

106th CONGRESS
1ST SESSION

H.R. 2488

CONFERENCE REPORT

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2488) “to provide for reconciliation pursuant to sections 105 and 211 of the concurrent resolution on the budget for fiscal year 2000,” having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

SECTION 1. SHORT TITLE; ETC.

(a) *SHORT TITLE.*—*This Act may be cited as the “Taxpayer Refund and Relief Act of 1999”.*

(b) *AMENDMENT OF 1986 CODE.*—*Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be con-*

(2) buildings placed in service after such date to the extent paragraph (1) of section 42(h) of the Internal Revenue Code of 1986 does not apply to any building by reason of paragraph (4) thereof, but only with respect to bonds issued after such date.

Subtitle B—Provisions Relating to Real Estate Investment Trusts

PART I—TREATMENT OF INCOME AND SERVICES PROVIDED BY TAXABLE REIT SUBSIDIARIES

SEC. 1111. MODIFICATIONS TO ASSET DIVERSIFICATION TEST.

(a) *IN GENERAL.*—Subparagraph (B) of section 856(c)(4) is amended to read as follows:

“(B)(i) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)), and

“(i) except with respect to a taxable REIT subsidiary and securities includible under subparagraph (A)—

“(I) not more than 5 percent of the value of its total assets is represented by securities of any 1 issuer,

“(II) the trust does not hold securities possessing more than 10 percent of the total

voting power of the outstanding securities of any 1 issuer, and

“(III) the trust does not hold securities having a value of more than 10 percent of the total value of the outstanding securities of any 1 issuer.”.

(b) EXCEPTION FOR STRAIGHT DEBT SECURITIES.—
Subsection (c) of section 856 is amended by adding at the end the following new paragraph:

“(7) STRAIGHT DEBT SAFE HARBOR IN APPLYING PARAGRAPH (4).—Securities of an issuer which are straight debt (as defined in section 1361(c)(5) without regard to subparagraph (B)(iii) thereof) shall not be taken into account in applying paragraph (4)(B)(i)(III) if—

“(A) the issuer is an individual, or

“(B) the only securities of such issuer which are held by the trust or a taxable REIT subsidiary of the trust are straight debt (as so defined), or

“(C) the issuer is a partnership and the trust holds at least a 20 percent profits interest in the partnership.”.

SEC. 1112. TREATMENT OF INCOME AND SERVICES PROVIDED BY TAXABLE REIT SUBSIDIARIES.

(a) *INCOME FROM TAXABLE REIT SUBSIDIARIES NOT TREATED AS IMPERMISSIBLE TENANT SERVICE INCOME.*—Clause (i) of section 856(d)(7)(C) (relating to exceptions to impermissible tenant service income) is amended by inserting “or through a taxable REIT subsidiary of such trust” after “income”.

(b) *CERTAIN INCOME FROM TAXABLE REIT SUBSIDIARIES NOT EXCLUDED FROM RENTS FROM REAL PROPERTY.*—

(1) *IN GENERAL.*—Subsection (d) of section 856 (relating to rents from real property defined) is amended by adding at the end the following new paragraphs:

“(8) *SPECIAL RULE FOR TAXABLE REIT SUBSIDIARIES.*—For purposes of this subsection, amounts paid to a real estate investment trust by a taxable REIT subsidiary of such trust shall not be excluded from rents from real property by reason of paragraph (2)(B) if the requirements of either of the following subparagraphs are met:

“(A) *LIMITED RENTAL EXCEPTION.*—The requirements of this subparagraph are met with respect to any property if at least 90 percent of the leased space of the property is rented to per-

sons other than taxable REIT subsidiaries of such trust and other than persons described in section 856(d)(2)(B). The preceding sentence shall apply only to the extent that the amounts paid to the trust as rents from real property (as defined in paragraph (1) without regard to paragraph (2)(B)) from such property are substantially comparable to such rents made by the other tenants of the trust's property for comparable space.

“(B) *EXCEPTION FOR CERTAIN LODGING FACILITIES.*—The requirements of this subparagraph are met with respect to an interest in real property which is a qualified lodging facility leased by the trust to a taxable REIT subsidiary of the trust if the property is operated on behalf of such subsidiary by a person who is an eligible independent contractor.

