



Breakout Session
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U.S. Tax Implications of Foreign Investment in U.S. Real Estate

**Jessica Su, CPA
Director**

TRUSTA, An Accountancy Corporation
700 Bishop Street, #1700
Honolulu, HI 96813





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U.S. Person vs Non-U.S. Person

- U.S. Person (U.S. citizen, green card holders or noncitizen physically present in the United States for at least 183 days during any year, or more than 183 days over a three-year rolling period) – Taxed on worldwide basis.
- Non-U.S. Person – Subject to U.S. income tax only on income that is either effectively connected with a U.S. trade or business (“ECI”) or U.S. source income.

Income Tax Implications

Rental income/expenses

- Withholding Tax – 30% on payment made to a foreign person
 - Exception – Claim that income is effectively connected with a US trade or business
 - Form W-7 – Individual Identification Number
 - Form W-8ECI – Claim of income effectively connected with a US trade or business
 - Form 1042-S – Foreign person's US source income subject to withholding tax
 - US tax treaties
- Federal Income Tax – Graduate income tax rates
- Hawaii Income Tax – Graduate income tax rates
- General Excise Tax - 4%
- Transient Accommodations Tax - 9.25%
- Honolulu City and County Surcharge Tax – 0.5%

Income Tax Implications

Disposition of U.S. Real Estate

- Definition of U.S real property interest
 - Any interest in real property located in the US or the Virgin Islands, or
 - Interest in a domestic corporation
- FIRPTA – 10% of amount realized
- HARPTA – 5% of amount realized (does not apply to stock)
- Long-term (> one year) capital gain tax rate:
 - Federal 15%, Hawaii 7.25% (apply to individuals only)
- Short-term (< or = one year) capital gain tax rate - Ordinary income tax rate

Estate Tax

Exclusion: Gross estate located in the US is \$60,000

Estate tax rate

Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in Column A	Column D Rate of tax on excess over amount in Column A
\$ -	\$ 10,000	\$ -	18%
10,000	20,000	1,800	20%
20,000	40,000	3,800	22%
40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
100,000	150,000	23,800	30%
150,000	250,000	38,800	32%
250,000	500,000	70,800	34%
500,000	-----	155,800	35%

Gift Tax Implication

Annual Gift Exemption

U.S. person: \$13,000

Gift Tax Rate

Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in Column A	Column D Rate of tax on excess over amount in Column A
\$ -	\$ 10,000	\$ -	18%
10,000	20,000	1,800	20%
20,000	40,000	3,800	22%
40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
100,000	150,000	23,800	30%
150,000	250,000	38,800	32%
250,000	500,000	70,800	34%
500,000	-----	155,800	35%

Structure of Real Estate Ownership

- Direct foreign individual
- Domestic Corporation
- Domestic Limited Liability Company
- Foreign Corporation

Direct Individual Investment

Advantages

- Preferential long-term capital gain (15%) on a flat basis for capital assets held for more than 1 year
- Lower acquisition cost
- Easier to obtain institutional financing

Disadvantages

- 10% FIRPTA Withholding and 5% HARPTA Withholding at the time of sale
- 30% withholding tax on rental income unless an election is made to treat the rental income as effectively connected with U.S. trade or business income

Direct Individual Investment

Disadvantages -Continued

- Estate tax exposure (federal maximum tax rate 35%, Hawaii maximum tax rate 8.25%)
- Need to file individual income tax return in the U.S. for the sale of property or rental income
- No confidentiality on owner's information and property is exposed to garnishment by creditors of individual owner
- Need to probate property to transfer rights to heirs and beneficiaries

Direct Investment via Domestic Corporation

Advantages

- No FIRPTA or HARPTA withholding when the company sale the real estate but will be subject to 10% withholding if sale of the stock when the stock is considered as USRPI
- Nonresident owner does not file tax return in the U.S., only the domestic corporation files the corporate tax return
- Relatively low cost of structuring and maintenance
- Provides relative level of confidentiality for owner

Direct Investment via Domestic Corporation

Disadvantages

- Structure is not eligible for long term capital gain tax rate
- Corporate federal income taxation up to 35% plus state level corporate income tax
- Possible double taxation upon issuance of dividends
- Estate tax exposure
- Probate in the U.S. necessary to transfer shares to heirs and beneficiaries

Direct Investment via Domestic Limited Liability Company

Advantages

- Eligible for long-term capital gain tax rate
- No double taxation
- Low organizational and maintenance cost
- Protection available against creditors
- Easy access to institutional credit facility

Direct Investment via Domestic Limited Liability Company

Disadvantages

- Subject to FIRPTA 10% and HAPRTA 5% withholding tax on the sale of property if “single-member” LLC
- Estate tax exposure as Units of U.S. LLC is U.S. property for U.S. estate tax purposes.
- Probate in the U.S. necessary to transfer units to heirs and beneficiaries.

Direct Investment via Foreign Corporation

Advantages

- Protection from estate tax in the U.S.
- Shareholders may sell stock on a tax-free basis (however, the purchaser does not receive a “step-up” tax basis)
- Nonresident owner does not file tax return with the IRS, only the foreign corporation files Form 1120-F
- Relatively low structuring and maintenance cost
- Relatively higher level of protection from creditors in U.S. through limited liability and foreign jurisdiction

Direct Investment via Foreign Corporation

Disadvantages

- Not eligible for 15% long-term capital gain treatment
- Federal corporate income tax rate up to 35% plus state income tax
- 10% FIRPTA and 5% HARPTA withholding tax at time of the sale
- Risk of imposition of “branch profit tax” in addition to corporate and state income tax
- Risk of probate in foreign country and in the U.S. to transfer rights