Concurrent Session: Timberland REIT Roundtable

Thursday, March 31st
9:45am – 11am
Marriott Marquis, Washington DC

Discussion Leaders:
Karen Balek, Sr. Director-Tax, Weyerhaeuser
Scott Winer, VP-Taxes, Rayonier Inc.

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Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B01
PLR-115789-15
Date:
October 13, 2015

LEGEND:

Taxpayer

Initial Lenders

Administrative Agent

Lenders

Voting Participants

Date 1

Date 2

A

B

C

D

Dear :

This is in reply to a letter dated April 30, 2015, requesting a ruling that the patronage dividends described below do not constitute gross income to Taxpayer for purposes of § 856(c)(2) or § 856(c)(3).

FACTS

Taxpayer is a domestic corporation whose common stock is publicly traded. Taxpayer elected to be treated as a real estate investment trust ("REIT") beginning with its taxable year ending Date 1. Taxpayer is a calendar year taxpayer that uses an overall accrual method of accounting. Taxpayer's primary business is to own and manage timberland properties.

The Lenders are subchapter T (§§ 1381-1388) cooperatives owned by the patrons who borrow from them. The Lenders make distributions to their patrons in the form of "patronage dividends." The amounts of patronage dividends are based on the quantity or value of business done with the patron.

Taxpayer entered into a seven year credit agreement dated Date 2, (the "Credit Agreement") with the Initial Lenders to borrow $A from the Initial Lenders. Prior to closing the Credit Agreement, one of the Initial Lenders assigned $B of its commitment under the Credit Agreement to the Administrative Agent and Administrative Agent together with the Initial Lenders became the Lenders under the Credit Agreement. Administrative Agent sold participating shares in its share of the loan under the Credit Agreement to the Voting Participants in the cumulative amount of $C.

Taxpayer receives annual patronage dividends from the Lenders (and not from any Voting Participants), the terms of which are set by each Lender in its respective bylaws and other relevant documents (the patronage dividends received specifically by Taxpayer with respect to amounts borrowed under the Credit Agreement are "Patronage Dividends"). The amount of any Patronage Dividend depends on the amount borrowed and the time such amount is outstanding. Administrative Agent pays part of its Patronage Dividends in the form of equity. Per its bylaws, Administrative Agent targets D% of its total patronage dividends to be paid in equity until the target equity percentage has been met by the patron (in this case the Taxpayer).

REPRESENTATIONS

The following representations are made by Taxpayer:

(a) Taxpayer has used the proceeds of the Credit Agreement to pay off a mortgage of an affiliate secured by real estate assets described in § 856(c)(4)(A).

(b) The Patronage Dividends will be patronage dividends within the meaning of § 1388(a) and will be included on the tax return of Taxpayer as gross income.

(c) For financial accounting purposes, Taxpayer will treat the Patronage Dividends as a reduction in the interest expense related to Borrowings under the Credit Agreement.

LAW AND ANALYSIS

Section 856(c)(2) provides that in order for a corporation to qualify as a REIT, at least 95 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from sources that include dividends, interest, rents from real property, and gain from the sale or other disposition of stock, securities, and real property (other than property in which the corporation is a dealer).

Section 856(c)(3) provides that in order for a corporation to qualify as a REIT, at least 75 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from rents from real property, interest on obligations secured by real property, gain from the sale or other disposition of real property (other than property in which the corporation is a dealer), dividends from REIT stock and gain from the sale of REIT stock, abatements and refunds of taxes on real property, income and gain derived from foreclosure property, commitment fees to make loans secured by mortgages on real property or to purchase or lease real property, gain from certain sales or other dispositions of real estate assets, and qualified temporary investment income.

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

Section 301(a) provides that except as otherwise provided in chapter 1 of subtitle A of the Code (which chapter includes §§ 301, 316, 317, 856, and 1388), a distribution of property (as defined in § 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in § 301(c).

Section 301(c) provides, in part, that in the case of a distribution to which § 301(a) applies, that portion of the distribution which is a dividend (as defined in § 316) shall be included in gross income.

Section 316(a) provides that for purposes of subtitle A (which subtitle includes §§ 856 and 1388), the term "dividend" means any distribution of property made by a corporation to its shareholders (1) out of its earnings and profits accumulated after February 28, 1913, or (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Section 316(a) provides in the flush language that, except as otherwise provided in subtitle A, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. It provides further that to the extent that any distribution is, under any provision of subchapter C of chapter 1 of subtitle A, treated as a distribution of property to which § 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

Section 1388(a) provides that, for purposes of subchapter T, the term "patronage dividend" means an amount paid to a patron by an organization to which part I of subchapter T applies (1) on the basis of quantity or value of business done with or for such patron, (2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and (3) which is determined by reference to the net earnings of the organization from business done with or for its patrons. For this purpose, net earnings shall not be reduced by amounts paid during the year as dividends on capital stock or other proprietary capital interests of the organization to the extent that the articles of incorporation or bylaws of such organization or other contract with patrons provide that such dividends are in addition to amounts otherwise payable to patrons which are derived from business done with or for patrons during the taxable year.

Section 1388(a) further provides that the term patronage dividend does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions.

Section 1385(a)(1) provides, that, except as otherwise provided, each person shall include in gross income the amount of any patronage dividend which is paid in money, a qualified written notice of allocation, or other property (except a nonqualified written notice of allocation), and which is received by him during the taxable year from an organization described in § 1381(a).

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. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, "[o]ne 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."

Patronage dividends paid by a subchapter T cooperative are a return of earnings to its cooperative patrons based on the amount of business that the patron transacts with the cooperative. The patronage dividends paid by a subchapter T financing cooperative effectively reduce the costs that its patrons incur to borrow funds from the cooperative. The amounts paid by Lenders as Patronage Dividends represent earnings that the cooperatives are able to refund to Taxpayer based on the average amounts that Taxpayer borrowed from Lenders during the prior year. Thus, while Taxpayer must include Patronage Dividend income in its gross income under § 1385(a)(1), the Patronage Dividends effectively reduce Taxpayer's interest expense paid during the prior year. Under the facts of the instant case, exclusion of the Patronage Dividends from gross income for purposes of §§ 856(c)(2) and (c)(3) does not interfere with Congressional policy objectives in enacting the income tests under those provisions.

CONCLUSION

Accordingly, pursuant to § 856(c)(5)(J)(i), we conclude that the Patronage Dividends included in Taxpayer's gross income under § 1385 are excluded from its gross income for purposes of §§ 856(c)(2) and (c)(3).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provisions of the Code. Specifically, we do not rule whether Taxpayer qualifies as a REIT under Part II of Subchapter M of Chapter 1 of the Code. Additionally, we are not ruling on the tax treatment of the Credit Agreement and whether the agreement is a loan for federal income tax purposes.

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayer under a penalties of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

____

Steven Harrison
Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc:

Internal Revenue Service

Number: **201605005**
Release Date: 1/29/2016

Index Number: 856.01-00

Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B1
PLR-114627-15
Date: October 26, 2015

Legend:

Taxpayer =

State =

Dear :

This is in reply to a letter dated April 21, 2015, in which Taxpayer requests rulings in connection with its real estate investment trust ("REIT") foreign income under section 856 of the Internal Revenue Code of 1986, as amended (the "Code").

Facts:

Taxpayer is a corporation organized under the laws of State that has elected to be taxed as a REIT. Taxpayer was organized for the purpose of making direct and indirect investments in commercial timberland businesses. Taxpayer realizes profits from the harvest and sale of timber and the long-term appreciation of the underlying timber properties.

