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TaxNewsFlash

United States

No. 2016-542
December 7, 2016

Legislative update: REIT, real estate-related provisions among tax technical corrections

A bill introduced in the House of Representatives would make tax technical corrections with respect to real estate investment trust (REIT) and other real estate-related provisions enacted in 2015.

The bill, **H.R. 6439** [PDF 284 KB], the T*ax Technical Corrections Act of 2016,* includes the following corrections to provisions enacted in various laws including the *Protecting Americans from Tax Hikes (PATH) Act of 2015.*

The companion bill in the Senate is S. 3506.

The Joint Committee on Taxation (JCT) released a technical explanation of the provisions in the tax technical correction bill: **JCX-91-16**

REIT, real estate-related provisions

Section 856(c)(9), enacted as part of the PATH ACT, simplified the treatment of certain personal property that is ancillary to real property. Specifically, section 856(c)(9) provides:

- Personal property is treated as a "real estate asset" for the 75% asset test, to the extent that rents attributable to such personal property are treated as rents from real property under section 856(d)(1)(C) (i.e., the 15% test for rents from real property).

- For an obligation secured by a mortgage on both real property and personal property, if the fair market value of the personal property does not exceed 15% of the total fair market value of both real property and person property:

  - The obligation is considered as a "real estate asset" for the 75% asset test; and

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- The entire interest is treated as interest on “obligations secured by mortgages on real property” (i.e., qualifying for the 75% income test).

Shortly after the enactment, concerns were expressed that the treatment of ancillary person property as a real estate asset might be limited to for purposes of asset test and interest income—that is, a gain attributable to such personal property could still result in non-qualifying income for the income tests (e.g., a gain on disposition of hotel furniture, fixtures, and equipment (FF&E)).

In early 2016, a technical corrections bill was introduced in both Senate and House without addressing this concern. However, the “updated” tax technical corrections bill provides:

- Two conforming changes with respect to the REIT income tests. First, the provision treats gain from the sale or disposition of such ancillary personal property as gain from the sale or disposition of a real estate asset for purposes of the REIT income tests. Second, the provision treats gain from the sale or disposition of certain obligations secured by mortgages on both real property and personal property as gain from the sale or disposition of real property for purposes of the REIT income tests.

- For Foreign Investment in Real Property Tax Act—FIRPTA—purposes, the tax technical correction contains the same clarifications concerning the narrowed definition of a “qualified shareholder” and the immediate effective date of assumptions for determining a domestically controlled REIT.

Qualified shareholder

The PATH Act exempts from the definition of U.S. real property interest (USRPI), the stock of a REIT (either publicly traded or privately held) that is held by a “qualified shareholder.” The PATH Act also turns off the look-through rule of section 897(h)(1) with respect to USRPI-distributions of a REIT (whether publicly traded or not) unless the 10% investor rule applies.

For this purpose, a qualified shareholder is a foreign person that, **among other requirements:** (1) is eligible for treaty benefits under an income tax treaty with the United States, which includes an exchange of information program and whose principal class of interests is listed and regularly traded on one or more recognized stock exchanges; and (2) is a “qualified collective investment vehicle” (QCIV) (as defined). For this purpose, a QCIV means a foreign person that is, among other things, eligible for a reduced rate of withholding under the income tax treaty with the United States, even if such person holds more than 10% of the stock of such REIT.

The JCT’s technical explanation explains that the provision of the tax technical correction bill “…clarifies that the definition can be met only if the dividends article in the treaty imposes conditions on the benefits allowable in the case of dividends paid by a REIT.” This clarification is significant given that the income tax treaties between

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the United States and certain countries provide reduced withholding rates on dividends without distinguishing whether the payor is a “regular” C corporation or a REIT. By requiring specific reference to a REIT, many publicly traded investment vehicles of these countries would not likely meet the definition of a “qualified shareholder.” Thus, the potential application of the special “qualified shareholder” rules may be limited.

Domestically controlled REIT

The PATH Act provides three new rules for purposes of determining whether a REIT or RIC is domestically controlled. Among these rules, a publicly traded REIT is permitted to presume (absent actual knowledge to the contrary) that a person holding less than 5% of a class of publicly traded stock is a U.S. person. This could significantly minimize the uncertainty associated with the domestically controlled determination because a publicly traded REIT can now assume those stockholders not filing Schedules 13D/G as U.S. persons.

The PATH Act provides that the new rules for determining a domestically controlled REIT or RIC “shall take effect” on December 18, 2015—which could be interpreted to suggest that the determination rules are applied only for future period (i.e., a delayed effective date). The JCT’s technical explanation provides that the provision of the bills “…clarifies the effective date for the determination of domestic control by stating that the rule applies with respect to each testing period ending on or after the date of enactment (not that the rule takes effect on the date of enactment).”

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