IRS Nationwide TaxForum | 2018

Nonresident Aliens (NRAs) and U.S. Real Estate Investments

Nationwide Tax Forums

2018

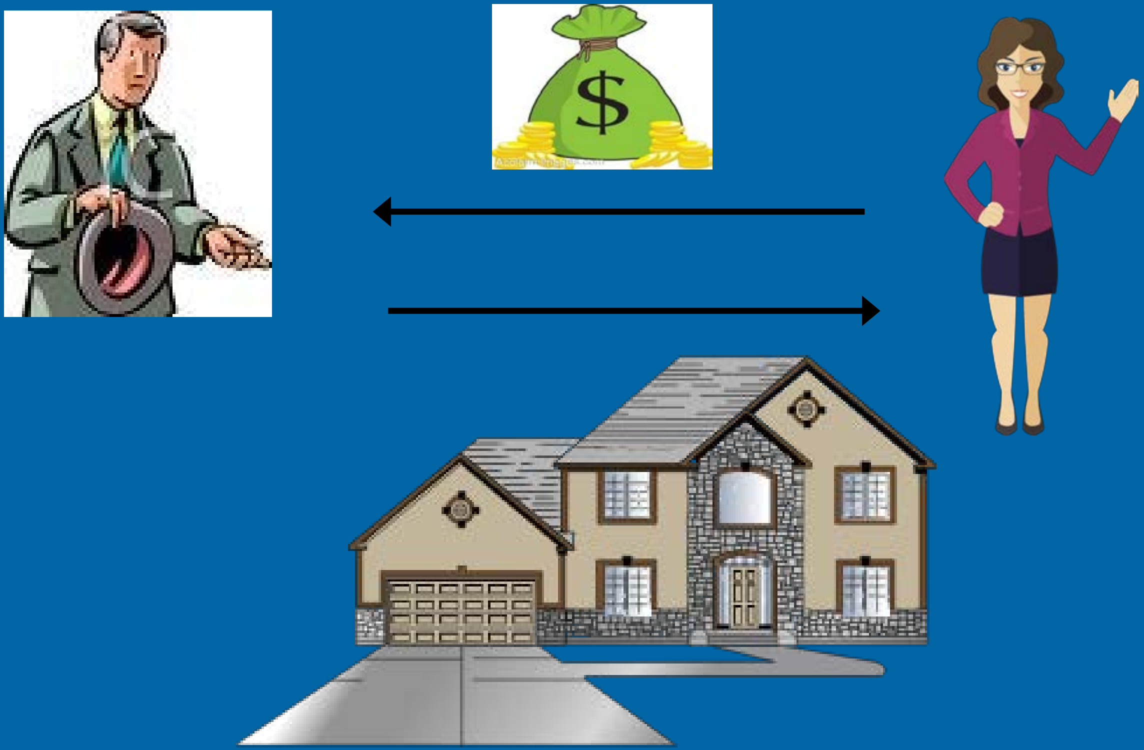
Life Cycle

Purchase → Holding Period → Disposition

Purchase of Real Property

Seller-Transferor

Foreign Buyer-
Transferee



Purchase of Real Property (cont'd)

- The United States does not impose tax or filing obligation on the acquisition of U.S. real property by an NRA
- U.S. tax is imposed on income earned during the ownership/rental phase of U.S. real property
- An Individual Taxpayer Identification Number (ITIN) should be obtained during the purchase phase for anticipated tax reporting requirements
- Use of LLCs and other entities

Rental Income from Real Property

- NRAs are generally taxed on 2 categories of income:
  - U.S. source fixed or determinable annual or periodical (FDAP) income (that is not effectively connected with a U.S. trade or business) – subject to U.S. tax at a 30% rate
  - Effectively connected income (ECI) – taxable at graduated rates on a net basis

Rental Income from Real Property

- Taxation of rental income depends on whether it is characterized as FDAP (passive investment income) or ECI
- Rental income as FDAP
  - Withholding at 30%
  - Form W-8BEN
- Rental income as ECI – either:
  - Must be engaged in a U.S. trade or business (USTB); or
  - Make election under IRC §871(d) to treat rental income as ECI.
  - Form W-8ECI

Rental Income from Real Property (cont'd)

- Election to treat income from real property as ECI
  - The election allows the NRA's income from U.S. real property, net of deductions properly allocated and apportioned to such income, to be taxed at graduated rates
  - Election remains in force for subsequent years and can only be revoked with the consent of the IRS
  - The election is made by attaching a statement (as described in Treas. Reg. §1.871-10) to the NRA's tax return.