Taxpayer operates in foreign countries through one or more foreign subsidiaries and associated intermediate holding companies (each, a "Foreign Sub"). Some Foreign Subs are qualified REIT subsidiaries ("QRSs") under section 856(i), partnerships, or disregarded entities. Taxpayer has jointly elected section 856(l) taxable REIT subsidiary ("TRS") status with other Foreign Subs that are corporations for federal income tax purposes (each, a "Foreign TRS").

Taxpayer expects that its Foreign TRSs will be either (i) controlled foreign corporations ("CFCs") within the meaning of section 957(a), with respect to which Taxpayer will be a United States shareholder within the meaning of section 951(b) (a "United States Shareholder"), (ii) passive foreign investment companies ("PFICs") within the meaning of section 1297(a), for which Taxpayer has made or intends to make elections under section 1295(a) to treat as qualified electing funds ("QEFs") for all taxable years during which the corporation was a PFIC that are included in the Taxpayer's holding period of the PFIC stock ("pedigreed QEFs"), or (iii) PFICs for which Taxpayer has not made a mark-to-market election and which are not pedigreed QEFs with respect to Taxpayer.

As a United States Shareholder with respect to the CFCs, Taxpayer is required under section 951(a)(1)(A)(i) to include in gross income its pro rata share of the CFCs' subpart F income, as defined in section 952(a). Taxpayer expects that the subpart F income of the CFCs will consist of items that are foreign personal holding company income ("FPHCI") within the meaning of section 954(c). Taxpayer's inclusions under section 951(a)(1)(A) that are attributable to the CFCs' deriving (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute "rents from real property" under section 856(d) if received by a REIT are referred to hereinafter as the "Subpart F Inclusions."

As a shareholder in PFICs for which Taxpayer has made QEF elections, Taxpayer is required under section 1293(a) to include in gross income its pro rata share of the earnings and profits of each QEF. Taxpayer expects to include amounts in income under section 1293(a) with respect to numerous PFICs for which it has made (or will make) QEF elections. Taxpayer's inclusions under section 1293(a) that are attributable to the QEFs' deriving (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute "rents from real property" under section 856(d) if received by a REIT are referred to hereinafter as the "QEF Inclusions."

As a shareholder in PFICs for which Taxpayer has not made mark-to-market elections and which are not pedigreed QEFs with respect to Taxpayer, Taxpayer is required under section 1291(a)(1)(B) to include certain amounts in gross income. Taxpayer expects to include amounts in income under section 1291(a)(1)(B) with respect to PFICs for which it has not made (and will not make) a QEF or mark-to-market elections (the "Non-QEF Inclusions" and, together with QEF Inclusions, the "PFIC Inclusions"). Taxpayer represents that the majority of the gross income that each of these PFICs will derive while owned by Taxpayer will be comprised of one or more of the following items: (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section

1221(a)(1); and (iv) items that also would constitute “rents from real property” under section 856(d) if received by a REIT.

Taxpayer expects to recognize foreign currency gains with respect to distributions of previously taxed earnings and profits (“PTI”) as described in section 986(c)(1) attributable to the Subpart F Inclusions and QEF Inclusions (the “Section 986(c) Gains”).

Taxpayer requests the following rulings:

1) The Subpart F Inclusions and the PFIC Inclusions will be treated as qualifying income under section 856(c)(2).

2) The Section 986(c) Gains will not be taken into account for purposes of section 856(c)(2).

Law and Analysis:

Ruling #1: Whether the Subpart F Inclusions and PFIC Inclusions will be treated as qualifying income under section 856(c)(2).

Section 856(c)(2) provides that, in order for a corporation to qualify as a REIT, at least 95 percent of the corporation’s gross income must be derived from certain enumerated sources, which include dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (other than property in which the corporation is a dealer), abatements and refunds of taxes on real property, income and gain derived from foreclosure property, and certain commitment fees.

Section 856(c)(5)(J) provides that to the extent necessary to carry out the purposes of part II of subchapter M 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 sections 856(c)(2) or (3) may be considered as not constituting gross income for purposes of sections 856(c)(2) or (3), or (ii) whether any item of income or gain that otherwise constitutes gross income not qualifying under sections 856(c)(2) or (3) may be considered as gross income which qualifies under sections 856(c)(2) or (3).

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. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, “[o]ne 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."

Subpart F Inclusions

Section 957 defines a CFC as a foreign corporation in which more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or the total value of the stock is owned by United States Shareholders on any day during the corporation's taxable year. A United States Shareholder is defined in section 951(b) as a United States person who owns 10 percent or more of the total voting power of the foreign corporation.

Section 951(a)(1)(A)(i) generally provides that if a foreign corporation is a CFC for an uninterrupted period of 30 days or more during a taxable year, every person who is a United States Shareholder of the corporation and who owns stock in the corporation on the last day of the taxable year in which the corporation is a CFC shall include in income the shareholder's pro rata share of the CFC's subpart F income for the taxable year.

Under section 952, subpart F income includes foreign base company income. Under section 954(a)(1), foreign base company income includes FPHCI, which is defined under section 954(c)(1) to mean certain enumerated types of income. Subject to certain exceptions, FPHCI includes (i) dividends, interest, royalties, rents, and annuities under section 954(c)(1)(A); and (ii) the excess of gains over losses from the sale or exchange of certain property under section 954(c)(1)(B).

Taxpayer's Subpart F Inclusions will be attributable to subpart F income of CFCs that consists of: (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute "rents from real property" under section 856(d) if received by a REIT. Therefore, treatment of the Subpart F Inclusions attributable to such income as qualifying income for purposes of section 856(c)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under section 856(c)(2).

PFIC Inclusions

Section 1297(a) provides that a foreign corporation is a PFIC if either (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or (2) the average percentage of assets (as determined in accordance with section 1297(e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent. Section 1297(b) defines the term "passive income" as income of a kind that would be FPHCI under section 954(c), subject to certain exceptions.

Section 1295(a) provides that a PFIC will be treated as a QEF with respect to a shareholder if (1) an election by the shareholder under section 1295(b) applies to such PFIC for the taxable year; and (2) the PFIC complies with such requirements as the Secretary may prescribe for purposes of determining the ordinary earnings and net capital gains of such company and otherwise carrying out the purposes of the PFIC provisions. Section 1293(a) provides that every United States person who owns (or is treated under section 1298(a) as owning) stock of a QEF at any time during the taxable year of such fund shall include in gross income (A) as ordinary income, such shareholder's pro rata share of the ordinary earnings of such fund for such year, and (B) as long-term capital gain, such shareholder's pro rata share of the net capital gain of such fund for such year.

Section 1291(a)(1) provides that if a United States person receives an excess distribution (as defined in section 1291(b)) in respect of stock in a PFIC that is a section 1291 fund (as defined in §1.1291-1T(b)(2)(v)), then (A) the amount of the excess distribution shall be allocated ratably to each day in the shareholder's holding period for the stock, (B) with respect to such excess distribution, the shareholder's gross income for the current year shall include (as ordinary income) only the amounts allocated under section 1291(a)(1)(A) to (i) the current year, or (ii) any period in the shareholder's holding period before the 1st day of the 1st taxable year of the company which begins after December 31, 1986, and for which it was a PFIC, and (C) the tax imposed by chapter 1 of the Code for the current year shall be increased by the deferred tax amount (determined under section 1291(c)). Under section 1291(a)(2), the rules of section 1291(a)(1) apply to any gain recognized on the disposition of stock of a section 1291 fund as if the gain were an excess distribution.

