June 14, 2018

Via: www.regulations.gov (IRS-2018-0010)

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2018-43) Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2018-43: Request for Comments Regarding Recommendations for Items that Should be Included on the 2018-2019 Priority Guidance Plan

Dear Sir or Madam,

In response to Notice 2018-43, Nareit appreciates the opportunity to offer our suggestions regarding regulatory guidance to be placed on the 2018-19 Priority Guidance Plan (PGP).

Nareit is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community.

REITs are real estate working for you. Through the properties they own, finance and operate, REITs help provide the essential real estate we need to live, work and play. All U.S. REITs own approximately $3 trillion in gross assets, public U.S. REITs account for $2 trillion in gross assets, and stock-exchange listed REITs have an equity market capitalization of over $1 trillion. In addition, more than 80 million Americans invest in REIT stocks through their 401(k) and other investment funds.

Executive Summary

Nareit's recommendations are listed in order of priority.

Most importantly, Nareit requests confirmation in guidance that the section 199A[1] deduction added to the Internal Revenue Code as part of Pub. L. No. 115-97 (also known as the Tax Cuts and Jobs Act, or TCJA), applies to shareholders invested in REITs through a mutual fund.

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[1] Unless otherwise noted, references to "section" in this letter refer to sections of the Internal Revenue Code of 1986, as amended (the Code).

Second, Nareit requests that the Administration use the authority under section 856(c)(5)(J) to treat "global intangible low-taxed income" (GILTI) inclusions under new section 951A as qualifying REIT income under section 856(c)(2).

Third, Nareit requests that the Administration clarify that existing multifamily buildings be depreciated over 30 years for taxpayers that elect out of the new section 163(j) limits on interest deductibility. Nareit agrees with the arguments set forth in the March 15, 2018 letter to Treasury Secretary Mnuchin submitted by the National Multifamily Housing Council and the National Apartment Association.

Fourth, Nareit agrees with the recommendations of The Real Estate Roundtable in its Feb. 21, 2018 letter to Treasury Secretary Mnuchin (the Feb. 21, 2018 letter), requesting clarification of aspects of new section 163(j) regarding allocation of indebtedness to a trade or business and among different activities of a taxpayer.

Fifth, Nareit recommends that the Administration clarify that under prior section163(j), disallowed interest will not be treated as "business interest" if properly attributable to a real property trade or business (RPTOB) and that RPTOB makes a RPTOB election under section 163(j)(7)(B).

Sixth, Nareit urges the Administration to confirm that a REIT capital gains dividend allocated to an "applicable partnership interest" retains long-term capital gains treatment to the extent attributable to the disposition of an asset by the REIT held for more than three years.

Seventh, as Nareit mentioned in our meeting with Treasury Assistant Secretary for Tax Policy and Acting Commissioner of the IRS David J. Kautter, we again recommend the withdrawal of Notice 2007-55 concerning the Foreign Investment in Real Property Tax Act (FIRPTA) consequences of liquidating REIT distributions to non-U.S. investors. Nareit submitted written requests for withdrawal of Notice 2007-55 in 2017, 2012, 2011, and 2009.

Eighth, Nareit also reiterates the following two requests (which were included in Nareit's May 30, 2017 submission to the Administration concerning recommendations for the 2017-18 PGP) relating to spin-offs under section 355 and which also have been included in prior Nareit submissions. Specifically, Nareit restates the recommendations included in its October 7, 2016 comments regarding the proposed regulations under section 355 concerning device and active trade or business (REG-134016-15) (the Proposed ATB Regulations) to narrow the application of those regulations. If these suggested changes are not possible, Nareit requests that the Treasury Department withdraw these regulations. Additionally, Nareit reiterates the recommendations included in its May 16, 2016 comment letter regarding Notice 2016-26 and the 2016-17 PGP in connection with the tax-free distributions of the stock of one REIT by another REIT. Specifically, the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act), which was enacted as part of Pub. Law 114-113, the "Consolidated Appropriations Act, 2016," and signed into law on December 18, 2015, generally prohibits tax-free distributions of REITs except in certain cases, such as when both the distributing and controlled corporations are REITs "immediately after" the distribution. Nareit requests that IRS and Treasury provide guidance recognizing Congressional intent that a newly electing REIT satisfies this "immediately after" requirement when it files its REIT election on Form 1120-REIT for that taxable year in a timely manner.

Ninth, Nareit reiterates the recommendations included in its May 30, 2017 comments and July 19, 2016 comments regarding the final, temporary (T.D. 9770) and proposed regulations (REG–126452–15) relating to certain transfers by C corporations of appreciated assets to regulated investment companies and REITs (the 2016 BIG Regulations). Nareit appreciates that the Treasury Department and IRS are considering revisions and technical changes to these regulations, as stated in the "Second Report to the President on Identifying and Reducing Tax Regulatory Burdens" (Executive Order 13789) (October 2, 2017).

Finally, Nareit encourages the Treasury Department and the IRS to carry over to the 2018-2019 PGP and to continue work on the revision of regulations under Treas. Reg. § 1.337(d)-7 regarding the treatment of certain foreign corporations. This request appears to fall within the scope of Item 6 under "Corporations and Their Shareholders" in the Third Quarter Update of the 2017-18 PGP ("Revising regulations under §1.337(d)-7 regarding the treatment of certain foreign corporations").