“(9) *ELIGIBLE INDEPENDENT CONTRACTOR.*—
For purposes of paragraph (8)(B)—

“(A) *IN GENERAL.*—The term ‘eligible independent contractor’ means, with respect to any qualified lodging facility, any independent contractor if, at the time such contractor enters into a management agreement or other similar serv-

ice contract with the taxable REIT subsidiary to operate the facility, such contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities for any person who is not a related person with respect to the real estate investment trust or the taxable REIT subsidiary.

“(B) SPECIAL RULES.—Solely for purposes of this paragraph and paragraph (8)(B), a person shall not fail to be treated as an independent contractor with respect to any qualified lodging facility by reason of any of the following:

“(i) The taxable REIT subsidiary bears the expenses for the operation of the facility pursuant to the management agreement or other similar service contract.

“(ii) The taxable REIT subsidiary receives the revenues from the operation of such facility, net of expenses for such operation and fees payable to the operator pursuant to such agreement or contract.

“(iii) The real estate investment trust receives income from such person with respect to another property that is attributable to a lease of such other property to

such person that was in effect as of the later of—

“(I) January 1, 1999, or

“(II) the earliest date that any taxable REIT subsidiary of such trust entered into a management agreement or other similar service contract with such person with respect to such qualified lodging facility.

“(C) RENEWALS, ETC., OF EXISTING LEASES.—For purposes of subparagraph (B)(iii)—

“(i) a lease shall be treated as in effect on January 1, 1999, without regard to its renewal after such date, so long as such renewal is pursuant to the terms of such lease as in effect on whichever of the dates under subparagraph (B)(iii) is the latest, and

“(ii) a lease of a property entered into after whichever of the dates under subparagraph (B)(iii) is the latest shall be treated as in effect on such date if—

“(I) on such date, a lease of such property from the trust was in effect, and

“(II) *under the terms of the new lease, such trust receives a substantially similar or lesser benefit in comparison to the lease referred to in subclause (I).*

“(D) *QUALIFIED LODGING FACILITY.—For purposes of this paragraph—*

“(i) *IN GENERAL.—The term ‘qualified lodging facility’ means any lodging facility unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility.*

“(ii) *LODGING FACILITY.—The term ‘lodging facility’ means a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis.*

“(iii) *CUSTOMARY AMENITIES AND FACILITIES.—The term ‘lodging facility’ includes customary amenities and facilities operated as part of, or associated with, the lodging facility so long as such amenities*

and facilities are customary for other properties of a comparable size and class owned by other owners unrelated to such real estate investment trust.

“(E) OPERATE INCLUDES MANAGE.—References in this paragraph to operating a property shall be treated as including a reference to managing the property.

“(F) RELATED PERSON.—Persons shall be treated as related to each other if such persons are treated as a single employer under subsection (a) or (b) of section 52.”.

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 856(d)(2) is amended by inserting “except as provided in paragraph (8),” after “(B)”.

(3) DETERMINING RENTS FROM REAL PROPERTY.—

(A)(i) Paragraph (1) of section 856(d) is amended by striking “adjusted bases” each place it occurs and inserting “fair market values”.

(ii) The amendment made by this subparagraph shall apply to taxable years beginning after December 31, 2000.

(B)(i) Clause (i) of section 856(d)(2)(B) is amended by striking “number” and inserting “value”.

(ii) The amendment made by this subparagraph shall apply to amounts received or accrued in taxable years beginning after December 31, 2000, except for amounts paid pursuant to leases in effect on July 12, 1999, or pursuant to a binding contract in effect on such date and at all times thereafter.

SEC. 1113. TAXABLE REIT SUBSIDIARY.

(a) IN GENERAL.—Section 856 is amended by adding at the end the following new subsection:

“(l) TAXABLE REIT SUBSIDIARY.—For purposes of this part—

“(1) IN GENERAL.—The term ‘taxable REIT subsidiary’ means, with respect to a real estate investment trust, a corporation (other than a real estate investment trust) if—

“(A) such trust directly or indirectly owns stock in such corporation, and

“(B) such trust and such corporation jointly elect that such corporation shall be treated as a taxable REIT subsidiary of such trust for purposes of this part.

Such an election, once made, shall be irrevocable unless both such trust and corporation consent to its revocation. Such election, and any revocation thereof, may be made without the consent of the Secretary.

“(2) 35 PERCENT OWNERSHIP IN ANOTHER TAXABLE REIT SUBSIDIARY.—The term ‘taxable REIT subsidiary’ includes, with respect to any real estate investment trust, any corporation (other than a real estate investment trust) with respect to which a taxable REIT subsidiary of such trust owns directly or indirectly—

“(A) securities possessing more than 35 percent of the total voting power of the outstanding securities of such corporation, or

“(B) securities having a value of more than 35 percent of the total value of the outstanding securities of such corporation.

