

Significant Changes to U.S. Taxation of REITs and Investments by Non-U.S. Investors in Real Property under the PATH Act

February 2, 2016

On December 18, 2015, President Obama signed into law an omnibus appropriations bill which included the Protecting Americans from Tax Hikes Act of 2015 (the "Act"). In addition to extending or making permanent a number of expiring and expired tax provisions, the Act contains significant changes to U.S. taxation of real estate investment trusts ("REITs") and to the tax consequences relevant to investments by non-U.S. investors in U.S. real property under provisions of the Code commonly known as "FIRPTA." [1] Each of the changes in the Act relating to REITs and FIRPTA are discussed below, and a comprehensive chart summarizing these changes is also included. Although not all of the changes are favorable to investment in REITs and U.S. real estate, in the aggregate the Act seems likely to facilitate increased foreign investment in REITs and other U.S. real estate assets.

REIT Specific Changes

1. Restriction on tax-free spin-offs involving REITs

In order to qualify for tax-free treatment under the Code, a spin-off must meet certain requirements, including the requirement that the distributed corporation be engaged in the active conduct of a trade or business. Prior to 2001, the Internal Revenue Service ("IRS") had been generally antagonistic to claims by REITs, which are intended to be passive investment vehicles, that such entities could qualify as being engaged in an active trade or business for the purposes of this rule. However, in 2001 the IRS ruled that a REIT could satisfy the active trade or business requirement solely by virtue of functions engaged in with respect to its rental activity. [2] More recently, the IRS issued a private letter ruling indicating that a REIT with a taxable REIT subsidiary ("TRS") could satisfy the active trade or business requirement by virtue of the active business of its TRS. [3] Subsequently, an increasing number of operating companies attempted to follow the transaction pattern. In such a spin-off transaction, an operating company typically would contribute its real estate assets to a newly formed REIT, and transfer certain assets and operations to a newly-formed TRS of such REIT sufficient to satisfy the active trade or business requirement (which active trade or business would be relatively small in relation to the trade or business remaining in the distributing corporation). The operating company would then spin off the newly formed REIT in a tax-free transaction, and lease back the real estate from the REIT for its ongoing operations.

Except as described below, the Act limits the use of the above spin-off transaction in two ways. First, the Act disallows tax-free treatment in a spin off if either the distributing corporation or controlled corporation is a REIT. Second, the Act prohibits a taxable corporation that is a party to a tax-free spin off from making a REIT election for a ten-year period beginning on the date of the distribution. The Act does not, however, impact the ability of a REIT to spin off another REIT (e.g., a REIT with a mixed portfolio of hotels and shopping centers would be permitted to spin off the hotel or shopping center portfolio tax-free) or a TRS (e.g., a REIT is still permitted to spin off a long-standing management business) tax-free, so long as, in the latter case, the TRS has been held for at least three years.

The restriction on tax-free REIT spin-offs is effective as of December 7, 2015, other than with respect to taxpayers who already have submitted a ruling request to the IRS on the tax-free treatment of a planned transaction. Furthermore, this change comes just months after the IRS released new guidance significantly limiting the availability of private letter rulings with respect to tax-free REIT spin-offs and expressing concern about tax-free REIT spinoffs.[4] The new guidance focused on transactions utilizing the structure described above (i.e., spin-offs in which the active business in the distributed corporation is relatively small in relation to the size of the active business remaining in the distributing corporation).

2. Repeal of preferential dividend rule for publicly offered REITs

A REIT is required to distribute 90% of its REIT taxable income on an annual basis. Prior to the changes imposed by the Act, generally a REIT is allowed to deduct distributions from its taxable income unless such distribution violates the preferential dividend rule. A distribution is a preferential dividend unless the distribution is (i) *pro rata*, (ii) with no preference to any share of stock as compared with other shares of the same class and (iii) no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by stockholders) to a preference. Irrespective of whether the violation is inadvertent or de minimis, the deduction is disallowed, subjecting that income to corporate income tax. Disallowed deductions increase the REIT's taxable income, requiring the REIT to increase its distributions to meet the 90% distribution requirement. If a REIT fails to distribute 90% of its income, then it could lose its status as a REIT for U.S. federal income tax purposes and therefore be subject to corporate income tax. The Act repeals the preferential dividend rule for publicly offered REITs effective for distributions made in tax years after December 31, 2014. A publicly offered REIT is a REIT that is required to file annual and periodic reports with the Securities and Exchange Commission. As such, privately held REITs will still be subject to the preferential dividend rule. The Act conforms the applicability of the preferential dividend rule to the rule in the regulated investment company ("RIC") context (the preferential dividend rule was repealed for publicly offered RICs in 2010).

