § 6012. Being “engaged in a trade or business” in the U.S. requires that income effectively connected with the same is treated as business income to a U.S. resident. IRC § 871(b) and § 882. *Effectively connected income* (“ECI”) is defined under IRC § 864(c) and generally includes income that is Fixed, Determinable, Annual, or Periodical (FDAP). FDAP encompasses almost all income except for gains from the disposition of real or personal property and items that are not included in gross income, such as tax-exempt bond interest.

There may not be a reporting requirement if there was sufficient tax withholding at the source, i.e., the connected tax liability was fully satisfied. Treas. Reg. § 1.6012-1(b)(2)(i) and 1.6012-2(g)(2)(i). However, if no return is filed, the non-resident may not claim deductions from their gross income for which they would have been eligible. IRC § 874(a), 882(c)(2), Treas. Reg. § 1.882-4.

Further, if a non-resident is taking a position based on a treaty provision which purports to override the U.S. tax law, a statement of such must be include with the taxpayer’s return. § 6114. These filing provisions are not exhaustive of all reporting requirements that a non-resident may face, as each foreign person will be different.

However, regardless of which IRS form that person files, each will likely need a Taxpayer Identification Number (“TIN”). The following examples include scenarios where a TIN is necessary:

1. Foreign buyers and sellers of real estate must provide their TINs on withholding returns, applications for withholding certificates, and other applicable elections made under § 897 and § 1445.

The buyer would withhold tax pursuant to § 1445 and remit it to the IRS. This requires the filing of Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interest*, and Form 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests (FIRPTA)*.

2. A request for reduction in FIRPTA withholding requires a TIN be include on Form 8288-B, *Application for Withholding Certificate for Disposition by Foreign Persons of U.S. Real Property Interests*. A Form 1040-NR, *Nonresident Alien Income Tax Return*, must also be completed to claim the reduction.
3. A foreign corporation holding an interest in U.S. real property may elect under IRC § 897(i) to be treated as a domestic corporation for FIRPTA reporting. This will also allow the foreign corporation to take advantage of certain non-

recognition provisions of the Code otherwise unavailable to such foreign entities. For example, a § 351 property-stock exchange to a corporation does not result in a taxable transaction.

To avoid delaying a real estate transaction, it is recommended to apply for a TIN in advance. *Please note that the application and assignment of a TIN will not subject a taxpayer to be classified as a U.S. resident.*

B. Obtaining Taxpayer Identification Numbers

Generally, a foreign person would apply for an Individual TIN (“ITIN”) using Form W-7, *Application for IRS Individual Taxpayer Identification Number*. Foreign entities will use the Form SS-4, *Application for Employer Identification Number*. To reiterate the discussion above, having an ITIN will allow the person to request a reduced tax liability based on their circumstances, such as available deductions.

On this point, we suggest that you consult with your own personal tax advisor or CPA or contact us, and we can put you in touch with a CPA who specializes in assisting foreign investors and addressing FIRPTA matters.

C. Denial of TIN Applications

Please note that the IRS may deny a TIN application if a need for such number is not demonstrated. Thus, ensure that the proper box is checked on Form W-7. For example, checking box “h” and entering “Exception 4” next to it will be appropriate for U.S. real property dispositions by foreign persons. See the instructions for Form W-7 for additional exceptions.

In the event the IRS denies a TIN application, the IRS will issue a rejection letter (Letter 3793 SC/CG) along with instructions for resolving the issue. When reapplying for Exception 4, this letter must be included along with Form W-7.

D. Partnerships & Trusts

For partnerships, Form 8804, 8805, and 8813 must be used to report a foreign partner’s share of ECI, which, as detailed in a prior section, generally consists of all income resulting from engaging in a trade or business in the U.S. For publicly traded trusts and real estate investment trusts, Forms 1042 and 1042-S must be filed to report the income and withholding of foreign persons.

E. Form 1099-S, Proceeds From Real Estate Transactions

During the closing of a real estate transaction, the broker will report the sale on Form 1099-S. For withholding purposes, it must be indicated on the form if the transferor is a foreign person.

F. Practical Considerations

While certain tax treaties may provide relief for U.S. income taxes of residents through exemptions or foreign tax credits (“FTC”), additional administrative costs may rise with increased reporting requirements. A significant concern is the requirement of U.S. citizens and residents to file Foreign Bank Account Reports (“FBAR”) for non-U.S. bank accounts valued at \$10,000 or more. The failure to file an FBAR can result in civil penalties between \$10,000 or 50% of the amount in each account. Please note that a penalty may be applied for each account, each year.

III. FIRPTA & USRPI

A. Foreign Investors in U.S. Real Estate

You won't need your citizenship or a green card, but you will need an Individual Taxpayer Identification Number (ITIN). That's a tax-processing number assigned to foreign nationals who are required to have a U.S. taxpayer identification number but do not have one and are ineligible for Social Security numbers.

