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FIRPTA ALERT

FOREIGN INVESTMENT IN US REAL ESTATE

This Alert provides an expanded overview of the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") and its impact on foreign individuals and foreign corporations investing in U.S. real estate. FIRPTA is codified primarily in Internal Revenue Code ("IRC") §897 and operates to ensure that foreign persons are subject to U.S. taxation on gains derived from U.S. real property.

I. Statutory Framework

IRC §897(a)(1) provides that gain or loss of a nonresident alien individual or foreign corporation from the disposition of a United States real property interest (USRPI) shall be treated as effectively connected with a U.S. trade or business. This treatment overrides general sourcing rules and ensures such gain is subject to U.S. taxation on a net basis.

II. Definition of U.S. Real Property Interest (USRPI)

Under IRC §897(c)(1), a USRPI includes (i) direct ownership of U.S. real property, including land, buildings, and associated improvements, and (ii) interests in domestic

corporations that are classified as U.S. real property holding corporations (USRPHCs). Treasury Regulation §1.897-1 provides additional guidance on what constitutes real property and related interests.

III. U.S. Real Property Holding Corporation (USRPHC)

Treas. Reg. §1.897-2 provides that a corporation is a USRPHC if the fair market value of its U.S. real property interests equals or exceeds 50 percent of the total value of its real property and business assets. This classification is critical because stock of a USRPHC is treated as a USRPI, thereby extending FIRPTA beyond direct real estate ownership.

IV. Taxation of Foreign Individuals

Foreign individuals (nonresident aliens) are subject to U.S. federal income tax under IRC §871(b) on effectively connected income. Gain from the sale of U.S. real estate is treated as ECI under §897 and taxed on a net basis at graduated rates. Additionally, depreciation recapture under IRC §§1245 and 1250 may apply to increase taxable income.

V. Taxation of Foreign Corporations

Foreign corporations are taxed under IRC §882 on effectively connected income, including gains from U.S. real estate. In addition to corporate income tax, IRC §884 imposes a branch profits tax on the corporation's effectively connected earnings and profits that are deemed repatriated. This creates a second layer of tax similar to dividend withholding.

VI. FIRPTA Withholding Requirements

IRC §1445 requires a transferee (buyer) to withhold tax on the acquisition of a USRPI from a foreign seller. Treasury Regulations §§1.1445-1 through 1.1445-11 govern the

mechanics of withholding. The withholding is generally calculated as a percentage of the gross sales price and serves as a prepayment of tax, not the final liability. Taxpayers may apply for a withholding certificate to reduce or eliminate excess withholding.

VII. Practical Implications for Investors

FIRPTA ensures that foreign investors cannot avoid U.S. taxation through offshore ownership structures. Both direct and indirect investments in U.S. real estate fall within its scope. Investors must comply with U.S. filing requirements, including filing Form 1040-NR or Form 1120-F, as applicable, and reporting gains and income connected with U.S. real estate activities.

VIII. Planning Considerations

Proper planning is essential to mitigate the impact of FIRPTA. Strategies may include selecting appropriate entity structures (e.g., partnerships vs corporations), utilizing debt financing to reduce taxable income, applying for withholding certificates, and considering the timing of transactions. Coordination with estate and gift tax planning is also important for foreign investors.

IX. Conclusion

FIRPTA is a comprehensive regime designed to ensure U.S. taxation of foreign investors in U.S. real property. The combination of substantive tax rules under IRC §897 and withholding requirements under §1445 creates a robust enforcement mechanism. Foreign investors should carefully structure investments and plan exit strategies to manage tax exposure effectively.

We are International Attorneys and Advisors and we strive to provide our clients the highest quality of legal and tax representation in the complex area of tax law.

This alert has provided only general information and specific factual scenarios may change any conclusions that would apply.

We strongly recommend you consult a corporate and tax attorney regarding your particular case. Should you need additional information it will be our pleasure to assist you.

Sincerely,

Ruben Flores, Attorney & CPA