



**Tax Withholding Requirements**  
*for*  
**Foreign Citizen / Residents Who Sell US / California Property**

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# General Withholding Rules on Foreign Seller Sales

## General Rule for IRS

The IRS requires the escrow co. must withhold 15% of the sales price on the sale of United States real property interests by foreign persons (on sales above \$1,000,000), and either 15% or 10% on sales between \$300,001 and \$1,000,000, and either 15% or \$0 for sales of \$300,000 and under. The lower withholding amount at both levels requires the buyer to purchase the property with the intent to use it as a residence.

<b>GROSS SALES PRICE</b>	<b>Buyer Intends To Use Property as a Residence?</b>	<b>YES</b>	<b>No</b>
	<b>\$300,000 and Under</b>	<b>\$0</b>	<b>15%</b>
	<b>\$300,001- \$1,000,000</b>	<b>10%</b>	<b>15%</b>
	<b>Over \$1,000,000</b>	<b>15%</b>	<b>15%</b>

**What Does the Buyer Acquires the Property for Use as a Residence Mean?** It does not mean the buyer must certify he or she will use the acquired property as a primary residence. The buyer is acquiring the property for use as a residence if on the date of the transfer the buyer (or the buyer's family) has definite plans to reside at the property for at least 50 percent of the number of days that the property is used by any person during each of the first two 12-month periods following the date of the transfer. The number of days that the property will be vacant is not taken into account in determining the number of days such property is used by any person. So this is an intent test as of the date of closing – the buyer is being asked to forecast his or her planned use for the acquired property for the next two years.

## General Rule for FTB

California requires withholding of 3.3% of the sales price (or 12.3% of the gain optional rate, or 0 withholding in a loss sale, but the 0 withholding in a loss sale is only available if the IRS has issued the foreign seller an individual taxpayer ID number ("ITIN") by the closing date, otherwise seller is stuck with 3.3% x sales price.) California requires withholding on: all individuals (even California residents); non-California partnerships; non-California corporations; most trusts; estates.



# Who Counts As A Foreign Person for IRS Withholding?

- A. Who counts as a foreign person?** A nonresident alien individual; a foreign corporation; a foreign partnership; a foreign trust; a foreign estate.
- B. Who counts as a nonresident alien?** These are individuals who meet two conditions: (1) they are not US citizens, and (2) not (full-time) legal US residents.
- C. Example (1).** A US citizen living in Paris sells his Los Angeles vacation home—*no withholding required on US citizens (no matter where they live at the time of sale).*

**Example (2).** A Danish citizen has a US work visa, lives and works in San Diego and sells her San Diego home—*no withholding on full-time legal US residents.*

**Example (3).** A Canadian vacationing 5 months a year in the US on a Canadian tourist visa sells her Palm Springs house—*10% withholding required, the Canadian citizen is on a vacation visa in the US and is not a legal US resident.*

**Example (4).** A Canadian vacationing 5 months a year in the US on a Canadian tourist visa sells her Palm Springs house, also happens to have a social security number from when she worked in the US 5 years ago—*10% withholding required, the Canadian citizen is on a vacation visa in the US and is not a full-time legal US resident, the fact that she has a social security number does not change the fundamental facts that she is not a US citizen nor a US resident at the time of sale.*

- D. Who determines whether the seller is a foreign person?** The seller does by signing the certification of “non-foreign status” to remove the 10% withholding obligation. The certification is not valid unless seller can include a valid social security number or ITIN. Escrow must accept signed certification with valid number unless it has actual knowledge or notice the certification is false.

**Example (5).** Same facts as **Example (4)**, except Canadian signs certification of non-foreign status and includes valid social security number, however both Canadian seller and seller’s agent have informed escrow seller is a Canadian citizen who comes to the US on a vacation visa—*despite validly completed certification, escrow should withhold 10% since it has actual knowledge the seller is neither a US citizen nor a full-time legal US resident at the time of sale.*

## Withholding Notes / 8828-B Issues

**When and How Must the 15% or 10% Be Sent in to the IRS?** The general rule is that the 15% or 10% should be sent into the IRS not later than the closing date (but technically escrow has 20 days after the close to get the 15% or 10% to the IRS). The 15% or 10% should be accompanied by the IRS Forms 8288 and 8288-A (typically prepared by escrow). The 15% or 10% must be sent in whether foreign seller has an ITIN at close or not.

