



SHORT SALES AND FIRPTA WITHHOLDING – HOW DOES IT WORK?



By:

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About the Author:

Ms. Glendinning joined the firm in 1987 and has headed the International Tax Department since 1996. She has authored articles regarding various international tax issues and frequently gives presentations on U.S. income and estate taxation of foreign nationals doing business in the U.S.

The current economic climate has had a substantial effect on the real estate market. For many property owners, the mortgage balance owed on their property exceeds its value. Many of these property owners cannot afford to continue making the mortgage payments. In order to avoid foreclosure, lenders have approved sales of properties for a price that is less than the outstanding mortgage balance. This is referred to as a “short sale.”

The negotiations for a successful short sale can be complicated and lengthy for any seller. However, when the seller is a foreign person, additional complications can apply. The most significant complication of a short sale and a foreign seller is the withholding requirements under the Foreign Investment in Real Property Tax Act (FIRPTA).

Under FIRPTA, a foreign seller is required to have 10% of the gross sales price deducted from the net proceeds. This amount is sent to the IRS as a deposit against the actual tax owed on the sale. In a short sale, there are no net proceeds payable to the seller, since the sales price does not even cover the amount owed on the property. In some cases, the seller has to provide cash at closing. The question then arises about how to handle the 10% withholding requirement under FIRPTA.

Unfortunately, there is no exemption from the withholding requirements under FIRPTA in the case of a short sale. However, there are a couple of options to consider if a foreign seller is in this situation.

There is an exception to the withholding that applies to all sales of real estate, not just short sales. No withholding under the FIRPTA regulations is required if:

- a. The sales price is \$300,000 or less, and
- b. The buyer signs an affidavit that states they intend to use the property for personal purposes for at least 50% of the time the property is occupied for the 2 years immediately following closing.

If this exception applies, then no withholding is required and the closing can take place as planned. However, if this exception does not apply, another alternative is available.

In most cases (but not all), the seller will incur a tax loss on the sale of the property. This situation occurs when the seller is selling the property for less than they paid for the property. If this is the case, no tax will be assessed on the sale of the property. The seller may apply to the IRS and request that the withholding be reduced to zero, since no tax will ultimately be owed. The application for the reduced withholding (called a withholding certificate) must be sent to the IRS no later than date of closing. It typically takes around 90 days after submission of the application for the reduced withholding to be approved by the IRS, so it is imperative that the application be submitted as soon as lender approval is obtained. In some hardship cases, the IRS will expedite the processing of the application. Once the IRS issues the withholding certificate, the closing can take place without the 10% withholding.

I would be happy to assist you and your foreign sellers with the filing of these applications or with any questions you may have regarding this procedure.

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