The preceding sentence shall not apply to a qualified REIT subsidiary (as defined in subsection (i)(2)). The rule of section 856(c)(7) shall apply for purposes of subparagraph (B).

“(3) EXCEPTIONS.—The term ‘taxable REIT subsidiary’ shall not include—

“(A) any corporation which directly or indirectly operates or manages a lodging facility or a health care facility, and

“(B) any corporation which directly or indirectly provides to any other person (under a franchise, license, or otherwise) rights to any brand name under which any lodging facility or health care facility is operated.

Subparagraph (B) shall not apply to rights provided to an eligible independent contractor to operate or manage a lodging facility if such rights are held by such corporation as a franchisee, licensee, or in a similar capacity and such lodging facility is either owned by such corporation or is leased to such corporation from the real estate investment trust.

“(4) *DEFINITIONS.—For purposes of paragraph (3)—*

“(A) *LODGING FACILITY.—The term ‘lodging facility’ has the meaning given to such term by paragraph (9)(D)(ii).*

“(B) *HEALTH CARE FACILITY.—The term ‘health care facility’ has the meaning given to such term by subsection (e)(6)(D)(ii).”.*

(b) *CONFORMING AMENDMENT.—Paragraph (2) of section 856(i) is amended by adding at the end the fol-*

lowing new sentence: “Such term shall not include a taxable REIT subsidiary.”

SEC. 1114. LIMITATION ON EARNINGS STRIPPING.

Paragraph (3) of section 163(j) (relating to limitation on deduction for interest on certain indebtedness) is amended by striking “and” at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting “, and”, and by adding at the end the following new subparagraph:

“(C) any interest paid or accrued (directly or indirectly) by a taxable REIT subsidiary (as defined in section 856(l)) of a real estate investment trust to such trust.”

SEC. 1115. 100 PERCENT TAX ON IMPROPERLY ALLOCATED AMOUNTS.

(a) *IN GENERAL.*—Subsection (b) of section 857 (relating to method of taxation of real estate investment trusts and holders of shares or certificates of beneficial interest) is amended by redesignating paragraphs (7) and (8) as paragraphs (8) and (9), respectively, and by inserting after paragraph (6) the following new paragraph:

“(7) *INCOME FROM REDETERMINED RENTS, REDETERMINED DEDUCTIONS, AND EXCESS INTEREST.*—

“(A) *IMPOSITION OF TAX.*—There is hereby imposed for each taxable year of the real estate

investment trust a tax equal to 100 percent of re-determined rents, redetermined deductions, and excess interest.

“(B) REDETERMINED RENTS.—

“(i) IN GENERAL.—The term ‘redetermined rents’ means rents from real property (as defined in subsection 856(d)) the amount of which would (but for subparagraph (E)) be reduced on distribution, apportionment, or allocation under section 482 to clearly reflect income as a result of services furnished or rendered by a taxable REIT subsidiary of the real estate investment trust to a tenant of such trust.

“(ii) EXCEPTION FOR CERTAIN SERVICES.—Clause (i) shall not apply to amounts received directly or indirectly by a real estate investment trust for services described in paragraph (1)(B) or (7)(C)(i) of section 856(d).

“(iii) EXCEPTION FOR DE MINIMIS AMOUNTS.—Clause (i) shall not apply to amounts described in section 856(d)(7)(A) with respect to a property to the extent such amounts do not exceed the one percent

threshold described in section 856(d)(7)(B) with respect to such property.

“(iv) EXCEPTION FOR COMPARABLY PRICED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

“(I) such subsidiary renders a significant amount of similar services to persons other than such trust and tenants of such trust who are unrelated (within the meaning of section 856(d)(8)(F)) to such subsidiary, trust, and tenants, but

“(II) only to the extent the charge for such service so rendered is substantially comparable to the charge for the similar services rendered to persons referred to in subclause (I).

“(v) EXCEPTION FOR CERTAIN SEPARATELY CHARGED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

“(I) the rents paid to the trust by tenants (leasing at least 25 percent of the net leasable space in the trust’s property) who are not receiving such service from such subsidiary are substantially comparable to the rents paid by tenants leasing comparable space who are receiving such service from such subsidiary, and

“(II) the charge for such service from such subsidiary is separately stated.

