

**UNDERSTANDING THE ISSUES FACING
FOREIGN INVESTORS IN U.S. REAL PROPERTY**

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Foreign buyers have long found real estate in the United States to be an attractive investment. Florida has had a particular appeal during the past half century because of its weather, beaches, tourism, rental market, and . . . since 1971 . . . Mickey Mouse! The level of foreign investment in Florida has waxed and waned over the years depending on a number of fluctuating variables such as currency exchange rates, competition from other vacation destinations for Europeans (such as Spain, Turkey, and Italy), changes in tax structures and treaties, immigration laws, travel concerns, health care issues . . . and of course, the Great Recession. Currently, however, surveys show that foreign investment in U.S. is hot and getting hotter. The latest data from the National Association of Realtors confirms that Florida is one of the major U.S. destinations of international residential real estate buyers. Approximately 25 percent of foreign home buyers in the U.S. purchase property in Florida, with the Bradenton-Sarasota-Venice area ranking 4th in the state as the preferred destination. In the 12 months ended June 2014, the dollar value of purchases of non-resident foreigners buying property in Florida was estimated at approximately \$7.97 billion, an increase from the previous 12-month period's level of \$6.43 billion. Nationally, five countries (Canada, China, Mexico, India, U.K.) accounted for 54 percent of foreign sales. Here in Florida, we know that the largest percentage of our foreign buyers hail from Canada, followed by Western Europe and Latin America.

As an accountant, you are very likely to encounter foreign nationals in your profession, particularly if you have relationships with real estate brokers and associates who may seek assistance from you in connection with the purchase or sale of real estate by a non-U.S. investor. The typical foreign buyer has a general knowledge of the fact that there are U.S. laws and procedures which he or she will need to consider and follow, but foreign buyers are often uncertain as to the specific issues with which they must deal. Even when a buyer is aware of the applicability of a particular legal requirement or limitation (such as the desirability of not qualifying as a U.S. resident under the "substantial presence test"), he or she will often be misinformed as to the specifics of that requirement or limitation.

The U.S. laws that specifically govern the foreign real estate investor started to appear on a large scale in the late 1970's. Increases in U.S. real estate ownership by non-U.S. persons reached such significant levels during the 1970's that numerous Federal and state laws and regulations were adopted, and existing laws were "reformed," to measure, tax, study, and regulate this phenomenon.

This article will focus on the basic issues which every foreign national who becomes the owner of U.S. real estate (whether directly or indirectly) needs to address. Emphasis will be placed on how these issues impact you as you seek to represent and advise your client in connection with the purchase, ownership, and eventual sale, of real estate. The goal of this material is to help make you an informed and knowledgeable accountant who understands the needs of his or her prospective foreign buyer or seller, so that you will be more successful in satisfying those needs.

Branches of the Decision Tree: How to Take Title

One of the most significant decisions faced by a foreign real estate purchaser is how to take title. The choices include: ownership in one's individual name or with one's spouse or other family members, ownership in a U.S. corporation or a corporation organized outside the United States, or the use of another type of legal entity such as a partnership or trust. The factors which influence this decision should be analyzed before a contract offer is even submitted, so that the ultimate buyer is properly named in the contract. An assignment of the contract by the buyer after it is signed, even if permitted by the terms of the contract, creates the potential for problems. Mortgage financing contingencies and condominium association approval requirements are just two examples of contract conditions that must be exercised by the correct buyer. Waiting too long to determine the best way in which to take title can, at best, result in delays while corrective action is taken with the lender and the condominium association and, at worst, result in an unintended waiver by the buyer of those types of contract contingencies.

The factors which bear on this decision are many and can be complex:

U.S. Estate and Gift Taxes

Generally, property having a U.S. situs that is owned by a foreign individual at his or her death is subject to United States estate tax. All real property, and some personal property, located in the U.S. is deemed to have a U.S. situs for this purpose. Because U.S. estate tax rates are so high (with the maximum rate currently being 40%) and the estate tax credit for foreign persons so low (absent a favorable treaty, only \$60,000 of a foreign decedent's estate will be exempt from tax, as compared to \$5,430,000 as of January 1, 2015, for a U.S. resident or citizen), structuring the ownership vehicle to avoid these estate taxes is usually a high priority.

Real property held by a foreign married couple as tenants by the entirety (the most common way in which U.S. husbands and wives take title) can cause the property to be taxed twice for estate taxes in

the U.S. . . . once in the estate of the first to die, and then again when the second spouse dies. This is due to the fact that foreign persons are generally not entitled to the benefit of the marital estate tax exemption available to U.S. citizens. Consequently, property passing to a spouse at death is fully taxable, unless provided otherwise by an applicable foreign tax treaty. In addition, there is a tax rule that causes 100% of the value of property owned by non-U.S. citizen spouses to be included fully in the estate of the first spouse to die, except to the extent the surviving spouse can prove contribution of independent funds toward the acquisition of the property. We can refer to this as the “joint property tracing rule.” The harsh result of double taxation can be minimized, though not eliminated, by some relatively simple pre-closing planning. If the husband and wife can document, through the use of separate checks or comparable means, that they have contributed equally and individually to the purchase price of the property, the value of the property included in the estate of the first to die is cut in half.