**What is the 8828-B option?** In the alternative to the above, seller may file an IRS Form 8288-B (withholding certificate request), and escrow company may (at its discretion) hold the 15% or 10% in a client trust account while the 8288-B is being reviewed by the IRS. In this case, escrow should insist on seeing a copy of the 8288-B prepared by seller's tax professional, plus proof of mailing to the IRS, ***not later than the closing date***. Filing an 8288-B withholding certificate request can lead to a refund of much or all of the 15% or 10% withholding tax within 3 months of application.

**What Is the General Rate of Income Tax for the IRS and FTB?** The Federal Taxes are generally 15% x the gain on sale; the California Taxes are generally 9% x the gain of sale.



# BIG EXAMPLE

In 2014, Canadians Suzy & Jeff purchase a Los Angeles house for \$1,000,000. In January 2016, they sell the house for \$1,200,000. Escrow does not forward to Suzy & Jeff \$180,000 of the \$1.2M, since that is the required withholding tax ( $\$1.2\text{M} \times 15\% = \$180,000$ ). Note the real federal income tax is only approximately \$30,000 ( $\$200,000 \text{ gain} \times 15\% \text{ tax rate} = \$30,000$ )).

## **Federal Tax Options:**

**Option 1:** Suzy & Jeff take no special action. After completing a tax return in January, 2017 (they can't do a tax return until the year after the sale: 2017), Suzy & Jeff will receive a refund in the amount of \$150,000 ( $\$180,000 \text{ withholding tax} - \$30,000 \text{ real tax} = \$150,000$ ) around June 2017 (17 months after the close, yikes!!), plus they will receive no interest on the \$150,000 the IRS held for 17 months.

**Option 2:** Suzy & Jeff prepare and submit an IRS Form 8288-B Withholding Certificate Application (via tax professionals experienced at 8288-B submissions such as DIRECTS) and escrow company agrees to hold the \$180,000 in its trust account until the IRS responds to the 8288-B (the escrow co. is legally allowed to hold the withholding tax if the seller submits the 8288-B to the IRS prior to the close). If done properly, it is likely the IRS approves a refund of \$150,000 in April 2016 (and escrow sends into the IRS the required \$30,000 within 20 days of when the refund is approved). The day the letter is received the escrow can release the \$150,000, over a full year earlier than sellers Suzy & Jeff would have otherwise received this amount. This is the 8288-B withholding certificate request process, a tremendous potential benefit to the foreign seller.

**State Tax Options:** At closing, Suzy & Jeff will choose to send into Sacramento \$24,600 ( $\$200,000 \text{ appreciation} \times 12.3\%$ ), because that's less than the default rate of  $3.3\% \times \$1.2\text{M} \text{ (gross sales price)} = \$39,600$ . This \$24,600 stays in Sacramento until Suzy & Jeff do a tax return in 2017, but they do get some refund in 2018 because the real California tax is likely less than \$24,600.

**Note 1:** Suzy & Jeff must file a federal and state tax return in the year after the sale (even if they received a total refund of the withholding tax via the 8288-B process already), and it is at this stage they will receive a refund for any excess taxes withheld. For the refund of federal taxes, Suzy & Jeff must keep the Form 8288-A, Stamped (by the IRS) Copy B, which will be mailed to them by the IRS. Suzy & Jeff must send this stamped Copy B back to the IRS at the tax return stage, to prove to the IRS they have Suzy & Jeff's withholding tax (Great system IRS, thanks!).

**Note 2: What if Suzy & Jeff sell the home they purchased for \$1,300,000 in 2011 and sold it for \$1,200,000 in 2016 (i.e., for a \$100,000 loss)? Answer:** For the federal (15% of the sales price) withholding, that the home is selling for a loss is irrelevant. For California state withholding, the Form 593-C provides the potential for Suzy & Jeff to be subject to zero withholding in a loss sale, but only if they have procured their US taxpayer ID numbers by the closing date (otherwise  $3.3\% \times \text{the sales price}$  is withheld!!!).

