NAREIT Alert (December 18, 2015)

NAREIT Alert Important Industry Updates from NAREIT

Dec. 18, 2015

Late on Dec. 15, Congressional leaders announced they had reached agreement on a $650 billion year-end "tax extenders" package named the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act) that they believe lays the groundwork for Congress and the next President to consider comprehensive tax reform. On Dec. 17, the House of Representatives voted 318-109 to approve the measure, the Senate voted 65 to 33 on Dec. 18 to approve it, and President Obama signed the bill into law the same day. The leaders released the PATH Act's statutory language, a section-by-section summary, a detailed summary by the Joint Committee on Taxation and a revenue estimate of all provisions in the bill. Important elements of both FIRPTA and REIT reform are included in the PATH Act, and NAREIT commends the leadership for incorporating both the FIRPTA and the Update and Streamline REIT Act (U.S. REIT Act) changes that were discussed in the Dec. 8 NAREIT Alert.

FIRPTA Reform

Foreign investors of any type will be able to double (5 percent to 10 percent) their investment in publicly traded U.S. REITs and certain other entities held by qualified shareholders that are exempt from the FIRPTA exit tax on gains from sale of stock and from capital gain distributions. The PATH Act also contains a useful presumption for listed REITs that will make it easier for them to be considered domestically controlled so as to be exempt from

FIRPTA, effective on the PATH Act's date of enactment.

Foreign pension and retirement fund investments in U.S. REITs and real estate will no longer be subject to the FIRPTA exit tax on gains from sale of the property or REIT stock and from capital gain distributions. The PATH Act reflects some technical changes made from the Dec. 7 proposal released by Ways & Means Chairman Kevin Brady (R-TX) that clarifies the original intent to exempt foreign pension plans from FIRPTA for both sales of REIT stock as well as REIT capital gains distributions, whether or not that ownership is direct or through a partnership.

Both changes will apply to any disposition on and after the package's date of enactment and for any distribution by a REIT on or after the enactment date for which the REIT receives a dividends paid deduction for its taxable year ending after such date. The PATH Act also includes three revenue raising FIRPTA proposals that were included in the Senate Finance Committee's passage of S. 915 on Feb. 11, 2015 that are described in detail in a Senate Finance Committee Report.

U.S. REIT Act

As described in more detail in the Dec. 8 NAREIT Alert, the PATH Act would include almost all of the provisions in the U.S. REIT Act that was introduced by Representatives Pat Tiberi (R-OH) and Richard Neal (D-MA) in 2012.

These provisions will improve safe harbors from the dealer sales rules; repeal the preferential dividend rules for both listed and public non-listed REITs and provide the IRS with the authority to provide relief to private REITs from these antiquated rules (effective for distributions in taxable years beginning after Dec. 31, 2014); enhance the ability of taxable REIT subsidiaries (TRSs) to provide certain services; eliminate potential double taxation of earnings and profits; enhance the ability of REITs to hold certain debt assets of listed and public non-listed REITs; enhance the ability of REITs to hold certain ancillary personal property; and improve certain REIT hedging abilities. One important change

from the Dec. 7 proposal is that another one of the U.S. REIT Act proposals to expand certain services that a timberland REIT TRS can provide was included in the PATH Act.

Other than the preferential dividend changes as described above, the U.S. REIT Act changes will apply to post-2015 taxable years.

REIT Spin-offs

Under the PATH Act, C corporations will no longer be able to spin off REITs in a tax-free transaction, but REITs will be able to spin off REITs and their TRSs held for at least three years on a tax-free basis. The PATH Act includes a technical change that clarifies that a TRS can be spun off on a tax-free basis even if the REIT holds the TRS through a partnership which it controls or if the TRS creates a new TRS to effectuate the spin transaction.

The PATH Act also includes a transition rule permitting a tax-free spin-off for companies which had filed prior to Dec. 7 with the IRS for a private letter ruling related to such a spin-off plan so long as the request has not been withdrawn, issued or denied as of that date.

In addition, beginning in post-2017 taxable years, the permissible size of TRSs will be reduced from 25 percent to 20 percent.

The proposal contained in the Dec. 7 proposal to limit contingent rents discussed in the Dec. 8 NAREIT Alert is not included in the PATH Act.

Other Real Estate Provisions

Finally, the PATH Act: 1) makes permanent: a) the 15-year depreciation period for leasehold improvements for property placed in service after Dec. 31, 2014; and, b) the 5-year (rather than 10-year) holding period for built-in gain tied to the conversion of a C corporation to an S corporation (and by extension to a REIT), effective in taxable years beginning after

Dec. 31, 2014; and, 2) extends for two years the section 179D deduction for energy efficient commercial buildings while updating that section's ASHRAE standards, retroactively for 2015, and then for 2016.

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