As illustrated above, ownership in one's individual name can result in U.S. estate tax for a foreign investor. However, he or she may opt to take title that way notwithstanding these potential consequences, and purchase life insurance to mitigate the risk. This is a particularly viable option where the buyers are young, or the property is low enough in value that the \$60,000 estate tax exemption will result in little or no tax.

Another factor that may warrant the taking of title in a foreign buyer's individual name is the existence of a treaty between the United States and the buyer's country of domicile, and in some cases, citizenship. Under these treaties, the citizens or residents of certain countries may benefit by more favorable estate tax credits or other modifications to the U.S. estate tax laws. For example, the treaty with Germany affords German citizens a generous marital exemption which can greatly reduce the significance of U.S. estate tax considerations when selecting the manner in which to take title to U.S. real estate. Several treaties permit the use of a pro rata portion of the U.S. exemption based upon the proportion of U.S. assets as compared with worldwide assets. For example, if a Canadian person owns a property in Florida that is worth 10% of his worldwide estate, his estate can qualify for an estate tax exemption equal to 10% of the U.S. estate tax exemption, which under current law would be \$543,000. This may be enough to eliminate U.S. estate tax. If a treaty is used to reduce or eliminate estate tax, an estate tax return must still be filed upon the death of the property owner. The process of filing an estate tax return for a foreign owner having a property interest greater than \$60,000 will ultimately clear the potential estate tax lien from the property, and facilitate a future sale.

A qualified domestic trust (called a “QDOT”) can be established after the death of the first spouse to die or incorporated into the estate plan of a foreign client. This type of trust will operate to postpone the imposition of estate tax until the surviving spouse dies or sells the property and distributes the proceeds. The possible use of a QDOT is often factored into a comprehensive estate plan for an international client. It is not something that is established when the property is purchased.

If your foreign buyer decides that complete avoidance of U.S. estate tax is a high priority, then the most likely vehicle for taking title will be a non-U.S. corporation. This is due to the fact the stock of a non-U.S. corporation owned by a foreign individual is not a U.S. situs asset for estate tax purposes. With a few exceptions available from treaties (such as with the U.K. and Germany), a corporation formed in a United States jurisdiction does not offer this benefit. Your buyer will need to consult with his legal counsel and tax advisor to select the best jurisdiction for establishing the corporation. For reasons that will be discussed under U.S. Income Taxes below, the use of an already existing corporation that owns other assets is not generally recommended for isolated purchases of real estate. Further, the use of a corporation will almost invariably increase the tax consequences of selling the property during lifetime, as discussed below under U.S. Income Taxes. Therefore, it is important to establish the contract closing date so as to allow sufficient time to permit formation of a new corporation.

Other types of entities, such as partnerships or trusts, may be selected by your buyer for holding title to the real estate, but use of such vehicles is less common and usually dictated by considerations beyond those of the U.S. estate tax.

Gift tax is imposed on the transfer of U.S. situs property by foreign clients. The gift tax rates mirror the estate tax rates. After a closing has occurred, changing title to U.S. real estate can have significant gift tax consequences, for which there are very meager lifetime exemptions. Nonresident aliens are generally limited to the annual exemption (currently \$14,000 per year). Gifts to a spouse can qualify for the larger spousal annual exemption (currently \$147,000 per year).

U.S. Income Taxes

Nonresident alien individuals and foreign corporations are required to file U.S. income tax returns and pay tax on any gain resulting from the sale of U.S. real property. The rates of tax on capital gains for individuals was reduced from previous levels in 1997, making the ownership of real estate by foreign individuals even more attractive. However, the capital gains tax for corporations was not lowered by that law, causing the discrepancy in capital gain tax rates between individuals and corporations to be made even greater. Generally, the maximum capital gains tax rate for individuals is 20% for property held twelve months or more, while that for entities taxed as corporations remains at 35% regardless of the holding period. Consequently, the selection of a corporation (or a limited liability company taxed as a corporation) to take title, while having benefits for U.S. estate tax purposes, could be disadvantageous for income tax purposes.

Limited liability companies can elect to be taxed as either a corporation or a partnership, and there are no limitations prohibiting foreign persons or entities from being members of a limited liability company. For this reason, the LLC is a vehicle that is popular with foreign investors for owning U.S. real estate. However, there is simply no universal answer to the question of what is the “best” way for a foreign investor to hold title, because the interaction of U.S. laws with the laws of the domicile

and citizenship of the investor are different from country to country. For example, Canadians are not generally advised to hold title in a U.S. LLC because of the adverse tax consequences in Canada.

U.S. income tax returns must also be filed, and the appropriate tax paid, by any foreign person who engages in a trade or business in the United States. This includes the rental of U.S. real property where the taxpayer has elected to pay tax at the progressive rates (15% to 39.6%) rather than allow withholding at the source of payment at the flat tax rate of 30%. The procedure for making this election is discussed in more detail later in this article under Withholding Taxes. Generally, a foreign investor who rents real property in the United States is well advised to elect to treat that income as being effectively connected to a trade or business. Not only can he secure the benefit of lower tax rates, but those rates are applied to his net income from the property after permitted deductions for depreciation and other costs of doing business. By comparison, the 30% withholding rate is applied against gross income.

