

The NC Connection

January 2010
An Investors Title Company Publication

Get Connected!



The Impact of State-Specific Nonresident Withholding Requirements on a § 1031 Exchange

by Anna Gregory Wagoner, Exchange Counsel
Click [here](#) for Anna Gregory's Bio

In today's real estate market, many real estate investors invest in states other than where they reside. For investors taking advantage of the tax-deferral offered under Section 1031 by structuring a like-kind exchange, it is not unusual to see sales of real estate by nonresidents. A handful of states have state nonresident withholding requirements for real estate sales that apply to the gain for state income tax purposes. Common wisdom might lead a nonresident seller to assume that if they are treating the sale as relinquished property in a 1031 exchange, the nonresident withholding would not

apply. Beware! This assumption may catch a nonresident seller unaware. In some states there is either a waiver process to avoid nonresident withholding in a 1031

exchange, or an exception to withholding if there is a 1031 exchange. Paying the required withholding out of the net sales proceeds of the relinquished property may have a negative tax consequence. The payment of the tax could result in "boot" in the exchange, because a portion of the property sales proceeds were used to pay a tax rather than to purchase replacement property. Typically, the taxpayer would receive a refund of the tax paid, if he is successful in deferring gain recognition because of the exchange. This can create a real dilemma! Below is a summary of the nonresident withholding requirements for some states in which ITEC has facilitated exchanges.

Alabama

Ala. Code s. 40-18-86 requires withholding on the sale of real property by nonresident individuals, trusts, partnerships, corporations, limited liability companies, limited liability partnerships, and unincorporated organizations. The withholding amount is 3 percent or 4 percent of the purchase

Inside this issue:

The Impact of State-Specific Withholding Requirements on a § 1031 Exchange	1-4
NC Fun Facts	2
Claims Corner	5
RESPA Rule FAQs	5
ITC Online Rate Calculator	6
ALTA 7-06	7

The Impact of State-Specific... continued from page 1

price or the seller's gain, if the seller completes Form NR-AF2 (Affidavit of Seller's Gain). Transfers where there is complete non-recognition of gain by the seller are exempt from withholding. Transfers where gain is partially recognized are subject to withholding only to the extent of the recognized gain. If the exemption applies, the seller should complete Form NR-AF3 (Seller's Certificate of Exemption). If any money remains in the exchange after the expiration of the exchange period, this exemption will apply only if the seller agrees to have the qualified intermediary remit any payment due to the Alabama Department of Revenue.

California

Pursuant to California Franchise Tax Board Publication 1016 (rev. 06-2009), all sellers of California relinquished property are subject to withholding, regardless of whether or not they are residents of California. Each seller is required to complete Form 593-C (Real Estate Withholding Certificate) and submit it to the withholding agent. The withholding amount is 3.33 percent of the sales price, or, in the alternative, withholding may be based on the gain at specific rates according to the type of seller. Sellers doing 1031 exchanges are exempt from withholding, but if the exchange fails, the qualified intermediary must withhold the appropriate amount. If there is more than \$1,500.00 of taxable boot in the exchange, the qualified intermediary must withhold 3.33 percent of the boot. Any withholding should be submitted to the CA Franchise Tax Board along with Form 593 (Real Estate Withholding Tax Statement).

Hawaii

Pursuant to Section 235-68, Hawaii Revised Statutes (HRS), a buyer of Hawaii real property

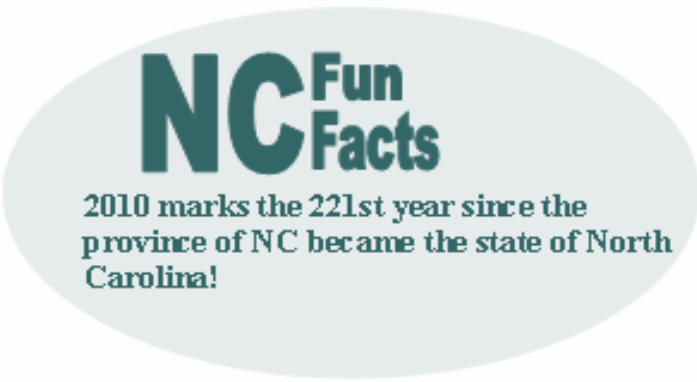
must withhold tax if the seller is a nonresident person or entity. In order to avoid withholding, the taxpayer must certify that they are exempt by filing Form N-289 (Certification for Exemption from the Withholding Tax), request a waiver or adjustment of amount withheld using Form N-288B (Application for Withholding Certificate), or allow the 5 percent of amount realized to be withheld at closing using Form N-288 (Hawaii Withholding Tax Return) and Form N-288A (Statement of Withholding). It is generally understood that if withholding is required, the taxpayer should be able to pay into the exchange at closing, an equivalent amount from separate funds, and he may be able to offset boot recognition by funds he paid into the transaction. Then, if he ultimately owes no tax to HI, he can file for a refund.