Rental Income from Real Property (cont'd)

Return Filing Requirements

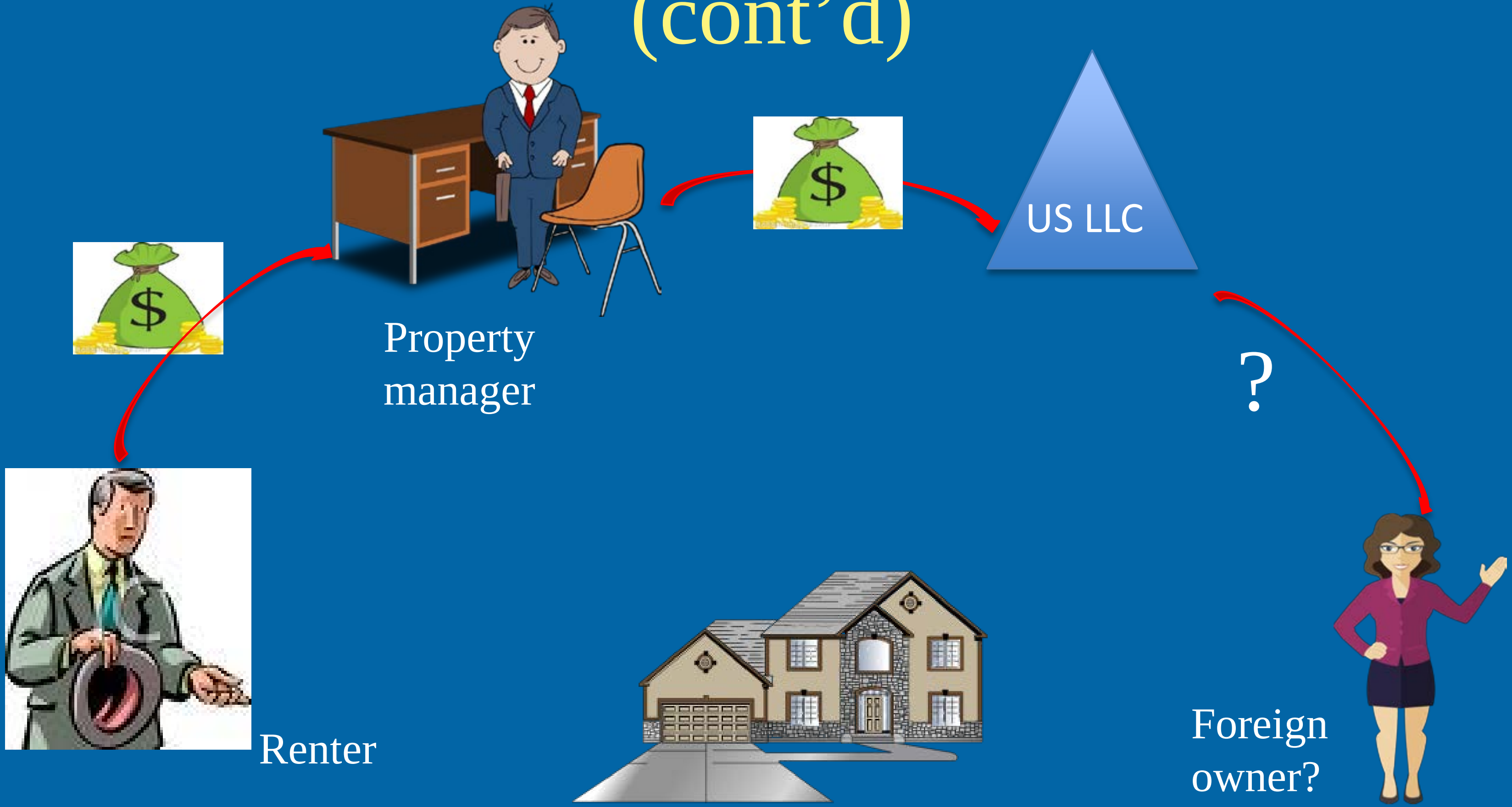
- If NRA is not engaged in a USTB during year and all tax fully withheld at source, no U.S. tax return required
- U.S. tax return is required if:
  - Tax liability is not fully satisfied by withholding
  - NRA is engaged in a USTB, even if the NRA has no income that is effectively connected with that USTB, no U.S.-source income, or his or her income is exempt under an income tax treaty or the Code
- Form 1040NR, Schedule NEC - If not ECI
- Form 1040NR, Schedule E - ECI

