



# TaxNewsFlash

## United States

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### **Final regulations: Recognition period, C corporation property becoming property of REIT**

The U.S. Treasury Department and IRS today released for publication in the Federal Register final regulations (T.D. 9810) concerning corporate-level tax that is imposed on certain transactions when property of a C corporation becomes the property of a real estate investment trust (REIT).

Today's [final regulations](#) [PDF 365 KB] modify the rules that were released as temporary and proposed regulations in June 2016, and reflect a five-year period (instead of a 10-year period) as the appropriate length of the recognition period for purposes of the section 1374 treatment when property of a C corporation becomes the property of a REIT.

#### **Background**

The *Protecting Americans Against Tax Hikes Act of 2015* (PATH Act) added section 355(h) to the Code to provide that the exception under section 355 (allowing for tax-free corporation separations) will not apply to a distribution if either the distributing corporation or the controlled corporation is a REIT. There are exceptions permitting a REIT to distribute the stock of another REIT or taxable REIT subsidiary under certain conditions, as well as certain grandfathered transactions.

Furthermore, the PATH Act added section 856(c)(8), which provides that neither a distributing nor a controlled corporation, nor their respective successors, can elect REIT status during the 10-year period following a section 355 distribution (other than an election for the controlled corporation when both the distributing and controlled corporations are REITs immediately following the distribution).

Temporary and proposed regulations (released in June 2016) provided that a C corporation engaging in a conversion transaction involving a REIT within a 10-year period following a related section 355 distribution recognizes gain and loss as if it had

sold all the converted property to an unrelated party at fair market value on the date of the conversion transaction, regardless of whether the C corporation makes a deemed sale election (specifically, the C corporation is treated as if had made a deemed sale election in connection with the conversion transaction). The temporary regulations also generally provided that when a REIT is a party to a section 355 distribution occurring within the 10-year period following a conversion transaction for which a deemed sale election has not been made, the REIT recognizes any remaining unrecognized built-in gains and losses resulting from the original conversion transaction (after taking into account the impact of section 1374 in the interim period).

Importantly, under the temporary regulations, notwithstanding that the recognition period under section 1374—i.e., generally speaking, the period following a conversion transaction during which gain recognized on a sale or exchange of property acquired by a REIT in the conversion transaction will be subject to corporate-level tax, up to the amount of the “built-in gain” in the asset at the time of the conversion transaction—was shortened permanently to five years as part of the PATH Act, assets acquired by REITs in conversion transactions occurring on or after August 8, 2016, were to be subject to a 10-year recognition period.

Read an initial report about the June 2016 regulations in [\*\*TaxNewsFlash-United States\*\*](#).

In October 2016, the chairmen and ranking members of the House Ways and Means Committee and of the Senate Finance Committee wrote to the Treasury Secretary stating that the length of the recognition period included in the temporary regulations and the proposed regulations (i.e., 10 years) was inconsistent with congressional intent and the longstanding practice of treating REITs and RICs as having the same built-in gain recognition period as S corporations, or five years. The leaders of the congressional tax-writing committees asked that the temporary regulations and the proposed regulations be modified to provide that REITs, RICs and S corporations are all subject to the same five-year built-in gain recognition period in order to be consistent with congressional intent and longstanding practice.

## **Final regulations**

With today's release, the final regulations provide that the term “recognition period” means the recognition period described in section 1374(d)(7) beginning:

- In the case of a conversion transaction that is a qualification of a C corporation as a RIC or a REIT—on the first day of the RIC’s or the REIT’s first tax year
- In the case of other conversion transactions—on the day the RIC or the REIT acquires the property

Accordingly, for most conversion transactions, the recognition period will be five years, and not 10 years. However, a REIT (or certain of its affiliates) may still be subject to corporate-level tax to the extent that it engages in a section 355 transaction within 10 years following a conversion transaction.

## Effective date

The IRS and Treasury stated that the final regulations will apply prospectively from a date that is 30 days after January 18, 2017 (the scheduled date of publication in the Federal Register), but taxpayers may choose to apply the definition of recognition period in the final regulations, instead of the 10-year recognition period in the temporary regulations, for conversion transactions occurred on or after August 8, 2016.

The IRS and Treasury reported that they will continue to study other issues addressed in the temporary regulations and proposed regulations, and welcome further comment on those issues.

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