All-cash purchases are permitted, but U.S. law mandates that cash transactions over \$10,000 be reported to the federal government. The requirement for reporting may involve everyone connected to the transaction (purchaser, real estate agents, attorneys and title companies). The government wants to know how you earned the money and that it was legally obtained. Cash buyers can potentially save money on mortgage application fees, loan origination fees, appraisals and title insurance.

On Form W-7 you will be required to give a valid reason for your application. Depending on your nationality, you may also need a valid foreign passport, visa and two or more current photo identifications, such as a driver's license.

Former President Barack Obama signed into law a measure easing a 35-year-old tax on foreign investment in U.S. real estate, potentially opening the door to greater purchases by overseas investors, a major source of capital infusion into our economy after the financial crisis.

Contained in the \$1.1 trillion spending measure, which was passed to avoid a government shutdown, is a provision that treats foreign pension funds the same as their U.S. counterparts for real estate investments. The provision waives the tax imposed on such investors under the 1980 Foreign Investment in Real Property Tax Act, known as FIRPTA.

“FIRPTA has historically made direct investment in U.S. property a non-starter for trillions of dollars-worth of foreign pensions,” said James Corl, a managing director at private equity firm Siguler Guff & Co. “This tax-law modification is a game changer” that could result in hundreds

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of billions of new capital flows into U.S. real estate. The concept of encouraging foreign investment and legal immigration in the United States has been embraced by current President Donald Trump, who has reached out to numerous foreign investors to encourage investment in the U.S.

B. Intended Use of Real Estate

We advise our real estate professionals that are assisting foreign investors to first find out what the intended use of the property will be by that foreign entity:

1. Is it an investment for rental?
2. Is it an investment as a vacation home without rental purposes (used only by the foreign person or family)?
3. Is it an investment as an eventual long-term residence?
4. Is it an investment as residence for their children, who may be attending college in the U.S.?

By determining the primary use for your property and how long you plan to own it, you'll be able to provide information to your real estate agent and your real estate attorney that will help guide the search and sale. Foreign buyers are eligible to buy single-family homes, condominiums, duplexes, triplexes, quadraplexes and townhomes. Housing cooperatives or "co-ops" often have rules prohibiting foreign ownership. That's because co-ops generally require that a buyer's source of income be from the United States and that most of the majority of the buyer's assets be kept in the U.S.

However, keep in mind that simply buying real estate in the United States does not give foreign owners any rights or privileges regarding legal stay or status. If you're interested in staying in the U.S. longer than allowed by a standard visa, contact an immigration lawyer.

Foreign investors can purchase property directly - in their own names - or through some sort of business entity, such as a domestic corporation, foreign corporation, limited partnership, joint venture, real estate investment trust or limited liability company.

How the property will be used should play into your decision. Additionally, the structure through which you purchase your property can have dramatic tax consequences. All-cash purchases are permitted, but U.S. law mandates that cash transactions over \$10,000 be reported to the federal government. The requirement for reporting involves everyone. Your real estate attorney and/or accountant should be able to provide counsel concerning your options.

C. Citizenship Through Foreign Investment – EB5 Visa

The EB5 Visa Program is an outstanding foreign investment opportunity that not only is a way to invest in the United States, in both business and real estate, but it also offers a path to citizenship. It's an investment program combined with a preference for a visa for qualified foreign investors which again has been solidly embraced and advanced by the Trump Administration, with surprising bipartisan support from both Republicans and Democrats, who have agreed and acknowledged this concept. On May 5, 2017, President Donald Trump approved a renewal of the EB5 Visa Program as part of the first major piece of legislation of his administration. This signaled President Trump's support of legal immigration for those foreign nationals who want to come to the United States and invest in this country and create jobs.

The EB5 Visa Program provides for significant foreign investment that benefits our U.S. economy and creates jobs. The nature of the EB5 Visa Program is far more detailed in its scope than this article can encompass, but several interesting articles on EB5 Visa Programs can be found online. We've provided a link in our reference list at the end of this article to the government's webpage.

D. How Do Foreign Investors Secure Financing?

This is a question that our office often hears from our real estate partners assisting foreign buyers in acquiring real estate. Due to high risk for lenders engaging in real estate transactions in Florida involving non-U.S. citizens, these mortgage loans may have a higher rate than conventional financing for U.S. citizens.

For example, the FHA will not even fund an ITIN mortgage loan. FHA requires a social security number and legal citizenship in order to obtain a mortgage so that avenue is closed for foreign investors. Many other lenders are reluctant to loan to foreign persons since they don't have the experience or interest in such business.

Before a foreign person applies for a U.S. mortgage, they must first establish credit and earn a good credit score. You can start building your credit score by opening U.S. bank and credit card accounts. You'll also want to be sure to report all income on your tax returns. Lenders use this income information to determine how much money they are willing to loan you to buy a home.

From our experience, it is generally an accepted rule of thumb that qualified foreign buyers with a 30 to 40 percent down payment can often obtain financing for their Florida real estate purchases. Some of the lenders we deal with require foreign persons acquiring Florida real estate to also have a specific amount (sometimes \$100,000 or more) on deposit with the bank while others cap loan limits at \$1 million or \$2 million. The foreign person may also be required to present a minimum of three months of bank statements to document their financial wherewithal.