Maine

A buyer of Maine real property must withhold tax in the amount of 2.5 percent of the sales price if the seller is a nonresident individual, estate or trust or a business not domiciled in Maine by filing Form REW-1 (Real Estate Withholding Return for Transfer of Real Property). A seller who is effecting a 1031 exchange may apply for an exemption from withholding at least five (5) business days prior to closing by submitting Form REW-5 (Request for Exemption or Reduction in Withholding) along with a copy of the Exchange Agreement.

Maryland

Pursuant to §10-912 of the Tax-General Article, Annotated Code of Maryland, withholding is required on the sale of real property by a nonresident individual or entity. The withholding amount is 7.5 percent of the total payment to a nonresident individual or 8.25 percent of the total payment to a nonresident entity, using Form MW506NRS (Return of Income Tax Withholding for Nonresident Sale of Real Property). In order to avoid withholding, the taxpayer must apply for a Certificate of Full or Partial Exemption from the Maryland Comptroller's office at least 21 days before closing, using Form MW506AE (Application for a Certificate of Full or Partial Exemption). The qualified intermediary is required to send a letter, along with the exemption form, certifying that there will be no cash boot to the taxpayer. If the taxpayer receives any boot in the exchange, as a result of not



The Impact of State-Specific... continued from page 2

successfully completing his deferred exchange, he will still need to file a return and pay taxes to both the IRS and the state of Maryland.

New Jersey

Pursuant to New Jersey P.L. 2005, Chapter 20, Assembly No. 3510, nonresident individual, estates or trusts who sell New Jersey property are subject to withholding. The withholding amount is determined by multiplying the gain on the sale of the property by the highest gross income tax rate of 8.97 percent. In order to avoid withholding, the taxpayer must request an exemption using Form GIT/REP-3 (Seller's Certification of Residency/Exemption) and indicate that the gain is not intended to be recognized pursuant to I.R.C. § 1031, or pay estimated tax prior to or at closing using Form NJ-1040ES (New Jersey Gross Income Tax Declaration of Estimated Tax). If taxes are paid prior to or at closing, the seller will receive a Nonresident Seller's Tax Prepayment Receipt (Form GIT/REP-2). If the taxpayer receives boot or if the exchange fails, the qualified intermediary must withhold 2 percent of the value of the boot received or 2 percent of the total consideration if the exchange fails.

New York

Pursuant to New York State Tax Law - Article 22, Section 663, nonresident individual, estate or trust sellers of New York relinquished property are subject to withholding. The withholding amount is determined by multiplying the gain by the highest applicable rate of New York State personal income tax in effect for the taxable year. In order to avoid withholding, the taxpayer must certify that no tax will be due in Part III of Form IT-2663 (Nonresident Real Property Estimated Income Tax Payment Form). Because it is unclear whether or no the can make that certification in a deferred exchange, he should consult with his tax advisor before choosing this option.

Oregon

ORS 314.258 requires withholding on the sale of real property where the seller is a nonresident individual or a C corporation not doing business in Oregon. Tax must be withheld unless the seller

submits an exemption form (Form WC) prior to the closing of replacement property. There is an exemption if the seller intends to defer tax under § 1031 or § 1033. Withholding is the lesser of: 4 percent of the consideration; 8 percent of the gain; or the net proceeds (the amount disbursed to the taxpayer, including boot). The seller must provide the authorized agent a calculation of the withholding amount on Form WC and the authorized agent is entitled to rely on the seller's calculation. If the seller does not provide the authorized agent with a form WC, the authorized agent must withhold 4 percent of the consideration or the entire net proceeds, whichever is less. The authorized agent must submit Form WC to the State within 30 days from closing. If there is withholding, the authorized agent tender it to the State within 20 days of disbursement, along with the tax payment voucher ("TPV") form and must provide form OR-18 to the seller.