The “branch profits tax” is a particular type of U.S. income tax that can impact a foreign investor, but which can sometimes be legally avoided through careful attention to the ownership structure of real property. The branch profits tax is based upon the deemed repatriation of income from a foreign corporation to its foreign shareholders. It is a 30% tax on all distributions of U.S. income by the foreign corporation to those shareholders. It does not apply, however, to distributions in liquidation of the corporation. This latter fact is the reason why, when a corporation is used by a foreign investor to hold title to U.S. real estate, each parcel of property is held in a separate corporation. A corporation owning a single asset can more readily be liquidated upon the sale of the property, thus allowing the proceeds of the sale to be distributed to the shareholders without it being taxed in the U.S. as a dividend or pursuant to the branch profits tax.

Note that prior to filing a tax return, the foreign person must apply for, and receive, an Individual Taxpayer Identification Number (ITIN). With respect to a corporation, if the officers of the corporation are also foreign persons, then the officer who is identified on the application for the tax identification number must also obtain an ITIN. Since the IRS adopted guidelines on June 22, 2012, governing the documentation requirements for persons applying for an ITIN, the process has become much more difficult. For one thing, ITINs now expire after five years after which the taxpayer must reapply. For another, notarized copies of documentation are no longer accepted. The taxpayer must submit either original documents or copies of the original documents certified by the issuing agency (absent a tax treaty with the country of issuance which provides to the contrary). A passport is the most frequently used form of identification, but creates the obvious problem when a taxpayer must relinquish his passport for two months or more as the ITIN application winds its way through the process . . . not to mention the risk of it being lost.

Florida Corporate Income Taxes

Although the State of Florida does not levy an income tax on individuals, it does impose an income tax at a flat rate of 5.5% on the adjusted net income derived by a corporation organized in or doing business in Florida. A foreign corporation that owns Florida real property is also required to file a Florida income tax return and pay tax on the corporation's net income derived from the rental or sale of the Florida property.

Florida does recognize the Subchapter S election for corporations which, if available and exercised, entitles a corporation to be treated as a partnership for tax purposes. Consequently, Subchapter S corporations are not subject to the 5.5% corporate income tax in Florida. Unfortunately, neither foreign corporations, nor U.S. corporations having foreign shareholders, are eligible to elect Subchapter S status. However, as mentioned above, the limited liability company can elect to be treated as a corporation, as a partnership or (for single member LLCs) as a disregarded entity for Federal tax purposes. If one of the latter two are made applicable, the LLC not be subject to Florida's corporate income tax.

In short, the selection of either the corporate or limited liability company form of ownership as a vehicle for taking title to real estate may have the disadvantage of creating potential income tax liability to the State of Florida.

U.S. Probate

When a person dies owning real or tangible property situated in the United States in his individual name, the distribution of the property must be administered through the local court in the county where the property is located. The court supervision of the distribution of a decedent's property is referred to as probate administration. The decedent's will is admitted to the court, and if accepted as genuine, dictates how the property should be distributed. If a will cannot be located or does not exist, the decedent's property will be distributed in accordance with state law, usually to family members. The court appoints a personal representative, who may be named in the decedent's will, to handle estate administration matters, including notification and payment of creditors of the probate estate.

Property held in trust or jointly with right of survivorship (such as applies when a married couple holds title as tenants by the entirety) is not subject to probate administration. Property held in any other manner in one's individual name will require probate administration in order for the property to legally pass to the heirs or devisees. The expense of this process includes attorney's fees, filing costs, legal advertising for notices, and, where the personal representative is not a resident of Florida, the cost of a bond for the personal representative. These factors should be considered by a foreign purchaser of U.S. real estate who contemplates taking title in his individual name or as a tenant in common without any right of survivorship. Furthermore, if a foreign purchaser decides to take title

in his individual name, he would be well advised to obtain a Florida will. Relying solely on a will drafted under the laws of his country of citizenship can create problems because of possible language and legal differences. A foreign owner of U.S. real estate needs to consider the merits of having a Florida will that devises only his Florida property. By executing such a document, he can control the way in which estate taxes will be allocated, be assured that the will is executed in conformity with Florida law, and name a personal representative who will be permitted to serve under Florida law. All of these things will help facilitate the probate process and reduce the cost.

In Florida and throughout the United States, we typically use revocable trusts to facilitate the ownership and distribution of property. The use of such trusts is far less common in foreign jurisdictions and can cause significant income tax problems for foreign purchasers.

Estate planning for a foreign person must be done in careful coordination with foreign legal and tax counsel.

Additional Factors Having an Influence

Many other variables can also enter into the equation when a non-U.S. person considers how to take title to real estate. Among these is the cost of establishing and maintaining a corporation if one is to be used for this purpose, the personal or family considerations of creating rights of survivorship with other owners of the property, the length of time the buyer contemplates owning the property, the intended use of the property, the impact of applicable treaty provisions, and the buyer's interest in immigrating to the United States. So, while the foregoing discussion highlights some rules of thumb regarding the structure of real estate ownership by foreigners, as the accounting professional working with your foreign client, you need to know that the decision tree has many branches which will need to be explored.

