INVESTMENT IN U.S. REAL ESTATE BY FOREIGN INVESTORS

By Ruben Flores, CPA & Attorney

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- Corporate Services
- Estate Planning
- Asset Protection

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- Tax Planning
- Tax Returns
- Financial

TRENDS IN FOREIGN INVESTMENT

Texas is a favorable place for foreign investment in Real Estate because of various factors:

- Good Investment Opportunity
- Rising Crime and Violence in some foreign countries
- To provide better educational and economic opportunities to the family and children
- Business relocation and domiciliation

CRITICAL QUESTIONS OF FOREIGN PERSONS

- Legal and tax implications of investing in U.S. Real Estate
- U.S. immigration status and options
- U.S. tax status and obligations
- Estate and inheritance taxes
- Best legal forms for a foreign person to invest in U.S. Real Estate

WHO IS CONSIDERED A U.S. TAXPAYER: DEFINITION & CONSEQUENCES

01

THREE CATEGORIES OF RESIDENCY

Foreign Persons need to carefully evaluate their residency status before they invest in U.S. Real property:

1. **Income Tax Resident**

   According to Income Tax Law

2. **Estate Tax Resident**

   According to Estate Tax Law

3. **Immigration Resident**

   According to Immigration Law

**The definition and rules are different for each category*

1 DEFINITION OF INCOME TAX RESIDENT

U.S. INCOME TAX RESIDENT

- U.S. Citizen (Born in U.S./U.S. Parents)
- Permanent Resident/Green Card= USR
- Substantial Presence (> 183 Days) = Tax Resident

VS

FOREIGN INCOME TAX RESIDENT

- Not U.S. Citizen
- Temporary Visas
- No Substantial Presence (< 183 Days)
- Treaty Exception
- Closer Connection Test

U.S. INCOME TAXATION SYSTEM

U.S. INCOME TAXPAYER

GLOBAL INCOME

FOREIGN INCOME TAXPAYER

U.S. SOURCE INCOME

2

DEFINITION OF ESTATE TAX RESIDENT

U.S. ESTATE TAX RESIDENT

- U.S. Citizen
- Foreign Person who lives in U.S. with no present "intent" to leave

VS

FOREIGN ESTATE TAX RESIDENT

- Foreign person who does not live or have a domicile in the U.S.
- Foreign Person who lives in U.S. but has the present intent to leave and return to foreign country

U.S. ESTATE TAXATION SYSTEM

U.S. ESTATE TAXPAYER
(BASED ON INTENT)

GLOBAL ESTATE

FOREIGN ESTATE TAXPAYER

U.S. ESTATE

IMMIGRATION OPTIONS 02

IMMIGRATION AND U.S. REAL ESTATE

Merely investing in US real estate alone does not qualify the foreign person for a US immigration or visa status.

In general, in order to qualify for a business or investor visa the investment has to be considered an active business (not passive) and must generate US employment.(Visa L1, E2, EB5)

Thus, an investment in US real estate that is considered an active business and has US employees may qualify:

1. Commercial properties with active involvement & employees
2. Rental properties with active involvement and employees

*Each form of ownership has different tax consequences

IMMIGRATION OPTIONS FOR A FOREIGN INVESTOR

U.S. CITIZEN

- Born in U.S.
- Born of U.S. parents
- Naturalized

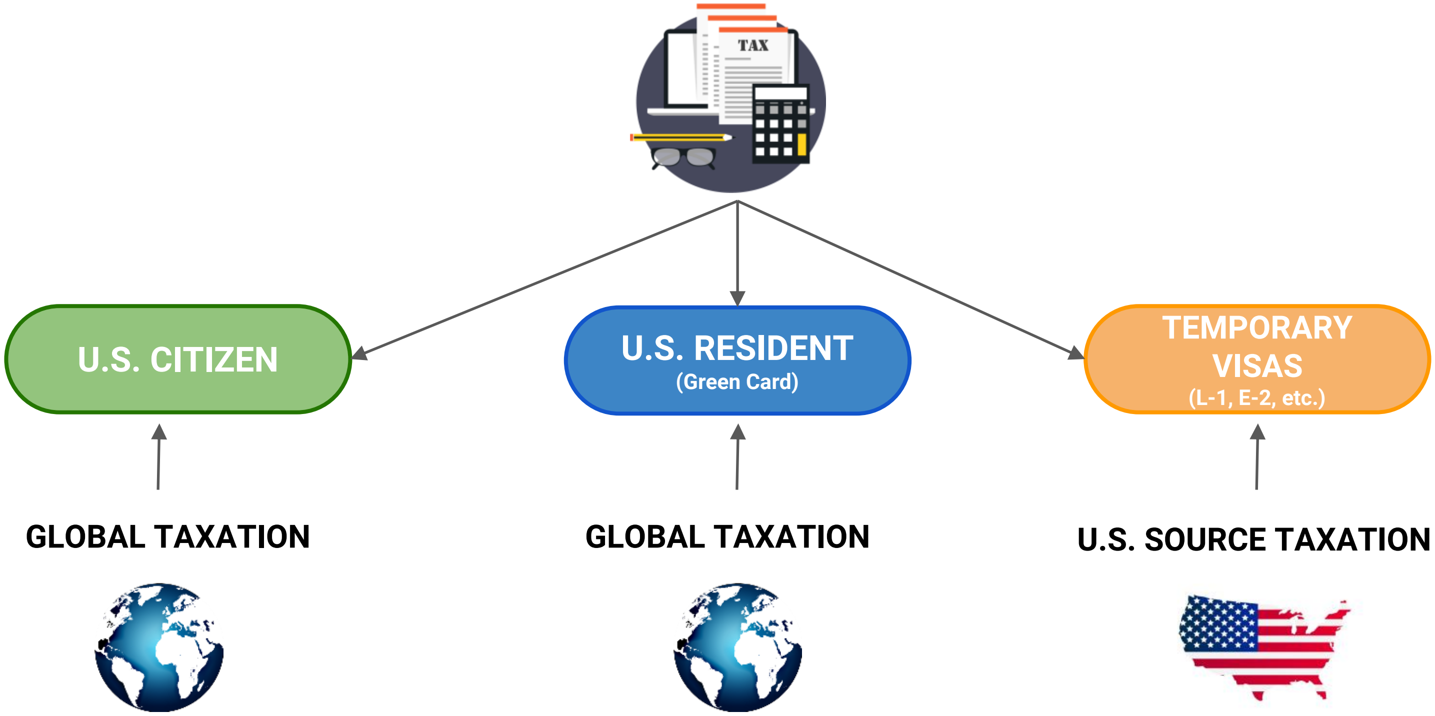
PERMANENT RESIDENT

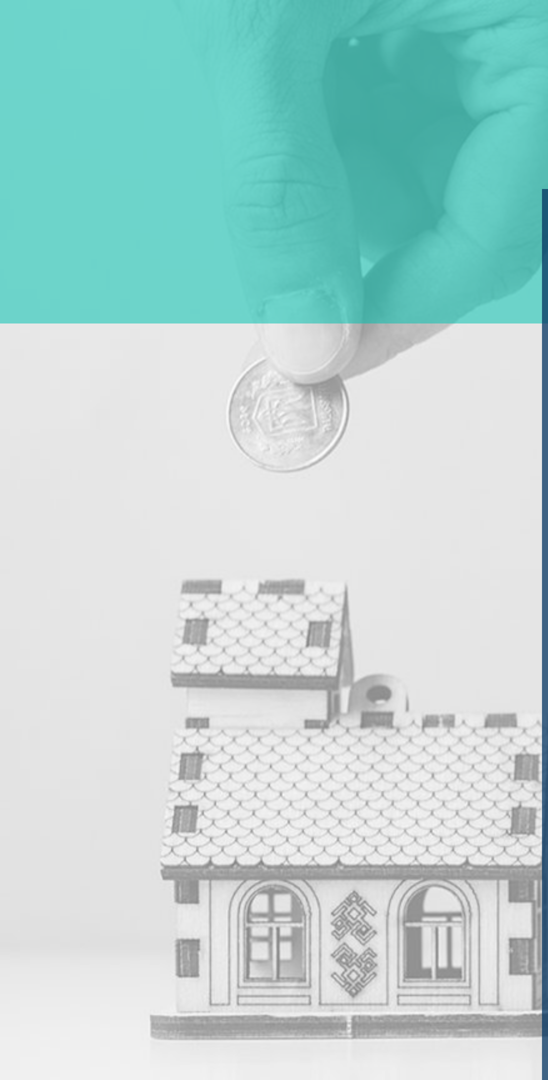
- Residency through family
- Residency through investment
- Residency through professional or educational achievements