Taxpayer's QEF Inclusions will be attributable to income of PFICs (with respect to which a QEF election has been or will be made) that consists of: (i) interest; (ii) dividends; (iii) gains from the sale or other disposition of stock, securities, or real property that is not property described in section 1221(a)(1); and (iv) items that also would constitute "rents from real property" under section 856(d) if received by a REIT. Taxpayer's Non-QEF Inclusions are derived with respect to PFICs that will generate the same types of passive income. Therefore, treatment of the PFIC Inclusions as qualifying income for purposes of section 856(c)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under section 856(c)(2).

Ruling #2: Whether the Section 986(c) Gains will be taken into account for purposes of section 856(c)(2).

In general, sections 959(d) and 1293(c) provide that when a taxpayer includes in income a Subpart F Inclusion or QEF Inclusion, the subsequent distribution to the shareholder of the PTI attributable to the inclusion is not treated as a dividend for purposes of chapter 1 of the Code.

Section 986(c)(1) provides that foreign currency gain or loss with respect to distributions of PTI (as described in section 959 or section 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.

Section 856(n)(1)(A) provides that “passive foreign exchange gain” for any taxable year will not constitute gross income for purposes of section 856(c)(2).

Section 856(n)(3) defines passive foreign exchange gain as: (A) real estate foreign exchange gain (as defined in section 856(n)(2)); (B) foreign currency gains (as defined in section 988(b)(1)) which is not described in subparagraph A and is attributable to (i) any item of income or gain described in section 856(c)(2), (ii) the acquisition or ownership of obligations (other than foreign currency gains attributable to any item described in clause (i)), or (iii) becoming or being the obligor under obligations (other than foreign currency gain attributable to any item of income or gain described in clause (i)); and (C) any other foreign currency gains determined by the Secretary.

While the Section 986(c) Gains are not foreign currency gains defined in section 988(b)(1), such Section 986(c) Gains are attributable to the Subpart F Inclusions and QEF Inclusions, items of income that are qualifying income for purposes of section 856(c)(2). This Section 986(c) Gain is substantially similar to passive foreign exchange gain described in section 856(n)(3)(B)(i). Therefore, pursuant to section 856(n)(3)(C), the Section 986(c) Gains are excluded from gross income for purposes of section 856(c)(2) because these foreign currency gains are considered passive foreign exchange gain that is excluded from gross income for purposes of section 856(c)(2).

Conclusion:

Based on the facts and representations set forth above, we rule that (i) under section 856(c)(5)(J)(ii), the Subpart F Inclusions are considered gross income that qualifies for purposes of section 856(c)(2), (ii) under section 856(c)(5)(J)(ii), the PFIC Inclusions are considered gross income that qualifies for purposes of section 856(c)(2), and (iii) under section 856(n)(3)(C), the Section 986(c) Gains are excluded from gross income for purposes of section 856(c)(2).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code.

This ruling is directly only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

____

Steven Harrison
Branch Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions and Products)

[JOINT COMMITTEE PRINT]

GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 2015

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

MARCH 2016

JCS–1–16

pitalization. Accordingly, the collection period expires 10 years after assessment, plus the actual time spent in a combat zone, regardless of the length of the postponement period available for hospitalized taxpayers to comply with their tax obligations.

Effective Date

The provision applies to taxes assessed before, on, or after the date of the enactment (December 18, 2015).

B. Real Estate Investment Trusts

Overview

In general

A real estate investment trust ("REIT") is an entity that otherwise would be taxed as a U.S. corporation but elects to be taxed under a special REIT tax regime. To qualify as a REIT, an entity must meet a number of requirements. At least 90 percent of REIT income (other than net capital gain) must be distributed annually;[848] the REIT must derive most of its income from passive, generally real estate-related, investments; and REIT assets must be primarily real estate-related. In addition, a REIT must have transferable interests and at least 100 shareholders, and no more than 50 percent of the REIT interests may be owned by five or fewer individual shareholders (as determined using specified attribution rules). Other requirements also apply.[849]

If an electing entity meets the requirements for REIT status, the portion of its income that is distributed to its shareholders as a dividend or qualifying liquidating distribution each year is deductible by the REIT (whereas a regular subchapter C corporation cannot deduct such distributions).[850] As a result, the distributed income of the REIT is not taxed at the entity level; instead, it is taxed only at the investor level. Although a REIT is not required to distribute more than the 90 percent of its income described above to retain REIT status, it is taxed at ordinary corporate rates on amounts not distributed or treated as distributed.[851]

A REIT may designate a capital gain distribution to its shareholders, who treat the designated amount as long-term capital gain when distributed. A REIT also may retain net capital gain and pay corporate income tax on the amount retained, while the shareholders include the undistributed capital gain in income, obtain a credit for the corporate tax paid, and step up the basis of their

[848] Even if a REIT meets the 90-percent income distribution requirement for REIT qualification, more stringent distribution requirements must be met in order to avoid an excise tax under section 4981.

[849] Secs. 856 and 857.

[850] Liquidating distributions are covered to the extent of earnings and profits, and are defined to include redemptions of stock that are treated by shareholders as a sale of stock under section 302. Secs. 857(b)(2)(B), 561, and 562(b).

[851] An additional four-percent excise tax is imposed to the extent a REIT does not distribute at least 85 percent of REIT ordinary income and 95 percent of REIT capital gain net income within a calendar year period. In addition, to the extent a REIT distributes less than 100 percent of its ordinary income and capital gain net income in a year, the difference between the amount actually distributed and 100 percent is added to the distribution otherwise required in a subsequent year to avoid the excise tax. Sec. 4981.

REIT stock for the amount included in income.[852] In this manner, capital gain also is taxed only once, whether or not distributed, rather than at both the entity and investor levels.

Income tests

A REIT is restricted to earning certain types of generally passive income. Among other requirements, at least 75 percent of the gross income of a REIT in each taxable year must consist of real estate-related income. Such income includes: rents from real property; gain from the sale or other disposition of real property (including interests in real property) that is not stock in trade of the taxpayer, inventory, or other property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business; interest on mortgages secured by real property or interests in real property; and certain income from foreclosure property (the "75-percent income test").[853] Qualifying rents from real property include rents from interests in real property and charges for services customarily furnished or rendered in connection with the rental of real property,[854] but do not include impermissible tenant service income.[855] Impermissible tenant service income includes amounts for services furnished by the REIT to tenants or for managing or operating the property, other than amounts attributable to services that are provided by an independent contractor or taxable REIT subsidiary, or services that certain tax exempt organizations could perform under the section 512(b)(3) rental exception from unrelated business taxable income.[856] Qualifying rents from real property include rent attributable to personal property which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property for the taxable year does not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, the lease.[857]

In addition, rents received from any entity in which the REIT owns more than 10 percent of the vote or value generally are not qualifying income.[858] However, there is an exception for certain rents received from taxable REIT subsidiaries (described further below), in which a REIT may own more than 10 percent of the vote or value.

In addition, 95 percent of the gross income of a REIT for each taxable year must be from the 75-percent income sources and a sec-

[852] Sec. 857(b)(3).

[853] Secs. 856(c)(3) and 1221(a)(1). Income from sales that are not prohibited transactions solely by virtue of section 857(b)(6) also is qualified REIT income.

[854] Sec. 856(d)(1)(A) and (B).

[855] Sec. 856(d)(2)(C).