3. Authority for alternative remedies for private REITs to address certain REIT distribution failures

The Act grants the IRS authority to provide an appropriate remedy for violations by private REITs of the preferential dividend rule that were inadvertent or resulting from reasonable cause for tax years beginning after December 31, 2015.

4. Reduction in percentage limitation on assets of REIT which may be TRSs

Generally, a REIT cannot own more than 10% of the value of a single entity. There is an exception for TRSs whereby up to 25% of a REIT's assets can be composed of securities of one or more TRSs. The Act restores the percent limitation to 20%, which was the limitation prior to 2008. [5] This reduction could significantly impact REITs that rely heavily on their TRSs to own assets and conduct activities that the REIT cannot do on its own. The reduced percentage limitation is effective for taxable years beginning after December 31, 2017.

5. Prohibited transaction safe harbors

A REIT is subject to a 100% prohibited transactions tax on the sale of property held as inventory or primarily for sale to customers in the ordinary course of its business. However, if a sale meets the requirements of a safe harbor provision, including a requirement that the REIT (i) does not make more than seven sales of property during the year, or (ii) (a) the aggregate adjusted tax basis of property sold during the year does not exceed 10% of the aggregate tax basis of all of the REIT's assets as of the beginning of the year, or (b) the fair market value of property sold during the year does not exceed 10% of the fair market value of all of the REIT's assets as of the beginning of the year, then the prohibited transaction tax does not apply.[6] The Act provides an alternative methodology for satisfaction of this requirement, whereby the requirement can be satisfied if (i) the aggregate adjusted basis or fair market value of the property sold in the taxable year is not more than 20% of the aggregate basis or fair market value of all of the REIT's assets and (ii) the average adjusted basis percentage or average fair market value over the preceding three-year period is not more than 10% of the aggregate basis or fair market value of all of the REIT's assets. The alternative methodology may allow a REIT with a large portfolio of assets to sell more of its assets in a single year without being subject to the risk of a prohibited transaction tax than under pre-Act law. This expansion of the safe harbor provision is effective for taxable years beginning after December 31, 2015.

6. Limitations on designation of dividends by REITs

A REIT can pass through the character of the income it earns to its shareholders. As such, a shareholder who receives a capital gains or qualified dividend is taxed at capital gain rates. Effective for distributions in tax years beginning after December 31, 2014, the Act limits the total amount of dividends that can be designated by a REIT as qualified dividends or capital gains dividends to the dividends actually paid by the REIT.

7. Debt instruments of publicly offered REITs and mortgages treated as real estate assets

In order to qualify as a REIT for tax purposes, a REIT must meet, among other tests, the 75% asset test, 75% income test and 95% income test. To satisfy the 75% asset test, 75% of the value of the assets must be real estate assets (such as real property, interests in real property, mortgages on real property (or interests therein) and shares in other qualified REITs), cash or cash items, and government securities. A REIT also must satisfy the 75% income test, whereby 75% of the REIT's gross income must be derived from certain real estate sources, such as rents from real property, interest in obligations secured by real property (or interests in real property), gain from the sale of real property (including from the sale of an interest in real property or an interest in a mortgage on real property), and dividends from or gains from the sale of qualified REITs. The 95% income test requires that 95% of a REIT's gross income be derived from items that are included under the 75% income test and certain other types of passive income, such as dividends, interest, and gain from the sale or disposition of securities (that are not dealer property). Under pre-Act law, debt instruments of publicly offered REITs and interests in mortgages on interests in real property were not qualifying assets under the 75% asset test and income from such assets was not qualifying income under the 75% income test (although such income did qualify generally under the 95% income test). Effective for tax years beginning after December 31, 2015, debt instruments issued by publicly offered REITs and interests in mortgages on interests in real property will be qualifying assets for purposes of the 75% asset test. However, income from debt instruments of publicly offered REITs will not qualify for the 75% income test unless the income qualified for the 75% income test under pre-Act law and does not account for more than 25% of a REIT's assets by value. The amount of such publicly offered REITs' debt instruments generally is limited to 25% of a REIT's gross assets.