South Carolina

South Carolina Code Section 12-8-580 requires any person who purchases real property from a nonresident individual, corporation, partnership, trust or estate to withhold South Carolina income taxes from the seller. South Carolina Revenue Advisory Bulletin #02-6 provides guidance on how to apply this regulation. Form I-290 (Nonresident Real Estate Withholding) is used to determine the amount to be withheld. It will be based on either the gain provided by seller on Form I-295 (Seller's Affidavit), or on the amount realized, if Form I-295 is not provided. The amount withheld is 7 percent if the seller is not a corporation and 5 percent if the seller is a corporation. The buyer must remit the withholding amount on or before the fifteenth day of the month following the month in which the sale takes place, but may be extended if the seller is effecting a 1031 exchange. The seller will report the sale or the exchange on its South Carolina income tax return.

The seller has two options for remitting the required withholding: The first is to pay the withholding out of his own funds at closing, instead of using a portion of the sales proceeds. This prevents using exchange funds for the non-exchange expense of withholding tax. The second option is to shift the

The Impact of State-Specific... continued from page 3

burden for paying the withholding amount to the qualified intermediary. Although the responsibility may be shifted, the liability for the withholding remains with the buyer. The Seller will fill out Form I-295 stating that it is intended that the transfer qualify as a nontaxable like-kind exchange under IRC Section 1031. The seller must also fill out Form I-290 as if the sale were taxable. The qualified intermediary will hold the Form I-290 in escrow until the exchange is complete. The seller will need to provide the realized gain on Form I-295 in order to avoid calculating the withholding amount based on the sales price. It will be tempting for the seller to fill in “zero” gain, since he is doing an exchange, but the Advisory Bulletin clearly states that the I-290 must be completed as if the transaction were taxable. Once it appears that the transaction will not “qualify” (i.e., be fully tax-deferred), the qualified intermediary is required, under the contract with Buyer, to withhold money from the seller’s exchange funds to meet the withholding requirements. The QI must remit the I-290 and withholding amount by the 15th day of the month following the month it becomes apparent that the exchange will not qualify. If it appears that the transaction will fully qualify as a nontaxable like-kind exchange, the I-290 will not be filed and no withholding payment will be made.

withholding amount is either 2.5 percent of the total payment or 6.5 percent of the estimated capital gain. The withholding must be paid to the “real estate reporting person” before the deed is recorded and must be remitted to the Tax Commissioner within 30 days after it is withheld. If the seller intends to defer tax under § 1031, he may request an exemption from withholding by filing Form WV/ NRAE (Application for Certificate of Full or Partial Exemption) with the State Tax Department no later than 21 days prior to the closing date.

All of the rules and exceptions described above show how cumbersome the nonresident withholding requirement can be, when the nonresident seller is effecting a 1031 exchange. It is incumbent upon the taxpayer to seek competent tax and legal advice from independent advisors in each state where his properties are located, to make sure he complies with these and other state-specific requirements. Otherwise he may encounter unexpected tax consequences at both the state and federal level. Early communication among all the parties (the taxpayer, their advisors, attorneys, settlement agents and QI) as to any special, state-specific rules will help eliminate confusion and misunderstanding in the transaction.

If the seller does not use all of his exchange proceeds, at the end of the exchange period, the qualified intermediary will return the balance of exchange funds to the seller, but must deduct the withholding amount from the exchange funds prior to returning them to the seller. It is important to note that if the seller does not provide the qualified intermediary with a completed I-295, the qualified intermediary has no choice but to withhold based on the gain realized. If the taxpayer originally completed a Form I-295 reporting the realized gain, as if it were a taxable sale, and now realizes that he will only recognize a partial gain, most Qualified Intermediaries will accept a revised I-295 to show the actual recognized gain. The QI will submit withholding based on the revised affidavit.

West Virginia

Pursuant to W. Va. Code § 11-21-71b, nonresident individuals or entities are subject to withholding upon the sale of West Virginia real property. The

Missed a prior edition of the NC Connection?

Click below to access them.

[December 2009](#)

[November 2009](#)

[October 2009](#)

[September 2009](#)

[August 2009](#)

[July 2009](#)



Disclose! Disclose! Disclose!

One of the gravest dangers facing the unwary attorney or paralegal in today's real estate market is the failure to disclose adequately facts of which the attorney or paralegal is aware, but which may be unknown to the parties in the transaction

for whom the attorney or the attorney's paralegal has agreed to perform some duty. These dangers become dramatic or newsworthy when the attorney or paralegal is indicted, a law license is suspended, or a large civil judgment is obtained because of incomplete or inaccurate loan documentation which is misleading to one or more of the parties with an interest in the transactions.

