Podcast Transcript

Estate and Tax Planning for Globally Mobile Clients: Purchasing U.S. Real Estate by Non-U.S. Persons

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Lee: The United States has a complex tax system that can differ from that of one's home country. For that reason, there are many tax issues non-Americans should be aware of when purchasing real estate located in the United States. I'm Leeann Lee, and you're listening to BakerHosts.

On today's episode, we'll discuss the acquisition of U.S. real estate by non-Americans, the tax consequences, and steps to take to minimize the tax impact. We're joined by Private Wealth partner, George McCormick, who is located in our New York office. In his practice, George focuses on tax and estate planning for international clients with a connection to the United States. Welcome to the show, George.

McCormick: Thanks, Leeann. Happy to be here again.

Lee: So, to start us off, what are the main tax issues or consequences non-Americans should be aware of when purchasing U.S. real estate?

McCormick: Well, the most important thing that I would inform a non-American of – who is considering purchasing U.S. real estate – is if they purchase that real estate in their individual name and then later pass away, that asset is subject to U.S. federal estate tax. On prior podcasts, we've talked about U.S. federal estate tax mostly for Americans, U.S. citizens, and U.S. residents, and the exemptions that they're afforded against the estate tax. But for non-U.S. citizens, non-U.S. residents, while only a few types of assets are subject to U.S. estate tax, real estate is one of them. And notably for non-U.S. persons, they only have a $60,000 estate tax exemption amount, and the highest rate of tax is 40%.

So, as an example, let's say a non-U.S. person purchases a New York City apartment for $10 million, which is not really that unrealistic in New York at all. At a $10 million value, there is a potential almost $4 million of estate tax exposure. So, it is very important for clients to be aware of this potential tax issue before purchasing U.S. real estate.

Lee: Now, you mentioned estate tax concerns for non-Americans buying real estate. What steps can someone take to minimize their tax exposure?

McCormick: The most important step is to not purchase the real estate in their own name. If it is in their own name, then it is fully subject to estate tax. I'd also mention that they should not use a limited liability company to purchase the real estate either. Other than individual ownership, an LLC is the most common type of purchaser I see for U.S. real estate because of the liability protection. But an LLC is transparent or see-through from a U.S. tax perspective, so it provides no protection against estate tax.

So, there are other types of structures and strategies a client should consider before purchasing the real estate. There are a few different types of commonly seen structures. Either a non-U.S. company is the owner of the property, or a non-U.S. company that owns a U.S. company which owns the property or a trust, in some circumstances, perhaps, partnership. The reason why we use these structures because with the non-U.S. company, if the client passes away, they die owning a non-U.S. company and not the underlying U.S. real estate. With a trust, we would structure the trust in such a way that the client doesn't have too much control or interest in the trust that would put the asset, the real estate, in their estate.

Lee: Okay, let's change gears. Are there income tax issues to think about when buying U.S. real estate?

McCormick: Yes. The client should definitely be thinking about income tax planning as well. Estate tax is a given for any non-U.S. person that is purchasing U.S. real estate. So, when they're looking at a type of ownership structure, the income tax issues often dictate what type of structure they utilize. And the income tax issues are often directly related to the use of the property. Right? So, is it a personal use property? Or maybe there is really no income or little income. Or is it a personal use property and rented some? Is the property owned for purely rental income or rental yield or capital appreciation? Or a combination of all of these different things? And so, we look at all of those issues, and then we look at the client's particulars in the country they live in and things like that. And that is how we arrive at an ownership structure that we recommend.

Lee: And now, what are some other issues to consider when purchasing U.S. real estate?

McCormick: Well, one other tax issue I'll mention here first is that, in addition to the federal estate tax, there are certain states that impose a state estate tax, like New York does. So, this is even more of a reason for a non-U.S. person, who is considering purchasing U.S. real estate, to create some sort of ownership structure.

Aside from taxes, what I tell clients is that it is very important to try to get this ownership structure in place before they purchase the property. If the client purchases the property in their individual name, it is very difficult, almost impossible, to get that property into some sort of estate tax protected structure. So, it is very important that the structure is in place before closing. And that the trust or the company, or whatever legal person it is, is the one that takes ownership at closing. And to me, ideally, that ownership structure is in place before the contract is signed.

So, in most places in the U.S., purchasing real estate is sort of a two-step process. You look at the property, you like the property, you make an offer. And then, once the offer is accepted, you sign a contract. And you put down, for example, 10%. And then there is 30, 60, 90 days, something like that. There is due diligence, and then the second part is the closing.

To me, really, the ownership structure should be in place not only at the closing, but by the time they sign the contract. One reason is because there is maybe some sort of quirky, grey tax issues about if you change the name between signing the contract and the closing. But the other issue, from a non-tax perspective, is that if you have a person in their individual name sign a contract and then they say they want to change the name of the purchaser before closing, that can sometimes scare sellers. And, you know, it can make things kind of strange and awkward in the deal and maybe even make them want to back out. So, again, just to reiterate, it is very important that they get the structure in place.

I'll also add that we're trying to minimize U.S. taxes here, but we don't want to create unintentional issues from a non-U.S. tax perspective. We want the client to have advice from a lawyer or tax advisor in their country of residence to make sure the structure that I'm suggesting works for that country as well.

Lee: Clearly there are many issues to consider before buying U.S. real estate. So, what are the main points you would like clients to take away from this?

McCormick: The first thing that they should be aware of is that if you're a non-U.S. person and you purchase U.S. real estate in your individual name and you pass away, you'll be subject to U.S. federal estate tax on that asset and almost on the entire value of the asset at a 40% rate. Therefore, they should consider some sort of ownership structure, whether it is a corporation, a company, a trust, that is the purchaser of the property. They should get tax advice from an advisor who understands these issues to make sure it is structured properly. And they should also be consulting with an advisor in their home country to make sure there is no unintentional tax issues in that country.

Lee: Well, as always, this has been a great conversation. Thank you, George.

McCormick: Thanks, Leeann.

Lee: If you have any questions for George, his contact information is in the show notes. As always, thanks for listening to BakerHosts.

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