Recommendations

Confirm Through Guidance That Section 199A Deduction Applies to Shareholders Invested in REITs through Mutual Funds

To treat corporate and noncorporate business income more similarly under the income tax laws and to provide more resources for businesses to invest and create jobs, section 199A provides a deduction for individuals, estates, and trusts. As relevant here, the deduction is generally equal to the lesser of 20% of a taxpayer's combined qualified business income amount (CQBIA), or 20% of the taxpayer's income (reduced by any net capital gain), plus 20% of the sum of qualified REIT dividends and qualified publicly traded partnership income. CQBIA is generally defined as 20% of qualified business income with respect to a qualified trade or business of a partnership, S corporation or sole proprietorship (with certain wage and basis limitations).

Section 199A's 20% deduction with respect to qualified REIT dividends is meant to apply to REIT shares held through regulated investment companies (RICs or mutual funds). Section 199A(f)(4) provides the Secretary with the authority to "prescribe such regulations as are necessary to carry out the purposes of this section . . . ., including regulations … for the application of this section in the case of 'tiered entities.'" The term "tiered entities" is not defined in the statute. In previously issued regulatory guidance, the

Treasury Department has used the term to describe tiers of entities including RICs, REITs, and partnerships.[2]

Mutual funds combine the capital of many shareholders to invest in a diversified portfolio of securities. By satisfying a number of requirements including that they are widely held and distribute substantially all of their income, mutual funds can deduct dividends paid; all income is taxed at the shareholder level. Half of all households owning mutual funds have low or moderate incomes.[3] Modeled after mutual funds, REITs give all investors access to the benefits of real estate investment along with the advantages of investing in publicly traded stock. REITs combine the capital of many shareholders to invest in a diversified portfolio of income-producing real estate. REITs offer distinct advantages for smaller investors: greater diversification through investing in a portfolio of properties rather than a single building and expert management by experienced real estate professionals. Many mutual funds own REIT securities, and some mutual funds are REIT-specific, meaning that 100% of their portfolios consist of REIT securities.

Millions of taxpayers own REITs through mutual funds. Under Pre-TCJA law, domestic shareholders of REITs through mutual funds were taxed identically to direct domestic shareholders of such REITs. There is no policy rationale for treating investors – particularly the low and moderate income investors who hold REIT shares through mutual funds-- differently than investors who hold REIT stocks directly. Nareit requests that the Department of the Treasury exercise its authority under sections 199A(f)(4) and 7805 to provide guidance confirming that shareholders of REITs through mutual funds are eligible for section 199A's 20% deduction. We strongly believe that the general authority provided to the Secretary under section 199A(f)(4) "to carry out the purposes of this section" permits regulations to allow all REIT shareholders (direct and indirect) to obtain the 20% deduction attributable to REIT shareholders as Congress intended.

Confirm that GILTI Inclusions Qualify for 95% REIT Gross Income Test Purposes

Background

The TCJA fundamentally reformed the U.S. international tax system by replacing deferral with a dividend exemption system and by adopting measures to prevent U.S. tax base erosion. One of the primary anti-base erosion measures that was enacted targets the shifting of intangible income to low- or zero-tax jurisdictions by subjecting a U.S. multinational's GILTI to current U.S. tax.[4] In general, GILTI is defined

[2] Treas. Reg. § 1.362-3(d)(5)(C); *see also* Treas. Reg. § 1.7704-1(a)(2)(iii).
[3] Figure 7.6, 2018 Investment Company Fact Book (The Investment Company Institute).
[4] According to the Senate Finance Committee's "Reasons for Change", the GILTI provision is intended to address incentives for U.S. corporations "to allocate income that would otherwise be subject to the full U.S. corporate tax rate to foreign affiliates operating in low-or zero-tax jurisdictions." The Committee believed that "intangible income is mobile and constitutes a large portion of the foreign-source income earned by U.S. corporations, and significant erosion of the U.S. tax base could result if no base protection measures were adopted in a move to a participation

as a U.S. shareholder's aggregate pro-rata share of net tested income of controlled foreign corporations (CFC) in excess of a base amount, generally 10% of CFC "qualified business asset investment" (QBAI) reduced by CFC interest expense. Congress specified that the GILTI inclusion is to be treated like a subpart F inclusion under section 951(a)(1)(A), but it is included in gross income under section 951A.[5] C corporations generally are allowed a 50% GILTI deduction (37.5% after 2025) under section 250.

Congress created the REIT rules in 1960 to provide a way for the average investor to invest in a professionally managed portfolio of real estate assets, including foreign real estate.[6] REITs can own foreign real estate directly or indirectly through other entities, including through taxable REIT subsidiaries (TRSs).[7] Congress created the TRS rules almost two decades ago to allow REITs to perform activities related to their real estate investments that do not qualify under the REIT asset and gross income tests, subject to the limitation under section 856(c)(4)(B)(ii) that (effective Jan. 1, 2018) no more than 20% of the value of a REIT's total assets can be represented by securities of one or more TRSs. [8]

Even though they do not own or invest in intangibles as such term is broadly understood, REITs investing outside of the United States are likely to be subject to the GILTI inclusion because: 1) the QBAI amount is determined by using adjusted tax basis as calculated using Alternative Depreciation System (ADS) lives and conventions, so assets held for the long-term typically have an adjusted tax basis well below their fair value; and, 2) land is excluded from QBAI, but for many foreign TRSs, land represents a significant fraction of their total assets..

