NEWS & KNOWLEDGE

Editorial: Property Tax Planning Essential For Foreign Investors

Daily Business Review
October 8, 2013

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It is no secret that the South Florida real estate market has been a buying opportunity for wealthy foreigners in light of the decline in U.S. home prices and the lower value of the U.S. dollar against some foreign currencies. According to the National Association of Realtors, foreign buyers have purchased more than $68 billion worth of U.S. residential real estate over the 12 months ending March 2013, with approximately 23 percent of those sales (over $15 billion) taking place in Florida.

Buyers from all over the world have been acquiring U.S. real estate for their own personal use, as well as for investment purposes, and Latin Americans have become one of the largest purchasers of real estate in Florida. According to a study conducted by the Miami Association of Realtors, Brazilians are ranked second in terms of foreigners buying real estate in Florida, while Venezuelans are ranked third, Argentineans are fourth and Colombians are ranked sixth. When considering an investment in U.S. real property, proper tax planning is essential for foreign investors.

Those planning to purchase U.S. real estate have many considerations to take into account. The ownership structure and intended use of the property can have dramatically different tax consequences to the foreign investor, so a well-advised foreign investor will consider the tax implications of an investment in U.S. real estate prior to making an acquisition. Unfortunately, many foreign investors do not consider the U.S. tax consequences related to an investment in U.S. real estate until they are ready to dispose of the property. Changing the ownership structure after acquisition can be time consuming and costly, though it may still be possible to avoid income tax.

When the direct foreign investor ultimately sells the real property, they will have to pay U.S. taxes pursuant to the Foreign Investment in Real Property Tax Act. Under FIRPTA, the foreigner is required to file a U.S. federal income tax return and pay U.S. taxes on gain from the sale of such U.S. real property as if the foreigner was a U.S. person. The tax is generally enforced by requiring the purchaser to withhold 10 percent of the gross sale proceeds of the sale at closing. With direct ownership of income-generating properties, the foreign investor is

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also faced with the implications of a 30 percent withholding tax on gross rental income and the potential for annual federal, state and local tax return filing obligations.

Purchasing real property directly is not always the best choice. In addition to the income tax consequences noted above, the direct ownership of U.S. real estate would also subject the foreign investor to U.S. estate taxes upon his or her death. In addition, direct ownership does not provide the foreigner with privacy or liability protection that is often desirable for foreigners investing in U.S. real estate and easily attainable with proper planning prior to the acquisition.

In lieu of making a direct investment, there are several business structures available to foreign investors purchasing U.S. real estate. It is possible to purchase real estate through corporations, pass through entities, and even through certain trusts, but the best structure for a particular investor depends upon his or her particular circumstances. With proper tax planning, a foreigner investing in U.S. real estate can avoid a personal U.S. tax return filing obligation and the U.S. estate tax, while minimizing the U.S. federal income taxes incurred from the operations of the property and gain upon the ultimate disposition of the property.

For example, by acquiring the real property through a U.S. corporation, the foreign buyer can avoid the obligation to file an income tax return with the Internal Revenue Service and minimize the amount of U.S. taxes incurred by capitalizing the corporation with a combination of debt and equity. Through the application of a carefully structured non-U.S. lending entity, this corporate structure often allows a foreign related party lender to receive the interest payments free from U.S. federal income tax, while also permitting the corporation to deduct the interest payments and reduce its U.S. income tax liability. This structure also permits the foreigner investor to avoid U.S. estate taxes by holding his or her ownership of the U.S. corporation through a separate foreign corporation. For a foreign investor, identifying a property and seizing the moment is typically the easiest part of the process. Choosing the right structure for the acquisition from a legal, tax and risk standpoint, is not quite as simple. Although tax planning can (and often does) occur after purchasing U.S. real estate, the most effective tax planning occurs prior to making the acquisition.

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