[856] Sec. 856(d)(7)(A) and (C). If impermissible tenant service income with respect to any real or personal property is more than one percent of all amounts received or accrued during the taxable year directly or indirectly with respect to such property, then the impermissible tenant service income with respect to such property includes all such amounts. Sec. 856(d)(7)(B). The amount treated as received for any service (or management or operation) shall not be less than 150 percent of the direct cost of the trust in furnishing or rendering the service (or providing the management or operation). Sec. 856(d)(7)(D). For purposes of the 75-percent and 95-percent income tests, impermissible tenant service income is included in gross income of the REIT. Sec. 856(d)(7)(E).

[857] Sec. 856(d)(1)(C).

[858] Sec. 856(d)(2)(B).

ond permitted category of other, generally passive sources such as dividends and interest (the "95-percent income test").[859]

A REIT must be a U.S. domestic entity, but it is permitted to hold foreign real estate or other foreign assets, provided the 75-percent and 95-percent income tests and the other requirements for REIT qualification are met.[860]

Asset tests

At least 75 percent of the value of a REIT's assets must be real estate assets, cash and cash items (including receivables), and Government securities[861] (the "75-percent asset test").[862] Real estate assets are real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs.[863] No more than 25 percent of a REIT's assets may be securities other than such real estate assets.[864]

Except with respect to securities of a taxable REIT subsidiary, not more than five percent of the value of a REIT's assets may be securities of any one issuer, and the REIT may not possess securities representing more than 10 percent of the outstanding value or voting power of any one issuer.[865] In addition, not more than 25 percent of the value of a REIT's assets may be securities of one or more taxable REIT subsidiaries.[866]

The asset tests must be met as of the close of each quarter of a REIT's taxable year. However, a REIT that has met the asset tests as of the close of any quarter does not lose its REIT status solely because of a discrepancy during a subsequent quarter between the value of the REIT's investments and such requirements, unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition.[867]

Taxable REIT subsidiaries

A REIT generally cannot own more than 10 percent of the vote or value of a single entity. However, there is an exception for ownership of a taxable REIT subsidiary ("TRS") that is taxed as a corporation, provided that securities of one or more TRSs do not represent more than 25 percent of the value of REIT assets.

A TRS generally can engage in any kind of business activity except that it is not permitted directly or indirectly to operate either a lodging facility or a health care facility, or to provide to any other person (under a franchise, license, or otherwise) rights to any

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[859] Sec. 856(c)(2).

[860] See Rev. Rul. 74–191, 1974–1 C.B. 170.

[861] Government securities are defined for this purpose under section 856(c)(5)(F), by reference to the Investment Company Act of 1940. The term includes securities issued or guaranteed by the United States or persons controlled or supervised by and acting as an instrumentality thereof, but does not include securities issued or guaranteed by a foreign, state, or local government entity or instrumentality.

[862] Sec. 856(c)(4)(A).

[863] Temporary investments in certain stock or debt instruments also can qualify if they are temporary investments of new capital, but only for the one-year period beginning on the date the REIT receives such capital. Sec. 856(c)(5)(B).

[864] Sec. 856(c)(4)(B)(i).

[865] Sec. 856(c)(4)(B)(iii).

[866] Sec. 856(c)(4)(B)(ii).

[867] Sec. 856(c)(4). In the case of such an acquisition, the REIT also has a grace period of 30 days after the close of the quarter to eliminate the discrepancy.

brand name under which any lodging facility or health care facility is operated.[868]

However, a TRS may rent a lodging facility or health care facility from its parent REIT and is permitted to hire an independent contractor[869] to operate such facility. Rent paid to the parent REIT by the TRS with respect to hotel, motel, or other transient lodging facility operated by an independent contractor is qualified rent for purposes of the REIT's 75-percent and 95-percent income tests.[870] This lodging facility rental rule is an exception to the general rule that rent paid to a REIT by any corporation (including a TRS) in which the REIT owns 10 percent or more of the vote or value is not qualified rental income for purposes of the 75-percent or 95-percent REIT income tests.[871] There is also an exception to the general rule in the case of a TRS that rents space in a building owned by its parent REIT if at least 90 percent of the space in the building is rented to unrelated parties and the rent paid by the TRS to the REIT is comparable to the rent paid by the unrelated parties.[872]

REITs are subject to a tax equal to 100 percent of redetermined rents, redetermined deductions, and excess interest. These are defined generally as the amounts of specified REIT transactions with a TRS of the REIT, to the extent such amounts differ from an arm's length amount.[873]

Prohibited transactions tax

REITs are subject to a prohibited transaction tax ("PTT") of 100 percent of the net income derived from prohibited transactions. For this purpose, a prohibited transaction is a sale or other disposition of property by the REIT that is "stock in trade of a taxpayer or other property which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held for sale to customers by the taxpayer in the ordinary course of his trade or business"[874] and is not foreclosure property. The PTT for a REIT does not apply to a sale if the REIT satisfies certain safe harbor requirements in section 857(b)(6)(C) or (D), including an asset holding period of at least two years.[875] If the conditions are met, a REIT may either (1) make no more than seven sales within a taxable year (other than sales of foreclosure property or involuntary conversions under section 1033), or (2) sell either no more than 10 percent of the aggregate bases, or no more than 10

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[868] The latter restriction does not apply to rights provided to an independent contractor to operate or manage a lodging or health care facility if such rights are held by the corporation as a franchisee, licensee, or in similar capacity and such lodging facility or health care facility is either owned by such corporation or is leased by such corporation from the REIT. Sec. 856(l)(3).

[869] An independent contractor will not fail to be treated as such for this purpose because the TRS bears the expenses of operation of the facility under the contract, or because the TRS receives the revenues from the operation of the facility, net of expenses for such operation and fees payable to the operator pursuant to the contract, or both. Sec. 856(d)(9)(B).

[870] Sec. 856(d)(8)(B).

[871] Sec. 856(d)(2)(B).

[872] Sec. 856(d)(8)(A).

[873] Sec. 857(b)(7).

[874] This definition is the same as the definition of certain property the sale or other disposition of which would produce ordinary income rather than capital gain under section 1221(a)(1).

[875] Additional requirements for the safe harbor limit the amount of expenditures the REIT can make during the two-year period prior to the sale that are includible in the adjusted basis of the property, require marketing to be done by an independent contractor, and forbid a sales price that is based on the income or profits of any person.

percent of the aggregate fair market value, of all its assets as of the beginning of the taxable year (computed without regard to sales of foreclosure property or involuntary conversions under section 1033), without being subject to the PTT tax.[876]

REIT shareholder tax treatment

Although a REIT typically does not pay corporate level tax due to the deductible distribution of its income, and thus is sometimes compared to a partnership or S corporation, REIT equity holders are not treated as being engaged in the underlying activities of the REIT as are partners or S corporation shareholders, and the activities at the REIT level that characterize its income do not generally flow through to equity owners to characterize the tax treatment of REIT distributions to them. A distribution to REIT shareholders out of REIT earnings and profits is generally treated as an ordinary income REIT dividend and is treated as ordinary income taxed at the shareholder's normal rates on such income.[877] However, a REIT is permitted to designate a "capital gain dividend" to the extent a distribution is made out of its net capital gain.[878] Such a dividend is treated as long-term capital gain to the shareholders.[879]

REIT shareholders are not taxed on REIT income unless the income is distributed to them (except in the case of REIT net capital gain retained by the REIT and designated for inclusion in the shareholder's income as explained in the preceding footnote). However, since a REIT must distribute 90 percent of its ordinary income annually, and typically will distribute or designate its income as capital gain dividends to avoid a tax at the REIT level, REIT income generally is taxed in full at the shareholder level annually.