Congress expressly permitted TRSs to undertake virtually any activity other than directly or indirectly operating or managing a hotel or health care facility. However, Congress has enacted significant and meaningful limitations on TRSs. First, only 20% of a REIT's assets can consist of securities in TRSs. Second, TRSs are fully subject to corporate income tax. Third, Congress limited inappropriate income and deduction shifting between a REIT and its TRSs by imposing a 100% excise tax on redetermined rents, redetermined deductions, excess interest and redetermined TRS service income.[9] TRSs allow

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exemption system." See Explanation of the Senate Finance Committee FY 2018 Reconciliation Legislation, at 365 (Nov. 29, 2017). The Conference Report on page 626 states that the final bill follows the Senate amendment.

[5] "[A] U.S. shareholder of any CFC must include in gross income for a taxable year its [GILTI] in a manner generally similar to inclusions of subpart F income." H.R. Rep. No. 466, 115th Cong., 1st Sess. 641 (2018) (Emphasis added).

[6] Foreign real estate qualifies as a real estate asset for purposes of the REIT asset tests of section 856(c)(4). *See* Rev. Rul. 74-191, 1974-1 C.B. 170.

[7] Congress expressly acknowledged REITs using TRSs outside the United States by creating a special rule for lodging or healthcare facilities in section 856(d)(8)(B)(ii).

[8] S. Rep. No. 201, 106th Cong., 1st Sess. 57-58 (1999) ("The Committee believes, however, that certain types of activities that relate to the REIT's real estate investments should be permitted to be performed under the control of the REIT, through the establishment of a 'taxable REIT subsidiary'. . .. Another type of activity that the Committee believes appropriate for a subsidiary is management and operation of the real estate in which a REIT has developed expertise with respect to its own properties that it also would like to provide to third parties.")

[9] Section 857(b)(7).

REITs to remain competitive in the ever-evolving real estate industry while at the same time ensuring that the vast majority of their income is from real estate-related or passive sources.

REITs are subject to GILTI inclusions under section 951A in respect of their foreign TRSs that are treated as CFCs, but REITs are not allowed the GILTI deduction under section 250 by virtue of section 857(b)(2)(A). Accordingly, the full amount of a REIT's GILTI inclusion is subject to the 90% distribution requirement to REIT shareholders under section 857(a)(1) and, to the extent not distributed, subject to corporate tax under section 857(b)(1).

Although a REIT's foreign investments do not implicate the international anti-base erosion policy concerns underlying GILTI, the impact of GILTI inclusions on the REIT gross income tests, particularly the 95% gross income test under section 856(c)(2),[10] could have the unintended consequence of jeopardizing REIT status. While Congress appropriately addressed the treatment of a REIT's section 965 deemed repatriation inclusion under the REIT gross income tests,[11] it did not similarly address the treatment of section 951A GILTI inclusions. The House bill would have clearly treated its version of section 951A inclusions as qualifying income for purposes of the 95% gross income test,[12] but the final legislation is silent on the treatment of section 951A GILTI inclusions for purposes of the 95% and the 75% gross income tests.

In 2008, Congress enacted section 856(c)(5)(J) to provide the Secretary the authority to treat items of gross income that are not otherwise qualifying income for purposes of the REIT gross income tests as either: i) excluded from gross income under the REIT rules; or, ii) items of qualifying gross income under the REIT rules.[13] As the primary Senate sponsor of the REIT Investment Diversification and Empowerment Act of 2007 that later was incorporated into the 2008 tax legislation enacted as part of the Code, Senator Hatch clearly indicated that the IRS should issue guidance concluding that Subpart F

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[10] Under section 856(c)(2), a REIT must derive at least 95% of its gross income from any source that qualifies for the 75% gross income test under section 856(c)(3) (*i.e.*, rents from real property, mortgage interest, gain from the sale or other disposition of real property, and other types of real estate-related income), as well as interest, dividends, gains from the sale or other disposition of stock and securities, and other types of passive income.
[11] *See* section 965(m)(1)(A) (a REIT's section 965 inclusion is not considered an item of gross income for purposes of the 95% and 75% REIT gross income tests under section 856(c)(2) and (3), respectively).
[12] *See* section 4301(c)(4) of the House bill (expressly including section 951A(a) inclusions as qualifying income under new subparagraph (J) in section 856(c)(2)).
[13] *See* Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 110th Congress, JCS-1-09, at 234 ("The Congress believes it is desirable for the Treasury Department to be permitted to issue generally applicable guidance in appropriate cases").

income should constitute qualifying income under the REIT 95% gross income test.[14] The IRS has exercised its section 856(c)(5)(J) authority in a number of private letter rulings.[15]

Need for Clarification

Clarification is needed to ensure that GILTI inclusions do not adversely impact the ability of REITs to satisfy the 95% gross income test.[16] This lack of clarity is creating significant uncertainty for certain REITs owning foreign real estate with respect to their ability to retain REIT status. If GILTI inclusions are treated as non-qualified income, a REIT holding non-U.S. real estate assets could find it increasingly difficult over time to satisfy the 95% income test due to complexities associated with integration of acquisitions of foreign real estate and the tax depreciation associated with QBAI. This difficulty arises even though the REIT: i) will continue to derive virtually all of its income from QBAI (not intangible property); ii) is not operating in low- or zero-tax jurisdictions; and, iii) is unable to utilize any foreign tax credits. As such, the foreign real estate and related activities of a REIT, even if conducted through a

[14] *See* 153 Cong. Rec. S10931 (daily ed. Aug. 3, 2007) ("To prevent similar delays in the future, Title I clearly provides the Secretary of the Treasury with the authority to determine what items of income can be treated either as ''good income'' or disregarded for purposes of the REIT income tests. Under this authority, it is expected that, for example, the IRS would conclude that dividend-like items such as Subpart F deemed dividends and PFIC income would be treated in the same manner as dividends for purposes of the 95 percent gross income test. Further, the IRS could convert many of its rulings it issued to individual taxpayers into public guidance, which could be a more efficient use of its resources.") (statement of Sen. Orrin Hatch).

