



# Can Foreign Investors Use 1031 Exchanges?

by **Greg Lehmann, Attorney**

Double Board Certified • Commercial and Residential Real Estate Law

## The Big Picture

Because Section 1031 of the U.S. Tax Code qualifies the property, not the person, foreign investors are not disqualified from using this section of the tax code. In other words, neither the statute nor the attendant regulations restrict eligibility based on citizenship or residence.

## Why This Matters:

A 1031 exchange is available to foreign sellers of real property held for productive use in a trade or business, or held for investment purposes, as long as the relinquished and replacement properties are located in the United States. IRC §897(e). The foreign exchanger must provide the qualified intermediary (QI) with an IRS Form W8-BEN (in lieu of a Form W-9) that discloses the exchanger's Individual Tax Identification Number (ITIN). An ITIN can be applied for on IRS Form W-7.

## Withholding Requirement

The Foreign Investment in Real Property Tax Act (FIRPTA) requires withholding on dispositions of U.S. real estate by "foreign persons," defined as non-resident foreign individuals or foreign partnerships, corporations, trusts or estates. (IRC §§861, 871, 882, 897, 6039C, 6652). In accordance with these sections, the buyer must (1) withhold fifteen percent (15%) from the proceeds of the sale of real property if the seller is a foreign person and (2) send the withholding directly to the Internal Revenue Service (IRS) within 20 days of the transaction closing to ensure any taxable gain realized by the foreign seller is paid.

## Strategy No. 1: Evaluating Exceptions to the Withholding Requirement

In order to take full advantage of Section 1031, foreign sellers should plan in advance of their sale, and consult with tax, legal, and financial advisors to determine whether they qualify for an exception to the withholding requirement. If the foreign seller waits until the sale is imminent, the ability to defer the tax on the FIRPTA escrowed amount is put at risk. All of the rules of a typical 1031 exchange apply to executing a tax deferred exchange for a foreign seller (i.e. use of a qualified intermediary, complying with the 45-day identification rule, closing on the replacement property within 180 days, applying all proceeds from the sale to the purchase of the replacement property, etc.).

## Strategy No. 2. Deposit into Exchange Account

If the foreign seller has not timely obtained a withholding certificate, it can nevertheless replace the escrowed FIRPTA funds with cash from outside of the transaction. This would allow the exchange to proceed without any tax ramifications.

## The Takeaway

While a foreign investor can execute a 1031 exchange of real property, careful tax planning is essential. Consultation with tax, legal, and financial advisors, along with a qualified intermediary, should be commenced as soon as possible prior to the sale of the property.

## About Us

Greg Lehrmann is the founding member of Excel 1031 Exchange with 42 years of experience in commercial and residential real estate. For the past three decades he has dedicated his career to 1031 exchange work and has handled tens of thousands of exchanges throughout the country.

Mr. Lehrmann is a distinguished attorney double board certified in commercial and residential real estate law by the Texas Board of Legal Specialization. Only 2% of attorneys in Texas meet this exacting standard. He has a B.B.A. with honors in accounting from The University of Texas and a J.D. from The University of Texas School of Law.

Mr. Lehrmann facilitates 1031 transactions while educating and advising fellow real estate professionals about the transformative benefits of 1031 exchanges. He has written and spoken extensively about 1031s, and has published numerous articles including:

"§1031 Tax-Deferred Exchanges: Evolving Rules, Greater Opportunities" (July 2002 Tierra Grande)

"Using Advanced §1031 Exchange Strategies to Improve Client Investment Returns", (Spring 2005 SIOR Professional Report – national publication of Society of Industrial and Office REALTORS®)

"Keeping Uncle Sam Out of The Oil Patch", (January/February 2008 – Landman national magazine)

"Safe Harbor" (July 2008 Texas Realtor article on vacation-home exchanges.)

Mr. Lehrmann and his wife, Texas Supreme Court Senior Justice Debra Lehrmann, have two sons, Gregory & Jonathan, practicing attorneys, and three beautiful grandchildren.



 [www.excel1031exchange.org](http://www.excel1031exchange.org)    [greg@excel1031exchange.org](mailto:greg@excel1031exchange.org)    (512) 213-9571

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