Withholding Taxes

Sales of U.S. Real Property

In 1980, with the enactment of the Foreign Investment and Real Property Tax Act ("FIRPTA"), the United States Congress significantly revised the way in which foreign individuals and entities were to be taxed upon the disposition of U.S. real property interests. FIRPTA subjected gains of foreign persons derived from such disposition to U.S. tax as "income effectively connected with the conduct of a trade or business" in the United States. This characterization is automatic and, unlike some other types of income, does not require that the taxpayer file an election. The income from the sale of real estate is now taxed at graduated rates on a net basis. However, FIRPTA also made this income subject to a withholding mechanism enacted to ensure the collection of the tax.

Under FIRPTA, persons purchasing U.S. real estate from foreign sellers are required to withhold and remit at closing ten percent (10%) of the gross sales price of the property. This amount is not the tax itself, but is a tax deposit which is applied by the seller against the actual tax due, when the seller files the required U.S. income tax return. Upon filing that return, the foreign seller may receive a refund of that portion of the tax deposit that exceeds the actual tax liability. Since the withholding amount is based upon the gross sales price, the foreign seller needs to be sure that there will be sufficient cash available at closing from which the withholding can be paid. If the structure of the sale contemplates a purchase money mortgage, or if a large existing mortgage will be paid from the proceeds of the sale, it is possible that the net cash available to the seller will be insufficient to cover the 10% withholding amount. In that event, the seller will need to come to the closing with additional monies. Short sales in recent years created particular problems in this regard.

There are three types of exemptions which can relieve a buyer from the obligation to withhold under FIRPTA: (i) a non-foreign affidavit is provided by the seller (which would also be available if the seller is a resident alien), (ii) the purchase price and intended use of the property qualify the transaction as exempt, or (iii) the seller obtains a withholding certificate. If the seller is, in fact, a foreign person, then only the latter two are applicable. In representing a foreign seller, you should address with him, prior to the execution of the contract, whether or not an exemption is available and the consequences if it is not. It is also important to address these issues with a person who is purchasing from a foreign person since the withholding tax obligation is legally imposed on the buyer. Furthermore, it is the buyer's intended use which may either qualify, or disqualify, the transaction for an exemption.

- Non-foreign Affidavit Under the terms of FIRPTA, it is presumed that every seller is a foreign person subject to withholding. This presumption is overcome, and the buyer relieved of the withholding obligation, only if the seller furnishes to the buyer an affidavit of the seller stating, under penalty of perjury, that the seller is not a foreign person. That affidavit must set forth the seller's U.S. Taxpayer Identification Number and the seller's home address (if an individual) or business address (if an entity). A buyer should retain that affidavit as proof to the I.R.S., in the event of inquiry, that the buyer had no withholding obligation in connection with the transaction. It should be noted, however, that obtaining an affidavit is not sufficient to relieve a buyer of his withholding obligation if the buyer has actual knowledge that the affidavit is false, or if the buyer receives notification from an agent of either the buyer or the seller that the affidavit is false. If the buyer wrongfully fails to withhold the 10% tax deposit required by FIRPTA, the buyer will have personal liability for not only the tax, but also for interest and penalties that accrue on the tax.
- Price and Use Exemption The second type of exemption is applicable only in residential transactions, which does not include vacant residential properties. A transaction will automatically be exempt from withholding if the sales price of the property is \$300,000 or less, and the property will be used by the purchaser or the purchaser's family as a personal

residence for at least 50% of the time that the property is used for each of the two twelve-month periods immediately following the closing. For purposes of determining whether this residency period is satisfied, days during which the property is vacant will not be counted. It is not necessary that the property be used as a principal residence; its occasional use as a vacation home will satisfy these requirements as long as the minimum time threshold for use is met. This residency requirement cannot be satisfied if the buyer is a corporation or other legal entity.

A buyer takes some risk in asserting that a purchase transaction is eligible for exemption from this withholding. The Internal Revenue Service has the benefit of a “look back” test as to whether or not the requisite period of use as a residence has been satisfied. If the buyer does not, in fact, use the property as a residence for at least 50% of the days that the property is used, during each of the two twelve-month periods following closing, the I.R.S. can make a direct claim against the buyer for failure to withhold. The buyer's only defense to such a claim would be to show that a change in circumstances, not contemplated at the time of closing, prevented the buyer from using the property for the requisite number of days.

Although there is no requirement under the law for filing a claim for this exemption with the I.R.S., or otherwise documenting the basis for the exemption, it is the practice of most attorneys and other closing agents handling the transaction to prepare a document for signature by the buyer (frequently an affidavit) reciting the accuracy of the facts which qualify the transaction as being exempt from withholding. While the execution of such a document is not controlling against the I.R.S., it does document, as of the closing, the present intent of the buyer to use the property as his residence, and may be persuasive should a change in circumstances prevent the buyer from using the property as a personal residence.