[15] *See, e.g.*, Priv. Ltr. Rul. 201122016 (Mar. 1, 2011) (receipt of interest and costs related to a claim for properties taken under eminent domain are not considered in determining whether the REIT gross income tests are satisfied); Priv. Ltr. Rul. 201145008 (Aug. 4, 2011) (receipt of payment related to settlement of a breach of contract claim does not constitute gross income for purposes of the REIT gross income tests); Priv. Ltr. Rul. 201226004 and 201246013 (subpart F inclusions related to CFC foreign personal holding company income and passive foreign investment company inclusions qualified for the 95% gross income test); PLR 201537020 section 956 inclusions related to CFC stock pledges/guarantees on loans made to finance the REIT's acquisition of real estate assets qualified for the 95% gross income test); Priv. Ltr. Rul. 201418022 (Jan. 28, 2014) and Priv. Ltr. Rul. 201433005 (May 5, 2014) (receipt of patronage dividends is excluded from gross income for purposes of the REIT gross income tests); Priv. Ltr. Rul. 201418037 (Jan. 27, 2014) (receipt of payments from bankruptcy estate, including settlement payments, to the extent such payments would not have qualified under the REIT gross income tests, are excluded from the REIT gross income tests). *Cf.* Priv. Ltr. Rul. 9636014 (Jun. 6, 1996) (receipt of a settlement payment related to a lease dispute is not be taken into account in the REIT gross income tests); *see also* Priv. Ltr. Rul. 200039027 (Jun. 29, 2000) (receipt of payments related to settlement of a lawsuit and other legal claims are not includible in gross income for purposes of the REIT gross income tests); Priv. Ltr. Rul. 200115023 (Jan. 11, 2001) (a positive Section 481 adjustment is not taken into account to determine whether the REIT gross income tests have been met); Priv. Ltr. Rul. 200127024 (Apr. 1, 2001) (receipt of a break-up fee in connection with the termination of a merger with two REITs is not includible in gross income for purposes of the REIT gross income tests); Priv. Ltr. Rul. 200414025 (Dec. 17, 2003) (receipt of guarantor substitution payment in not includable in gross income for purposes of the REIT gross income tests); Priv. Ltr. Rul. 200528004 (Apr. 5, 2005) and Priv. Ltr. Rul. 200614024 (Dec. 28, 2005) (taxable income associated with the receipt of state tax credits is not considered in determining whether REIT gross income tests are satisfied).

[16] This clarification would have no impact on the continued requirement of a REIT to take the GILTI income into account for purposes of calculating its taxable income that needs to be distributed to its shareholders.

TRS, are not the intended target of GILTI. At a minimum, the application of GILTI to the ownership of foreign real estate should not jeopardize REIT status.

Nareit requests that the Treasury Department and IRS exercise the authority granted to them under section 856(c)(5)(J) to issue guidance concluding that GILTI income qualifies under the REIT 95% income test. GILTI inclusions are in essence advance payments of dividends from foreign subsidiaries. Confirming that GILTI inclusions qualify for the 95% gross income tests is consistent with the TCJA's legislative history that GILTI inclusions be similar to inclusions of Subpart F and with Senator Hatch's statement when section 856(c)(5)(J) was enacted that subpart F inclusions be treated similarly to dividend income. Such treatment also would be consistent with Congressional intent in authorizing REITs to own a limited threshold of TRS securities while permitting TRSs to engage in virtually any activity other than hotel/health care facility management and operation.

Confirm that the TCJA's 30 Year ADS Period Applies to Existing Properties of Electing RPTOBs

New section 163(j) limits a taxpayer's deduction for "business interest" to an amount not in excess of the sum of 1) the business interest income of the taxpayer; 2) 30% of the "adjusted taxable income" of the taxpayer; and, 3) floor plan financing interest of the taxpayer. [17] "Business interest" means interest on indebtedness properly allocable to a "trade or business."[18] "Adjusted taxable income" is defined as a taxpayer's taxable income with certain adjustments, including the removal of any item of income, gain, deduction, or loss that is not properly allocable to a "trade or business."[19]

Section 163(j)(7)(A)(ii) excludes any electing RPTOB from the definition of "trade or business" for purposes of section 163(j).[20] As a result, interest on indebtedness properly allocable to an electing RPTOB is not limited by section 163(j). In addition, a taxpayer's "adjusted taxable income" is calculated without regard any items from a RPTOB. A RPTOB making the election under section 163(j)(7)(B) is required to use the ADS cost recovery periods for its residential real property, non-residential real property, and qualified improvement property.[21]The TCJA also modified section 168(g)(3) to reduce the ADS period for multifamily properties from 40 years to 30 years.

