

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **200522020**

Release Date: 6/3/2005

CC:INTL:B04:TPerry

PRENO-115487-05

UILC: 1445.00-00, 1445.01-00, 897.00-00, 897.02-00

date: May 02, 2005

to: Mr. Fred Dulas
Revenue Service Representative
(Large & Mid-Size Business)

from: Mr. Robert W. Lorence, Jr.
Senior Counsel, Branch 4
Office of Associate Chief Counsel (International)

subject: Transfer of Options to Purchase Real Property by Foreign Persons

This Chief Counsel Advice responds to your request for assistance on March 22, 2005. This advice may not be used or cited as precedent.

ISSUE

Whether withholding tax is required under § 1445 when a nonresident alien individual disposes of an option to acquire a U.S. real property interest before exercising the option?

CONCLUSION

Yes, under Treas. Reg. § 1.1445-1(b)(3)(iii), a transferee of an option to acquire a U.S. real property interest must deduct and withhold a tax equal to 10% of the amount realized by the transferor upon the disposition.

FACTS

In the Florida real estate market, some nonresident alien individuals have acquired options to purchase U.S. real property interests and sold the options before

exercising the options and taking title to the underlying property. The transferees of the options (often real estate developers) are not withholding tax on amounts realized from the sale of the options under § 1445(a).

LAW AND ANALYSIS

Under § 897(a), gain or loss of a nonresident alien individual or foreign corporation from the disposition of a U.S. real property interest is subject to U.S. tax as if the gain or loss were effectively connected with the conduct of a U.S. trade or business. Under § 1445(a), if a foreign person disposes of a U.S. real property interest, the transferee of such interest is required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition.

Under § 897(c)(1)(A)(i), a U.S. real property interest includes an interest in real property located in the United States. Section 897(c)(6) provides that an interest in real property includes "...options to acquire land or improvements thereon, and options to acquire leaseholds of land and improvements thereon." Treas. Reg. § 1.897-1(d)(2)(ii)(B) provides "an option, a contract or a right of first refusal to acquire any interest in real property (other than an interest solely as a creditor) will itself constitute an interest in real property other than solely as a creditor." As a result, an option to acquire an interest in real property located in the United States is itself a U.S. real property interest subject to tax under § 897 upon its disposition.

Treas. Reg. § 1.1445-1(b)(3)(iii) provides that the transferee of an option to acquire a U.S. real property interest must deduct and withhold a tax equal to 10 percent of the amount realized by the foreign transferor upon the disposition. (Section 1.1445-1(b)(3)(iii), however, does not require withholding upon the initial grant of an option). Thus, the withholding tax under § 1445 applies when a foreign transferor sells an option to another person for consideration. Under § 1461, transferees of the options are liable for the tax if they fail to withhold.

Please call Tracy Perry at (202) 622-3860 if you have any further questions.

Robert W. Lorence, Jr.
Senior Counsel, Branch 4
Office of Associate Chief Counsel (International)