BUSINESS/INVMT VISAS

- Business Visa
- Investment Visa
- Many Others

TAX CONSEQUENCES OF IMMIGRATION STATUS





TAX CHALLENGES FOR FOREIGN INVESTORS

03

TAXES ON U.S. REAL ESTATE GAINS

INCOME TAX

Indiv. = 37%
Corp. = 21%

CAPITAL GAINS TAX

Indiv. = 20%
Corp. = 21%

FIRPTA WITHHOLDINGS TAX

Indv. = 15 %
Corp. = 15%

ESTATE TAX

Indiv. = 40%
Corp. = 0%

** Note: This chart does not include tax on rentals, property taxes, sales tax, etc.*

WAYS TO INVEST IN U.S. REAL ESTATE

A foreign person has two ways to invest and own real estate:

1. **DIRECT INVESTMENT** – Individually

2. **INDIRECT INVESTMENT** – Companies, Partnership, etc.

**Each form of ownership has different tax consequences*

U.S. TAXATION OF REAL PROPERTY INTEREST

- INVESTMENT OPTIONS
  - DIRECT INVESTMENT
    - Individual

  - INDIRECT INVESTMENT
    - U.S. Corporation
      U.S. Partnerships

    - Foreign Corporation

**Note: How you invest determines how you are taxed*

FIRPTA – Foreign Investment Real Property Tax Act

- *FIRPTA* taxes real estate gains of foreign investors by requiring withholdings on the gross sales price, regardless if gain or loss on sale.

- It makes the buyer, agents, and other real estate professionals responsible for the tax if not withheld.

- Includes sales of Real Estate, and may include sales of corporate stock or partnership interests.

Note: Does not matter if Real Estate is held directly or indirectly, it may be subject to FIRPTA.

U.S. REAL PROPERTY DEFINED

U.S. REAL PROPERTY

Real Property and its improvements or permanent attachments located in the U.S., also includes stock of a *"U.S. Real Estate Holding Co."*

U.S. REAL ESTATE HOLDING COMPANY

A U.S. Corporation with US real estate that is more than 50% of total of global real property and other Business property. The sale of stock of the corporation is treated as a sale of U.S. real property.

WITHHOLDING REQUIREMENTS - FIRPTA

15% withholding required upon sale of U.S. real property, also sale of stock of USRP company

15% of gross sales price

Forms 8288 & Form 8288-A Required

Seller and his/her agents are responsible

EXCEPTIONS TO WITHHOLDING

<u>No</u> Withholding Required if:

- ➢ Seller provides "***Non foreign affidavit***"
- ➢ Sale of house to be used as residence and sales price is less than $300,000
- ➢ Seller obtains an "***Exception Certificate***" from the IRS.

04 FIRPTA EXAMPLES

EXAMPLE #1 SALE AT A LOSS

U.S. REAL ESTATE

FP

Cost $600,000

Price $500,000

BUYER

1) U.S. Real Estate is a U.S. Property
1) Seller and buyer subject to FIRPTA
1) Withholding required at 15%