The applicable ADS period for pre-TCJA residential real property owned by electing RPTOBs is unclear. Nareit agrees with the comments of NMHC and NAA in their letter dated March 15, 2018, and urges the Administration to confirm that the ADS period applicable to such property is 30 years. As noted by NMHC

[17] Section 163(j)(1).
[18] Section 163(j)(5).
[19] Section 163(j)(8).
[20] Section 163(j)(7)(A)(ii).
[21] Section 168(g)(1)(F).

and NAA in the March 18, 2018 letter, retaining the pre-TCJA ADS 40-year period would reduce the ability of electing RPTOBs to invest in their assets or develop new properties, contrary to the goals of the TCJA.

Clarify Aspects of New Section 163(j) Regarding Allocation of Debt to a Trade or Business and among Different Activities of a Taxpayer

Nareit supports the recommendations of The Real Estate Roundtable in its Feb. 21, 2018 letter that the Treasury Department and IRS clarify that interest (other than investment interest) on debt incurred by an owner of an entity engaged in a RPTOB, that can be properly traced to the owner's investment of funds in that real property trade or business, will be treated as interest that is allocable to that RPTOB, and therefore exempt from the new business interest limitations, if that RPTOB has made (or is treated as having made) an election out of the new interest limitation rule. Nareit also agrees that it would be helpful to provide guidance regarding how indebtedness would be allocated among different activities of a taxpayer.

Confirm that Disallowed Interest Carried Forward under Pre-TCJA Section 163(j) Will not Be Treated as "Business Interest" If Properly Allocable to an Electing RPTOB

Notice 2018-28 announced that Treasury and the IRS would issue regulations clarifying that taxpayers with "disqualified interest" disallowed under prior section 163(j)(1)(A) for the last year beginning before Jan. 1, 2018, may carry such interest forward as "business interest" to the taxpayer's first taxable year beginning after Dec. 31, 2017.[22] Notice 2018-28 further states that "business interest" carried forward will be subject to potential disallowance under new section 163(j) in the same manner as any other "business interest" otherwise paid or accrued in a taxable year beginning after Dec. 31, 2017. Notice 2018-28 indicates that the anticipated treatment of disallowed interest under prior section 163(j)(1)(A) will be consistent with new section 163(j)(2), which generally provides that taxpayers may carry forward interest disallowed under new section 163(j) and such interest is treated as "business interest" paid or accrued in the succeeding taxable year.

Nareit commends Treasury and the IRS for confirming that disallowed interest under prior section 163(j) would be carried forward to the new section 163(j) regime. This issue is important to Nareit's members, as prior section 163(j) applied to interest expense of TRSs. [23] Many of our members have TRSs with old section 163(j) disallowed interest carryforwards.

[22] 2018-16 I.R.B. 492, § 3.
[23] Section 163(j)(3)(C) (2017) (treating interest paid by a TRS as "disqualified interest").

To ensure that the congressional intent behind the electing RPTOB exception is advanced, Nareit recommends that the regulations envisioned by Notice 2018-28 treat disallowed interest under prior section 163(j) be treated as interest properly allocable to a RPTOB, not as “business interest,” in the year that the RPTOB makes an election under section 163(j)(7)(B), whether the election is made in 2018 or subsequently. Without such a clarification, it is possible that disallowed interest carried forward under prior section 163(j) attributable to a RPTOB may *never* be deducted if that RPTOB makes a section 163(j)(7)(B) election in 2018 or any subsequent year.

For example, assume a REIT’s TRS only engaged in a RPTOB in 2017 and its interest deductions were disallowed under prior section 163(j). If that TRS makes a RPTOB election in 2018 to be able to deduct its interest incurred in 2018, then the TRS will have an “adjusted taxable income” in 2018 of zero, because no items attributable to its electing RPTOB will be included in its “adjusted taxable income.” Thus, the TRS may not be able to deduct any of its disallowed interest under prior section 163(j) and may *never* be able to deduct that interest if its only business is a RPTOB.

In the case of interest carried forward under prior section 163(j), the taxpayer never had the ability to make a RPTOB election before enactment of new section 163(j). There is no consistency goal advanced by treating interest from a RPTOB conducted in 2017 as “business interest” in 2018. Rather, such a result unnecessarily penalizes the taxpayer for making the RPTOB election in 2018. Accordingly, we recommend that if the carried forward interest under old section 163(j) is (1) attributable to a RPTOB conducted in the year of disallowance and (2) that RPTOB makes an election in 2018 (or any subsequent year), then the carried forward interest should not be treated as “business interest.”

Confirm that REIT Capital Gain Dividends Allocated to an “Applicable Partnership Interest” Retain Long-term Capital Gains Treatment to the Extent Attributable to the Disposition of an Asset Held by the REIT for More than Three Years

Prior to enactment of the TCJA, the gain attributable to the sale of a capital asset held for more than one year was treated as long-term capital gain. New section 1061 requires a three-year holding period in order for certain gains allocable to an “applicable partnership interest” to qualify for long-term capital gain treatment; otherwise, such gains are treated as short-term capital gain and taxed at higher ordinary income tax rates. Section 1061 requires this three-year holding period by replacing the term “1 year” in section 1222(3) (“The term ‘long-term capital gain’ means gain from the sale or exchange of a capital asset held for more than 1 year, if and to the extent such gain is taken into account in computing gross income“) with “3 years.”