“(vi) *EXCEPTION FOR CERTAIN SERVICES BASED ON SUBSIDIARY’S INCOME FROM THE SERVICES.*—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if the gross income of such subsidiary from such service is not less than 150 percent of such subsidiary’s direct cost in furnishing or rendering the service.

“(vii) *EXCEPTIONS GRANTED BY SECRETARY.*—The Secretary may waive the tax otherwise imposed by subparagraph (A) if

the trust establishes to the satisfaction of the Secretary that rents charged to tenants were established on an arms' length basis even though a taxable REIT subsidiary of the trust provided services to such tenants.

“(C) *REDETERMINED DEDUCTIONS.*—*The term ‘redetermined deductions’ means deductions (other than redetermined rents) of a taxable REIT subsidiary of a real estate investment trust if the amount of such deductions would (but for subparagraph (E)) be decreased on distribution, apportionment, or allocation under section 482 to clearly reflect income as between such subsidiary and such trust.*

“(D) *EXCESS INTEREST.*—*The term ‘excess interest’ means any deductions for interest payments by a taxable REIT subsidiary of a real estate investment trust to such trust to the extent that the interest payments are in excess of a rate that is commercially reasonable.*

“(E) *COORDINATION WITH SECTION 482.*—*The imposition of tax under subparagraph (A) shall be in lieu of any distribution, apportionment, or allocation under section 482.*

“(F) *REGULATORY AUTHORITY.*—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph. Until the Secretary prescribes such regulations, real estate investment trusts and their taxable REIT subsidiaries may base their allocations on any reasonable method.”.

(b) *AMOUNT SUBJECT TO TAX NOT REQUIRED TO BE DISTRIBUTED.*—Subparagraph (E) of section 857(b)(2) (relating to real estate investment trust taxable income) is amended by striking “paragraph (5)” and inserting “paragraphs (5) and (7)”.

SEC. 1116. EFFECTIVE DATE.

(a) *IN GENERAL.*—The amendments made by this part shall apply to taxable years beginning after December 31, 2000.

(b) *TRANSITIONAL RULES RELATED TO SECTION 1111.*—

(1) *EXISTING ARRANGEMENTS.*—

(A) *IN GENERAL.*—Except as otherwise provided in this paragraph, the amendment made by section 1111 shall not apply to a real estate investment trust with respect to—

(i) securities of a corporation held directly or indirectly by such trust on July 12, 1999,

(ii) securities of a corporation held by an entity on July 12, 1999, if such trust acquires control of such entity pursuant to a written binding contract in effect on such date and at all times thereafter before such acquisition,

(iii) securities received by such trust (or a successor) in exchange for, or with respect to, securities described in clause (i) or (ii) in a transaction in which gain or loss is not recognized, and

(iv) securities acquired directly or indirectly by such trust as part of a reorganization (as defined in section 368(a)(1) of the Internal Revenue Code of 1986) with respect to such trust if such securities are described in clause (i), (ii), or (iii) with respect to any other real estate investment trust.

(B) NEW TRADE OR BUSINESS OR SUBSTANTIAL NEW ASSETS.—Subparagraph (A) shall cease to apply to securities of a corporation as

of the first day after July 12, 1999, on which such corporation engages in a substantial new line of business, or acquires any substantial asset, other than—

(i) pursuant to a binding contract in effect on such date and at all times thereafter before the acquisition of such asset,

(ii) in a transaction in which gain or loss is not recognized by reason of section 1031 or 1033 of the Internal Revenue Code of 1986, or

(iii) in a reorganization (as so defined) with another corporation the securities of which are described in paragraph (1)(A) of this subsection.

(C) LIMITATION ON TRANSITION RULES.—Subparagraph (A) shall cease to apply to securities of a corporation held, acquired, or received, directly or indirectly, by a real estate investment trust as of the first day after July 12, 1999, on which such trust acquires any additional securities of such corporation other than—

(i) pursuant to a binding contract in effect on July 12, 1999, and at all times thereafter, or

(ii) in a reorganization (as so defined) with another corporation the securities of which are described in paragraph (1)(A) of this subsection.

(2) *TAX-FREE CONVERSION.—If—*

(A) at the time of an election for a corporation to become a taxable REIT subsidiary, the amendment made by section 1021 does not apply to such corporation by reason of paragraph (1), and

(B) such election first takes effect before January 1, 2004,

such election shall be treated as a reorganization qualifying under section 368(a)(1)(A) of such Code.

