QUERIN LAW LLC

Why Oregon Realtors® Should Get Out Of The FIRPTA Business

FIRPTA and Buyer Liability. Until the last few years, the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") was just an arcane acronym; most residential real estate brokers had no knowledge of what it stood for, what it was, or how it worked. Fewer cared. After all, they had never handled a FIRPTA transaction involving the sale of real property by "foreign persons".[1]

But during the Great Recession it was widely believed that as prices plummeted, many foreign persons were purchasing homes in the United States for investment. It was also widely assumed that eventually these buyers would become sellers, so the real estate industry needed to familiarize itself with FIRPTA, since it levies up to a 15% tax on the sale price at closing.

Eventually, alarm bells began to go off when it became known that if FIRPTA applied to a transaction, but was ignored, the buyer would become automatically liable for their seller's tax bill. Suddenly, real estate agents and their brokerages began to become concerned about their duty to appropriately inform their buyer-clients about the application of FIRPTA if the seller might be a foreign person.[2] *And how would they know which seller was a foreign person and which one was not?*

As many brokers know, the RMLS™ listing form asks sellers whether they are a foreign person. And until the 2019 OREF Sale Agreement form was published, it contained a representation that the seller was *not* a foreign person.[3] So, the question naturally arises, "If FIRPTA applies, and the seller is a foreign person, but says they are not, are the representations in the RMLS™ listing and Sale Agreement sufficient to insulate the buyer from liability for the seller's taxes?" Unfortunately, the answer is "No".

Seller Certification (or Affidavit) of Non-Foreign Status. But the buyer is absolutely protected – like crosses on vampires – if the seller signs a Certification of Non-Foreign Status ("Certificate"). It is a fairly benign document: (a) stating that the seller is *not* a nonresident alien for purposes of U.S. income taxation; (b) identifying their Social Security Number (or Employer Identification Number); and (c) their home address.

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[1] According to the IRS here, "A payee is subject to nonresident alien (NRA) withholding only if it is a foreign person. A foreign person includes a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, a foreign estate, and any other person that is not a U.S. person. It also includes a foreign branch of a U.S. financial institution if the foreign branch is a qualified intermediary. Generally, the U.S. branch of a foreign corporation or partnership is treated as a foreign person."

[2] This is not to suggest that FIRPTA makes brokers automatically liable if the withholding law is ignored. But if a buyer ended up having to pay their seller's FIRPTA withholding, that buyer could quite possibly ask: "Why didn't my agent inform me about this risk?"

[3] Why it was removed is a mystery to me. It should be put back, along with an affirmative representation that the seller will cooperate with escrow in signing whatever documents and forms escrow requires for closing with a *non-foreign* person.

Above the seller's signature is an acknowledgment that it may be disclosed to the IRS by the buyer, and that if any of the above statements are false, it could be punishable by fine, imprisonment, or both. Then, "under penalties of perjury" the seller signs declaring that they have examined the document and to the best of their knowledge and belief it is true, correct, and complete.

The Rub. Hmmm. Sounds simple enough. *Nada*. You see, under the FIRPTA law, the Certificate is to be given by the seller to the *buyer* to hold for five years. How many sellers do you suppose would willingly turn over their Social Security Number to their buyer to hold for half a decade?

Enter the Qualified Substitute Rule. The answer is obvious – find someone else to do so. In 2008, the "Qualified Substitute" law went into effect, which "…means, with respect to a disposition of a United States real property interest— (A) the person (including any attorney[4] or title company) responsible for closing the transaction, other than the transferor's agent, and (B) the transferee's agent."[5] So in Oregon, the buyer's real estate agent or the title company closing the transaction may serve as the Qualified Substitute for the buyer to hold the Certificate. In that capacity they must deliver to the buyer a signed declaration under penalty of perjury that they are in possession of the Certificate. This is the buyer's assurance that they will not get tagged if their seller turns out to be a "foreign person".

The Other Rub. *But h*ow many sellers do you suppose would willingly turn over their social security number to their buyer's real estate agent/brokerage to hold for half a decade?

Role of Oregon Title Insurance Companies as Qualified Substitutes. Though it was not always the case, as of 2019, *all* major title companies in the Portland Metro area have agreed to serve as Qualified Substitutes. I believe this is also the case in the Bend area of Central Oregon.

This is an accommodation that only makes sense – who is in a better position to electronically retain the Certificate with the seller's social security number or Tax ID Number than the title company that handled the transaction from the opening to closing of escrow, disbursed the funds, and recorded the deed of conveyance? And we know that sellers do not object to providing escrow with their social security number or Tax ID Number – it is required in order that escrow can complete and submit the 1099-S (Proceeds from Real Estate Transactions) to the IRS.