When a REIT realizes capital gain on the disposition of a property, it may designate a distribution to shareholders attributable to such gain as a capital gain dividend.[24] If so designated, section 857(b)(3)(B) provides that the shareholders treat such capital gain dividend as "a gain from the sale or exchange of a capital asset **held for more than 1 year**." (Emphasis added). Because section 857(b)(3)(B) treats such gain as the result of sale or exchange of an asset held only for more than "1 year," some practitioners have expressed concern that section 1061 would prevent capital gain dividend income allocated to an applicable partnership interest from satisfying the three-year holding period requirement of section 1061 even if the REIT held the asset generating such gain for longer than three years.

When a lower capital gains tax rate was available for property held for more than 18 months during the 1990s after the enactment of the Taxpayer Relief Act of 1997, Notice 97-54, 1997-2 C.B. 323 permitted REITs to designate capital gain dividends as eligible for the lower rate to the extent that they had held the relevant assets for more than 18 months (notwithstanding the "held for more than 1 year" language in section 857(b)(3)(B)).

Similarly, when a lower capital gains tax rate was available for property held for more than five years between 1997 and 2003, Publication 550, "Investment Income and Expenses (Including Capital Gains and Losses)," at 24 (2003) instructed that REITs may designate a portion of their capital gain dividends by reference to the gain on assets sold with a longer-than-five-year holding period.[25]

Application of section 1061 on a look-through basis as previously was permitted in Notice 97-54 and Publication 550 provides for an equitable result. The fact that the statute characterizing REIT capital gain dividends provides that such gain is treated as arising from the sale or exchange of a capital asset held for more than one year clearly is intended to provide for long-term capital gain treatment for such income items in typical circumstances. That provision was drafted many years prior to the enactment of section 1061, and it would seem that consideration was not given to coordinating the provisions during the drafting process. The purposes of section 1061 would not be served by characterizing all REIT capital gain dividend income allocated with respect to an applicable partnership interest as short-term capital gain. Accordingly, Nareit requests that the Treasury Department and IRS confirm that shareholders allocated REIT capital gain dividends through applicable partnership interests may continue to treat such gains as long-term capital gains to the extent they are attributable to dispositions of assets held by the REIT for more than three years.

[24] Section 857(b)(3)(B).
[25] *See also* Notice 2004-39, 2004-22 I.R.B. 982 (describing the designation under prior law of a portion of a capital gain dividend as 5-year gain).

Withdraw Notice 2007-55/Treat REIT Liquidations and Redemptions as Sales/Exchanges of Stock for all Shareholders

FIRPTA treats any gain from a non-U.S. person's sale of a U.S. real property interest (USRPIs) as if the non-U.S. person were doing business in the United States, and therefore subjects that gain to full U.S. income tax as well as full filing requirements. To enforce the FIRPTA regime, the Code requires U.S. persons who acquire real property from non-U.S. investors to withhold 15% of the gross proceeds (up from 10% prior to the PATH Act) or 21% in the case of certain distributions by a REIT, and remit withheld amounts to the IRS. FIRPTA taxation applies both to sales of direct interests in U.S. real estate as well as to sales of shares of corporations the assets of which primarily consist of U.S. real estate (United States Real Property Holding Corporations, or USRPHCs).

Recognizing that "portfolio" investors of listed real estate companies, such as REITs, are more akin to securities owners than to direct real estate investors, since its inception in 1980 FIRPTA provides a limited exception for sales of stock in a USRPHC that is regularly traded on an established securities market (so long as the seller owns 10% or less of that company in the case of REITs, up from 5% or less prior to the PATH Act with respect to all listed USRPHCs) and sales of stock in a domestically controlled REIT. Additionally, since 2004 REIT capital gains distributions have been subject to an up-to-21% FIRPTA withholding tax unless they are paid to 5% (10% after the PATH Act) or less shareholders of a publicly traded REIT, in which case the distributions are subject to the same withholding rates as ordinary dividends (30% or a lower tax treaty rate).

As more fully presented in a comment letter by the American Bar Association Tax Section (the Tax Section) dated June 10, 2008, and as Nareit has requested in in its 2012, 2011, and 2009 written submissions to the IRS and Treasury Department, Nareit believes that Notice 2007-55 should be withdrawn. [26]

As a result, if a third-party stock sale would be exempt under current law (for example, as in the case of sales of shares of a "domestically controlled REIT," which are not United States Real Property Interests, or USRPIs), then the tax treatment of a non-dividend distribution that gives rise to a constructive sale or exchange ought to be taxed the same way. Nareit agrees with this specific recommendation of the Tax Section as well as the other recommendations contained in its June 10, 2008 comment letter.

[26] Nareit's prior submissions stated that the withdrawal of Notice 2007-55 also should not apply if a REIT relies on the "cleansing exception" of section 897(c)(1)(B). However, this exception is no longer necessary because Congress clarified in the PATH Act that the cleansing exception does not apply to REITs and RICs.

Spin-off Provisions

Proposed ATB Regulations concerning active trade or business requirement

The Proposed ATB Regulations would make significant changes to one of the factors to be taken into account in determining whether a distribution by a corporation of its subsidiary was used principally as a device within the meaning of section 355(a)(1)(B).

The Proposed Regulations would introduce a distinction between “Business Assets” and “Nonbusiness Assets,” with the former defined as gross assets used in one or more “Businesses,” including cash and cash equivalents held as a reasonable amount of working capital for one or more “Businesses.” A “Business,” in turn, would be defined as an active trade or business, within the meaning of section 355(b) and Treas. Reg. § 1.355-3, without regard to, inter alia, the requirements relating to the active conduct throughout the five-year period preceding a distribution and acquisitions during such period (an ATB).