PART II—HEALTH CARE REITS

SEC. 1121. HEALTH CARE REITS.

(a) *SPECIAL FORECLOSURE RULE FOR HEALTH CARE PROPERTIES.—*Subsection (e) of section 856 (relating to special rules for foreclosure property) is amended by adding at the end the following new paragraph:

“(6) *SPECIAL RULE FOR QUALIFIED HEALTH CARE PROPERTIES.—*For purposes of this subsection—

“(A) *ACQUISITION AT EXPIRATION OF LEASE.—*The term ‘foreclosure property’ shall in-

clude any qualified health care property acquired by a real estate investment trust as the result of the termination of a lease of such property (other than a termination by reason of a default, or the imminence of a default, on the lease).

“(B) GRACE PERIOD.—In the case of a qualified health care property which is foreclosure property solely by reason of subparagraph (A), in lieu of applying paragraphs (2) and (3)—

“(i) the qualified health care property shall cease to be foreclosure property as of the close of the second taxable year after the taxable year in which such trust acquired such property, and

“(ii) if the real estate investment trust establishes to the satisfaction of the Secretary that an extension of the grace period in clause (i) is necessary to the orderly leasing or liquidation of the trust’s interest in such qualified health care property, the Secretary may grant 1 or more extensions of the grace period for such qualified health care property.

Any such extension shall not extend the grace period beyond the close of the 6th year after the taxable year in which such trust acquired such qualified health care property.

“(C) INCOME FROM INDEPENDENT CONTRACTORS.—For purposes of applying paragraph (4)(C) with respect to qualified health care property which is foreclosure property by reason of subparagraph (A) or paragraph (1), income derived or received by the trust from an independent contractor shall be disregarded to the extent such income is attributable to—

“(i) any lease of property in effect on the date the real estate investment trust acquired the qualified health care property (without regard to its renewal after such date so long as such renewal is pursuant to the terms of such lease as in effect on such date), or

“(ii) any lease of property entered into after such date if—

“(I) on such date, a lease of such property from the trust was in effect, and

“(II) under the terms of the new lease, such trust receives a substantially similar or lesser benefit in comparison to the lease referred to in subclause (I).

“(D) *QUALIFIED HEALTH CARE PROPERTY.*—

“(i) *IN GENERAL.*—The term ‘qualified health care property’ means any real property (including interests therein), and any personal property incident to such real property, which—

“(I) is a health care facility, or

“(II) is necessary or incidental to the use of a health care facility.

“(ii) *HEALTH CARE FACILITY.*—For purposes of clause (i), the term ‘health care facility’ means a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients and which, immediately before the termination, expiration, default, or breach of the

lease of or mortgage secured by such facility, was operated by a provider of such services which was eligible for participation in the medicare program under title XVIII of the Social Security Act with respect to such facility.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

**PART III—CONFORMITY WITH REGULATED
INVESTMENT COMPANY RULES**

**SEC. 1131. CONFORMITY WITH REGULATED INVESTMENT
COMPANY RULES.**

(a) DISTRIBUTION REQUIREMENT.—Clauses (i) and (ii) of section 857(a)(1)(A) (relating to requirements applicable to real estate investment trusts) are each amended by striking “95 percent (90 percent for taxable years beginning before January 1, 1980)” and inserting “90 percent”.

(b) IMPOSITION OF TAX.—Clause (i) of section 857(b)(5)(A) (relating to imposition of tax in case of failure to meet certain requirements) is amended by striking “95 percent (90 percent in the case of taxable years beginning before January 1, 1980)” and inserting “90 percent”.

(c) *EFFECTIVE DATE.*—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

**PART IV—CLARIFICATION OF EXCEPTION FROM
IMPERMISSIBLE TENANT SERVICE INCOME**

**SEC. 1141. CLARIFICATION OF EXCEPTION FOR INDE-
PENDENT OPERATORS.**

(a) *IN GENERAL.*—Paragraph (3) of section 856(d) (relating to independent contractor defined) is amended by adding at the end the following flush sentence:

“In the event that any class of stock of either the real estate investment trust or such person is regularly traded on an established securities market, only persons who own, directly or indirectly, more than 5 percent of such class of stock shall be taken into account as owning any of the stock of such class for purposes of applying the 35 percent limitation set forth in subparagraph (B) (but all of the outstanding stock of such class shall be considered outstanding in order to compute the denominator for purpose of determining the applicable percentage of ownership).”.