The most prevalent and obvious of the inaccurate documents which get attorneys and paralegals in trouble is the inaccurate HUD statement. Inaccurate HUD statements have been cited as principal factors in recent indictments and civil lawsuits against attorneys and paralegals. This problem is simply avoided. **The HUD statement should accurately show the identity and capacity of and the amounts paid to all parties who receive a check paid from the attorney's closing account.** There can be no taint of fraud where there is full disclosure. Lack of complete and accurate disclosure may result in insured closing claims, title policy claims, malpractice claims or worse. Examples of transactions where attorneys and paralegals have been implicated in fraud because of inaccurate HUD statements include flip transactions, fraudulent purchase price agreements with developers, and transactions which are documented and closed as refinance transactions when in fact they are purchase transactions.

Recently Updated!
HUD Information Booklet for Consumers

RESPA Rule FAQs

The Department of Housing and Urban Development offers a "frequently asked questions" resource regarding the RESPA Rule and the new GFE/HUD documents. The resource may be accessed by clicking this graphic or by visiting www.hud.gov/respa. Be sure to revisit the link often as new Q&As are added frequently.

© Investors Title Insurance Company

Need a way to save your client money? Take advantage of our discounted rates.

www.invtitle.com/Resource Center/ITC Rate Calculator

ITIC Rate Calculator

Select a State region:

Select policy rate method:

Enter Owner coverage amount: \$200,000.00

Enter Mortgagee coverage amount: \$175,000.00

Calculated (risk) premium (estimate) **\$410.00**

ITIC Rate Calculator

Select a State region:

Select policy rate method:

Enter Owner coverage amount: \$200,000.00

Enter Mortgagee coverage amount: \$175,000.00

Enter highest prior coverage amount (if applicable): \$175,000.00

Prior policy date (if applicable) mm/dd/yyyy:

Calculated (risk) premium (estimate) **\$253.75**

\$156.25 in savings!

Note: The amounts above include Insured Closing Letter Premium.

Use this calculator to **estimate** title insurance rates offered by Investors Title Insurance Company. For additional information or to verify qualifications for discounted rates, please contact your local Investors Title branch or agent office.

Rates provided here are only a sampling of those most frequently used **and do not include all fees that may be applicable such as commitment fees and endorsement charges**. Rates for a variety of other types of coverages are available. For additional information or to verify qualifications for discounted rates, please contact your local Investors Title branch or agent office.

Prior HUD-1s or prior policies within fifteen years on identical land qualify the transaction for a reissue rate.

© Investors Title Insurance Company



2010 2010 2010 2010 2010 2010 2010 2010 2010

ALTA 7-06

The title insurance concern is whether the M/M home is personal property (which is not insured by the title policy) or real property. Loans made to acquire the M/M home secured by a lien noted only on the title are normally personal property; loans on real property may be secured by deeds of trust and recorded at the register of deeds in the county where the property is located. If the M/M home is permanently affixed to the realty and the title is cancelled, with the intent of the owner for the M/M to be real property, the M/M home becomes a fixture of the real property. If both the "title" and "deed of trust" exist, there possibly exists a title insurance conflict and confusion: does the title policy insure just the land described in the deed of trust? How can the title policy insure the M/M home as real property if the "title" still exists?

A typical requirement for NC, reads as follows: If the Mobile or Manufactured Home is to be treated as "real property" (1) the Mobile or Manufactured Home must be permanently attached to the real property, or be in the process of permanent attachment to the real property; (2) If the attorney is not in possession of the Certificate of Origin or Certificate of Title then the attorney must search the DMV records to discover whether a title is in existence:

- a) If the title is in existence or outstanding then it must be detitled using the MVR-46G form and this form must then be recorded in the county register of deeds after it has been processed by DMV. All liens on the title must be canceled or released.
- b) If no title is found after a search using the serial or VIN number, or using the current and previous owner.s names then the attorney shall record a [Declaration of Intent to Affix](#) the M/M home to real property signed by the current owner or seller of the real property.
- c) If the attorney is in possession of the Certificate of Origin, it may be recorded with the [Declaration of Intent to Affix](#) at the county register of deeds. Note: the Certificate of Origin should be marked with a notation that the home is now real property and that no title exists.

NOTE: Upon receipt of said Declaration of Intent AND subject to the facts related, or receipt of the MVR-46G, no mobile home exception will be made in the final Owner's Policy or Loan Policy; also, the ALTA 7 [insert ALTA #] Endorsement, if requested, will be attached to the final Policy.