# Exceptions to Withholding Requirement for Non-US Citizen / Residents

**There is no withholding of US federal (IRS) taxes if (any one of the following):**

1. The sales price is \$300,000 or under the buyer intends to use the property at a residence.
2. When there is ZERO “amount realized” in the transaction (i.e., a gift).
3. A Section 121 sale is of the non-US citizen / resident’s principal residence (unlikely for a non-US citizen /resident to have their principal residence in California, but only needed it to be principal residence two of last five years). 10% withholding is only avoided via the 8288-B withholding certificate request process (could receive 10% withholding back within 3 months of application to the IRS).
4. A like-kind exchange under IRC Section 1031. **For simultaneous exchanges with no boot**, no 10% withholding is required if the seller-transferor merely notifies in writing the purchaser-transferee (of the relinquished property) that there is no gain or loss because of IRC Section 1031, and if the purchaser-transferee sends a copy of the transferor’s notice to the IRS within 20 days of the date of transfer. **For exchanges with any boot or deferred like-kind exchanges**—*10% withholding is waived only with the 8288-B withholding certificate request process (could receive 10% withholding back within 3 months of application to the IRS as described on page 4).*

**There is no withholding of California State (FTB) taxes if:**

1. The purchase price is no more than \$100,000.
2. A sale under Code Sections 1031 or 121.



# Procuring Taxpayer ID Numbers Isn't Easy Anymore

## What evidence must a Foreign Citizen / Resident submit to the IRS?

**Answer:** The non-US citizen / resident must submit: (a) a certified copy of the passport; plus (b) a copy of real estate a sales agreement; plus (c) an IRS Form 8288 (either a Form 8288 with a Form 8288-A, or a Form 8288-B (if a withholding certificate is being applied for).

## What is a certified copy of the passport?

**Answer:** A copy of the passport, certified by:

- (a) A consulate office of the non-US citizen / resident's home country located in the US (such as the Canadian Consulate in Los Angeles);
- (b) A government office in the foreign citizen's home country which issues passports (such as a Canadian governmental passport office in Vancouver); or
- (c) Private tax professional in the US (or in foreign countries), specifically permitted by the IRS to certify foreign passports (an "IRS approved certifying acceptance agent").

## What else must be submitted?

**Answer:** A completed IRS form W-7 (careful, this can be a tricky form to complete correctly).

**Note:** *Starting in 2016, previously issued ITIN's not used on a US tax return within the prior 5 years will be invalidated.*

## How Can a Foreign Person Determine if Their Previously Issued ITIN is Still Valid?

**Answer:** Phone the IRS at 1.800.908.9982 for ITIN verification.

**DIRECTS In Palm Desert, California, has several tax professionals who have been approved by the IRS to act as certifying acceptance agents. DIRECTS is able to obtain taxpayer ID numbers within a month for all non us citizens / residents.**

# AT DIRECTS WE...

A.) Certify Non-US Passports and Prepare Applications to Obtain US Taxpayer ID Numbers. We certify passports through a variety of methods:

- (i) Through in person meetings at our Palm Desert location.
- (ii) Via our certifying acceptance agents meeting with non-US citizen/residents in a Southern California location of the non-US person's request (available in San Diego, with advance notice, in the greater Los Angeles area).
- (iii) On Their Computer Via Skype with one of our Certifying Acceptance Agents.

B.) Prepare applications to procure US tax ID numbers (called EIN numbers) for sales by corporations, partnerships and trusts.

C.) Prepare all tax forms incident to sales and rentals by non-US citizen/residents, such as:

- (i) the IRS Forms 8288 (withholding tax form sent in by escrow), 8288-A and 8288-B (application for withholding certificate to refund the excess withholding tax quickly)
- (ii) All 593 Forms (state withholding forms at the time of sale) — **We prepare these for sales by non-US citizen residents and for sales by Americans.**
- (iii) IRS Forms 1040NR (tax return to report to gains on sale by the non-US citizen/resident or rental income to the IRS) and Cal. Forms 540NR (for the state).

D.) Prepare forms to remove the withholding obligation on property managers for rentals by non-US citizen/residents (the IRS Form W-8ECI).

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