(b) *EFFECTIVE DATE.*—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

**PART V—MODIFICATION OF EARNINGS AND
PROFITS RULES**

**SEC. 1151. MODIFICATION OF EARNINGS AND PROFITS
RULES.**

(a) RULES FOR DETERMINING WHETHER REGULATED INVESTMENT COMPANY HAS EARNINGS AND PROFITS FROM NON-RIC YEAR.—Subsection (c) of section 852 is amended by adding at the end the following new paragraph:

“(3) DISTRIBUTIONS TO MEET REQUIREMENTS OF SUBSECTION (a)(2)(B).—Any distribution which is made in order to comply with the requirements of subsection (a)(2)(B)—

“(A) shall be treated for purposes of this subsection and subsection (a)(2)(B) as made from the earliest earnings and profits accumulated in any taxable year to which the provisions of this part did not apply rather than the most recently accumulated earnings and profits, and

“(B) to the extent treated under subparagraph (A) as made from accumulated earnings and profits, shall not be treated as a distribution for purposes of subsection (b)(2)(D) and section 855.”.

(b) CLARIFICATION OF APPLICATION OF REIT SPILLOVER DIVIDEND RULES TO DISTRIBUTIONS TO MEET

QUALIFICATION REQUIREMENT.—Subparagraph (B) of section 857(d)(3) is amended by inserting before the period “and section 858”.

(c) *APPLICATION OF DEFICIENCY DIVIDEND PROCEDURES.*—Paragraph (1) of section 852(e) is amended by adding at the end the following new sentence: “If the determination under subparagraph (A) is solely as a result of the failure to meet the requirements of subsection (a)(2), the preceding sentence shall also apply for purposes of applying subsection (a)(2) to the non-RIC year.”.

(d) *EFFECTIVE DATE.*—The amendments made by this section shall apply to distributions after December 31, 2000.

Subtitle C—Modification of At-Risk Rules for Publicly Traded Nonrecourse Debt

SEC. 1161. TREATMENT UNDER AT-RISK RULES OF PUBLICLY TRADED NONRECOURSE DEBT.

(a) *IN GENERAL.*—Subparagraph (A) of section 465(b)(6) (relating to qualified nonrecourse financing treated as amount at risk) is amended by striking “share of” and all that follows and inserting “share of—

“(i) any qualified nonrecourse financing which is secured by real property used in such activity, and

“(ii) any other financing which—

“(I) would (but for subparagraph (B)(ii)) be qualified nonrecourse financing,

“(II) is qualified publicly traded debt, and

“(III) is not borrowed by the taxpayer from a person described in subclause (I), (II), or (III) of section 49(a)(1)(D)(iv).”.

(b) *QUALIFIED PUBLICLY TRADED DEBT.*—Paragraph (6) of section 465(b) is amended by adding at the end the following new subparagraph:

“(F) *QUALIFIED PUBLICLY TRADED DEBT.*—For purposes of subparagraph (A), the term ‘qualified publicly traded debt’ means any debt instrument which is readily tradable on an established securities market. Such term shall not include any debt instrument which has a yield to maturity which equals or exceeds the limitation in section 163(i)(1)(B).”.

(c) *EFFECTIVE DATE.*—The amendments made by this section shall apply to debt instruments issued after December 31, 1999.

(b) *EFFECTIVE DATE.*—The amendment made by subsection (a) shall apply to distributions after December 31, 2000.

SEC. 1505. CONTROLLED ENTITIES INELIGIBLE FOR REIT STATUS.

(a) *IN GENERAL.*—Subsection (a) of section 856 (relating to definition of real estate investment trust) is amended by striking “and” at the end of paragraph (6), by redesignating paragraph (7) as paragraph (8), and by inserting after paragraph (6) the following new paragraph:

“(7) which is not a controlled entity (as defined in subsection (l)); and”.

(b) *CONTROLLED ENTITY.*—Section 856 is amended by adding at the end the following new subsection:

“(l) *CONTROLLED ENTITY.*—

“(1) *IN GENERAL.*—For purposes of subsection (a)(7), an entity is a controlled entity if, at any time during the taxable year, one person (other than a qualified entity)—

“(A) in the case of a corporation, owns stock—

“(i) possessing at least 50 percent of the total voting power of the stock of such corporation, or

“(ii) having a value equal to at least 50 percent of the total value of the stock of such corporation, or

“(B) in the case of a trust, owns beneficial interests in the trust which would meet the requirements of subparagraph (A) if such interests were stock.