REIT shareholders are not entitled to any share of REIT losses to offset against other shareholder income. However, if the REIT itself has income, its losses offset its income in determining how much it is required to distribute to meet the distribution requirements. Also, REIT losses that reduce earnings and profits can cause a distribution that exceeds the REIT's earnings and profits to be treated as a nontaxable return of capital to its shareholders.

Tax exempt shareholders

A tax exempt shareholder is exempt from tax on REIT dividends, and is not treated as engaging in any of the activities of the REIT. As one example, if the REIT borrowed money and its income at the REIT level were debt-financed, a tax exempt shareholder would not

[876] Sec. 857(b)(6).

[877] Because a REIT dividend is generally paid out of income that was not taxed to the distributing entity, the dividend is not eligible for the dividends received deductions to a corporate shareholder. Sec. 243(d)(3). A REIT dividend is not eligible for the 20 percent qualified dividend rate to an individual shareholder, except to the extent such dividend is attributable to REIT income from nondeductible C corporation dividends, or to certain income of the REIT that was subject to corporate level tax. Sec. 857(c).

[878] Sec. 857(b)(3)(C). Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the taxable year. Sec. 1222.

[879] A REIT may also retain its net capital gain without distribution, while designating a capital gain dividend for inclusion in shareholder income. In this case, the REIT pays corporate-level tax on the capital gain, but the shareholder includes the undistributed capital gain in income, receives a credit for the corporate level tax paid, and steps up the basis of the REIT stock for the amount included in income, with the result that the net tax paid is the shareholder-level capital gain tax. Sec. 857(b)(3)(D).

have debt-financed unrelated business income from the REIT dividend.

Foreign shareholders

Except as provided by the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"),[880] a REIT shareholder that is a foreign corporation or a nonresident alien individual normally treats its dividends as fixed and determinable annual and periodic income that is subject to withholding under section 1441 but not treated as active business income that is effectively connected with the conduct of a U.S. trade or business, regardless of the level of real estate activity of the REIT in the United States.[881] A number of treaties permit a lower rate of withholding on REIT dividends than the Code would otherwise require.

Although FIRPTA applies in many cases to foreign investment in U.S. real property through a REIT, REITs offer foreign investors some ability to invest in U.S real property interests without subjecting gain on the sale of REIT stock to FIRPTA (for example, if the REIT is domestically controlled).[882] In general, if any class of stock of a corporation is regularly traded on an established securities market, stock of such class is subject to FIRPTA only in the case of a person who, at some time during the testing period, held more than 5 percent of such class of stock.[883] Also, if the REIT stock is publicly traded and the foreign investor does not own more than five percent of such stock, the investor can receive distributions from the sale by the REIT of U.S. real property interests without such distributions being subject to FIRPTA.[884]

1. Restriction on tax-free spinoffs involving REITs (sec. 311 of the Act and secs. 355 and 856 of the Code)

Present Law

A corporation generally is required to recognize gain on the distribution of property (including stock of a subsidiary) to its shareholders as if the corporation had sold such property for its fair market value.[885] In addition, the shareholders receiving the distributed property are ordinarily treated as receiving a dividend equal to the value of the distribution (to the extent of the distributing corporation's earnings and profits),[886] or capital gain in the case of an acquisition of its stock that significantly reduces the shareholder's interest in the parent corporation.[887]

An exception to these rules applies if the distribution of the stock of a controlled corporation satisfies the requirements of section 355.

[880] Pub. L. No. 96–499. FIRPTA treats income of a foreign investor from the sale or disposition of U.S. real property interests as effectively connected with the operation of a trade or business in the United States. Such income is taxed at regular U.S. rates and withholding obligations are imposed on payors of the income. Secs. 897 and 1445.

[881] As noted above, REITs are not permitted to receive income from property that is inventory or that is held for sale to customers in the ordinary course of the REIT's business. However, REITs may engage in certain activities, including acquisition, development, lease, and sale of real property, and may provide "customary services" to tenants.

[882] Sec. 897(h)(2).

[883] Sec. 897(c)(3).

[884] Sec. 897(h)(1).

[885] Sec. 311(b).

[886] Sec. 301(b)(1) and (c)(1).

[887] Sec. 302(a) and (b)(2).

If all the requirements are satisfied, there is no tax to the distributing corporation or to the shareholders on the distribution.

One requirement to qualify for tax-free treatment under section 355 is that both the distributing corporation and the controlled corporation must be engaged immediately after the distribution in the active conduct of a trade or business that has been conducted for at least five years and was not acquired in a taxable transaction during that period (the "active business test").[888]

For this purpose, the active business test is satisfied only if (1) immediately after the distribution, the corporation is engaged in the active conduct of a trade or business, or (2) immediately before the distribution, the corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged immediately after the distribution in the active conduct of a trade or business.[889] For this purpose, the active business test is applied by reference to the relevant affiliated group rather than on a single corporation basis. For the parent distributing corporation, the relevant affiliated group consists of the distributing corporation as the common parent and all corporations affiliated with the distributing corporation through stock ownership described in section 1504(a)(1) (regardless of whether the corporations are otherwise includible corporations under section 1504(b)),[890] immediately after the distribution. The relevant affiliated group for a controlled distributed subsidiary corporation is determined in a similar manner (with the controlled corporation as the common parent).

In determining whether a corporation is directly engaged in an active trade or business that satisfies the requirement, IRS ruling practice formerly required that the value of the gross assets of the trade or business being relied on must ordinarily constitute at least five percent of the total fair market value of the gross assets of the corporation directly conducting the trade or business.[891] The IRS suspended this specific rule in connection with its general administrative practice of moving IRS resources away from advance rulings on factual aspects of section 355 transactions in general.[892]

Section 355 does not apply to an otherwise qualifying distribution if, immediately after the distribution, either the distributing or the controlled corporation is a disqualified investment corporation and any person owns a 50 percent interest in such corporation and did not own such an interest before the distribution. A disqualified investment corporation is a corporation of which two-thirds or more

[888] Sec. 355(b).
[889] Sec. 355(b)(1).
[890] Sec. 355(b)(3).
[891] Rev. Proc. 2003–3, sec. 4.01(30), 2003–1 I.R.B. 113.
[892] Rev. Proc. 2003–48, 2003–29 I.R.B. 86. Since then, the IRS discontinued private rulings on whether a transaction generally qualifies for nonrecognition treatment under section 355. Nonetheless, the IRS may still rule on certain significant issues. See Rev. Proc. 2016–1, 2016–1 I.R.B. 1; Rev. Proc. 2016–3, 2016–1 I.R.B. 126. Recently, the IRS announced that it will not rule in certain situations in which property owned by any distributing or controlled corporation becomes the property of a RIC or a REIT; however, the IRS stated that the policy did not extend to situations in which, immediately after the date of the distribution, both the distributing and controlled corporation will be RICs, or both of such corporations will be REITs, and there is no plan or intention on the date of the distribution for either the distributing or the controlled corporation to cease to be a RIC or a REIT. See Rev. Proc. 2015–43, 2015–40 I.R.B. 467.

of its asset value is comprised of certain passive investment assets. Real estate is not included as such an asset.[893]

The IRS has ruled that a REIT may satisfy the active business requirement through its rental activities.[894] More recently, the IRS has issued a private ruling indicating that a REIT that has a TRS can satisfy the active business requirement by virtue of the active business of its TRS.[895] Thus, a C corporation that owns REIT-qualified assets may create a REIT to hold such assets and spin off that REIT without tax consequences to it or its shareholders (if the newly-formed REIT satisfies the active business requirement through its rental activities or the activities of a TRS). Following the spin-off, income from the assets held in the REIT is no longer subject to corporate level tax (unless there is a disposition of such assets that incurs tax under the built in gain rules).

