By Renea M. Glendinning, CPA

rglendinning@kbgrp.com
Phone (941)365-4617
www.kbgrp.com

1990 Main Street, Suite 801
Sarasota, Florida 34236

ALTERNATIVES FOR NONRESIDENTS TO CONSIDER IN TAKING TITLE TO U.S. REAL ESTATE

Before a nonresident purchases U.S. real estate, careful consideration should be given to the best way to take title from a U.S. income and estate (inheritance) tax perspective, taking into account the nonresident's specific circumstances. This article will illustrate some of the U.S. tax advantages and disadvantages of some of the most commonly-used alternatives of holding U.S. real estate available to nonresidents.

INDIVIDUAL OWNERSHIP-Taking title in the individual's name is the most frequently-used alternative. It is the method that results in the least amount of U.S. income tax when property is sold. If the property is held for at least one year before it is sold, the maximum tax is calculated at 15% of the profit. However, this could be the most disadvantageous method of holding title if the nonresident dies while still owning the property. The U.S. estate tax rates start at 18% and increase to a maximum of 45% on property valued at $1,500,000 and above. The estate tax is assessed on the fair market value of the property at the date of death of the owner. It is payable to the IRS no later than 9 months after date of death and, if not paid timely, is subject to penalties and interest, which are payable in addition to the estate tax. The estate tax applies to property valued in excess of $60,000. To illustrate the severity of the tax, property valued at $500,000 would result in a U.S. estate tax of $142,800. While the U.S. is generally regarded as somewhat of a tax haven in terms of its income taxes, the estate tax on nonresidents can be somewhat onerous.

U.S. CORPORATE OWNERSHIP-Nonresidents are eligible to take title to the U.S. real estate in the name of a U.S. corporation. Unlike individual ownership, the corporation does not get the benefit of the 15% maximum tax rate on long-term capital gains. Corporate income tax rates on taxable income are 15% on $0 to $50,000, 25% on $50,001 to $75,000, 34% on $75,001 to $100,000 and 39% on $100,001 to $335,000. At a taxable profit of $335,001 to $10,000,000, the tax rate is a flat 34%. If the property is located in Florida, then there is a state income tax of 5.5% of profit in excess of $5,000

that must also be paid. The overall highest income tax rate for property in Florida held through a U.S. corporation is approximately 38%. Compared to the maximum individual tax rate of 15% on the sale of property, the corporate income tax rate is very high. This is obviously a disadvantage of U.S. corporate ownership of real estate. The potential advantage of U.S. corporate ownership of U.S. real estate is from the standpoint of U.S. estate taxes. Although the value of shares in a U.S. corporation owned by a nonresident is generally subject to U.S. estate tax upon the death of the owner, estate tax treaties with certain countries (for example, United Kingdom and Germany) provide for an exemption of these shares from the U.S. estate tax. This can be a substantial benefit for those nonresidents who qualify.

FOREIGN CORPORATE OWNERSHIP-The foreign (non-U.S.) corporation is subject to the same income tax rates as the U.S. corporation. The benefit of the foreign corporation lies with the U.S. estate tax. Unlike the U.S. corporation, all nonresidents are exempt from U.S. estate tax upon their death if the property title is held by a foreign corporation. The country of residence of the owner is irrelevant.

U.S. LIMITED LIABILITY COMPANY OWNERSHIP-U.S. limited liability companies have become increasingly popular as an alternative for ownership of U.S. real estate by nonresidents, due to their extreme flexibility. The limited liability company is a legal entity. The taxability of a limited liability company is dependent on several factors. A limited liability company with 2 or more members is taxed as a partnership, unless it has elected to be taxed in another manner, such as a corporation. If the limited liability company has only one member and it has not elected to be taxed as a corporation, then it is treated, for income tax purposes, as a "disregarded entity" and is taxed directly to the owner. For example, if the owner of a single-member limited liability company is a foreign individual, then the rules and tax rates applicable to foreign individuals will apply. The single-member limited liability company will provide the owner with legal limited liability, but it will be taxed in the U.S. for income and estate tax purposes as if the company did not exist.

Ideally, the nonresident would make an informed decision on how to take title of his U.S. real estate before the closing on the purchase. Unfortunately, this is rarely the case. If the nonresident already holds title in one way, but finds it desirable to change the method of ownership, this can generally be accomplished. However, making the change could result in taxes and costs that could have been avoided had the proper decision been made before the purchase. Since this article deals exclusively with U.S. taxation, it is recommended that the nonresident consult his tax advisor in his home country to determine the tax effect in his country of residence before any final decision is made with respect to U.S. taxes.

Dated: October 11, 2008

ABOUT THE AUTHOR

Renea M. Glendinning, CPA is a shareholder of Kerkering, Barberio & Co., P.A., an independent accounting firm located in Sarasota, Florida. She joined the firm in 1987 and has headed their International Tax Department since 1996. Ms. Glendinning has authored articles regarding various international tax issues and frequently gives presentations on U.S. income and estate taxation of foreigners doing business in the U.S.