HARPTA/FIRPTA

This handout is a basic explanation of some Federal and State of Hawaii taxation laws and requirements. The information provided should only be used to familiarize individuals with some of the terms and requirements of these laws and should not replace the advice and counsel of a licensed tax advisor or attorney.

What is a "USRPI"?

"USRPI" or "**United States Real Property Interest**" is a term that means any interest in real property located in the United States regardless of whether the property owner is a citizen of the United States.

What is "FIRPTA"?

"FIRPTA" stands for the **Foreign Investment in Real Property Tax Act,** a federal law**.**

- FIRPTA requires a foreign seller of a USRPI to pay a capital gains tax upon the sale of USRPI. This law and Sections 897 and 2445 of the Internal Revenue Service Code (IRC) require withholding of the capital gains tax due when the sale closes**.**
- Under IRC Section 1445, the Buyer or Transferee is required to withhold an amount equal to ten percent (10%) of the "amount realized" on sale, which is normally 10% of the sales price.
    - This withholding is required without regard to the amount of cash present in the transaction.
- The Buyer must send the funds to the Internal Revenue Service within twenty (20) days of closing.
- Section 1445 presumes that every Seller of a USRPI is a foreigner who is responsible for paying the tax <u>unless</u> the Buyer is provided with a properly completed and approved "non-foreign certification" form which is signed and sworn to by the Seller.
    - This form certifies that the Seller is not a foreigner and provides the Seller's name, address, and individual tax payer identification number (ITIN).

- The “non-foreign certification” should be retained by the Buyer for a period of at least five years
- The Buyer may rely on the “non-foreign certification” unless he or she has actual knowledge that the certification is false.

FIRPTA Relief

When applicable, the Seller may provide the Buyer a **non-foreign status certification.**

- This form, prepared by the Seller, identifies the Seller as a U.S. taxpayer.
- The completed document must be provided to the Buyer on a timely basis, prior to closing, with the taxpayer (Seller’s) tax identification number.
- If the Buyer knows such representation to be false, either through direct knowledge or through information provided by his agent, he cannot avoid liability for the taxes due by relying on a false certification form.

If the Seller is a foreigner, but the amount to be withheld exceeds the Seller’s tax liability, the Seller may apply for a **withholding certificate** from the IRS (IRS Form 8288-B).

- This form must be completed before closing and must be approved by the IRS in order to either reduce or eliminate the withholding tax burden and clear the Buyer from potential tax liability.
- Normally, the IRS has ninety days to rule on a properly completed withholding certificate.
    - The process often takes longer and approval may not be received until after closing.
    - In such cases, the Buyer should continue to have the required ten percent withheld.
    - The remittance to the IRS is not due until twenty days after receipt of the IRS approval.
    - Buyers should be cautioned that they must determine that proper and timely application for the withholding certificate has been made by the Seller.

- In the event that funds are withheld after closing pending an IRS ruling, the law provides for the funds to be temporarily retained by the Buyer.
- Because Buyer retention is probably not acceptable to the Seller, both parties should be advised to have legal counsel prepare an agreement regarding the retention and disposition of the funds.
- Such agreements may be available from escrow.

FIRPTA Filing

Remittance of withheld funds is made with form 8288.

- If a reduced withholding is approved, forms 8288-A and 8288-B must also be attached where applicable.
- Remittance and submission of forms are due not later that twenty days after closing
    - Or, if applicable, twenty days after receipt of a ruling where an application is pending at closing.
- A Seller is not relieved from the obligation to file a U.S. tax return simply because funds have been withheld and remitted or if no tax is owed.
- All such applications and filings require an Individual Taxpayer Identification Number (ITIN).
- Without an ITIN, the IRS will not rule on withholding applications and Sellers may not receive credit for the remittance of withheld taxes due.

The Importance of an ITIN

Without an ITIN the IRS will not process a withholding certificate, a remittance, or a tax return,

- Foreign Sellers should be counseled to apply for an ITIN with sufficient lead time to avoid closing delays.
- Sellers often purchase a USRPI as an investment property.
    - The best time to obtain an ITIN is at the time of purchase.
    - Later application may delay the sale.