Explanation of Provision

The provision makes a REIT generally ineligible to participate in a tax-free spin-off as either a distributing or controlled corporation under section 355. There are two exceptions, however. First, the general rule does not apply if, immediately after the distribution, both the distributing and the controlled corporations are REITs.[896] Second, a REIT may spin off a TRS if (1) the distributing corporation has been a REIT at all times during the 3-year period ending on the date of the distribution, (2) the controlled corporation has been a TRS of the REIT at all times during such period, and (3) the REIT has had control (as defined in section 368(c)[897] applied by taking into account stock owned directly or indirectly, including through one or more partnerships, by the REIT) of the TRS at all times during such period. For this purpose, control of a partnership means ownership of at least 80 percent of the profits interest and at least 80 percent of the capital interests.

A controlled corporation will be treated as meeting the control requirements if the stock of such corporation was distributed by a TRS in a transaction to which section 355 (or so much of section 356 as relates to section 355) applies and the assets of such corporation consist solely of the stock or assets held by one or more TRSs of the distributing corporation meeting the control requirements noted above.

If a corporation that is not a REIT was a distributing or controlled corporation with respect to any distribution to which section 355 applied, such corporation (and any successor corporation) shall not be eligible to make a REIT election for any taxable year beginning before the end of the 10-year period beginning on the date of such distribution.

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[893] Sec. 355(g).

[894] Rev. Rul. 2001–29, 2001–1 C.B. 1348.

[895] Priv. Ltr. Rul. 201337007. A private ruling may be relied upon only by the taxpayer to which it is issued. However, private rulings provide some indication of administrative practice.

[896] As long as a REIT election for each corporation is effective immediately after the distribution, the elections may be made after that time.

[897] Under section 368(c), the term “control” means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Effective Date

The provision generally applies to distributions on or after December 7, 2015,[898] but does not apply to any distribution pursuant to a transaction described in a ruling request initially submitted to the Internal Revenue Service on or before such date, which request has not been withdrawn and with respect to which a ruling has not been issued or denied in its entirety as of such date.

2. Reduction in percentage limitation on assets of REIT which may be taxable REIT subsidiaries (sec. 312 of the Act and sec. 856 of the Code)

Present Law

A REIT generally is not permitted to own securities representing more than 10 percent of the vote or value of any entity, nor is it permitted to own securities of a single issuer comprising more than 5 percent of REIT value.[899] In addition, rents received by a REIT from a corporation of which the REIT directly or indirectly owns more than 10 percent of the vote or value generally are not qualified rents for purposes of the 75-percent and 95-percent income tests.[900]

There is an exception from these rules in the case of a TRS.[901] No more than 25 percent of the value of total REIT assets may consist of securities of one or more TRSs.[902]

Explanation of Provision

The provision reduces to 20 percent the permitted percentage of total REIT assets that may be securities of one or more TRSs.

Effective Date

The provision applies to taxable years beginning after December 31, 2017.

3. Prohibited transaction safe harbors (sec. 313 of the Act and sec. 857 of the Code)

Present Law

REITs are subject to a prohibited transaction tax ("PTT") of 100 percent of the net income derived from prohibited transactions. For this purpose, a prohibited transaction is a sale or other disposition of property by the REIT that is "stock in trade of a taxpayer or other property which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held for sale to customers by the taxpayer in the ordinary

[898] The provision does not apply to distributions by a corporation pursuant to a plan under which stock constituting control (within the meaning of section 368(c)) of the controlled corporation was distributed before December 7, 2015.
[899] Sec. 856(c)(4)(B)(iii).
[900] Sec. 856(d)(2)(B).
[901] Sec. 856(d)(8).
[902] Sec. 856(c)(4)(B)(ii).

course of his trade or business"[903] and is not foreclosure property. The PTT for a REIT does not apply to a sale if the REIT satisfies certain safe harbor requirements in section 857(b)(6)(C) or (D), including an asset holding period of at least two years.[904] If the conditions are met, a REIT may either (1) make no more than seven sales within a taxable year (other than sales of foreclosure property or involuntary conversions under section 1033), or (2) sell either no more than 10 percent of the aggregate bases, or no more than 10 percent of the aggregate fair market value, of all its assets as of the beginning of the taxable year (computed without regard to sales of foreclosure property or involuntary conversions under section 1033), without being subject to the PTT tax.[905]

The additional requirements for the safe harbor limit the amount of expenditures the REIT or a partner of the REIT can make during the two-year period prior to the sale that are includible in the adjusted basis of the property. Also, if more than seven sales are made during the taxable year, substantially all marketing and development expenditures with respect to the property must have been made through an independent contractor from whom the REIT itself does not derive or receive any income.

Explanation of Provision

The provision expands the amount of property that a REIT may sell in a taxable year within the safe harbor provisions, from 10 percent of the aggregate basis or fair market value, to 20 percent of the aggregate basis or fair market value. However, in any taxable year, the aggregate adjusted bases and the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the three taxable year period ending with such taxable year may not exceed 10 percent of the sum of the aggregate adjusted bases or the sum of the fair market value of all of the assets of the REIT as of the beginning of each of the 3 taxable years that are part of the period.

The provision clarifies that the determination of whether property is described in section 1221(a)(1) is made without regard to whether or not such property qualifies for the safe harbor from the prohibited transactions rules.

Effective Date

The provision generally applies to taxable years beginning after the date of enactment (December 18, 2015). However, the provision clarifying the determination of whether property is described in section 1221(a)(1) has retroactive effect, but does not apply to any sale of property to which section 857(b)(6)(G) applies.

[903] This definition is the same as the definition of certain property the sale or other disposition of which would produce ordinary income rather than capital gain under section 1221(a)(1).

[904] Additional requirements for the safe harbor limit the amount of expenditures the REIT can make during the two-year period prior to the sale that are includible in the adjusted basis of the property, require marketing to be done by an independent contractor, and forbid a sales price that is based on the income or profits of any person.

[905] Sec. 857(b)(6).

4. Repeal of preferential dividend rule for publicly offered REITs; authority for alternative remedies to address certain REIT distribution failures (secs. 314 and 315 of the Act and sec. 562 of the Code)

Present Law

A REIT is allowed a deduction for dividends paid to its shareholders.[906] In order to qualify for the deduction, a dividend must not be a "preferential dividend."[907] For this purpose, a dividend is preferential unless it is distributed pro rata to shareholders, with no preference to any share of stock compared with other shares of the same class, and with no preference to one class as compared with another except to the extent the class is entitled to a preference.

Similar rules apply to regulated investment companies ("RICs").[908] However, the preferential dividend rule does not apply to a publicly offered RIC (as defined in section 67(c)(2)(B)).[909]

Explanation of Provision

The provision repeals the preferential dividend rule for publicly offered REITs. For this purpose, a REIT is publicly offered if it is required to file annual and periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

For other REITs, the provision provides the Secretary of the Treasury with authority to provide an appropriate remedy to cure the failure of the REIT to comply with the preferential dividend requirements in lieu of not considering the distribution to be a dividend for purposes of computing the dividends-paid deduction where the Secretary determines the failure to comply is inadvertent or is due to reasonable cause and not due to willful neglect, or the failure is a type of failure identified by the Secretary as being so described.