8. Asset and income test clarification regarding ancillary personal property

In general, rents received from the lease of personal property ancillary to real property is treated as rents from real property if the amount of the rent received attributable to personal property does not exceed 15% of the total rents received under the lease. However, such ancillary personal property was not considered real estate for the purposes of the 75% asset test. The Act conforms the 75% asset test to the 75% income test with respect to leases of personal property. For tax years beginning after December 31, 2015, certain ancillary personal property that is leased with real property will be treated as real property for the purposes of the 75% asset test if the rents attributable to that personal property are treated as rent from real property under the 75% income test. Furthermore, an obligation secured by a mortgage on such property is treated as real property for purposes of the 75% income test and 75% asset test if the fair market value of the personal property is not more than 15% of the total fair market value of the personal property and real property combined.

9. Hedging Provisions

Income from hedging transactions entered into to manage risk of interest rate changes, price changes or currency fluctuations with respect to borrowing, made or to be made to acquire or carry real estate assets if properly identified as such, generally are excluded from gross income under both the 75% and 95% income tests. For tax years after December 31, 2015, the Act expands the scope of hedging transactions producing excluded income (when properly identified). The Act excludes from gross income for the purposes of the 75% and 95% gross income tests hedges that primarily manage risk with respect to a prior hedge entered into in connection with property that has been disposed of or liabilities that have been extinguished.

10. Modification of REIT earnings and profits (E&P) calculation to avoid duplicate taxation

Distributions made by a REIT are treated as dividends by shareholders to the extent of the REIT's current and accumulated earnings and profits ("E&P"). Any distributions made in excess of current and accumulated E&P are treated as a return of shareholder's capital which reduces the shareholder's tax basis for the stock (or a capital gain to the extent the distributions exceed tax basis). The Act modifies the calculation of E&P in a way that addresses an inconsistency in the calculation of depreciation for E&P purposes and taxable income purposes where a REIT elects to use an accelerated or bonus method of depreciation. Generally, a REIT electing to use an accelerated or bonus method of depreciation is permitted a larger deduction in its early depreciation years with respect to its taxable income, but not for the purposes of calculating E&P (so that depreciation for E&P purposes in such situations generally is lower in earlier years and higher in later years when compared to REIT taxable income). Under pre-Act law, in the later depreciation years the REIT would be permitted to reduce its E&P by its depreciation deductions only to the extent of the depreciation allowable in that year for REIT taxable income purposes, effectively disallowing for E&P purposes the amount accelerated for taxable income purposes. For tax years after December 31, 2015, the Act permits a REIT to fully utilize the larger amount of depreciation available to a REIT for E&P purposes where such depreciation was taken in earlier years for taxable income purposes.

11. Treatment of certain services provided by TRSs

As described in item 5 above, a REIT is subject to a 100% prohibited transaction tax on the sale of property held as inventory or primarily for sale to customers in the ordinary course of its business. This rule generally restricts a REIT in its ability to market and develop real property. In the past, a third-party contractor would have provided these services to a REIT. Effective for tax years beginning after December 31, 2015, a REIT can conduct these marketing property development activities through a TRS without subjecting the parent REIT to a prohibited transaction tax.

With respect to certain property acquired or owned by a REIT that is under foreclosure, a REIT is permitted to elect to treat such property as "foreclosure property" for a specified grace period, which allows a REIT to receive otherwise non-qualifying income or to sell the property without becoming subject to the 100% prohibited transaction tax or endangering its REIT status. Such a foreclosure election automatically terminates if, more than 90 days after the day on which such property was acquired, the property is used in a trade or business conducted by the REIT other than through an independent contractor from which the REIT derives no income. Under the Act, a REIT may, through a TRS, operate foreclosure property without causing the property to lose its status as foreclosure property.

