

# What Foreigner's Need to Consider Before Buying Real Estate In the United States



We are licensed by the state of California to help individuals, corporations, or groups of people buy and sell real estate in California. We make use of the most advanced tools on the market to identify properties for purchase. This insures our clients have the best opportunity at identifying the best properties at the best prices for purchase. We facilitate all phases of the real estate transaction for our client from purchase to close. In this document we discuss what foreign buyers need to consider when buying real estate in America. One of the most common crossroads faced by foreign buyers of U.S. real estate is deciding how to take title of the property being purchased. The obvious answer is “*in my own name,*” but there are many variables to consider in structuring your U.S. real estate acquisition.

If foreign buyers do take title in their name, the good news is that when they decide to sell their property, the gain will be taxed at the long-term capital gains rate of 15 percent, assuming the property was held for more than a year. However, when it comes to estate taxes, the foreign buyer who holds the title in his name is taking a significant risk because if he passes away while owning U.S. real estate, the entire value in excess of \$60,000 is going to be subject to a tax at rates as high as 45 percent.

For U.S. tax residents, green card holders and American citizens, it's a different story. The current standard exemption for U.S. citizens and resident aliens is \$2 million. So if the value of their assets is less than \$2 million at the time of death, they will not be subject to the U.S. estate tax. Also, the U.S. citizen and green card holder can pass on all assets to their spouse's estate tax-free.

There are additional risks surrounding foreigners owning rental property. Anyone who owns U.S. real estate that is operating as a rental property is entitled to take a tax deduction for depreciation, mortgage interest, property taxes, expenses of management and repairs, etc. The benefit is that income tax is only paid on the net rental income, assuming that there is a profit after the deduction of all of the rental expenses.

## **Net Election**



Foreign owners of U.S. rental property face a more complex issue. As long as they file their income taxes to report the rental activity (income or loss) in a timely manner, they are entitled to make a special election called the “net election.” This election allows them to

report the rental income net of all property related expenses (interest, taxes, maintenance, depreciation, etc.). However, if a non-U.S. person does not file their income taxes timely, they lose the opportunity to make the “net election” and will be subject to a federal income tax of 30 percent of the gross rent with no deduction for any business expenses. So a foreign owner of U.S. rental real estate who has not been filing his tax returns because he is losing money and does not see the value or need to file annual income tax returns is in for a rude awakening. Even worse, when they sell their real estate, they will not be entitled to use any of those prior losses to reduce the gain on sale since they were not properly reported to the IRS. This is a harsh law but it is how the IRS enforces tax compliance.

## Foreign Investment Real Property Tax Act



There are a many tax issues facing the foreign buyer of U.S. real estate. Yet, with proper tax planning and compliance taking into consideration both income tax and estate tax issues, the result can and will be tax efficiency and ultimately a greater return on your investment.

On the flip side, selling real estate in the U.S. presents another set of rules. Similar to purchasing real estate, there are many variables and rules that nonresidents need to be aware of in order to avoid common pitfalls.

The overriding law is FIRPTA, the Foreign Investment Real Property Tax Act. Under FIRPTA, when a foreign person sells their U.S. real estate, the closing agent or title company will deduct and withhold 10 percent of the gross sales price from his/her proceeds and send it to the Internal Revenue Service. Congress created FIRPTA as a way to prohibit foreigners from taking profits made from the sale of their U.S. real estate back to their native county without paying U.S. income taxes. The 10 percent withholding is intended to ensure that the IRS collects the income tax upon disposition of such interests.

Whether a property is residential or commercial, parties involved with the sale, such as a title company or closing agent (usually an attorney), are required to ask about whether or not the seller is a foreign person. And because the U.S. differs from many foreign countries by integrating immigration and tax status, it is extremely important to understand how FIRPTA defines a foreigner to avoid confusion.

According to FIRPTA, a nonresident alien individual is defined as a person who is neither a U.S. citizen nor a resident of the United States. The code bases this on two tests: the green card test and the substantial presence test.

- The **green card test** states that once an individual receives their green card, they are deemed to be a resident of the United States and will be taxed on his or her worldwide income, the same as a U.S. citizen.
- Under the **substantial presence test**, a foreign individual will be considered a resident for U.S. federal tax purposes if he or she is physically present in the U.S. for 183 days or more during the current calendar year.

If the seller does not have a green card, is not a U.S. citizen and does not meet the substantial presence test, then he or she will be subject to the FIRPTA withholding. The closing agent has 20 days after closing to report and pay the tax to the IRS on Form 8288.

If the seller determines that the 10 percent FIRPTA withholding is more than their true tax liability, they have the option of filing an application with the IRS to request a reduced withholding. If all of the information is properly presented to the IRS, the IRS will generally comply and reduce the amount to be paid by the withholding agent. The balance can then be returned to the seller.

There are exceptions to be aware of as well. The most common one is that if the buyer purchases the property with the intent of using that property as their primary residence and the sales price is less than \$300,000, no withholding is required. The buyer must plan 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 purchase.

Although there are many rules and regulations pertaining to the sale and disposition of property in the U.S., they don't have to be confusing. Whether you are buying or selling, consult with a tax professional as well as a real estate attorney to ensure that you do not make any expensive mistakes.

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Best regards,

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