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Basic U.S. Tax Considerations In Investing In U.S Real Estate

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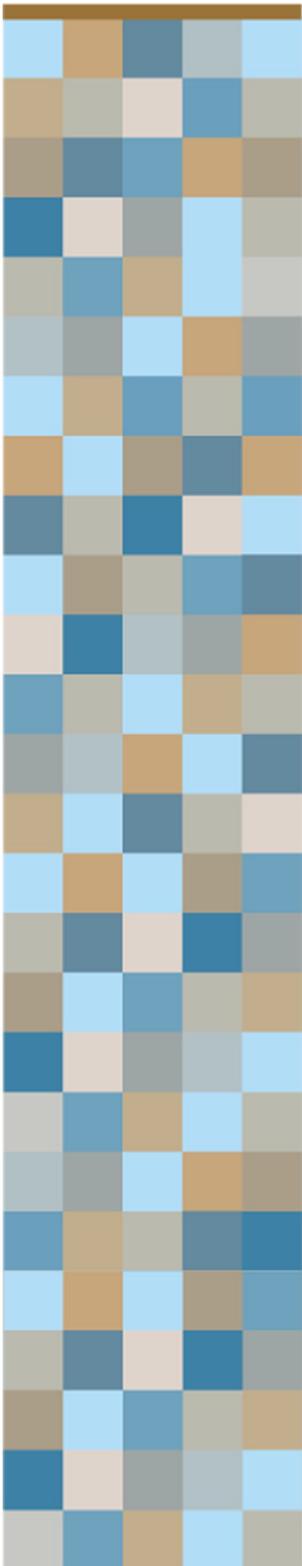
Background. Whether your¹ investment in U.S. real estate is intended for personal use – that is, the property will be used by you and your family exclusively as a personal residence (perhaps also made available on occasion to friends and extended family *gratis*); investment use – that is, held as an investment property, rented to unrelated third parties; or for both personal and investment use, you will want to be aware that its ownership could subject you to U.S. tax.

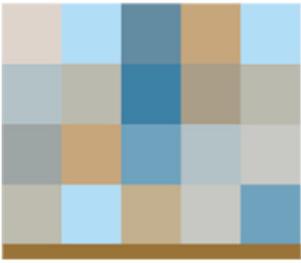
Advance planning for the purchase and ownership of U.S. real estate can help minimize the U.S. tax consequences. The purpose of this article is to provide an overview of the applicable U.S. tax implications and to introduce structures that may help minimize them. You are advised to seek experienced tax counsel in connection with your transaction.

What's at Stake? The U.S. imposes income tax on rental income from U.S. investment property; and on gain realized upon the later sale of U.S. property (whether investment property or personal use property). A transfer tax is also imposed on gratuitous transfers of U.S. property during the owner's lifetime (gift tax) or upon death (estate tax).

Rental Income. If you lease U.S. real estate you will be subject to U.S. income tax under one of two constructs: a gross rental basis or a net income basis. Absent a so-called "net election" (or facts establishing the intent to operate a business), gross rental income is subject to tax at the rate of 30%. A net election will permit you to pay tax at graduated ordinary income tax rates on the net income from the operation of the investment property. Generally, a net election is preferable because rental income is reduced by the expenses of operating the property such as depreciation, interest, insurance, property taxes, state income taxes, and maintenance costs. If you