In other words, any assets that qualify as used in an ATB, within the meaning of section 355(b) and Treas. Reg. § 1.355-3, regardless of the period during which such trade or business has been conducted, would be considered Business Assets under the Proposed Regulations. Nonbusiness Assets would be a corporation’s gross assets other than its Business Assets. The Proposed Regulations would require taxpayers to determine the amount of Business Assets and Nonbusiness Assets owned or deemed owned by the distributing corporation and the controlled corporation and to compare their relative “Nonbusiness Asset Percentages” with each other and would specify under what circumstances such ownership and such percentage are considered to be evidence of a device. In addition, in certain cases involving the separation of Business Assets from Nonbusiness Assets, a transaction would be considered to have been used principally as a device.

As stated in its Oct. 7, 2016 comment letter regarding the Proposed ATB Regulations, Nareit again respectfully recommends the following:

First, Nareit recommends amending the Proposed ATB Regulations to revert to a “device” test based on “investment assets,” rather than the new categories of “Business Assets” and “Non-Business Assets.”

Second, Nareit recommends that the IRS and Treasury Department modify the Proposed ATB Regulations to exempt transactions described in section 355(h)(2)(A) (relating to distributions of REITs by REITs), from the application of the heightened scrutiny of Prop. Treas. Reg. § 1.355-2(d)(2)(iv) and the per se rule of Prop. Treas. Reg. § 1.355-2(d)(5).

Third, Nareit recommends that the IRS and Treasury Department expand the “Business Assets” test in the Proposed ATB Regulations for purposes of the “device” test under section 355 to include real estate owned by a REIT (and certain of its affiliates), without regard to whether such real estate would otherwise qualify as used in an active trade or business of the REIT.

Finally, Nareit recommends that the IRS and Treasury Department include an example in the final regulations to demonstrate the application of the "anti-abuse" rule of Prop. Treas. Reg. § 1.355-2(d)(2)(iv)(E) (not taking into account a transaction or series of transactions undertaken with a principal purpose of affecting the Nonbusiness Asset Percentage). In particular, Nareit requests that an example be included exempting from the Proposed ATB Regulations' anti-abuse rule the case in which a REIT begins, no later than one year before a distribution, to self-manage properties that had been externally managed.

If it is not possible to amend the Proposed ATB Regulations to incorporate the above recommendations, Nareit recommends that the Treasury Department withdraw the Proposed ATB Regulations so that non-tax motivated transactions not be negatively impacted by excessive regulation.

Confirm that section 355(h)(2)(A) should apply, and section 856(c)(8) should not apply, when the effective date of the REIT election or elections—that is, the first day the entity or entities are treated as a REIT—coincides with or precedes the date of the distribution under section 355

The PATH Act contained new rules limiting the availability of a REIT election for certain entities that have been spun-off in a tax-free section 355 transaction. However, the PATH Act generally preserved the ability of a REIT to achieve a tax-free spin-off of another REIT or a taxable REIT subsidiary. In order to qualify for tax-free treatment, among other things, section 355(h)(2)(A) provides that the distributing and the controlled corporations must both be REITs "immediately" after the distribution.

As a practical matter, the manner in which a corporation makes a REIT election is to file an IRS Form 1120-REIT rather than a regular Form 1120 as its tax return. The due date of the Form 1120-REIT is the 15th day of the 3rd month after the end of the REIT's taxable year, which can be extended. Even though the form is filed after the end of the REIT's taxable year, the REIT "election" is effective for the taxable year to which the return relates.

The JCT Technical Explanation indicates Congress intended that "[a]s long as a REIT election for each corporation is effective immediately after the distribution, the elections may be made after that time." Nareit requests that IRS and Treasury provide guidance recognizing Congressional intent that a corporation satisfies the "immediately" requirement of section 355(h)(2)(A) when the newly-electing REIT files its Form 1120-REIT for the taxable year in a timely manner.

Transfers of Appreciated Property by non-REIT Corporations to RICs and REITs

Among other things, the PATH Act made permanent the 5-year period for the recognition of gain under section 1374, which had been reduced from 10 years in previous years on a temporary basis. Additionally, the previous final regulations under section 337(d) (the 2013 Regulations) generally provided that, when a REIT disposes of appreciated property after converting to a REIT from a C corporation or acquiring property from a C corporation (a Conversion Transaction), the REIT must apply the rules of section 1374 for a specified built-in gain recognition period (currently five years) and pay tax at the corporate level on any built-in gain except to the extent that the C corporation either recognizes gain on the transaction or elects "deemed sale" treatment to recognize and pay tax on the gain from the transaction. The PATH Act also generally eliminated the ability of non-REIT C corporations to participate in tax-free REIT spin-offs under section 355, either as a distributing corporation or a controlled corporation. The PATH Act further restricted REIT spin-offs by prohibiting a non-REIT C corporation that has engaged in a tax-free spin-off from electing to be a REIT within 10 years of the spin-off.

The 2016 BIG Regulations generally require deemed sale treatment (with no ability to elect section 1374 treatment) for any C corporation that engages in a Conversion Transaction within 10 years of a tax-free spin-off that involves the converting C corporation (the Automatic Deemed Sale Rule).