The U.S. home loan market offers an array of safe, affordable mortgages, including some that will allow Muslims to buy a home without violating Islamic laws against paying interest should that be an issue of concern.

When the time comes to apply for a mortgage on your Florida investment, our experience has been for the foreign person to consider major banks with global operations. These lenders will have the experience necessary to verify credit established in other countries and to guide you through the U.S. home-buying process. However, we have been pleasantly surprised by some local regional banks who have been willing to engage in lending to foreign persons. Although all of this requires compliance with the aforementioned IRS regulations and some due diligence.

E. How the U.S. Real Estate Market Works

Prior to acquiring Florida real estate, foreign persons need to recognize that the way U.S. real estate transactions are carried out may differ from their home country. For acquisitions in Florida, a purchaser must submit and have executed by the Seller, a real estate contract identifying the key points in the real estate transactions. The standard accepted statewide contract is the Florida Bar/Florida Board of Realtors contract form, often referred to as the “FARBAR”.

Certain geographic areas have their own specific accepted contract, such as in Naples, Florida where agents generally use the Naples Area Board of Realtors contract form “NABOR” for purchase in Collier County.

Our firm highly recommends that any foreign purchaser be represented by qualified real estate counsel, and we suggest consulting with our attorneys for any acquisition of real property in Florida. Our firm can assist with drafting of the contract, negotiating the terms, reviewing and issuing title insurance and closing the transaction. Our fees are quoted as a flat fee based upon each particular transaction. More information about our firm can be located on our website in the Real Estate section.

IV. TAX LIABILITY CONSIDERATIONS

There are certain tax implications that are applicable in the acquisition of Florida property that are worth noting. They are Home Country Tax Liability and the U.S. Estate Tax Liability.

Currently, the U.S. has tax treaties with over 60 countries. If the alien is from a country that has an income tax treaty with the United States, the treaty may act to change these results, subject to certain required filings with the IRS, to claim the treaty benefit.

Note: For a majority of our firm’s foreign investors, those from Germany and Canada, there are tax treaties in place. Please use the contact information at the end of this article if you would like us to assist you with specific information on the tax treaties in place affecting Canadian and German residents. As indicated, Attorney Justin Mooney has written an article specific to tax

treaties between the United States and Canada and also with Germany which has bearing on key questions facing the citizens of those countries.

A. Home Country Tax Liability

A foreign property owners' tax liability in his home country will vary depending upon where the purchaser is from and whether that country has a tax treaty with the United States (see discussion above regarding consulting with our office on those particular tax treaties and how it affects your purchase).

Our firm may also suggest that you consult a tax attorney familiar with your home country's treaty or tax laws to get answers to tax-related questions affecting your particular situation.

The United States government requires that foreign nationals pay U.S. income taxes (state and federal) on any net income (rental revenues less expenses) received from rental property. If tax returns are not filed in a timely fashion, a tax of 30 percent of the gross rental income may be assessed, in addition to other applicable interest and penalties.

Even if you're incurring losses in the early years of your investment and you don't owe any taxes to the government, you still must file your tax returns in a timely manner or be subject to financial penalty. Our office can help you sort through this requirement.

B. U.S. Estate Tax Liability

For the 2018 tax year, an estate of a non-married U.S. citizen or resident with \$11,180,000 in assets may pass tax-free to the beneficiaries. However, the estate of a non-resident foreign individual will be taxed on its U.S. situs assets if those assets exceed a value of \$60,000. The rate of tax applied to the excess value is 40%. Thus, estate tax considerations are necessary when contemplating the implications of § 7701(b) and the U.S. person classification.

Please note that the estate tax due may be mitigated if the U.S. has an estate tax treaty with the individuals country of residence. As of the date of this article, the U.S. only has 15 estate tax treaties, significantly less than the 60+ income tax treaties in place.

Summary:

This is an overview of certain of the issues facing foreign persons investing in real estate in Florida. We are here to help. Please feel free to call or email us and we can provide further information:

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Disclaimer as to legal advice

Please consider the above article as a general discussion of issues surrounding acquisition of real estate in Florida by foreign persons. Each particular real estate transaction is unique. The information contained in this article and the suggested links to other articles is intended as general guide for the foreign person to get a general overview of the investment process in acquiring Florida real estate.

Given the changing nature of laws, rules and regulations, and the inherent hazards of electronic communication, there may be delays, omissions or inaccuracies in information contained in this transmission or in accessing some of the links provided.

This article should not be relied upon as legal advice on acquiring real estate nor on tax advice provided to the reader but only as general and not specific information in regards to foreign persons acquiring real estate in Florida.

Before making any decisions, it is suggested that the reader retain appropriate legal or tax counsel to provide specific advice on their particular issue and not intended to provide specific legal advice to any particular reader of this article on his/her specific situation.

Reference List:

U.S. News and World Report. May 18, 2018. The 25 Best Places People are Moving to in 2018.

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Kevin F. Jursinski & Associates website, Real Estate Section. <https://www.kfjlaw.com/practice-areas/real-estate-law/>

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