- Withholding Certificate The third basis for an exemption from withholding is the obtaining of a Withholding Certificate from the I.R.S. by the seller. In applying for a Withholding Certificate, a seller presents the I.R.S. with facts and documentation to show that the maximum possible tax on the sale of the property would be an amount less than the 10%-withholding amount. The information which a seller must present includes the seller's tax basis in the property (generally, his purchase price of the property plus other costs incurred for capital improvements and for costs of the purchase itself, less any applicable depreciation), the amount realized from the sale (generally, the gross sales price of the property less commissions and other costs of sale) and the maximum tax rate applicable to the seller. Because the amount realized from the sale must be certain, an Application for Withholding Certificate cannot be filed before the seller has a binding contract of sale. The Application must be filed on or before the date of closing. Therefore, if a foreign seller intends to apply for a Withholding Certificate, prompt attention must be paid to this matter shortly after the contract is signed. Typically, Applications for Withholding Certificate are prepared by the seller's accountant, and cannot readily be completed by the seller himself,

particularly if he is not conversant with U.S. tax law. In a change to the original rules, in order for an Application for Withholding Certificate to be accepted, all parties to the application must have a U.S. tax identification number or apply for one with the filing of the application. That means that the foreign seller will need to have or apply for an ITIN, which as discussed above, adds its own level of complexity.

If the seller has made application for a Withholding Certificate prior to closing, the buyer is not thereby relieved of the obligation to withhold at closing. However, the buyer is relieved of the obligation of sending the withholding amount to the I.R.S. within twenty days after closing. Instead, the monies may be held (typically in an escrow arrangement) pending receipt of the Withholding Certificate. Once the Withholding Certificate is issued (which, in practice generally takes around 90 days, but sometimes takes longer) the amount due to the I.R.S., as evidenced by the Withholding Certificate, can then be disbursed. The amount required to be disbursed to the I.R.S. is the amount evidenced on the Withholding Certificate as the maximum tax liability of the seller. This amount must be forwarded by the buyer to the I.R.S. within twenty days after the Withholding Certificate is issued, and must be accompanied by Form 8288 and 8288A. The remaining balance of the withheld amount may then be disbursed to the seller. It is recommended that an escrow agent be identified, and an escrow agreement be executed at closing, to handle the withheld monies.

As mentioned above, FIRPTA imposes the obligation to withhold tax upon the buyer, not the seller or the closing agent. If an exemption is not applicable, it is incumbent upon the buyer to forward the withheld amount to the I.R.S. within twenty days after the closing. Failure to do so can subject the buyer to interest and penalties. Remittance of the withholding tax must be accompanied by Form 8288 and 8288A.

Rental of U.S. Real Property

Rent derived from the leasing of U.S. real property is subject to a withholding tax under the Internal Revenue Code. Generally, the withholding amount is 30% of the rent, although this percentage may be reduced, or the tax on interest income entirely eliminated, by applicable treaty. The rate of withholding applies not only to the rent itself, but also to the amount of any taxes, interest on mortgages, premiums on insurance, condominium or homeowners' assessments, and other items paid by the tenant to or for the account of the landlord.

A foreign landlord can avoid the withholding tax if he elects to be treated as a U.S. taxpayer operating a trade or business in the United States by filing Form 4224 with the withholding agent. By filing this form, the landlord will become obligated to file a U.S. income tax return, and will be taxed in the same manner as a U.S. taxpayer, based upon net income from the property. The graduated tax rate scale will then be applicable, rather than the flat tax rate of 30%. In most cases, making the election will be more beneficial to the foreign property owner than allowing the 30% withholding tax

to be paid. However, each foreign investor should analyze the consequences of the “trade or business” election with his tax advisor. An ITIN is required for a taxpayer who files Form 4224 to be treated as a U.S. citizen.

If you represent real estate agents or real estate management companies, it is important to note that both the tenant and the rental agent are “withholding agents” under the law, and as such have primary responsibility to either remit the 30% withholding on the rental amount or obtain an executed Form 4224 from the landlord. A rental agent becomes classified as a withholding agent if he collects rents for the seller, or otherwise has “control, receipt, custody, disposal or payment” of the rental income of a foreign person. A “foreign person” is defined to include nonresident aliens, foreign partnerships, foreign trusts, foreign estates, and foreign corporations. Failure to withhold the required tax and submit it to the I.R.S. will subject the rental agent to personal liability for the tax, interest and penalties. Therefore, if the foreign landlord elects to be treated as a U.S. taxpayer operating a trade or business in this country (thereby avoiding the withholding tax), the rental agent must obtain from the landlord, an executed Form 4224. This form should be retained with the rental agent's records.

Mortgage Interest

If a real estate sale is structured to include a purchase money mortgage or other loan to be paid to a foreign person, the interest paid under such loan will be subject to a 30% withholding tax. As with rentals, the obligation to withhold is imposed upon the person making the payments (i.e., the borrower) and any other person having control, receipt, custody, disposal or payment of the income. The tax rate of 30% may be reduced by applicable treaty. Unlike the withholding tax on rent, interest on a debt obligation secured by a mortgage on real property does not qualify as the type of real property income for which an election may be filed to treat such income as effectively connected with a U.S. business. Since the election cannot be made, the income is subject to the withholding tax at a flat rate of 30% (or such lesser amount provided by applicable treaty).

