



## Real Estate Investments in the United States and Italy: Things Every Italian Should Know about Investing in Real Estate in the United States

New Jersey/Italy Trade Council

October 16, 2009

Frank T. Cannone, Esq.  
Gibbons P.C.  
[fcannone@gibbonslaw.com](mailto:fcannone@gibbonslaw.com)

New Jersey

One Gateway Center, Newark, New Jersey 07102  
Direct: 973-596-4621 Fax: 973-639-8340

New York

One Pennsylvania Plaza, 37th Floor 10119  
New York, NY 10019  
Direct: 212-613-2180

Marc D. Fitapelli, Esq.  
Gibbons P.C.  
[mfitapelli@gibbonslaw.com](mailto:mfitapelli@gibbonslaw.com)

New Jersey

One Gateway Center, Newark, New Jersey 07102  
Direct: 973-596-4737 Fax: 973-639-6392

New York Office

One Pennsylvania Plaza, 37th Floor  
New York, NY 10119  
Direct: 212-613-2169

## Basic Steps

- Locating a property
- Determining appropriate vehicle to acquire property
  - Plan for and mitigate taxes during operation and at eventual disposition (i.e. planning an exit strategy)
  - Plan for other issues (i.e. anonymity, home country tax implications)
- Structuring financing/investigate financing options
  - Importance of negotiating a contractual contingency for financing on terms that are reasonable and realistic
- LOI/Contract of Sale
- Conduct due diligence
  - Review title, leases and service contracts
  - Review environmental laws/regulations and local zoning restrictions
- Closing

## Basics of Structuring Joint Ventures

- What is a JV?
- Involves the formation of a new special purpose vehicle which is utilized to purchase real estate assets
- The terms of each JV agreement are unique
- Essential elements of a JV agreement are:
  1. Contributions
  2. Preferred returns
  3. Governance
  4. Winding up

## Sources of Financing (Traditional and Nontraditional)

- Owner
- Commercial Banks
- Insurance Companies
- Pension Funds
- Real Estate Investment Trusts
- Private Investors/Non-Bank Financial Institutions
- Mezzanine Lenders
- Tenancy-in-Common
- Joint Venture

## Introduction to REITs for the Foreign Investor

- A Real Estate Investment Trust, or REIT, is a corporation or trust whose predominant assets are equity and debt instruments in real estate
- No FIRPTA tax is imposed on the sale of REIT shares by foreigners if the REIT is:
  - (1) publicly traded; and
  - (2) the investor holds less than a 5% interest
- No FIRPTA tax is imposed on the sale of a “domestically controlled” private REIT (less than 50% of the value in stock was held directly or indirectly by foreigners within the last 5 years)
- A REIT is required to withhold 30% tax on ordinary dividends paid to foreign investors, but the actual withholding amount may be reduced under the U.S./Italy Tax Treaty

## Direct Ownership

Foreign  
Individual(s)



Real  
Property

- Not suited for income producing property; best suited for smaller vacation homes that are personally occupied
- Very simple with one level of income taxation
- Clients will be exposed to U.S. Gift and Estate Taxes
- Personal liability exposure
- Clients may consider purchasing life insurance products to mitigate U.S. Estate Tax exposure
- Client's presence in the U.S. will be known
- Client will need to file annual federal and state income tax return if the property is income producing
- FIRPTA withholding due at transfer (one exception if transfer is less than \$300,000)

## Ownership Through a U.S. Corporation

Foreign  
Individual(s)



U.S.  
Corporation



Real  
Property

- Individual(s) are not required to file federal or state income tax returns
- Only partial anonymity because U.S. income tax returns will disclose identity of individual investors who own more than 50% of company's stock
- FIRPTA withholding for sale of shares in U.S. corporation if 50% or more of the gross value consist of USRPI during a five year look back period
- No U.S. Gift Tax exposure
- U.S. Estate Tax exposure (may be mitigated with life insurance policy)
- Corporate income tax at graduated rate (up to 35%) plus state income tax
- Dividends to investors are subject to a 30% U.S. withholding tax, which may be reduced pursuant to a U.S./Italy Tax Treaty exception
- If all of the real estate is sold, the company may adopt a plan to liquidate and distribute the cash as a liquidating distribution. The gain would be subject to taxes, but there would be no withholding tax.