“(2) *QUALIFIED ENTITY*.—For purposes of paragraph (1), the term ‘qualified entity’ means—

“(A) any real estate investment trust, and

“(B) any partnership in which one real estate investment trust owns at least 50 percent of the capital and profits interests in the partnership.

“(3) *ATTRIBUTION RULES*.—For purposes of this paragraphs (1) and (2)—

“(A) *IN GENERAL*.—Rules similar to the rules of subsections (d)(5) and (h)(3) shall apply; except that section 318(a)(3)(C) shall not be applied under such rules to treat stock owned by a qualified entity as being owned by a person which is not a qualified entity.

“(B) *STAPLED ENTITIES*.—A group of entities which are stapled entities (as defined in section 269B(c)(2)) shall be treated as 1 person.

“(4) *EXCEPTION FOR CERTAIN NEW REITS.*—

“(A) *IN GENERAL.*—*The term ‘controlled entity’ shall not include an incubator REIT.*

“(B) *INCUBATOR REIT.*—*A corporation shall be treated as an incubator REIT for any taxable year during the eligibility period if it meets all the following requirements for such year:*

“(i) *The corporation elects to be treated as an incubator REIT.*

“(ii) *The corporation has only voting common stock outstanding.*

“(iii) *Not more than 50 percent of the corporation’s real estate assets consist of mortgages.*

“(iv) *From not later than the beginning of the last half of the second taxable year, at least 10 percent of the corporation’s capital is provided by lenders or equity investors who are unrelated to the corporation’s largest shareholder.*

“(v) *The corporation annually increases the value of its real estate assets by at least 10 percent.*

“(vi) *The directors of the corporation adopt a resolution setting forth an intent to engage in a going public transaction.*

No election may be made with respect to any REIT if an election under this subsection was in effect for any predecessor of such REIT.

“(C) *ELIGIBILITY PERIOD.—*

“(i) *IN GENERAL.—The eligibility period (for which an incubator REIT election can be made) begins with the REIT’s second taxable year and ends at the close of the REIT’s third taxable year, except that the REIT may, subject to clauses (ii), (iii), and (iv), elect to extend such period for an additional 2 taxable years.*

“(ii) *GOING PUBLIC TRANSACTION.—A REIT may not elect to extend the eligibility period under clause (i) unless it enters into an agreement with the Secretary that if it does not engage in a going public transaction by the end of the extended eligibility period, it shall pay Federal income taxes for the 2 years of the extended eligibility period as if it had not made an incubator*

REIT election and had ceased to qualify as a REIT for those 2 taxable years.

“(iii) RETURNS, INTEREST, AND NOTICE.—

“(I) RETURNS.—In the event the corporation ceases to be treated as a REIT by operation of clause (ii), the corporation shall file any appropriate amended returns reflecting the change in status within 3 months of the close of the extended eligibility period.

“(II) INTEREST.—Interest shall be payable on any tax imposed by reason of clause (ii) for any taxable year but, unless there was a finding under subparagraph (D), no substantial underpayment penalties shall be imposed.

“(III) NOTICE.—The corporation shall, at the same time it files its returns under subclause (I), notify its shareholders and any other persons whose tax position is, or may reasonably be expected to be, affected by the change in status so they also may file any appropriate amended returns to

conform their tax treatment consistent with the corporation's loss of REIT status.

“(IV) REGULATIONS.—The Secretary shall provide appropriate regulations setting forth transferee liability and other provisions to ensure collection of tax and the proper administration of this provision.

“(iv) Clauses (ii) and (iii) shall not apply if the corporation allows its incubator REIT status to lapse at the end of the initial 2-year eligibility period without engaging in a going public transaction if the corporation is not a controlled entity as of the beginning of its fourth taxable year. In such a case, the corporation's directors may still be liable for the penalties described in subparagraph (D) during the eligibility period.

“(D) SPECIAL PENALTIES.—If the Secretary determines that an incubator REIT election was filed for a principal purpose other than as part of a reasonable plan to undertake a going public transaction, an excise tax of \$20,000 shall be im-

posed on each of the corporation's directors for each taxable year for which an election was in effect.

