

## BASICS FOR FOREIGN BUYERS OF FLORIDA REAL ESTATE

**CAUTION: The information contained herein shall not be deemed tax advice to be relied upon in any specific transaction and is subject to change without notice. Application of the information contained herein to a specific transaction requires the advice of a Certified Public Accountant and/or a Tax Attorney who must rely upon their own sources of information before providing advice. The information provided is intended only as a general introduction and is not to be relied upon as the sole basis for any decision without verification from reliable professional sources familiar with the particular circumstances and the applicable laws in force at that time. Any contemplated purchase of Florida real estate should be reviewed with a competent Certified Public Accountant and/or Tax Attorney familiar with the laws of that individual's present country of tax residence to determine whether any of the suggestions made herein may have adverse tax consequences in that other country.**

1. HOW SHOULD TITLE BE HELD? Although there are various ways a non resident alien<sup>1</sup> can take title to real estate, a *limited liability company* ("LLC") offers several advantages. An LLC is an unincorporated, legal entity organized under the laws of state in the United States or those of another country. Ownership of property in an LLC affords limited liability to all of its owners in the same way shareholders are insulated from the liabilities of the corporation in which they hold shares. The owners of a LLC are called "members" and a LLC may have as few as one member. The LLC form is flexible and can provide for: (a) member or non-member management (b) free or restricted transferability of membership interests (c) admission of new members without necessity of recording new deeds, and (d) perpetual or limited existence. If there are several owner/members participating, their respective roles, entitlements and control features (e.g. votes necessary for action, management prerogatives, signatory authority, restrictions on membership interest transfers, assessments, etc.) should be governed by an *operating agreement*. An *operating agreement* is the LLC counterpart of a shareholders' agreement where the owner entity is a corporation..

When applying for a federal tax identification number, a multi member LLC must declare how it wishes the IRS to treat it for tax purposes. If the LLC so elects, it will not be taxed at the company level and its owners will receive "pass-through" tax treatment, which means that its owner/members are taxed as if income, losses, deductions and credits were earned or incurred directly by the owners, thereby avoiding double taxation, that is, by the preclusion of a tax on the company level and then another tax payable by the owners on their receiving distributions from the company. An LLC can distribute money or property to its owners on a "tax free" basis unless the distribution exceeds the amount the owner invested in the company. A single member LLC is automatically deemed a *disregarded entity* for tax purposes and is not required to file its own federal tax return. A multi member LLC is required to file an informational tax return and provide information annually to each of the members showing the member's share of the LLC's income, loss, deductions and credits for inclusion on each member's tax return.

2. WHAT IS THE TAX ON SALE? Whether or not the U.S. real property interest is owned directly or indirectly, a non resident alien selling United States such a real estate interest **is subject to tax on the net gain derived from the sale under the Foreign Investment in Real Property Tax Act ("FIRPTA")**. Net gain is computed by deducting from the net sale price (sale price minus sales commissions and certain closing costs) the original purchase price adjusted upward for acquisition costs and capital improvements made by the seller less accumulated depreciation deductions taken, as may be applicable to income producing property.

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<sup>1</sup> A "non-resident alien" is an individual who is neither a U.S. citizen nor a "resident alien". A "resident alien" is a non U.S. citizen who holds a green card or who meets a certain test called a "substantial presence test."

For example, if a property is sold for \$600,000 with a 6% commission (\$36,000) and other allowable closing costs of \$6,000, the net sale price is \$543,600. Assuming the property was purchased for \$480,000 and the seller made capital improvements of \$30,000<sup>2</sup> (e.g. flooring, built-in cabinetry, upgraded kitchen) for an acquisition cost plus improvements of \$510,000, the taxable gain would be \$33,600 [\$543,600 - \$510,000 = \$33,600]. If the property was owned for more than one year, long term capital gains tax rates would apply, with the maximum tax rate currently in effect being 15%.<sup>3</sup> Therefore, in our example, the maximum tax on the \$33,600 gain is \$5,040. Tax rates are higher if the seller is a corporation and state income tax also applies. The IRS and states require sellers to file an income tax returns whether or not a tax is payable.

Under FIRPTA, the buyer and buyer's settlement agent are responsible for the collection and remittance of the seller's capital gains tax to the IRS. To assure that the IRS gives accurate credit for the payment, the buyer and seller must have United States taxpayer identification numbers.

The settlement agent is required to withhold 10% of the full sale price<sup>4</sup> from the seller and upon settlement remit the same to the IRS within 20 days of settlement, **unless** the seller has sought relief by applying to the IRS for the issuance of a *Certificate of Reduced Withholding* prior to the settlement date, demonstrating that the tax payable is actually less than 10% of the sale price; in such event the settlement agent may retain 10% of the sale price in trust until such time as the IRS sends a letter approving the remittance of the actual tax incurred. The process of obtaining the letter from the IRS reducing the tax liability may take up to 120 days.

The seller's cost of applying for a *Certificate of Reduced Withholding* may range from \$1,000 - \$3,000 depending on the service provider and the complexity of the transaction.

There are other exceptions to FIRPTA's withholding requirements including a sale of a residential property for less than \$300,000, where the buyer has definite plans to reside in the property for at least 50% of the number of days that the property is used by any person for each of the next two, twelve month periods following the date of transfer. The buyer and buyer's settlement agent may rely on the buyer's sworn affidavit as to such definite plans.

