

national policy

bulletin



National Association of Real Estate Investment Trusts®

HOUSE TAX COMMITTEE APPROVES H.R. 2896: INCLUDES KEY REIT AND REAL ESTATE PROVISIONS

Today, the House Ways and Means Committee approved H.R. 2896, the American Jobs Creation Act of 2003. Similar in many ways to S. 1637 that the Senate Finance Committee approved on October 1, H.R. 2896 contains several provisions applicable to the REIT industry. For a copy of H.R. 2896, [CLICK HERE](#). For an explanation of the provisions in H.R. 2896, [CLICK HERE](#).

REIT Improvement Act Items

H.R. 2896 contains the first title of H.R. 1890, the REIT Improvement Act, other than a provision applicable to timber sales qualifying for a safe harbor from the prohibited transaction tax. For information about the REIT Improvement Act, [CLICK HERE](#).

The provisions include the important change to the “straight debt” asset test under which a company can lose its REIT status by extending credit in the ordinary course of business, *e.g.*, a loan to a tenant for leasehold improvements that is contingent on the tenant’s cash flow. Also included were provisions clarifying when certain rents from a taxable REIT subsidiary to a REIT

can qualify as “good rents,” and a change to the REIT hedging rules that, among other things, clarifies that gains a REIT earns from currency hedges of overseas debt qualify as good income.

The changes to the straight debt rule and the TRS rent rule would be retroactive to the effective date of the REIT Modernization Act, *i.e.*, taxable years beginning after December 31, 2000. The other provisions would apply to taxable years beginning after the date of enactment.

It is important to understand that S. 1637, the Senate counterpart to H.R. 2896, contains two provisions from the REIT Improvement Act that are not in the Ways and Means Committee bill: one that would treat REIT capital gains distributions received by a non-U.S. taxpayer the same as REIT ordinary dividends, and another that would allow REITs that sell timber to be certain that they are not engaging in “dealer sales” that would result in a 100% excise tax.

Tenant Improvements

H.R. 2896 provides that a landlord can write off second-generation tenant improvements over 15 years (as opposed to 39 years under current law) during 2004 and 2005. This would be in addition to current law that allows half of such tenant improvements to be written off through 2004 as “bonus depreciation.”

Earnings Stripping

H.R. 2896 would tighten up the “earnings stripping” rules to restrict the amount of interest that could be used to reduce a foreigner’s tax obligation incurred by operating a U.S. business. However, H.R. 2896 maintains the earnings stripping rules under current law for transactions between a REIT and its taxable REIT subsidiary.

Closely Held REITs

Although it contains several revenue-raising items, H.R. 2896 does not include any proposal to add another stock ownership test like the “closely held” REIT proposal that the Senate included earlier this year in its original version of the Jobs and Growth Tax Act.

Outlook

Both tax-writing committees are considering international tax reform bills before Congress

recesses this year because the World Trade Organization has ruled that certain provisions in the Internal Revenue Code are an illegal subsidy, and that the European Union can impose \$4 billion in annual tariffs unless these provisions are repealed. Both H.R. 2896 and S. 1637 would replace the illegal subsidies with other rules. However, the European Union could defer imposing tariffs if both the House and Senate pass bills in 2003, even if final legislation is not enacted until next year.

It is not clear whether the House or Senate will approve either H.R. 2896 or S. 1637, respectively, this year. NAREIT will seek to keep the REIT Improvement Act provisions in any corporate/international tax reform legislation considered by either body.

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