

FIRPTA Issues in §1031 Exchanges

The Foreign Investment in Real Property Transfer Act (IRC §1445 & Treasury Regulations §1.1445), more commonly known as “FIRPTA”, is a federal law that requires withholding on dispositions of U.S. real estate by “foreign persons,” defined as a nonresident alien individual, a foreign corporation that does not have a valid election under section 897(i) to be treated as a domestic corporation, a foreign partnership, a foreign trust, or a foreign estate. The law imposes an obligation upon a transferee (buyer) of any interest in the real estate to withhold 15% of the sale price (10% if a personal residence with a sale price of \$1 Million or less).

However, if the sales price is under \$300,000 and the transferee intends to reside in the property no withholding is required. There is a separate 30% withholding of income paid to Foreign Persons, which affects interest earnings on the exchange funds (but any interest withholding is generally done by the bank). The buyer (or designated withholding agent) is obligated to withhold 15% of the sale price of the real estate (10% if a personal residence with a sale price of \$1 Million or less) and send it to the IRS within 20 days after the date of the transfer.

Withholding Certificate. Withholding can be delayed, reduced, or eliminated if the Exchanger applies for and receives a Withholding Certificate (IRS Form 8288-B). The application for a Withholding Certificate must be submitted to the IRS on or before the Relinquished Property closing, along with a copy of the Replacement Property contract. The Exchanger must give a copy of the application to the withholding agent. Withholding is still required at 15% of the sale price of the real estate (10% if a personal residence with a sale price of \$1 Million or less), but the filed application permits the withholding agent to hold the withheld amount until the IRS makes a final determination. The IRS must act upon an application within 90 days. If the IRS declines to grant the exemption, payment of the withholding must be sent to the IRS within 20 days after receipt of the IRS’ notice of determination.

If the Withholding Certificate is not received prior to the purchase of the Replacement Property, the Exchanger will not have use of the withheld funds. Unintentional boot caused by withholding can be avoided if the Exchanger contributes sufficient additional cash into the escrow or exchange account to cover the applicable withholding amount so that the full 100% of the sale proceeds will be available to buy Replacement Property. It is possible to use all of the exchange funds and have a full deferral without adding cash, but advance planning is necessary to allow sufficient time to receive the Withholding Certificate.

Simultaneous (Concurrent) Exchange with NO Boot. If the Exchanger does a simultaneous exchange and there is absolutely no boot (including no debt relief), withholding is not required, but the Exchanger must provide the Buyer (other party to the exchange) with a signed “FIRPTA Notice of Non-Recognition Transfer” prior to the closing. The IRS does not require a particular form, but the Notice must include certain information. The buyer may rely upon the Notice unless they have actual knowledge that the facts stated are untrue (for example, if the closing statements indicate that there will be some form of boot). The buyer must send the Notice of Non-Recognition Transfer to the IRS not later than 20 days after the date of transfer. The Exchanger should provide a copy of the Notice of Non-Recognition Transfer to the QI.

It should be noted this only applies in a real property swap between two parties where there is no boot. Regulation 1.1445-2(d)(2)(iv) provides that the FIRPTA Notice of Non-Recognition Transfer cannot be used 1) if any boot will be received by the taxpayer or 2) where the transferee (party acquiring the relinquished property) cannot determine that the exchange has been completed and all the conditions for the exemption have been satisfied (there is no boot). A same day sale of the Relinquished Property to one party and the purchase of the Replacement Property by another party does not satisfy this requirement. The buyer of the Relinquished Property is not a party to the purchase of the Replacement Property.

Other Required Documents. The foreign Exchanger must provide the QI with an IRS Form W8-BEN (in lieu of a Form W-9) that discloses the Exchanger’s Individual Tax Identification Number (ITIN). An ITIN can be applied for on IRS Form W-7. IPX1031 will not disburse any funds (regardless of withholding) on behalf of a Foreign Person Exchanger who does not have an ITIN.