

Administrative, Procedural, and Miscellaneous

26 CFR § 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also: Part 1, §§ 856, 951, 951A, 986, 1291, 1293, 1296)

Rev. Proc. 2018-48

SECTION 1. PURPOSE

This revenue procedure provides guidance regarding how certain items of income are treated for purposes of determining whether a real estate investment trust (REIT) satisfies the gross income test in § 856(c)(2) of the Internal Revenue Code (Code). The types of income addressed are—

- Amounts required to be included in gross income under §§ 951(a)(1) (except by reason of § 965), 951A(a), 1291(a), 1293(a)(1), and 1296(a); and
- Amounts required to be taken into account under § 986(c) as foreign currency gain with respect to distributions of previously taxed earnings and profits.

SECTION 2. BACKGROUND

.01 To qualify as a REIT, a domestic corporation must, among other things, annually satisfy the gross income requirements of § 856(c)(2) and (c)(3). Under § 856(c)(2), at least 95 percent of the corporation's gross income must be derived from certain enumerated sources, including dividends, interest, rents from real property, and

gain from the sale or other disposition of stock, securities, and real property. Under § 856(c)(3), at least 75 percent of the corporation's gross income must be derived from a similar but narrower set of enumerated sources, generally focused on income from real estate assets.

.02 The legislative history underlying the tax treatment of REITs indicates that a central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. REP. NO. 86-2020, at 6 (1960), 1960-2 C.B. 819, at 822-23 states, "One of the principal purposes of your committee in imposing restrictions on types of income of a qualifying real estate investment trust is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business."

.03 Section 856(c)(5)(J) provides that to the extent necessary to carry out the purposes of part II of subchapter M (§§ 856 through 859 of the Code), the Secretary is authorized to determine, solely for purposes of such part, (i) whether any item of income or gain that does not otherwise qualify under § 856(c)(2) or (c)(3) may be considered as not constituting gross income for purposes of § 856(c)(2) or (c)(3), and (ii) whether any item of income or gain that otherwise constitutes gross income not qualifying under § 856(c)(2) or (c)(3) may be considered as gross income that qualifies under § 856(c)(2) or (c)(3).

.04 Some REITs are United States shareholders, as defined in § 951(b), in one or more controlled foreign corporations (CFCs), as defined in § 957. REITs may also own stock in domestic partnerships or trusts that are United States shareholders of CFCs. Additionally, some REITs own (or are treated under § 1298 as owning) stock in one or

more foreign corporations that are passive foreign investment companies (PFICs), as defined in § 1297. A United States person owning stock (or treated as owning stock) in a foreign corporation may be required under subpart F of part III of subchapter N (§§ 951 to 965 of the Code) or under part VI of subchapter P (§§ 1291 to 1298 of the Code) to include in gross income certain types of income or earnings of the foreign corporation. This inclusion may be required without regard to whether the foreign corporation makes a corresponding distribution of cash or property to the United States person.

.05 Section 986(c)(1) provides that foreign currency gain or loss with respect to distributions of previously taxed earnings and profits (as described in § 959 or § 1293(c)) attributable to movements in exchange rates between the times of the deemed and actual distribution shall be recognized and treated as ordinary income or loss from the same source as the associated income inclusion.

.06 Section 856(n)(1)(A) provides that passive foreign exchange gain (as defined in § 856(n)(3)) for any taxable year shall not constitute gross income for purposes of § 856(c)(2). In addition to the items specifically listed in § 856(n)(3)(A) and (B), under § 856(n)(3)(C), passive foreign exchange gain includes any other foreign currency gain as determined by the Secretary.

.07 The amounts that a REIT may be required to include in gross income under §§ 951(a)(1), 951A(a), 986(c), 1291(a), 1293(a)(1), or 1296(a) are not listed among the qualifying sources enumerated in § 856(c)(2) or (c)(3). However, § 965(m)(1)(A) provides that amounts required to be included in gross income under § 951(a) by reason of § 965(a) are not taken into account as gross income of a REIT for purposes of

applying § 856(c)(2) and (3). Additionally, amounts included in gross income under § 986(c) are not listed in § 856(n)(3)(A) or (B).

.08 Previously, the Internal Revenue Service (IRS) received requests to exercise the authority under § 856(c)(5)(J) and (n)(3)(C) to treat certain amounts determined under §§ 951(a)(1), 986(c), 1291(a), and 1293(a)(1) either as not constituting gross income or as qualifying gross income, for purposes of § 856(c)(2).

.09 Since § 951A was added to the Code by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97, 131 Stat. 2054 (2017), the IRS has received similar requests to exercise the authority under § 856(c)(5)(J) and (n)(3)(C) regarding REIT income inclusions and foreign currency gain with respect to global intangible low-taxed income (GILTI) under § 951A(a).

SECTION 3. SCOPE

This revenue procedure applies to any REIT that is required to include in gross income amounts under §§ 951(a)(1) (except by reason of § 965), 951A(a), 986(c), 1291(a), 1293(a)(1), or 1296(a).

SECTION 4. APPLICATION

.01 Pursuant to § 856(c)(5)(J)(ii), any amounts required to be included in gross income by a REIT under §§ 951(a)(1) (except by reason of § 965), 951A(a), 1291(a), 1293(a)(1), or 1296(a) are treated as qualifying income for purposes of § 856(c)(2).

.02 Pursuant to § 856(n)(3)(C), any amounts required to be taken into account by a REIT under § 986(c) as foreign currency gain with respect to distributions of previously taxed earnings and profits (as described in § 959 or § 1293(c)) are considered passive

foreign exchange gain (as defined in § 856(n)(3)) and, therefore, pursuant to § 856(n)(1)(A), do not constitute gross income for purposes of § 856(c)(2).

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after September 13, 2018. However, a REIT described in section 3 of this revenue procedure may choose to apply the rules set forth in section 4 of this revenue procedure with respect to any prior taxable year(s).

SECTION 6. DRAFTING INFORMATION

The principal authors of this revenue procedure are Grace Cho and Anna Boyd of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Ms. Cho at (202) 317-6945 (not a toll-free call).