International Investment and Trade in Services Survey Act

In 1976, Congress passed a law which had as its purpose, advancement of the “the national interest in obtaining comprehensive and reliable information on international investment.” That law, which has come to be known as the International Investment and Trade in Services Survey Act (“Survey Act”), directed the President of the United States to conduct a regular data collection program to secure current information on international capital flows and other information related to international investment. Pursuant to that directive, the President issued an Executive Order directing the U.S. Secretary of Commerce to adopt regulations implementing the intent of the Survey Act. The result was extensive regulations which require various levels of reporting of foreign investment in U.S. “business enterprises.” Under the terms of the regulations, the acquisition of an ownership interest

in United States real estate is deemed to constitute a “business enterprise.” This discussion regarding the Survey Act is limited to the acquisition of U.S. real estate by a foreign investor.

In 2009, the requirement of the law which mandated the filing of a report for the acquisition of a direct or indirect interest in U.S. real estate by a foreign investor was discontinued due to budget restrictions. However, by rule effective September 15, 2014, and applicable retroactively to January 1, 2014, the Bureau of Economic Analysis (“BEA”) has reinstated the mandatory reporting requirement for the acquisition of a U.S. real estate (and any other U.S. Business Enterprise) by any of the following: a nonresident alien, foreign corporation, foreign partnership, foreign estate, foreign trust or other foreign entity, as well as by a U.S. corporation, U.S. partnership, U.S. limited liability company, or any other type of U.S. entity if any nonresident alien or foreign entity owns or controls, whether directly or indirectly, a 10% or greater interest. The original BEA regulations provided for reporting on a single form, but the new rule institutes six different forms, each intended to apply to a different type of acquisition. These forms are known as the BE-13, Survey of New Foreign Direct Investment in the United States. Under the Act and new rule, a report is required to be filed within 45 days after the purchase of U.S. real estate by a foreign investor. In addition, depending upon the total value of all U.S. real estate and other business enterprises owned by the foreign investor, reports may be required every five years (the so-called “Benchmark Survey Report”), as well as annually and quarterly. The information gathered by the Department of Commerce through these reports is compiled and published on a periodic basis for use by federal and state governments, and the public in general. The Survey Act does require, however, that specific information provided by these reports is to be maintained on a confidential basis, and only the compiled data is to be made available to the general public.

A purchase of residential real estate by a foreign individual is totally exempt from the reporting requirements of the Survey Act if the property will be used exclusively for the personal use of the owner and not for profitmaking purposes. A corporation (and any other type of business entity) can claim this exemption if the sole purpose of holding the real estate is to allow it to be used as a residence by the individual owners of the corporation. No filing is required to claim this total exemption.

A transaction will be entitled to a partial exemption from the reporting requirements of the Survey Act if the total purchase price of the real estate acquired by a foreign investor does not exceed \$3,000,000. To be entitled to claim this partial exemption, the purchaser must file Form BE-13 Claim for Exemption.

If the purchase price of the property exceeds \$3,000,000, then the transaction is fully reportable and the appropriate Form BE-13 must be filed with the United States Department of Commerce within 45 days of the closing. The reporting forms require a substantial amount of information regarding the investment, including equity and debt components of the foreign parent funding; a question asking if the new U.S. operation will have research and development activities; a question asking if the new

operation is under construction; employment projections; and actual and projected construction expenditures by type and by year.

The penalty assessed for failing to file required reports under the Survey Act are a minimum of \$2,500 and a maximum of \$25,000. In addition, a criminal fine of up to \$10,000, and imprisonment for not more than one year may be imposed for willful failure to submit a required report. These criminal penalties may apply to any officer, director, employee or agent of a corporation which willfully fails to submit a required report. Therefore, if you are asked to be an officer of a company owned by a foreign national, take into account this potential risk if a required BE-13 is not filed.

Agricultural Foreign Investment Disclosure Act

Driven by the perception that foreign investors were acquiring U.S. farm land at a growing rate, and driving up the price of agricultural land beyond the means of the American farmer, Congress passed the Agricultural Foreign Investment Disclosure Act in 1978 ("Ag Disclosure Act"). The House Committee Report for this Act emphasized the need for preservation of the family farm, and an almost hostile attitude toward the purchase by foreign interests of U.S. agricultural land.

The purpose of the Ag Disclosure Act, and the regulations adopted thereunder, was to provide for the collection and evaluation of data regarding the investment by foreign persons in U.S. agricultural land. The ultimate design of the Ag Disclosure Act is to determine the effect which such investments have upon family farms and rural communities.

The Ag Disclosure Act imposes several reporting requirements upon "foreign persons" at the time such persons acquire or transfer any interest in agricultural land located within the United States. Such reports are required to be filed no later than 90 days after the transaction that triggers the reporting requirement. Generally, these reports must be filed by the person who actually acquires or transfers the land. However, in the case where an interest is held by a corporation or other entity, a reporting requirement may also be imposed upon the foreign shareholders or other persons who hold an interest in that entity. It is interesting to note that, although not specifically addressed in the Ag Disclosure Act itself or regulations, the filing form prepared by the Department of Agriculture also requires foreign persons to file a report whenever agricultural land held by that person is converted to non-agricultural use.

