

Plan Ahead to Reduce (or Eliminate) U.S. Withholding Tax when Selling or Transferring U.S. Subsidiaries holding U.S. Real Property

January 31, 2022 – Cross-Border Counselor

by Kendall R. Fisher and John D. Hollinrake, Jr.

Many Canadian companies and individuals own U.S. real property interests through a U.S. corporation. The Foreign Investment in Real Property Tax Act (“FIRPTA”) regime imposes a withholding tax (currently at a rate as high as 15%) on the gross proceeds realized by Canadians upon the sale or transfer of a U.S. real property interest. This withholding is imposed without regard to whether the disposition results in a taxable gain. However, with advance planning, this withholding may be reduced or eliminated.

A U.S. real property interest (“USRPI”) generally includes land, buildings, growing crops and timber, and mines, wells and other natural deposits (including oil and gas properties and mineral deposits) located in the United States and equity interests in a “United States real property holding corporation” (“USRPHC”) as well as certain interests in a USRPI-owning partnerships (subject to certain “look-through” rules). A U.S. corporation (or entity classified as a U.S. domestic corporation for U.S. federal income tax purposes) will generally be a USRPHC if, at any time during the prior 5 year period, the fair market value of its USRPIs equals or exceeds 50% of the aggregate fair market value of (a) such corporation’s USRPIs, (b) such corporation’s interests in foreign real property, and (c) such corporation’s other assets that are used or held for use in a trade or business.

If shares in a USRPHC are sold or transferred by a Canadian in certain tax-deferred transactions (as determined for U.S. federal income tax purposes), certain certification and filing requirements must be satisfied to avoid FIRPTA withholding.

If that sale or transfer is made pursuant to a taxable transaction (as determined for U.S. federal income tax purposes), FIRPTA withholding may be reduced (or eliminated) by filing an IRS Form 8288-B if the actual tax due on the “built-in gain” in the shares of the USRPHC is less than 15% of the gross sale proceeds (or if the shares are in a built-in loss position).

To be effective, an IRS Form 8288-B must be completed, signed, and filed with the IRS prior to the effective time of the sale or transfer. In order to be complete, the form must

Related People

- Kendall R. Fisher

Related Capabilities

- Canada Cross-Border Transactions

generally contain: (i) the U.S. taxpayer identification number of the transferor and the transferee; (ii) a description of the USRPI being transferred; (iii) the fair market value of the USRPI being transferred and evidence supporting the same (which, in some cases, requires an independent third-party appraisal); and (iv) the transferor's adjusted tax basis in the USRPI being transferred. If the Canadian transferor does not have a U.S. taxpayer identification number, it will need to obtain one.

Completing an IRS Form 8288-B often requires advanced planning. Canadian companies and individuals holding shares in a USRPHC (or USRPIs) may be able to significantly reduce the U.S. withholding taxes to which they are subject by planning ahead and timely filing an IRS Form 8288-B.