Effective Date

The provision to repeal the preferential dividend rule for publicly offered REITs applies to distributions in taxable years beginning after December 31, 2014.

The provision granting authority to the Secretary of the Treasury to provide alternative remedies addressing certain REIT distribution failures applies to distributions in taxable years beginning after December 31, 2015.

5. Limitations on designation of dividends by REITs (sec. 316 of the Act and sec. 857 of the Code)

Present Law

A REIT that has a net capital gain for a taxable year may designate dividends that it pays or is treated as paying during the

[906] Sec. 857(b)(2)(B).
[907] Sec. 562(c).
[908] Sec. 852(b)(2)(D).
[909] Sec. 562(c).

year as capital gain dividends.[910] A capital gain dividend is treated by the shareholder as gain from the sale or exchange of a capital asset held more than one year.[911] The amount that may be designated as capital gain dividends for any taxable year may not exceed the REIT's net capital gain for the year.

A REIT may designate dividends that it pays or is treated as paying during the year as qualified dividend income.[912] Qualified dividend income is taxed to individuals at the same tax rate as net capital gain, under rules enacted by the Taxpayer Relief Act of 1997.[913] The amount that may be designated as qualified dividend income for any taxable year is limited to qualified dividend income received by the REIT plus some amounts subject to corporate taxation at the REIT level.

The IRS has ruled that a RIC may designate the maximum amount permitted under each of the provisions allowing a RIC to designate dividends even if the aggregate of all the designated amounts exceeds the total amount of the RIC's dividends distributions.[914]

The IRS also has ruled that if a RIC has two or more classes of stock and it designates the dividends that it pays on one class as consisting of more than that class's proportionate share of a particular type of income, the designations are not effective for federal tax purposes to the extent that they exceed the class's proportionate share of that type of income.[915] The Internal Revenue Service announced that it would provide guidance that RICs and REITs must use in applying the capital gain provision enacted by the Taxpayer Relief Act of 1997.[916] The announcement referred to the designation limitations of Revenue Ruling 89–91.

Explanation of Provision

The provision limits the aggregate amount of dividends designated by a REIT for a taxable year under all of the designation provisions to the amount of dividends paid with respect to the taxable year (including dividends described in section 858 that are paid after the end of the REIT taxable year but treated as paid by the REIT with respect to the taxable year).

The provision provides the Secretary of the Treasury authority to prescribe regulations or other guidance requiring the proportionality of the designation for particular types of dividends (for example, capital gain dividends) among shares or beneficial interests in a REIT.

Effective Date

The provision applies to distributions in taxable years beginning after December 31, 2015.

[910] Sec. 857(b)(3)(C).
[911] Sec. 857(b)(3)(B).
[912] Sec. 857(c)(2).
[913] Sec. 1(h)(11) enacted in Pub. L. No. 105–34.
[914] Rev. Rul. 2005–31, 2005–1 C.B.1084.
[915] Rev. Rul. 89–81, 1989–1 C.B. 226.
[916] Notice 97–64, 1997–2 C.B. 323. Recently, the IRS modified Notice 97–64 and provided certain new rules for RICs; the designation limitations in Revenue Ruling 89–81, however, continue to apply. Notice 2015–41, 2015–24 I.R.B. 1058.

6. Debt instruments of publicly offered REITs and mortgages treated as real estate assets (sec. 317 of the Act and sec. 856 of the Code)

Present Law

At least 75 percent of the value of a REIT's assets must be real estate assets, cash and cash items (including receivables), and Government securities (the "75-percent asset test").[917] Real estate assets are real property (including interests in real property and mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs.[918] No more than 25 percent of a REIT's assets may be securities other than such real estate assets.[919]

Except with respect to a TRS, not more than five percent of the value of a REIT's assets may be securities of any one issuer, and the REIT may not possess securities representing more than 10 percent of the outstanding value or voting power of any one issuer.[920] No more than 25 percent of the value of a REIT's assets may be securities of one or more TRSs.[921]

The asset tests must be met as of the close of each quarter of a REIT's taxable year.[922]

At least 75 percent of a REIT's gross income must be from certain real estate related and other items. In addition, at least 95 percent of a REIT's gross income must be from specified sources that include the 75 percent items and also include interest, dividends, and gain from the sale or other disposition of securities (whether or not real estate-related).

Explanation of Provision

Under the provision, debt instruments issued by publicly offered REITs are treated as real estate assets, as are interests in mortgages on interests in real property (for example, an interest in a mortgage on a leasehold interest in real property). Such assets therefore are qualified assets for purposes of meeting the 75-percent asset test, but are subject to special limitations described below.

As under present law, income from debt instruments issued by publicly offered REITs that is interest income or gain from the sale or other disposition of a security is treated as qualified income for purposes of the 95-percent gross income test. Income from debt instruments issued by publicly offered REITs that would not have been treated as real estate assets but for the new provision, however, is not qualified income for purposes of the 75-percent income

[917] Sec. 856(c)(4)(A).

[918] Such term also includes any property (not otherwise a real estate asset) attributable to the temporary investment of new capital, but only if such property is stock or a debt instrument, and only for the one-year period beginning on the date the REIT receives such capital. Sec. 856(c)(5)(B).

[919] Sec. 856(c)(4)(B)(i).

[920] Sec. 856(c)(4)(B)(iii).

[921] Sec. 856(c)(4)(B)(ii).

[922] Sec. 856(c)(4). However, a REIT that has met the asset tests as of the close of any quarter does not lose its REIT status solely because of a discrepancy during a subsequent quarter between the value of the REIT's investments and such requirements, unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. Sec. 856(c)(4).

test, and not more than 25 percent of the value of a REIT's total assets is permitted to be represented by such debt instruments.

Effective Date

The provision is effective for taxable years beginning after December 31, 2015.

7. Asset and income test clarification regarding ancillary personal property (sec. 318 of the Act and sec. 856 of the Code)

Present Law

75-percent income test

Among other requirements, at least 75 percent of the gross income of a REIT in each taxable year must consist of real estate-related income. Such income includes: rents from real property; income from the sale or exchange of real property (including interests in real property) that is not stock in trade, inventory, or held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business; interest on mortgages secured by real property or interests in real property; and certain income from foreclosure property (the "75-percent income test"). Amounts attributable to most types of services provided to tenants (other than certain "customary services"), or to more than specified amounts of personal property, are not qualifying rents.

The Code definition of rents from real property includes rent attributable to personal property which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such property for the taxable year does not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such lease.[923]

For purposes of determining whether interest income is from a mortgage secured by real property, Treasury regulations provide that where a mortgage covers both real property and other property, an apportionment of the interest must be made. If the loan value of the real property is equal to or exceeds the amount of the loan, then the entire interest income is apportioned to the real property. However, if the amount of the loan exceeds the loan value of the real property, then the interest income apportioned to the real property is an amount equal to the interest income multiplied by a fraction, the numerator of which is the loan value of the real property and the denominator of which is the amount of the loan.[924] The remainder of the interest income is apportioned to the other property.

The loan value of real property is defined as the fair market value of the property determined as of the date on which the commitment by the REIT to make the loan becomes binding on the REIT. In the case of a loan purchased by a REIT, the loan value

[923] Sec. 856(d)(1)(C).