EXAMPLE #2 SALE AT A GAIN

U.S. REAL ESTATE

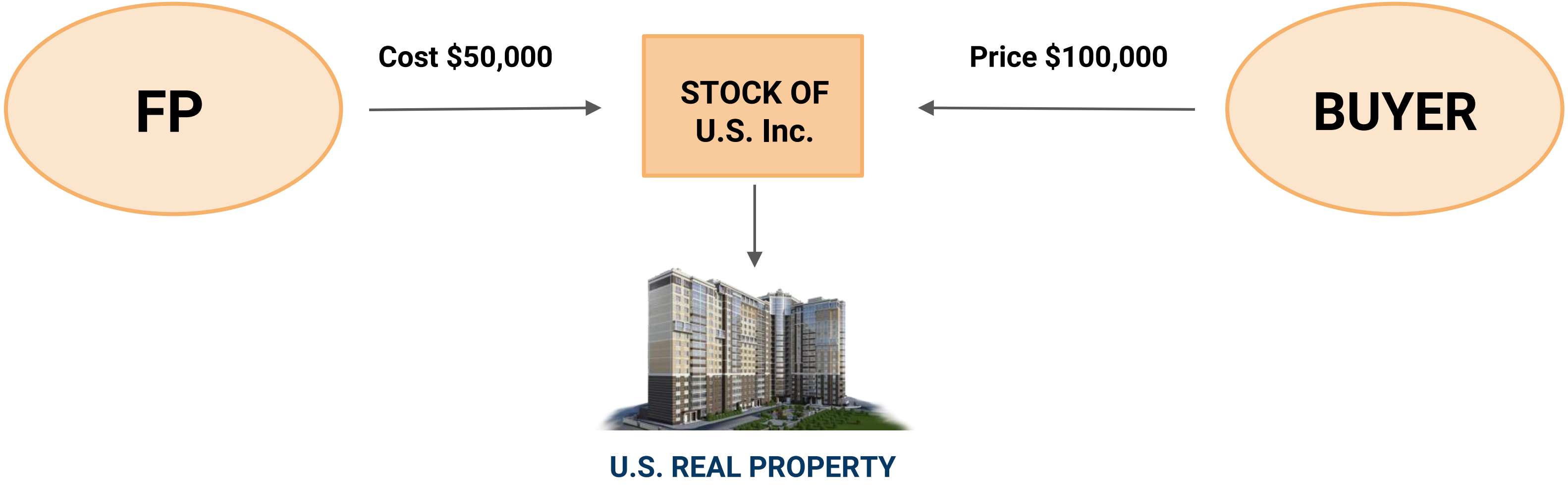
FP → **Cost $100,000**

Price $250,000 ← **BUYER**

1) U.S. Real Estate is not consider U.S./FIRPTA property if used as residence and price is less than $300,000

1) Seller and buyer not subject to FIRPTA

EXAMPLE #3 SALE OF A US COMPANY



1) Stock is considered U.S. Property interest if more than 50% of assets are U.S. real estate.
1) Seller & buyer subject to FIRPTA
1) Withholding required at 15%

EXAMPLE #4 SALE OF A FOREIGN COMPANY

FP

Cost $500,000

STOCK OF FOREIGN COMPANY

Price $1 million

BUYER

U.S. REAL PROPERTY

1) Stock is not considered U.S. property regardless of percentage

1) No withholding required

RENTAL INCOME FROM U.S. REAL ESTATE

RENTAL INCOME FROM U.S. REAL ESTATE

A foreign person that has rental property in the U.S. is subject to a 30% withholding tax on the gross rentals (no deductions allowed).