The Act also expands the 100% tax on redetermined rents, deductions and interest, where the arrangement between a REIT and its TRS are not on an arm's-length basis, to include redetermined TRS service income, where the services provided by a TRS to, or on behalf of, its parent REIT are not on an arm's-length basis. This change does not apply to service income attributable to services provided to the REIT's tenants.

FIRPTA-Related Changes

12. Exception for interests held by foreign retirement or pension funds

FIRPTA was enacted by Congress in 1980 in an attempt to ensure that non-U.S. persons did not receive more favorable tax treatment than U.S. persons on the disposition of U.S. real property by imposing at least one level of U.S. income tax on dispositions of U.S. real property by non-U.S. persons. Under FIRPTA, gain recognized by non-U.S. persons from investments in "United States real property interests" (USRPIs) is treated as income effectively connected with the conduct of a U.S. trade or business and is subject to U.S. federal income and withholding tax regardless of whether the non-U.S. person conducts any activity in the United States. Prior to the Act, a non-U.S. person included foreign pension funds or foreign retirement plans.

Under the Act, a "qualified foreign pension plan" will no longer be subject to income or withholding tax under FIRPTA upon the disposition of a USRPI. For purposes of this rule, a qualified foreign pension plan is defined as any trust, corporation, or other organization or arrangement —

1. which is created or organized under the law of a country other than the United States,
2. which is established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees (or persons designated by such employees),
3. which does not have a single participant or beneficiary with a right to more than 5% of its assets or income,
4. which is subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which it is established or operates, and
5. with respect to which, under the laws of the country in which it is established or operates, (a) contributions to such trust, corporation, organization or arrangement which would otherwise be subject to tax under such laws are deductible or excluded from the gross income of such entity or taxed at a reduced rate, or (b) taxation of any investment income of such trust, corporation, organization or arrangement is deferred or such income is taxed at a reduced rate.

The Act reduces the disparity in treatment between non-U.S. pension plans and U.S. pension plans investing in U.S. real estate. [7] The Act specifically indicates the term includes a non-U.S. entity wholly owned by a qualified foreign pension plan (even if located in a jurisdiction other than the jurisdiction of the pension plan). However, there are a number of outstanding issues involving the definition of qualified pension plans, such as the treatment of government-sponsored pension plans. In addition, the Act does not repeal the applicability of FIRPTA to foreign governments which otherwise are not subject to U.S. tax under a special exemption under the Code. [8] To the extent a non-U.S. investor receives income from the sale of a USRPI that is attributable to the investor engaging in a U.S. trade or business, such investor will continue to be subject to U.S. tax on income from the sale of a USRPI at the graduated rates generally applicable to U.S. persons. After the Act, however, where a qualified pension plan makes an election under 882(d) to be taxed on all of its U.S. source income on a net income basis, such pension plan will be exempt from tax on income from the sale of the property except with respect to any depreciation recapture.

13. Exception from FIRPTA for certain stock of REITs - Expansion of Publicly Traded Exception

Generally, non-U.S. shareholders of certain publicly traded REITs are exempt from tax under FIRPTA on dispositions of REIT stock or on distributions attributable to gain from the sale of a USRPI if such shareholders did not actually or constructively own more than 5% of the REIT's stock during a testing period. [9] The Act increases the ownership threshold for these exceptions from 5% to 10% effective for dispositions and distributions on or after December 18, 2015.

The Act also exempts from tax under FIRPTA dispositions of REIT stock or distributions attributable to gain from the sale of a USRPI held (directly or indirectly through one or more partnerships) by "qualified shareholders." For this purpose, the term qualified shareholder includes certain foreign publicly traded partnerships or corporations that are qualified collective investment vehicles and that maintain records on the identity of holders of 5% or more of the partnership or corporation's publicly traded class of interests or stock. However, to the extent an investor holds an interest in a qualified shareholder (other than solely as a creditor) and holds more than 10% of the stock of the REIT (whether through the qualified shareholder or otherwise) (an "applicable investor"), the amount of gain exempt from tax under FIRPTA is reduced proportionally by the percentage of the qualified shareholder held by the applicable investor. This complex provision is effective as of December 18, 2015.