- If the Seller does not have an ITIN at the time escrow is opened, the Seller should be advised to take immediate steps to obtain either an Employer Identification Number (EIN) by filing form SS-4 or an ITIN by filing form W-7.
    - A properly completed and supported form W-7 may be filed with forms 8288 and 8288-A and the withheld tax at closing.
    - This procedure does not allow for a reduced withholding.

What is a "HIRPI"?

"**HIRPI"** or "**Hawaii Real Property Interest**" is a term that means any interest in real property located in the State of Hawaii regardless of whether the property owner is a citizen of the United States. "HIRPI" is the Hawaii version of "USRPI".

What is "HARPTA"?

"HARPTA" stands for the **Hawaii Real Property Tax Act**, a State law.

- **HARPTA** requires all non-residents of Hawaii (regardless of citizenship or other residency) to have taxes withheld and remitted to the State within 20 days after the sale of a HIRPI closes.
- **HARPTA** presumes that every Seller is a non-resident and therefore subject to withholding unless proof is provided to the Buyer in the form of a properly completed and approved withholding certificate.
- The obligation to collect and remit the tax is placed upon the Buyer or Transferee of a HIRPI from a non-resident Seller.
- The Buyer or Transferee must deduct, withhold, and pay to the Hawaii Department of Taxation 5% of the "amount realized" by the Seller of a HIRPI, usually 5% of the sales price.

Relief is available for Sellers who have a reduced or no tax liability.

HARPTA Relief

The Seller may be exempt from the five percent withholding if he can provide the Buyer with a **Hawaii Resident Certification**.

- The **Hawaii Resident Certification** is provided on form N-289.

- This form requires the Seller’s federal taxpayer identification number, address, and a statement that the transferor is a Hawaii resident.
- Like FIRPTA, the **Hawaii Resident Certification** will not relieve the Buyer of his or her obligation to withhold funds.
- If the Buyer has information indicating that the certification is false. The Buyer cannot evade liability by relying on a form N-289 which he knows to be false.

Other provisions of HARPTA relief are available under some circumstances.

- The sale is of the transferor’s principal residence which is valued at not more than $300,000.
- Reduced withholding may be available upon documented proof that reduced or no tax liability exists.
- When a **withholding certificate** is filed, the Buyer should receive and retain a copy.
- The Buyer’s obligation continues until the State Department of Taxation has issued a withholding certificate, a copy of which the Buyer is entitled to receive.

HARPTA Remittance

- **HARPTA**, unlike **FIRPTA**, has no provision for retention of funds pending the processing of a withholding certificate.
- All funds withheld must be remitted within twenty days of closing.

FIRPTA AND HARPTA WITHOLDING

To satisfy both FIRPTA and HARPTA requirements, the combined cash requirement is fifteen percent (15%) of the sales price.

- The Seller must provide the cash funds to the Buyer so the funds can be remitted to the Federal and State tax agencies after closing.
- The cash may come from the sales proceeds and/ or other sources.

- Unless the Buyer has obtained properly prepared and approved **withholding certificates** from each of the taxing authorities, the entire amount should be withheld and remitted to the proper tax agencies.
- Failure to properly withhold and remit these funds results in the tax burden placed on the Buyer.
- In addition to the tax due, the Buyer may also be responsible for interest and penalties.

Installment Sales and Tax Deferred Exchanges

For both **HARPTA** and **FIRPTA**, when the sale involves an election to recognize gains on the installment sale method or if there is a deferral of tax liability, relief may be available.

Words of Caution

- Sellers' agents should be aware that the disposition of an investment property may raise questions about prior rental income derived from that property.
- Managing Agents for foreign owners of rental property are required to withhold and remit thirty percent (30%) of the gross rental proceeds.
- The lack of an ITIN would indicate that such filings were not made and may trigger an IRS requirement calling for the filing of up to six years of prior tax returns.
- Any Agent involved in the real estate transaction is subject to penalties if he or she knows the non-foreign certification is false and fails to notify the Buyer in writing of this falsehood.

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Internal Revenue Service Tax forms and instructions are available at:
http://www.irs.gov/

State of Hawaii Tax forms and instructions are available at:
http://www.state.hi.us/tax/a1_forms.htm