“(E) *GOING PUBLIC TRANSACTION.*—For purposes of this paragraph, a going public transaction means—

“(i) a public offering of shares of the stock of the incubator REIT;

“(ii) a transaction, or series of transactions, that results in the stock of the incubator REIT being regularly traded on an established securities market and that results in at least 50 percent of such stock being held by shareholders who are unrelated to persons who held such stock before it began to be so regularly traded; or

“(iii) any transaction resulting in ownership of the REIT by 200 or more persons (excluding the largest single shareholder) who in the aggregate own at least 50 percent of the stock of the REIT.

For the purposes of this subparagraph, the rules of paragraph (3) shall apply in determining the ownership of stock.

“(F) DEFINITIONS.—The term ‘established securities market’ shall have the meaning set forth in the regulations under section 897.”

(c) CONFORMING AMENDMENT.—Paragraph (2) of section 856(h) is amended by striking “and (6)” each place it appears and inserting “, (6), and (7)”

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years ending after July 14, 1999.

(2) EXCEPTION FOR EXISTING CONTROLLED ENTITIES.—The amendments made by this section shall not apply to any entity which is a controlled entity (as defined in section 856(l) of the Internal Revenue Code of 1986, as added by this section) as of July 14, 1999, which is a real estate investment trust for the taxable year which includes such date, and which has significant business assets or activities as of such date. For purposes of the preceding sentence, an entity shall be treated as such a controlled entity on July 14, 1999, if it becomes such an entity after such date in a transaction—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter, or

(B) described on or before such date in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

SEC. 1506. TREATMENT OF GAIN FROM CONSTRUCTIVE OWNERSHIP TRANSACTIONS.

(a) IN GENERAL.—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by inserting after section 1259 the following new section:

“SEC. 1260. GAINS FROM CONSTRUCTIVE OWNERSHIP TRANSACTIONS.

“(a) IN GENERAL.—If the taxpayer has gain from a constructive ownership transaction with respect to any financial asset and such gain would (without regard to this section) be treated as a long-term capital gain—

“(1) such gain shall be treated as ordinary income to the extent that such gain exceeds the net underlying long-term capital gain, and

“(2) to the extent such gain is treated as a long-term capital gain after the application of paragraph (1), the determination of the capital gain rate (or rates) applicable to such gain under section 1(h) shall be determined on the basis of the respective rate (or rates) that would have been applicable to the net underlying long-term capital gain.

(1) *IN GENERAL.*—*Except as otherwise provided in this section, the amendment made by this section shall apply to transfers made after February 8, 1999.*

(2) *EXCISE TAX.*—*Except as provided in paragraph (3) of this subsection, section 170(f)(10)(F) of the Internal Revenue Code of 1986 (as added by this section) shall apply to premiums paid after the date of the enactment of this Act.*

(3) *REPORTING.*—*Clause (iii) of such section 170(f)(10)(F) shall apply to premiums paid after February 8, 1999 (determined as if the tax imposed by such section applies to premiums paid after such date).*

SEC. 1511. RESTRICTION ON USE OF REAL ESTATE INVESTMENT TRUSTS TO AVOID ESTIMATED TAX PAYMENT REQUIREMENTS.

(a) *IN GENERAL.*—*Subsection (e) of section 6655 (relating to estimated tax by corporations) is amended by adding at the end the following new paragraph:*

“(5) *TREATMENT OF CERTAIN REIT DIVIDENDS.*—

“(A) *IN GENERAL.*—*Any dividend received from a closely held real estate investment trust by any person which owns (after application of subsections (d)(5) and (l)(3)(B) of section 856)*

10 percent or more (by vote or value) of the stock or beneficial interests in the trust shall be taken into account in computing annualized income installments under paragraph (2) in a manner similar to the manner under which partnership income inclusions are taken into account.

“(B) *CLOSELY HELD REIT.*—For purposes of subparagraph (A), the term ‘closely held real estate investment trust’ means a real estate investment trust with respect to which 5 or fewer persons own (after application of subsections (d)(5) and (l)(3)(B) of section 856) 50 percent or more (by vote or value) of the stock or beneficial interests in the trust.”.

(b) *EFFECTIVE DATE.*—The amendment made by subsection (a) shall apply to estimated tax payments due on or after September 15, 1999.

SEC. 1512. MODIFICATION OF ANTI-ABUSE RULES RELATED TO ASSUMPTION OF LIABILITY.

(a) *IN GENERAL.*—Section 357(b)(1) (relating to tax avoidance purpose) is amended—

(1) by striking “the principal purpose” and inserting “a principal purpose”, and

(2) by striking “on the exchange” in subparagraph (A).