14. Exception from FIRPTA for certain stock of REITs - Domestically Controlled Exception

Non-U.S. shareholders of a RIC [10] or a REIT are exempt from tax under FIRPTA on dispositions of RIC or REIT stock if the RIC or REIT qualifies as "domestically controlled." A RIC or REIT is domestically controlled if less than 50 percent in value of its stock continues to be held directly or indirectly by non-U.S. persons during a testing period. The Act introduces a number of presumptions intended to aid RICs and REITs in determining whether they are domestically controlled. First, a RIC or REIT shall presume that any person holding less than 5% of any class of its stock that is publicly traded is a U.S. person, unless it has actual knowledge otherwise. Second, a RIC or REIT shall presume that another RIC or REIT that holds its stock is a U.S. person if (i) such other RIC or REIT is domestically controlled and (ii) any class of stock of such other RIC or REIT is publicly traded (or, in the case of the RIC, it issues redeemable securities); however, if such other RIC or REIT is not domestically controlled, the RIC or REIT shall presume such other RIC or REIT is a non-U.S. person. Third, any stock in a RIC or REIT held by another RIC or REIT not described in the prior sentence shall be presumed to be held by a U.S. person in proportion to the stock of the other RIC or REIT which is held (or treated as held) by a U.S. person.

15. Increase in rate of withholding of tax on dispositions of USRPIs

Effective for dispositions occurring after February 16, 2016, the Act increases the rate of FIRPTA withholding from 10% to 15% of the gross proceeds of the sale of a USRPI (including the stock of a REIT). The increased withholding does not apply to the sale of a personal residence where the amount realized is \$1,000,000 or less. In such situations the 10% withholding rate continues to apply.

16. Interests in RICs and REITs not excluded from definition of USRPI under the cleansing rule

An interest in a corporation that is a USRPI generally can be cleansed of its status as a USRPI if it disposes of all its real estate assets in one or more fully taxable transactions (the so-called "cleansing rule"). Effective for dispositions on or after December 18, 2015 of the Act, a corporation that elects to be taxed as a RIC or a REIT (or elected to be so taxed during a specified look-back period) is no longer eligible for the cleansing rule.

Other Related Changes

17. Dividends derived from RICs and REITs ineligible for deduction for U.S. source portion of dividends from certain foreign corporations

U.S. corporations generally are entitled to deduct from their taxable income any dividends received from a foreign corporation only to the extent that the dividend is attributable to (i) income effectively connected with a trade or business, or (ii) a dividend received (directly or indirectly through a wholly-owned foreign corporation) from an 80% or more controlled U.S. corporation. The dividends received deduction is intended to alleviate the double taxation that occurs when dividend income is recognized relating to dividends from a corporation whose income was subject to U.S. tax. Given that the dividends of a RIC or REIT are deducted against the RIC or REIT's income without that income ever being subject to entity-level tax, the IRS has taken the position that dividends attributable to interest income of a controlled RIC or REIT cannot be considered for the dividends-received deductions. The Act codifies the IRS' interpretation of the eligibility of RIC or REIT dividends for the dividends-received deduction. On or after December 18, 2015, U.S. corporations no longer are eligible for a deduction for any dividends received from a foreign corporation that is attributable to a dividend received by such foreign corporation from a RIC or a REIT.

18. Permanent reduction in recognition period for built-in gains tax

In general, a REIT is subject to built-in gains tax if it disposes of property during a specified recognition period that it had obtained from a C corporation in a carryover basis transaction (e.g., the conversion of a C corporation to a REIT or a tax-free merger of a C corporation into a REIT). This recognition period, which had been 10 years, had been reduced temporarily to 7 years for 2009 and 2010, and 5 years for 2011 through 2014. Under the Act, the recognition period is reduced permanently to 5 years effective for tax years beginning after December 31, 2014.