Again, Nareit appreciates that the Treasury Department and IRS are considering revisions and technical changes to these regulations, as noted in the "Second Report to the President on Identifying and Reducing Tax Regulatory Burdens" (Executive Order 13789) (October 2, 2017).

As stated in its July 19, 2016 comment letter regarding the BIG Regulations, Nareit again respectfully recommends that the 2016 Regulations:

a) be modified so that the Automatic Deemed Sale Rule only applies when a Conversion Transaction and the accompanying spin-off are part of the same plan;

b) be modified so that the result of application of the Automatic Deemed Sale Rule is limited to the built-in gain at the time the spin-off transaction in any assets that both: i) are held at the time of the spin-off transaction by the distributing corporation, the controlled corporation, or a member of the separate affiliated group (SAG) (within the meaning of section 355(b)(3)(B)) of either of the distributing corporation or the controlled corporation; and, ii) are held at the time of the Conversion Transaction by the corporation engaged in the Conversion Transaction;

c) be modified so that the Automatic Deemed Sale Rule does not apply if both the distributing corporation and controlled corporation in a tax-free spin-off transaction are REITs immediately after the transaction, consistent with a similar exception under PATH Act; and,

d) adopt a two-year presumption rule, under which any Conversion Transaction completed within two years after a spin-off transaction is presumed to be part of a plan with the spin-off transaction, and any Conversion Transaction not completed within that period is presumed not to be part of a plan with the spin-off transaction.

If these changes are not adopted, Nareit recommends that the Treasury Department withdraw the BIG regulations and start over again so that non-tax motivated transactions not be negatively impacted by excessive regulation.

Exempt Transfers by a Foreign Corporation of Appreciated Assets to RICs and REITs from Treas. Reg. § 1.337(d)-7 If Such Foreign Corporation is Not Otherwise Subject to U.S. Tax

Nareit encourages the Treasury Department and the IRS to carry over to the 2018-2019 Priority Guidance Plan and to continue work on the revision of Treas. Reg. § 1.337(d)-7 regarding the treatment of certain foreign corporations (listed under Part 5, Corporations and Their Shareholders, on the May 9, 2018 update to the 2017-2018 Priority Guidance Plan).

By way of background, the Treasury and IRS adopted final regulations under section 337(d) in 2013 that render the regulation inapplicable to transfers of appreciated property to a RIC or REIT in a conversion transaction if the C corporation transferring the property is either a tax-exempt entity or the property is transferred to a RIC or REIT in a section 1031 transaction in which gain is not recognized.

Section 337(d)(1) directs the Treasury Department and IRS to issue regulations that may be necessary to carry out the purposes of the repeal of the *General Utilities* doctrine (generally speaking, to ensure two levels of tax on income and gains of C corporations and their shareholders), including rules to ‘‘ensure that such purposes may not be circumvented * * * through the use of a regulated investment company, a real estate investment trust, or tax-exempt entity * * *’

Treas. Reg. § 1.337(d)-7 was put in place so that corporate level taxation could not be avoided by a C corporation through transferring appreciated property to a REIT. Recognizing that transfers of appreciated property to a REIT by a tax-exempt C corporation or by means of a tax-deferred section 1031 like-kind exchange transaction are not circumventions of the *General Utilities* doctrine, the Treasury Department and IRS issued final regulations in 2013 exempting such transactions from the Deemed Sale rule.

The same principle should apply when a REIT acquires property from a foreign corporation—for example, by acquiring the stock of the foreign corporation and then liquidating it, a common transaction for REITs that are building foreign portfolios. Typically, the foreign corporation would not have been subject to US corporate tax upon a disposition of the property. If and to the extent that this is the case, Treas. Reg. § 1.337(d)-7 should not apply to the property in the hands of the REIT.

Nareit believes that this revision would resolve a significant issue relevant to perhaps dozens of major REITs; that the current regulation, as applied to property received by a REIT from a foreign corporation, is inappropriate, unnecessarily burdensome, and contrary to sound tax administration; that the revision would not be difficult to draft; and that the revision is not controversial.

* * * * *

All of the suggested recommendations above would fulfill the goals and objectives set forth in Notice 2018-43.

First, resolution of these issues would resolve significant issues relevant to the more than 1,000 entities that have elected REIT status and the millions of taxpayers who invest in REITs.

Second, the recommended guidance would reduce controversy and lessens the burden on taxpayers or the IRS.

Third, the recommended guidance involves regulations or other guidance that is outdated, unnecessary, ineffective, insufficient, or unnecessarily burdensome and that should be modified, streamlined, expanded, replaced, or withdrawn.

Fourth, the recommended guidance would be in accordance with Executive Order 13771 (82 F.R. 9339), Executive Order 13777 (82 F.R. 12285) or other Executive Orders. We would be happy to work with you to identify existing guidance with respect to which withdrawal may be appropriate in order to comply with Executive Order 13771. As noted above, we recommend withdrawal of Notice 2007-55.

Fifth, the recommended guidance promotes sound tax administration.

Sixth, the IRS can administer the recommended guidance on a uniform basis.

Seventh, the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance.

We would be pleased to discuss these comments if you believe it would be helpful. Please feel free to contact me at (202) 739-9408, or tedwards@nareit.com; Cathy Barré, Nareit's Senior Vice President, Policy & Politics, at (202) 739-9422, or cbarre@nareit.com; or Dara Bernstein, Nareit's Senior Vice President and Tax Counsel, at (202) 739-9446 or dbernstein@nareit.com.

Respectfully submitted,

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