FOREIGN INVESTMENT IN FLORIDA REAL ESTATE

Jeffrey Harrington, Esq.

In today's real estate market, and with the ongoing disparity between the U.S. dollar and the Euro/Pound, some sellers are looking to the pool of foreign investors who in other times perhaps would not. The purpose of this article is to highlight key issues of which foreign investors and their fiduciaries should be aware.

Qualifying Person - The Patriot Act

An individual must be at least 18 years of age and not under a mental disability to hold title to real property in Florida. [1] The individual need not be a resident, but the holding and transfer of real property by non-citizens may pose issues with regard to the Patriot Act (the "Act").[2] Specifically, the Patriot Act requires financial institutions to implement programs to prevent money laundering.[3] The concern is that the term "financial institution" is broadly defined such that real estate transactions may be construed to fall into categories prescribed by the Act.

Taxation

Taxation issues affecting foreign parties are varied and complex. For lay person purposes, however, the overarching concerns may be summarized as follows: (i) income tax, especially the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") and international treaties; (ii) estate taxes; and (iii) gift taxes.

FIRPTA

This federal act was especially important to Florida because it required foreign parties that previously did not have Florida taxable income to report income and pay taxes to Florida. F.S. §220.22 compels every taxpayer required to file a federal tax return to also file a Florida tax return, and Section 897(a)(1) of the I.R.C., added by FIRPTA, provides that "gain or loss of a nonresident alien individual or a foreign corporation from the disposition of a United States real property interest shall be taken into account . . . as if the taxpayer were engaged in a trade or business within the United States . . . and as if such gain or loss were effectively connected with such trade or business." As a result, Florida now taxes disposition of real property owned by foreign parties because it is not longer a sale from "sources outside the United States."[4]

With respect to federal income taxation, the treatment will depend upon such factors as the following:

(i) Whether the foreign investor is classified as a resident or non-resident alien;[5] (*See* "Domicile Test" below)

(ii) Whether the investor is an individual or business entity;[6] *and*

[1] *See* Fla. Stat. § 743.07
[2] The USA Patriot Act of 2001 (PL 107-56, October 26, 2001, 115 Stat 272)
[3] *See* 31 U.S.C.A. § 5318 (h)
[4] *See* F.S. §220.13(1)(b)(2)(b) (Supp. 1982). Previously, this transaction was subtracted from federal taxable income to arrive at Florida taxable income.
[5] *See* IRC § 7701(b)(1)(A). *See also* I.R.C. s 861(a)(5), 897(a)(1), 882(a)(1).
[6] *See* IRC § 1 and § 11. *See also* IRC §§ 161-96 (deductions for individuals and corporations), IRC §§ 211-20 (additional itemized deductions for individuals), and IRC §§ 241-49 (special deductions for corporations).

(iii) Whether a partnership, trust, or other conduit is utilized.

A foreign individual investing in United States real estate may utilize any one of a series of alternative investment structures components of which may be organized either in or outside the United States. These components may include corporations, partnerships, or trusts. Selection of the appropriate components and their classification as foreign or domestic may have a significant impact on the overall level of taxation.

A further consideration is the international tax treaties that exist between the U.S. and other countries. Such treaties generally preempt all other applicable state and federal rules such that existing treaties should be the starting point of the tax analysis.

Estate & Gift Taxes

A foreign national is subject to U.S. estate and gift tax upon (i) the foreign national's death, and (ii) the transfer of any property owned by the foreign national to another individual for less than full consideration. The property that is subject to the U.S. taxing jurisdiction is based upon the foreign national's residency and the situs of the property that is owned by the foreign national, the so-called "Domicile Test."

Domicile Test

For purposes of U.S. estate and gift taxes, residency is based upon the foreign national's domicile. Treas.Reg. § 20.0-1(b)(1) provides that:

> A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such change unless accompanied by actual removal.

Some courts have used the following factors to determine domicile:

1) Length of stay in the United States; frequency of travel overseas;
2) Location of business interests;
3) Location of family and close friends;
4) Location, ownership, cost, and size of home;
5) Location of personal belongings which are expensive and/or with great sentimental value; *and*
6) Declaration of residence.

There are numerous techniques and structures employed to minimize the foreign investor's tax exposure, discussion of which goes beyond the scope of this article.[7] Where the real estate investment is significant in terms of price, consulting an international attorney and/or an international accountant is well worthwhile in this regard.

[7] *See* "Can FIRPTA be Avoided with Financial Instruments?" by Jeffrey Rubinger in the Florida Bar Journal (March 2004).

301 Clematis Street · Suite 3000 · West Palm Beach · Florida · 33401 · Tel (561) 655-1573
Fax (561) 584-6549 · jeff@harringtonlawassociates.com · www.harringtonlawassociates.com