Summary of REIT and FIRPTA Reforms in the Act

Relevant Provision	Summary	Taxpayers Affected	Effective Date
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<p>1. Restriction on tax-free spin-offs involving REITs</p>	<p>Disallows tax-free treatment for spin-offs involving REITs and prohibits parties to a spin-off from making a REIT election for ten years. Does not restrict the ability of a REIT to spin off another REIT or a long-standing TRS.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>December 7, 2015 (other than for taxpayers with a pending ruling request)</p>
<p>2. Repeal of preferential dividend rule for publicly offered REITs</p>	<p>Repeals the preferential dividend rule for publicly offered REITs, which rule disqualifies certain distributions viewed as preferential from counting towards a REIT's 90% distribution requirement.</p>	<p>REITs (publicly traded and listed non-traded)</p>	<p>Distributions made in tax years beginning after December 31, 2014</p>
<p>3. Authority for alternative remedies to address certain REIT distribution failures</p>	<p>Grants the IRS authority to provide an appropriate remedy for inadvertent or reasonably caused violations of the rule</p>	<p>REITs (private)</p>	<p>Distributions made in tax years beginning after December 31, 2015</p>

<p>4. Reduction in percentage limitation on assets of REIT which may be TRSs</p>	<p>Reduces the maximum amount of a REIT's assets which can be comprised of the securities of one or more TRS from 25% to 20%.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Taxable years beginning after December 31, 2017</p>
<p>5. Prohibited transaction safe harbors</p>	<p>Expands the permitted methodologies for application of a safe harbor from prohibited transaction treatment on the sale of inventory property. Additional methodology allows a REIT to calculate certain relevant safe harbor thresholds using a three-year average.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Taxable years beginning after December 18, 2015</p>
<p>6. Limitations on designation of dividends by REITs</p>	<p>Limits the total amount of dividends that can be designated by a REIT as qualified dividends or capital gains dividends to the dividends actually paid by the REIT.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Distributions made in tax years beginning after December 31, 2014</p>

<p>7. Debt instruments of publicly offered REITs and mortgages treated as real estate assets</p>	<p>Expands the definition of real estate assets to include debt instruments issued by publicly offered REITs and interests in mortgages on real property for purposes of the 75% asset test and 95% income test.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Taxable years beginning after December 31, 2015</p>
<p>8. Asset and income test clarification regarding ancillary personal property</p>	<p>Expands the definition of real property to include ancillary personal property that is leased with real property if the rents attributable to that personal property are treated as rent from real property under the 75% income test.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Taxable years beginning after December 31, 2015</p>

<p>9. Hedging provisions</p>	<p>Expands the scope of hedging transactions excluded from gross income for the purposes of the REIT income tests to include hedges entered into to manage mistakes associated with property that has been disposed of or liabilities that have been extinguished.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Taxable years beginning after December 31, 2015</p>
<p>10. Modification of REIT earnings and profits (E&P) calculation to avoid duplicate taxation</p>	<p>Disallows a reduction in the current E&P by any amount that is not allowable in calculating taxable income for the tax year or was not allowable in calculating taxable income for any previous year.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Taxable years beginning after December 31, 2015</p>

<p>11. Treatment of certain services provided by TRSs</p>	<p>Permits (i) the development and marketing of real property by a TRS without subjecting the REIT to the prohibited transaction tax and (ii) the operation of foreclosure property by a TRS without causing the loss of foreclosure property status.</p> <p>Expands the 100 percent excise tax to include income from services provided by a TRS to its parent REIT that are not arm's-length.</p>	<p>REITs (publicly traded, listed non-traded, and private)</p>	<p>Taxable years beginning after December 31, 2015</p>
<p>12. Exception for interests held by foreign retirement or pension funds</p>	<p>Exempts qualified foreign pension plans from FIRPTA tax.</p>	<p>Qualified foreign pension plans investing in USRPIs</p>	<p>Distributions and dispositions after December 18, 2015</p>