In short, Oregon title/escrow companies are the obvious entities to serve as Qualified Substitutes. And if truth be told, many – if not all of them – have required sellers to sign a Certificate for *every* transaction they close, regardless of whether they are "foreign persons". What they haven't been doing, at least until now, is "formally" acting as the Qualified Substitute, and providing *every* buyer

[4] The reference to "attorney" is not "any attorney" but only the attorney "responsible for closing the transaction." In Oregon, Washington and California, attorneys do not typically close real estate transaction since title/escrow companies serve in that capacity.

[5] See, https://www.law.cornell.edu/uscode/text/26/1445

with a declaration that they are holding the seller's Certificate and will do so for the next five years. But this is no burden to the industry, since under Oregon Real Estate Agency regulations, title and escrow companies are already required to hold their transactional records for not less than six years.

Why is This Important for Oregon Realtors®? When buyers or sellers are damaged, or believe they have been damaged, frequently, the first place they look is to their real estate broker. If a seller lied about being a "foreign person" and the buyer got tagged for the seller's tax liability, it is likely they would ask their broker why they weren't warned about this. And that broker could likely ask the seller's broker why it wasn't vetted at the time of taking the listing.

And what will escrow say when asked why they didn't vet the issue? They will respond that they act as a "neutral" and do not render advice and have no duty to vet the FIRPTA issue with sellers and buyers. And lest you doubt this, sit down in a quiet room free of distractions for an hour, and closely examine the carefully drafted escrow instructions that both parties sign; they are replete with disclaimers for these types of responsibilities.

The Solution Going Forward. Oregon Realtors® have no business doing something escrow should be doing when a real estate transaction is first opened: Immediately get the Certificate of Non-Foreign Status signed by the seller. And at the time of closing, it should provide a declaration to the buyer that it is holding that document and will do so for the required period of time. How difficult is that? Realtors® should not want their fingerprints on the Certificate.

And to be absolutely safe, this should be in the form of a joint seller/buyer instruction to escrow; let them do the job they are paid to do.

Warning: Remember, escrow has no duty to proactively vet the "foreign person" issue. That is why it is important for brokers to make that a priority in <u>every transaction</u> – when escrow is opened, seller and buyer should "instruct" it to (a) get a Certificate of Non-Foreign Status signed by the seller, and (b) deliver a declaration to the buyer at closing that they are holding it. Preferably, put this instruction in writing and have seller and buyer sign and submit it to escrow.

And an added benefit of this approach is that 75% of the current FIRPTA section can be eliminated from the OREF Sale Agreement, since Realtors® will no longer need to vet the issue in order to protect themselves from liability. With luck, all the current inventory of FIRPTA forms can be eliminated, since FIRPTA will no longer be the elephant in the (closing) room.

Does This Result in any Added Burden to the Title/Escrow Industry? No, they've been quietly getting Certificates signed for years; they already hold them for six years – one year longer than the IRS requires; they already have their seller's Social Security or Tax ID Number for issuances of the 1099-S; and since they already collect and disburse funds, if they have to remit the seller's FIRPTA

withholding taxes, it is simply another part of their existing closing protocols[6] – similar to that required for Oregon withholdings for out-of-state sellers.[7]"

The only objection from the title industry I have ever heard to serving in this capacity is that the declaration given by the Qualified Substitute to the buyer confirming they are holding the Certificate is "under penalty of perjury". My response? Huh? What is wrong with telling the buyer under oath that you are holding the Certificate if it's true?

As for title and escrow companies in small towns, there are anecdotal reports that some of them may be hesitant to act as a Qualified Substitute since they are unfamiliar with the FIRPTA law. However, we know that their title insurance is underwritten by the larger companies. So, the solution seems to be for the larger companies to educate their smaller brethren about this law so they can perform their closing responsibilities. It isn't complicated: It only requires having sellers sign a Qualified Substitute form and delivering a declaration to their buyers confirming they are holding it. If a seller refuses to sign the Certificate, and their attorney or CPA does not provide escrow with adequate assurance they are not a foreign person, then it should make the necessary FIRPTA withholding and remit it to Uncle Sam. ***~Phil***

[6] To be clear, title companies have never objected to withholding a seller's FIRPTA taxes and remitting them to the IRS. The only objection by many of them – until now – has been formally serving as the Qualified Substitute.

[7] Escrow is required to withhold and disburse to the Oregon Department of Revenue taxable gains on real property sold by out-of-state residents. See, discussion here.