3. WILL A NON RESIDENT ALIEN OWNING U.S. PROPERTY BE SUBJECT TO U.S. ESTATE TAXES? In general, upon the death, a non resident alien owning U.S. property is subject to U. S. Estate Tax imposed on the value of his/her assets situated in the U.S. holdings exceeding \$60,000<sup>5</sup>. This tax would be imposed even if the property is held by a U.S. corporation, which is, in turn, owned by a foreign person.<sup>6</sup> However, holding U.S. property by a U.S. subsidiary of a foreign corporation affords protection against such

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<sup>2</sup> All paid receipts for capital improvements to the property must be retained and presented to the IRS with the seller's application for a *Certificate of Reduced Withholding*.

<sup>3</sup> If property is held for less than a year, short-term capital gains rates apply which are the same as ordinary income tax rates.

<sup>4</sup> If the seller is a domestic corporation, 35% of the recognized gain must be withheld.

<sup>5</sup> A tax treaty with the decedent's country of citizenship may favorably impact the treatment of U.S. Estate Tax.

<sup>6</sup> Estate planners recommend that life insurance be purchased as a funding source for the payment of estate taxes in cases where the potential taxable estate is substantial, thereby avoiding the necessity of making a possible untimely or forced liquidation of property to pay the tax.

estate taxes and also affords the beneficial owner's anonymity. The fact that federal tax rates on corporate capital gains far exceed the 15% maximum tax rate applicable to individuals realizing such gains is a disadvantage of corporate ownership.<sup>7</sup> Consideration must also be given to the tax laws of the country of the non resident alien's citizenship in selecting the most suitable entity in which to take title.

4.. WHAT ARE TYPICAL CLOSING COSTS? Attached hereto as Exhibits "A" and "B" are Seller's and Buyers' respective typical closing costs for property sales of \$300,000, \$600,000 and \$900,000, respectively.

The Buyer should also take into account the cost of obtaining a professional inspection of property, a right usually provided for in the purchase contract. Inspection costs range between \$350 - \$750 for a condominium unit and may be somewhat higher for a single family home, apartment buildings and commercial properties, with the latter properties requiring more than one-type of inspection. The seller should also take into account the cost of applying for a *Certificate of Reduced Withholding* as discussed above.

Additional expenses may be incurred when, for example: (a) if the seller is required to make repairs as may be disclosed in the buyer's professional inspection reports as opposed to a transaction where the buyer agrees to accept the property in its "As Is" condition ; (b) where other business arrangements attend the closing such as post occupancy arrangements ( where the seller remains in possession by agreement after the closing), and (c) where the title search discloses a defect in the title to the property and a cost is incurred by the seller to cure the defect.

5. WHAT IS TITLE INSURANCE? Buyers of Florida real estate customarily obtain a title insurance from a Florida licensed, title insurance company assuring that the buyer obtains good and marketable title to the property. Before closing, the title insurance agent examines the public records and obtains other information in order to verify ownership and identify mortgages and other liens encumbering the property all of which the seller needs to satisfy. At closing the seller will receive a check (or wire transfer) in the net amount due after paying outstanding mortgages, other liens, sales commissions and closing costs as may be adjusted for pro-rated items such as, real estate taxes and condominium or homeowners' association assessments.

The basic Owner's Title Policy coverage covers loss arising from (a) incorrect signatures on documents; (b) forgery and other types of fraud (c) defective recordation of prior deeds (d) certified judgment liens and other types of liens and (e) persons other than the seller claiming an ownership interest in the property after title has closed. The policy is issued for a one-time premium (the cost of the policy) which protects the insured owner for the duration of the insured's ownership. The rates for title insurance are governed by the State of Florida (promulgated rates) and are calibrated to the amount of the purchase price (the total insured interest). The title insurance premium is included as a buyer's closing cost in the typical closing costs attached hereto as Exhibits "A" and "B". If the purchase is being financed, the mortgage lender will also require the buyer, as borrower, to pay for a lender's title policy ("Mortgagee Policy") assuring the priority of its mortgage and the lender may also require other title related coverages specific to the transaction as endorsements to the Mortgagee Policy. When issued simultaneously with the Owner's Title Policy, the cost of Mortgagee Policy is nominal.<sup>8</sup>

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<sup>7</sup>States, including Florida, also impose a corporate income tax.

<sup>8</sup> Mortgagee Policy endorsements required by a lender range from \$25.00 to 10% of the premium charged on the Owner's Policy depending on the type of endorsement.

**IRS CIRCULAR 230 NOTICE: To ensure compliance with requirements imposed by the United States Treasury Department, you are hereby informed that any advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. For more information about the U. S. Treasury's IRS Circular 230 disclosure, See the IRS.GOV website.**

SOUTHEASTERN TITLE COMPANY

SOUTHEASTERN TITLE COMPANY was established in 1993, by its principal, M. KEITH MARSHALL, a Florida licensed attorney, with offices in the City of Aventura, Florida. Aventura is located midway between Miami and Fort Lauderdale, about a 20 minute drive to the business district of each City.

SOUTHEASTERN's goal is to provide professional and expeditious residential and commercial, real estate title closing services. All title insurance policies are underwritten by Old Republic National Title Insurance Company of which M. Keith Marshall is a licensed agent. Old Republic National Title Insurance Company is member of Old Republic Title Insurance Group, one of the largest title insurance groups in the United States having the highest financial strength ratings.

In addition to real estate title closings, SOUTHEASTERN administers the closings of mortgage financings, refinancings and "short sales". A "short sale" is where the mortgage lender agrees to accept less than what is owed on its mortgage in connection with an imminent sale of the mortgaged property to an unrelated third party.

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