Under the Ag Disclosure Act, agricultural land is defined as any land located within the United States that is currently being used to produce agricultural, forestry or timber products, or which, if currently idle, has in the previous five years been used to produce agricultural, forestry or timber products. Excluded from that definition is land that does not exceed 10 acres in the aggregate, so long as any agricultural, forestry or timber products produced on that land were used only for the personal or household use of the owner, and the total of the production yielded less than \$1,000 in annual gross sales. The reporting requirements of the Act are applicable whenever a foreign person

acquires or transfers any interest in agricultural land. This would include leasehold interests of ten years or more and partial interests in property, such as that held by a tenant in common. It has been interpreted not to include an interest under a contract for the purchase of land or an option to purchase property.

The reporting requirement is imposed upon all “foreign persons” who purchase agricultural land. As one might expect, this includes nonresident aliens, foreign corporations, foreign partnerships, foreign trusts, foreign estates, foreign governments, and other foreign entities. However, it also includes U.S. corporations, if five percent or more of the entity is owned, directly or indirectly, by foreign individuals or entities. This is a very low threshold, the significance of which can be illustrated by the following hypothetical:

Corporations A, W, X, Y and Z are all Florida corporations. The stock of Corporation A is owned equally by Corporations W, X, Y and Z. Mr. Schmidt, a German citizen, owns a 10% interest in Corporation W. Mr. Gonzalez, a citizen of Mexico, owns a 2% interest in Corporation Y; and Ms. Holstein, a Dutch citizen, owns an 8% interest in Corporation Z. Even though no other foreign individuals have any other interests, direct or indirect, in any of the five corporations, the interests of Schmidt, Gonzalez and Holstein, when combined, would be sufficient to cause Corporation A to be considered a “foreign person” subject to the reporting requirements of the Agricultural Foreign Disclosure Act. Thus, the message here is that whenever a foreign individual has any interest, no matter how remote or how small, in an entity that is considering a purchase or sale of agricultural land, the situation should be analyzed to determine the extent of the combined interests of all those foreign persons.

The penalty for failure to comply with the Disclosure Act can be substantial. The amount of the penalty is left to the discretion of the Secretary of Agriculture, except that it may not exceed 25% of the fair market value of the interest transferred or acquired, measured on the date the penalty is assessed. A penalty may be imposed upon any person who fails to make a required report or who knowingly files an incomplete or false or misleading report.

In general, the information required to be contained in the reports includes data which identifies the foreign person required to make the report, data about the transaction itself, limited data concerning the person who transferred his interest to the foreign person, data which identifies any transferee of the reporting foreign person, data concerning the agricultural purposes for which the foreign person is using and plans to use the land acquired, and data as to the name, address and relationship of any representative of the foreign person who completes the report form on behalf of the foreign person. If the reporting person is an entity other than a foreign government, the report must also include information identifying U.S. persons who hold an interest in the entity.

One of the chief concerns which some foreign persons have with respect to the Agricultural Foreign Investment Disclosure Act, is that it not only requires disclosure of significant information concerning the purchaser of the property, but, if that purchaser is an entity, the Department of Agriculture can investigate information which traces the ownership of that entity back to the third tier. Consequently, it becomes considerably complex for a foreign individual to maintain anonymity if he holds even a small and indirect interest in U.S. agricultural land.

If a foreign investor is strongly adverse to the thought of filing under the Ag Disclosure Act, he or she should consult with a knowledgeable attorney as to whether certain treaty-based rights or other legal basis may exist that would serve to exempt him or her from the obligation to report.

Racketeering Influenced and Corrupt Organizations

Under this somewhat intimidating and offensive title, also known as the RICO Act, the Florida legislature imposed a state filing requirement in 1981 for all alien business organizations which own real property or a mortgage on real property in Florida. "Alien business organizations" are defined to include all non-U.S. corporations, associations, partnerships, trusts, joint stock companies and other entities organized under laws other than those of the United States or its states, territories or possessions, and U.S. organizations, 10% or more of which are owned or controlled, directly or indirectly, by non-U.S. persons or entities. These entities are required to maintain a Florida registered agent and a Florida registered office. When the Act was initially adopted, the failure to make the required filing would essentially render void the entity's record title to the property or mortgage. Responding to an outcry from the title insurance industry, the legislature substantially revised the remedies portion of the Act in 1984. Under current law, a penalty of up to \$500 per year can be imposed for failure to file. However, this penalty will be forgiven if, upon receiving notification from the State that it has failed to file, the alien organization makes the required filing. With the sting of the potential penalty virtually eliminated, concern by foreign persons for this filing requirement has waned. However, the filing requirement continues to be imposed by law, and is a relatively inexpensive and non-burdensome requirement.

The major significance of the filing to foreign persons is the fact that the State of Florida can, under the RICO statute, require the production of substantial information and records regarding the organization and its shareholders or other owners. This right of investigation is geared to satisfy the primary purpose of the RICO Act which is to obtain information about organized crime activity--particularly drug smuggling--conducted by foreign persons through the use of corporations and other legal entities.