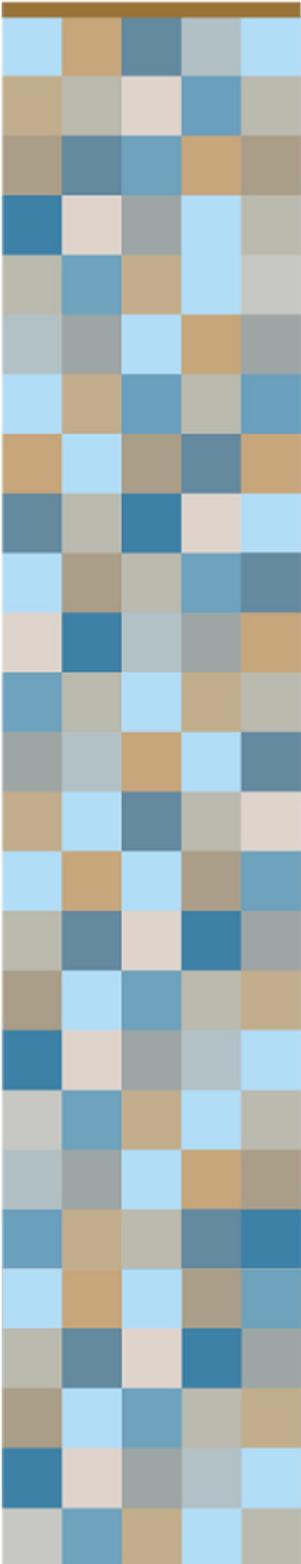
¹ This discussion assumes that the ultimate owner of the U.S. real estate is a non-U.S. Person, that is, a non-domiciled, non-resident alien. Importantly, the status of a non-U.S. Person may change as a result of presence in the U.S., status or immigration status. A green card holder is a U.S. Person.





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are purchasing U.S. real estate solely for personal use, the U.S. income tax consequences will be limited to tax upon sale of the property.

Transfer Taxes. At some point you may sell your U.S. real estate at a gain. Whether the U.S. real estate is investment property or personal use property, that gain will usually be subject to income tax. Further, a special set of rules require the buyer to withhold and deposit with the IRS 15% of the sales prices as a deposit against the tax due.

Estate and Gift Tax. Generally, the estate of a deceased non-U.S. Person includes the value of U.S. real estate owned directly² by him or her at the time of death; and is subject to a tax at a rate of up to 40%. An exemption is available for the first \$60,000 of value. Relief may be available under an estate tax treaty. Non-U.S. Persons are subject to gift tax a gift of interests in U.S. real estate and shares of stock in a U.S. corporation.

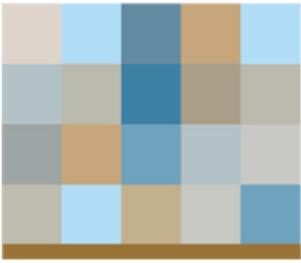
Holding Structures. While you can own title to U.S. real estate in your own name, there are both tax and non-tax reasons to consider using a holding entity (or in some cases through more than one entity). For example, U.S. real estate may be owned through a U.S. corporation, limited liability company or partnership. A foreign entity can also be used. Both domestic (U.S.) and foreign trusts can be used.

From a non-tax perspective, the use of a limited liability entity can insulate you from personal liability for losses or damages related to the operation or ownership of the property. For example, holding rental property through a limited liability entity may help avoid liability for injuries to a tenant or a repairman. Owning property through some types of entities can be helpful in protecting the identity of the ultimate owner of a property.

Holding company structures can affect the application of U.S. tax to real estate-related income and the application of U.S. estate and gift taxes.

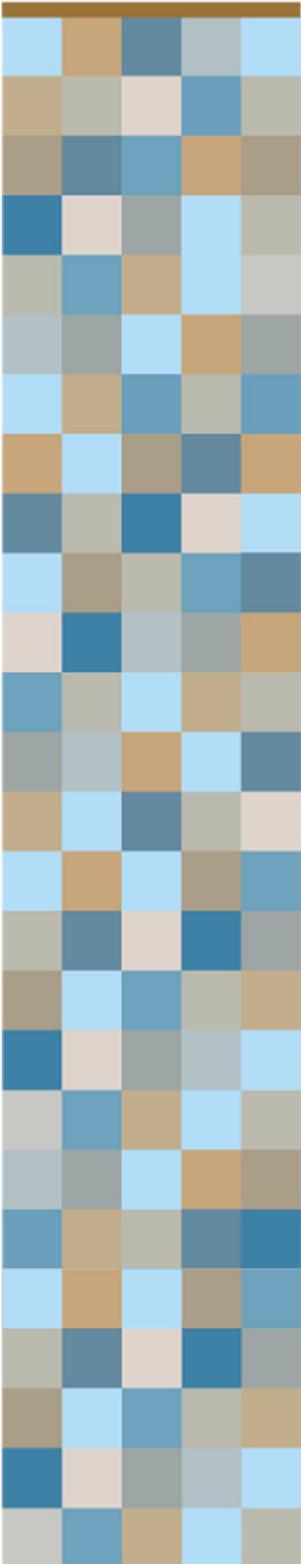
Foreign Corporation. Holding U.S. real estate to be used for investment will subject the corporation to U.S. income tax on the rental income either at a flat 30% on gross rental income or at graduated corporate rates (up to 21% federal) on net income if a net election is made. A foreign corporation may also be subject to "branch profits

