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## RENTALS, BY THE NON-RESIDENT ALIEN OWNER & U.S. TAXES

Non-resident alien (NRA) rental property owners need to be aware of the US tax regulations concerning their rental activity.

1. *Each* owner is required to file a US income tax return *each* year to report their share of rental income, whether it nets to a profit or a loss. There is no statute of limitation for unfiled tax returns. The regulations allow two options for reporting:
  - A. Report only the GROSS rental income and pay a 30% tax on it. No operating expense deductions are allowed. This is the default that the IRS can impose on unfiled, missed, years.
  - B. Elect to claim expenses and depreciation against the gross income when filing for the FIRST year of rental activity. Tax is calculated on only the NET INCOME. If there is a loss for any year, then it is carried over to subsequent years, to either offset net rental income, or profit (hopefully) on a sale of the property. (I have never had the filing of past returns challenged, yet)
- Option "A", is really easy -- and costly! Miss the filing deadline and the IRS is ALLOWED TO DENY the election to offset income with expenses. See the Espinosa case at the bottom of this article. Many NRA landlords ignore U.S. filing until forced to file, usually when they sell the property. Late filed years with taxable net income will be assessment penalties and interest.
2. DEPRECIATION IS MANDATORY in the US. . All buildings, major improvements, and personal property are depreciable. When the rental property is sold, the "tax basis" of the property is reduced by the depreciation that was, or should have been, taken. There is an allowable "catch-up" of depreciation for missed years, but the form is complicated. There is a recapture ("claw-back") of the depreciation, with some limitation, if a profit was made.
3. WITHHOLDING ON RENTAL INCOME: The renter or management company is required to withhold 30% of the GROSS income for taxes UNLESS a Form W-8BEN has been properly completed and given to the payer. It oddly is not sent to the IRS, just kept on file by the payer. The exemption is in effect only after receipt of the form. The withholding must be promptly deposited by the payer, and a possible refund only available the following year when filing the tax return.
4. FORM 1099-MISC report to the IRS of payments for services of \$600 or more is required starting in 2011. A penalty and denial of the expense possible. A Form W-9, "Request for Taxpayer Identification Number....," should be obtained before the work performed and/or any payment to an individual.
5. SALE OF THE RENTAL: another regulation, Foreign Investment in Real Property Tax Act (FIRPTA) covers the reporting and tax withholding on the gross sale price. See my FIRPTA summary for details.

A US Tax Court case, *Espinosa v. Commissioner*, 107 T.C. No. 9 (9/24/96) is a good illustration. The NRA owner did not file timely returns as requested by the IRS; subsequently the IRS calculated the tax based on 30% of the gross rents, "Option A". The NRA taxpayer later prepared "Option B" tax returns and challenged the IRS on grounds of fairness. He lost, all operating deductions were denied. Therefore gross rent was taxed at 30%, plus penalties and interest. *Espinosa* was simply foolish, however that case gave the IRS a court determination on which to base future actions. It has been my experience that you can voluntarily file past returns with little or no problem.

*This is simplified and general information presented to alert you to a potential problem. Consult with a competent U.S. tax advisor or tax attorney.*

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