1. Foreign Person is responsible

1. Property manager and persons that control the rentals are also responsible

RENTAL INCOME – BUSINESS ELECTION

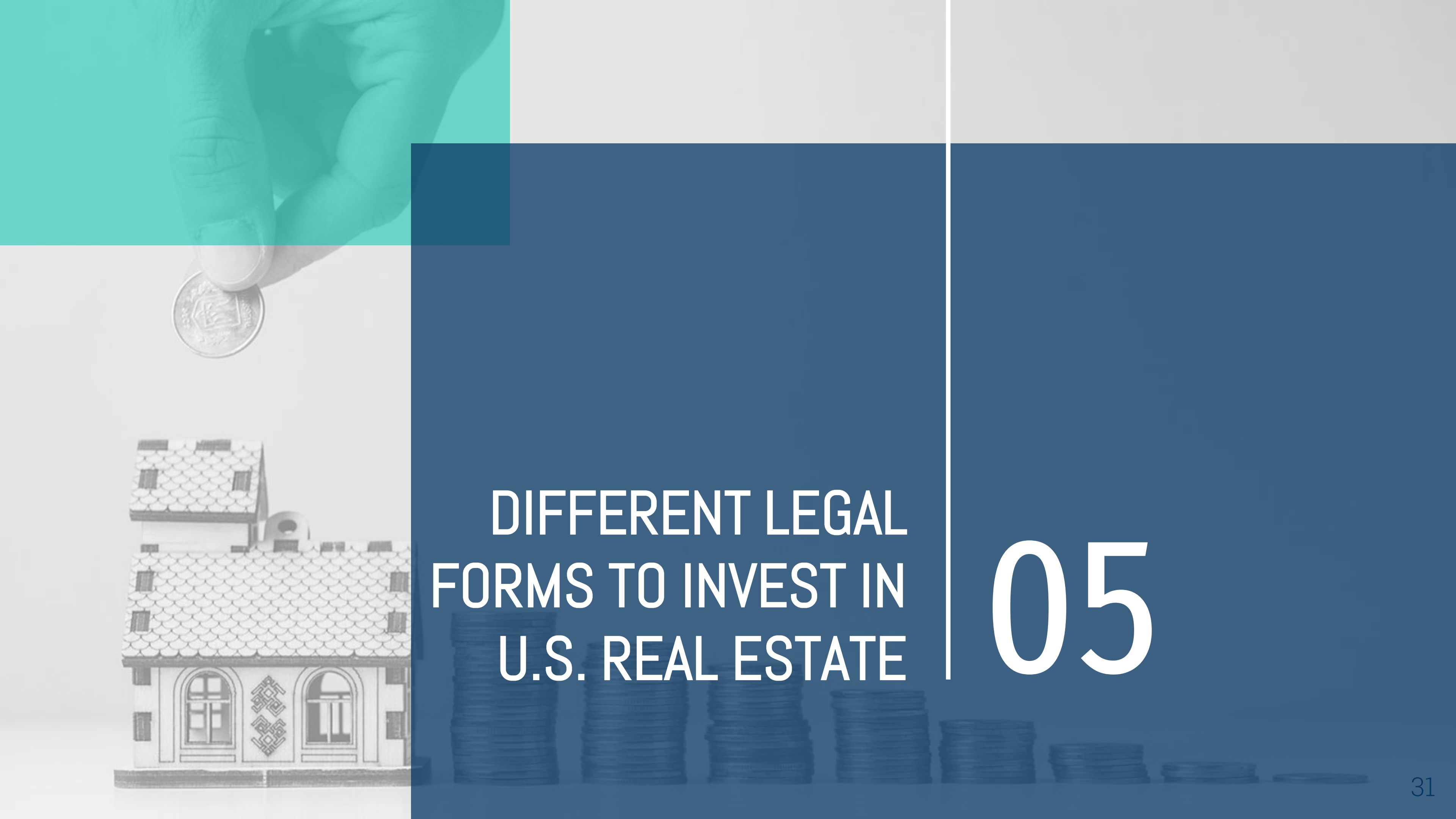
Tax Planning Tip

Foreign Person can make an election to treat the rental property as a U.S. trade or business and it is no longer subject to 30% withholding tax.

Instead, the net rental income is taxed at regular tax rates.

Deductions are allowed if the election is made:

1. **OPERATING EXPENSES**
2. **DEPRECIATION**
3. **INTERESTS**
4. **TAXES**



DIFFERENT LEGAL FORMS TO INVEST IN U.S. REAL ESTATE

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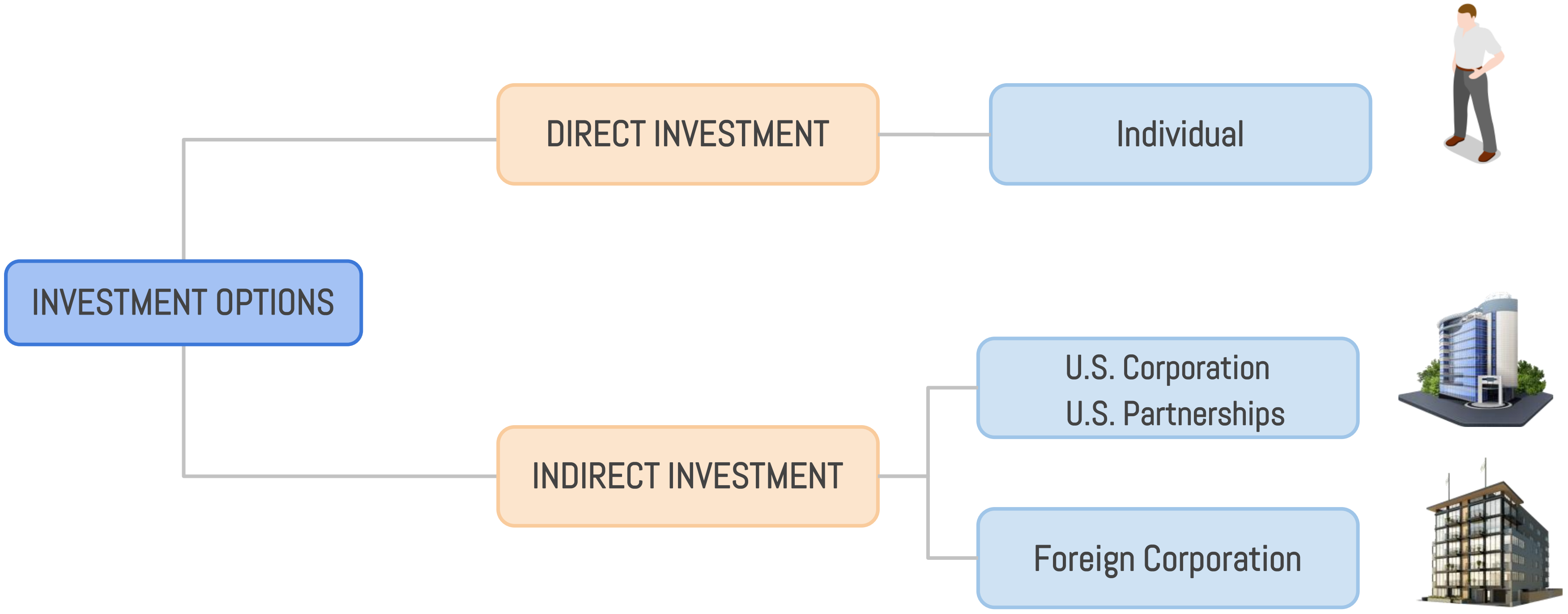
U.S. TAXATION OF REAL PROPERTY INTEREST



**Note: How you invest determines how you are taxed*

STRUCTURES FOR INVESTING IN U.S. REAL ESTATE

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STRUCTURE #1

FOREIGN INDIVIDUAL

U.S. Real Estate
(Personal Use)

- No Asset Protection
- Estate Tax applies
- FIRPTA Applies
- Capital Gains Tax

STRUCTURE #2

FOREIGN CORPORATION

U.S. Real Estate (Personal Use)

- Asset Protection
- No Estate Tax on shares
- Regular Tax applies to Property
- FIRPTA applies to property

STRUCTURE #3

FOREIGN CORPORATION

U.S. CORPORATION

U.S. Real Estate

- Asset Protection
- No Estate Tax on foreign shares
- No gift tax on foreign shares
- No FIRPTA on property
- Regular Tax rates applies to property

STRUCTURE #4

FOREIGN CORPORATION

Sec. 897 (i) Election

U.S. Real Estate

- Asset Protection
- No Estate Tax on shares
- FIRPTA does not applies to property
- Regular tax rates apply

STRUCTURE #5

FOREIGN INDIVIDUALS

U.S.
IRREVOCABLE TRUST

Beneficiaries

U.S. Personal
Real Estate

- Asset Protection
- No Estate Tax
- No FIRPTA
- Regular tax rates apply

THANK YOU!

Ruben Flores, CPA & Attorney

The Flores Group

SAN ANTONIO OFFICE
9901 IH 10 WEST, SUITE 777
San Antonio, TX 78230

(210) 340-3800

(210) 340-5200

floresgroup@floresgroupusa.com

www.floresattorneys.com