² There is uncertainty under U.S. tax law as to whether an interest in a partnership that holds U.S. situs real estate is itself treated as U.S. situs real estate for estate tax purposes. Most conservative commentators view it reasonable to assume that it is.



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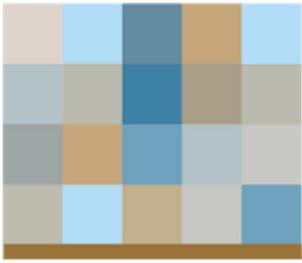


tax" on undistributed earnings. It will be subject to tax at the same graduated rate on gain recognized on the sale of the property. Withholding and deposit of 15% of the purchase price is required, but offsets tax due. Shares in a foreign corporation are not included in the U.S. estate of a shareholder who is a Non-U.S. Person. Generally holding investment property through a foreign corporation is not tax efficient.

Limited Liability Company. An LLC with more than one member is taxable a partnership for U.S. income tax purposes, unless it elects to be taxed as a corporation. As a partnership, all items of income, gain and loss flow through to the members and are reportable on their respective U.S. income tax returns. Members that are Non-U.S. Persons are subject to withholding. While not yet settled, the value of membership interests in an LLC taxed as a partnership may be included in the U.S. estate of a member who is a Non-U.S. Person. For these reasons, non-U.S. Persons generally avoid direct ownership of U.S. investment real estate through an LLC taxed as a partnership, though a single member LLC (disregarded for U.S. income tax purposes) is sometimes interposed between another entity, such as a trust, and U.S. real estate to limit liability for the ultimate owner.

Foreign Non-Grantor Trust. A foreign non-grantor trust is taxable in the U.S. on income, gain and loss recognized in connection with investment income. While there may be a U.S. tax filing requirement upon the receipt of distributions by the beneficiaries, there is typically no additional tax on the distribution of trust income or corpus to trust beneficiaries who are non-U.S. Persons. Neither the beneficiaries nor the trustee includes any value related to the U.S. real estate in their U.S. taxable estate. Typically, it is preferable for the trust to be the initial owner of the property. It is not uncommon for a trust to own the property through an LLC for liability purposes.

Summary. The ownership of U.S. real estate can subject a Non-U.S. Person to U.S. tax on income and gain associates with the property. There are various ownership structures that can minimize the tax and tax filing obligations associated with ownership of U.S. real estate. Early planning with a qualified professional can be important.



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Robert M. Finkel is the Partner-in-Charge of the firm's New York City office where he also serves as Chair of its Tax Practice Group. Mr. Finkel has over 30 years of experience as a tax and business lawyer. His practice focuses on the areas of individual and business taxation including tax controversy and tax litigation.

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Overview Of Structures For Holding U.S. Real Estate By Non-Resident Aliens

	Individually [No entity or LLC]	U.S Corp. [Owned by Foreign Corp.]	Foreign Corp. [Directly Owned by Non-U.S. Persons]	Foreign Non-grantor Trust [Non-U.S. Person Beneficiaries]
U.S. Income Tax on Operation and Sale Tax Rates: Operation: Sale:	YES Individual Rates -- Max 37%	YES Corporate Rates -- Max. 21%	YES Corporate Rates -- Max. 21%	YES Individual Rates -- Max 37%
Branch Profits Tax [Rate varies]	N/A	NO	YES	N/A
U.S. Tax on Dividends Paid (withholding rate varies)	N/A	YES	NO	N/A
U.S. Estate Tax	YES	No	NO	NO
FIRPTA Withholding	On Sale of Property	On Sale of Interests	On Sale of Property	On Sale of Property

If you have any questions regarding the matter raised in this Alert, please feel free to contact Robert Finkel at rfinkel@moritthock.com or (212) 239-5526.



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