Application for Authority to Do Business In Florida

If a foreign corporation, foreign limited liability company, or foreign limited partnership owning real property in Florida decides to rent that property, or otherwise conduct business in or from that

property, the Division of Corporations of the Department of State requires that the organization register to do business in Florida. This position of the Department of State is subject to dispute as far as its applicability to incidental rentals of real property. However, the Division of Corporations appears steadfast in its viewpoint. The Division also follows a practice of cross-referencing records of the Department of Revenue which include sales tax reports. Since the rental of real property is subject to sales tax, the Division has been following the procedure whereby it checks to see whether corporations, limited liability companies, or limited partnerships that are filing sales tax reports have also registered to do business in the State of Florida. If it finds that there is no registration to do business, those organizations are routinely notified that they are doing business in Florida without legal authorization. Penalties for failure to properly register for authorization to do business in Florida are significant: not less than \$500 or more than \$1,000 for each year or part thereof during which the corporation transacted business in Florida without a certificate of authority. To avoid a showdown with the Division, and the potential for an assessment of penalties, a foreign corporation, limited partnership or limited liability company which intends to lease its property is well advised to apply for authority to conduct business in the State of Florida. This entails both an initial registration and an annual filing.

Immigration

For a substantial number of foreign persons, investment in U.S. real property is viewed as the first step in obtaining some form of permanent immigration status. However, obtaining permanent resident status under the immigration laws is difficult unless the individual falls within one of the various statutory preference groups. Certainly, the mere purchase of a home, or possession of substantial wealth, will not be sufficient to entitle a foreigner to reside permanently in the U.S. As an accountant working with foreign investors, you will want to be attuned to the possibility that your investor's primary motivation in purchasing real estate may be to achieve some form of immigration status. The potential for acquiring that status needs to be assessed by a qualified immigration attorney, and is beyond the scope of this article.

Qualifying as a Nonresident Alien

Unless a foreign person has intentionally acquired the status of a U.S. resident alien, that person probably intends to remain a nonresident alien. As a nonresident alien, a foreign person is taxed in the U.S. only on U.S. source income, and avoids being taxed in the U.S. on his worldwide income. However, if a foreign person does not carefully keep track of the number of days that he is present in the United States, he can unwittingly be deemed a U.S. resident for U.S. income tax purposes. If he is deemed a U.S. resident, he will be subject to U.S. taxation on all of his worldwide income.

The formula for determining whether or not a person is a "U.S. resident" is probably one of the most basic items of information which a foreigner needs to know, while at the same time one of the most widely misunderstood. Basically, a foreign person can be present in the U.S. for no more than 182

days per year without being deemed a "U.S. resident" for U.S. income tax purposes. There is no flexibility in this test; if a foreign person is present in the U.S. for 183 or more days in any given year, then, *ipso facto*, he has passed the so-called "substantial presence test". Consequently, he is required to file a U.S. income tax return and pay tax on his worldwide income. On the other hand, even if he fails to meet the substantial presence test, he may still be deemed a U.S. resident unless one of two additional tests are met. First, he must keep track of the number of days that he has been present in the U.S. during each year, and apply the following formula: 100% of the number of days that he is present in the current year plus one-third of the number of days that he was present in the U.S. for the immediately preceding year, plus one-sixth of the number of days that he was present in the U.S. during the year preceding that. If the total produced by this formula is less than 183 days, he is deemed to be a nonresident alien. If, however, the total exceeds 182 days, then, in order to qualify as a nonresident alien, he must take an additional step and file a report with the Internal Revenue Service to show that he is "more closely connected" with his country of citizenship, or some other foreign country. This report must be filed for each tax year for which the foregoing formula yields a total number of days of 183 or more. The filing must provide information regarding the foreign person's country of citizenship and/or residence and identify other information, such as employment, church or synagogue affiliation, property ownership, tax reporting, and other information which documents that the foreign person is more closely connected with the foreign country than with the U.S. If this filing is required but not made, then the foreign person is automatically deemed to be a U.S. resident, subject to U.S. income tax.

As a general rule of thumb, a foreign person who never spends more than 121 days in any given year will be safe in assuming that he will not be deemed a U.S. resident for tax purposes.

Conclusion

Foreign owners of U.S. real estate, particularly those purchasing for the first time, are faced with many unique issues not applicable to U.S. persons. When the professionals advising foreign clients in the purchase or sale are conversant with all of those issues, not only is the transaction assured of proceeding more smoothly, but also the foreign individual is more likely to attain a comfort level with his investment decision. As those who work regularly with foreign purchasers of real estate can attest, a satisfied foreign investor will often want to introduce friends and business partners from his home country to the professionals who have served him competently. This potential for a networking effect can be a rewarding side benefit to accountants who take the time and interest to understand this market. With foreign investment on the rise, it's a good time to make that investment of time.

About the Author

Michele B. Grimes is Shareholder with Williams Parker Harrison Dietz & Getzen and a member of the firm's International Client Group. She is a Board Certified Real Estate Lawyer and specializes in real estate transactions. She has been awarded the highest AV Rating by Martindale Hubbell (5.0 out of 5.0). Michele is also an author and frequent guest speaker on issues affecting foreign purchasers of U.S. real estate. She can be reached at mgrimes@williamsparker.com or (941) 329-6611.