<p>13. Exception from FIRPTA for certain stock of REITs - Expansion of Publicly Traded Exception</p>	<p>Increases from 5 percent to 10 percent the maximum stock ownership a non-U.S. investor may hold in a publicly traded REIT to avoid FIRPTA tax upon receipt of capital gain dividends or disposition of such stock.</p>	<p>Non-U.S. investors in REITs</p>	<p>Taxable years beginning after December 31, 2015</p>
<p>14. Exception from FIRPTA for certain stock of REITs - Domestically Controlled Exception</p>	<p>Provides new presumption rules to aid REITs in determining whether their stock is domestically controlled.</p>	<p>Non-U.S. investors in REITs</p>	<p>Taxable years beginning after December 31, 2015</p>
<p>15. Increase in rate of withholding of tax on dispositions of USRPIs</p>	<p>Increases the rate of withholding on dispositions of USRPIs from 10% to 15% of the gross proceeds of the sale.</p>	<p>Non-U.S. investors in USRPIs</p>	<p>Dispositions occurring after February 16, 2016</p>

<p>16. Interests in RICs and REITs not excluded from definition of USRPI under the cleansing rule</p>	<p>Excludes interests in RICs and REITs from eligibility for a cleansing rule, whereby a corporation can terminate its status as a U.S. real property interest by selling all its U.S. real property assets in a taxable transaction.</p>	<p>Non-U.S. investors in RICs and REITs</p>	<p>Dispositions on or after December 18, 2015</p>
<p>17. Dividends derived from RICS and REITs ineligible for deduction for U.S. source portion of dividends from certain foreign corporations</p>	<p>Excludes dividends from a non-U.S. subsidiary attributable to dividends from a RIC or a REIT from eligibility for a dividends-received deduction.</p>	<p>U.S. corporations with a non-U.S. subsidiary, which subsidiary owns stock in a RIC or a REIT</p>	<p>Dividends on or after December 18, 2015</p>
<p>18. Permanent reduction in recognition period for built-in gains tax</p>	<p>Permanently reduces recognition period for built-in gains tax to 5 years</p>	<p>U.S. corporations holding appreciated property that have converted or will convert to REIT status and REITs acquiring appreciated property from a U.S. corporation in a carryover basis transaction</p>	<p>Taxable years beginning after December 31, 2014</p>

[1] References herein to the Code are to the Internal Revenue Code of 1986, as amended.

[2] Rev. Rul. 2001-29, 2001-1 C.B. 1348.

[3] PLR 201337007. A private letter ruling may be relied upon only by the taxpayer to which it is issued. However, private letter rulings provide some indication of administrative practice.

[4] Notice 2015-59 and Rev. Proc. 2015-43.

[5] The limitation was increased to 25% pursuant to the 2008 Housing Act.

[6] In general, the prohibited transactions safe harbor consists of the following requirements (with certain exceptions for foreclosure property), each of which must be met: (i) the REIT must have held the property for not less than two (2) years; (ii) the aggregate capitalized expenditures on the sold property during the two years prior to its sale do not exceed 30% of the net selling price for the property; (iii)(I) the REIT does not make more than seven (7) sales of property during the year, or (II) the aggregate adjusted tax basis of property sold during the year does not exceed 10% of the aggregate tax basis of all of the REIT's assets as of the beginning of the year, or (III) the fair market value of property sold during the year does not exceed 10% of the fair market value of all of the REIT's assets as of the beginning of the year; (iv) property, which consists of land or improvements, has been held by the REIT for the production of rental income for not less than two (2) years; and (v) if the requirement of (iii)(I) above is not met, substantially all of the marketing and development expenditures with respect to the property were made by an "independent contractor" (as defined for REIT purposes) from whom the REIT does not derive or receive any income.

[7] Non-U.S. pension plans may even be at an advantage to U.S. pension plans investing in U.S. real estate as non-U.S. pension plans generally are not subject to taxation in the U.S. on their unrelated business taxable income, which income may be generated by U.S. pension plans from investments in U.S. real property that are debt financed.

[8] See Section 892; Treas. Reg. Sec. 1.892-3T.

[9] Shareholders of a publicly traded corporation that is subject to FIRPTA as a "United States real property holding corporation," but which has not elected to be taxed as a REIT, are not eligible for this exception.

[10] The Act restores the application of this rule to RICs for tax years beginning after January 1, 2015 and makes such restoration permanent.

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- **Martin T. Hamilton**
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- **Mary B. Kuusisto**
Partner
- **Yuval Tal**
Partner
- **Peter M. Fass**
- **Jamiel E. Poindexter**
Partner
- **Amanda H. Nussbaum**
Partner