Rental Income – Failure to File

- A nonresident who fails to submit a timely filed income tax return (as determined under Treas. Reg. §1.874-1) loses the ability to claim deductions and credits against his income, including rental income, causing the gross rents to be subject to the 30 percent tax

Withholding Agent Responsibilities

Withholding Agent Responsibilities (cont'd)



Disposition of Rental Property

Foreign Seller-
Transferor

Foreign or Domestic
Buyer-Transferee

WH Agent

Section 1445 Withholding

Generally requires:

- Buyers to withhold 15% of the amount realized from foreign persons' dispositions of USRPIs,
- Foreign corporations to withhold 21% of the gain recognized on certain distributions of USRPIs, and
- Certain investment entities (e.g., REITs) to withhold 21% of the amount distributed to foreign persons that is attributable to gains from USRPIs.

Components of FIRPTA

- Disposition
- U.S. Real Property Interest (USRPI)
- Foreign Person (IRC § 897(a))

FIRPTA Withholding Forms

Forms:	Filed by:
▪ **Form 8288** – U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests	Buyer-Transferee
▪ **Form 8288-A** – Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests	Buyer-Transferee
▪ **Form 8288-B** – Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests	Seller-Transferor or Buyer-Transferee

Note: A TIN is required with the filing of each of these returns.

Seller/Transferor Filing Responsibility

- Files Form 1040NR
  - Reports gain/loss from disposition on Sch. D and/or Form 4797
  - Reports withholding and attaches IRS Stamped copy B of Form 8288

- Issues relevant to reporting gain/loss
  - Costs of sale
  - Computation of adjusted basis
  - Depreciation recapture

Partnership Disposition

- If a non publicly traded partnership with foreign partners disposes of a USRPI, the partnership:

  - Must withhold under §1446 on the amount of gain recognized that is allocable to foreign partners at 21% for foreign corporate partners, and 37% for all other foreign partners.

Partnership Interest - Disposition

- Subject to FIRPTA tax to the extent the gain is attributable to a USRPI (IRC § 897(g)).

- If 50% or more of the partnership's gross assets consist of USRPIs, and 90% or more of the value of the partnership's gross assets consist of USRPIs plus cash or cash equivalents, then –
  - Full amount of gain recognized is subject to withholding under IRC § 1445(e) (5), but
  - Amount taxable under IRC § 897 is limited to the gain recognized that is attributable, under IRC § 897(g), to USRPIs (§1.897-7T(a)).
- Sections 864(c)(8) and 1446(f) may apply if the partnership is engaged in a trade or business in the United States and has assets other than USRPIs.

IRS Publications and Additional Resources

- Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*
- Publication 519, *U.S. Tax Guide for Aliens*
- Publication 527, *Residential Rental Property*

IRS Publications and Additional Resources

- Publication 946, *How to depreciate property*
- International Tax Topics – IRS.gov
- Practice Unit "*Overview of Withholding under FIRPTA for Sales by Individuals*" – IRS.gov

Questions