## Indirect Ownership Through a Foreign Entity

Foreign Individual

(s)



Foreign  
Corporation



U.S.  
Corporation



Real  
Property

- Individual investor is not required to file a federal or state income tax return
- Complete anonymity because only the name of the foreign corporation will likely need to be disclosed on federal and state tax returns
- No U.S. gift or estate tax exposure
- U.S. branch profits taxes will not apply
- Corporate income tax at graduated rate (up to 35%) plus state income tax
- If all of the real estate is sold, the company may adopt a plan to liquidate and distribute the cash as a liquidating distribution. The gain would be subject to taxes, but there would be no withholding tax.

## Ownership Through a Foreign Entity

Foreign  
Individual(s)



Foreign  
Corporation



Real  
Property

- Individual investor(s) not required to file federal or state income tax returns
- Only partial anonymity because U.S. income tax returns will disclose identity of individual investors who own more than 50% of company's stock
- No U.S. Gift or Estate Tax exposure
- Corporate income tax at graduated rate (up to 35%) plus state income tax, which may be reduced pursuant to a U.S./Italy Tax Treaty exception
- No U.S. withholding tax on dividends, but foreign corporation is subject to harsher U.S. Branch profits taxes (may be reduced pursuant to a U.S./Italy Tax Treaty exception)
- No FIRPTA withholding for sale of interests in foreign corporation, but interests in foreign corporation that owns U.S. property may not be marketable
- FIRPTA withholding for sale of the underlying real estate or liquidation of foreign corporation

# Essential Taxes Incidental to Real Estate Ownership and Transfers

- FIRPTA: 10% withholding tax that applies to the disposition of real property by foreign persons or foreign corporations (see later slide)
- U.S. Gift Tax: Federal tax on transfers of property where the transferor receives nothing in return
- U.S. Estate Tax: Federal tax due on transfers at death. Although U.S. citizens are entitled to an unlimited marital deduction for any assets that pass to a surviving spouse who is a U.S. citizen, foreign persons generally can not take advantage of that deduction.
- U.S. Income Tax: Two types of federal income taxation patterns for foreigners: (i) taxation of passive income; and (ii) taxation of an active trade or business (see later slide)
- U.S. Branch Profits Tax: “Second layer” tax on after-tax business income of foreign corporation engaged in U.S. trade or business (analogous to a tax on dividends). This is a 30% tax applied to U.S. income *regardless of whether it was actually distributed as a dividend* (known as a phantom dividend tax).

## What is FIRPTA?

- Foreign Investment in Real Property Tax Act of 1980
- Foreign transferors of U.S. real property who are subject to FIRPTA are subject to a 10% withholding of the amount realized, which is an advance payment for regular income tax on gain
- Withholding is due within 20 days of the date of the transfer
- Unless a withholding certificate is obtained from the IRS, a transferee is required to remit the full amount of the withholding even if the transaction yields insufficient cash
- Generally foreign persons and foreign corporations are subject to FIRPTA upon the sale of United States Real Property Interests, which are defined broadly as any interest in real property (including leasehold interests) and interests in United States real property holding corporations

# Two Types of Federal Income Taxation Patterns

- 1. Income Effectively Connected with a U.S. Trade or Business**
  - Any income will be taxed on a net basis at the regular graduated tax rates applicable to U.S. citizens and residents
  - Only imposed on net income after applying deductions (i.e. depreciation and interest)
  - Foreign investors may elect to be engaged in a U.S. trade or business with respect to holdings of U.S. realty that generate rental income
  
- 3. Passive Income not Effectively Connected with a U.S. Trade or Business**
  - Subject to a 30% tax imposed on the gross amount of income
  - Applied to gross income with no offsetting deductions
  - Foreign investors holding debt in U.S. real estate frequently take advantage of the portfolio interest exemption

Note: U.S./Italy tax treaty may provide income tax exceptions.