[924] Treas. Reg. sec. 1.856–5(c)(1). The amount of the loan for this purpose is defined as the hightest principal amount of the loan outstanding during the taxable year. Treas. Reg. sec. 1.856–5(c)(3).

of the real property is the fair market value of the real property determined as of the date on which the commitment of the REIT to purchase the loan becomes binding.[925]

75-percent asset test

At the close of each quarter of the taxable year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items, and Government securities.

Real estate assets generally mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs.

Neither the Code nor regulations address the allocation of value in cases where real property and personal property may both be present.

Explanation of Provision

The provision allows certain ancillary personal property leased with real property to be treated as real property for purposes of the 75-percent asset test, applying the same threshold that applies under present law for purposes of determining rents from real property under section 856(d)(l)(C) for purposes of the 75-percent income test.

The provision also modifies the present-law rules for determining when an obligation secured by a mortgage is considered secured by a mortgage on real property if the security includes personal property as well. Under the provision, in the case of an obligation secured by a mortgage on both real property and personal property, if the fair market value of such personal property does not exceed 15 percent of the total fair market value of all such property, such personal property is treated as real property for purposes of the 75-percent income and 75-percent asset test computations.[926] In making this determination, the fair market value of all property (both personal and real) is determined at the same time and in the same manner as the fair market value of real property is determined for purposes of apportioning interest income between real property and personal property under the rules for determining whether interest income is from a mortgage secured by real property.

Effective Date

The provision is effective for taxable years beginning after December 31, 2015.

8. Hedging provisions (sec. 319 of the Act and sec. 857 of the Code)

Present Law

Except as provided by Treasury regulations, income from certain REIT hedging transactions that are clearly identified, including gain from the sale or disposition of such a transaction, is not included as gross income under either the 95-percent income or 75-

[925] Special rules apply to construction loans. Treas. Reg. sec. 1.856–5(c)(2).
[926] Sec. 856(c)(3)(B) and (4)(A).

percent income test. Transactions eligible for this exclusion include transactions that hedge indebtedness incurred or to be incurred by the REIT to acquire or carry real estate assets and transactions entered primarily to manage risk of currency fluctuations with respect to items of income or gain described in section 856(c)(2) or (3).[927]

Explanation of Provision

The provision expands the scope of the present-law exception of certain hedging income from gross income for purposes of the income tests, under section 856(c)(5)(G). Under the provision, if (1) a REIT enters into one or more positions described in clause (i) of section 856(c)(5)(G) with respect to indebtedness described therein or one or more positions described in clause (ii) of section 856(c)(5)(G) with respect to property that generates income or gain described in section 856(c)(2) or (3); (2) any portion of such indebtedness is extinguished or any portion of such property is disposed of; and (3) in connection with such extinguishment or disposition, such REIT enters into one or more transactions which would be hedging transactions described in subparagraph (B) or (C) of section 1221(b)(2) with respect to any position referred to in (1) above, if such position were ordinary property,[928] then any income of such REIT from any position referred to in (1) and from any transaction referred to in (3) (including gain from the termination of any such position or transaction) shall not constitute gross income for purposes of the 75-percent or 95-percent gross income tests, to the extent that such transaction hedges such position.

The provision is intended to extend the current treatment of income from certain REIT hedging transactions as income that is disregarded for purposes of the 75-percent and 95-percent income tests to income from positions that primarily manage risk with respect to a prior hedge that a REIT enters in connection with the extinguishment or disposal (in whole or in part) of the liability or asset (respectively) related to such prior hedge, to the extent the new position qualifies as a section 1221 hedge or would so qualify if the hedged position were ordinary property.

The provision also clarifies that the identification requirement that applies to all hedges under the hedge gross income rules is the requirement described in section 1221(a)(7), determined after taking account of any curative provisions provided under the regulations referred to therein.

Effective Date

The provision is effective for taxable years beginning after December 31, 2015.

[927] Sec. 856(c)(5)(G).

[928] Such definition of a hedging transaction is applied for purposes of this provision without regard to whether or not the position referred to is ordinary property.

9. Modification of REIT earnings and profits calculation to avoid duplicate taxation (sec. 320 of the Act and secs. 562 and 857 of the Code)

Present Law

For purposes of computing earnings and profits of a corporation, the alternative depreciation system, which generally is less accelerated than the system used in determining taxable income, is used in the case of the depreciation of tangible property. Also, certain amounts treated as currently deductible for purposes of computing taxable income are allowed as a deduction ratably over a period of five years for computing earnings and profits. Finally, the installment method is not allowed in computing earnings and profits from the installment sale of property.[929]

In the case of a REIT, the current earnings and profits of a REIT are not reduced by any amount which is not allowable as a deduction in computing its taxable income for the taxable year.[930] In addition, for purposes of computing the deduction for dividends paid by a REIT for a taxable year, earnings and profits are increased by the total amount of gain on the sale or exchange of real property by the trust during the year.[931]

These rules can by illustrated by the following example:

Example.—Assume that a REIT had $100 of taxable income and earnings and profits in each of five consecutive taxable years (determined without regard to any energy efficient commercial building deduction[932] and without regard to any deduction for dividends paid). Assume that in the first of the five years, the REIT had an energy efficient commercial building deduction in computing its taxable income of $10, reducing its pre-dividend taxable income to $90. Assume further that the deduction is allowable at a rate of $2 per year over the five-year period beginning with the first year in computing its earnings and profits.

Under present law, the REIT's earnings and profits in the first year are $98 ($100 less $2). In each of the next four years, the REIT's current earnings and profits are $100 ($98 as computed for the first year plus an additional $2 under section 857(d)(1) for the $2 not deductible in computing taxable income for the year).

Assume the REIT distributes $100 to its shareholders at the close of each of the five years. Under present law, the shareholders have $98 dividend income in the first year and a $2 return of capital and $100 dividend income in each of the following four years, for a total of $498 dividend income, notwithstanding that the REIT had only $490 pre-dividend taxable income over the period. The dividends paid by the REIT reduce its taxable income to zero in each of the taxable years.

Explanation of Provision

Under the provision, the current earnings and profits of a REIT for a taxable year are not reduced by any amount that (1) is not

[929] Sec. 312(k)(3) and (n)(5).

[930] Sec. 857(d)(1). This provision applies to a REIT without regard to whether it meets the requirements of section 857(a) for the taxable year.

[931] Sec. 562(e).

[932] Sec. 179D.

allowable as a deduction in computing its taxable income for the current taxable year and (2) was not so allowable for any prior taxable year. Thus, under the provision, if an amount is allowable as a deduction in computing taxable income in year one and is allowable in computing earnings and profits in year two (determined without regard to present-law section 857(d)(1)), section 857(d)(1) no longer applies and the deduction in computing the year two earnings and profits of the REIT is allowable. Thus, a lesser maximum amount will be a dividend to shareholders in that year. This provision does not change the present-law determination of current earnings and profits for purposes of computing a REIT's deduction for dividends paid.

In addition, the provision provides that the current earnings and profits of a REIT for a taxable year for purposes of computing the deduction for dividends paid are increased by any amount of gain on the sale or exchange of real property taken into account in determining the taxable income of the REIT for the taxable year (to the extent the gain is not otherwise so taken into account). Thus, in the case of an installment sale of real property, current earnings and profits for purposes of the REIT's deduction for dividends paid for a taxable year are increased by the amount of gain taken into account in computing its taxable income for the year and not otherwise taken into account in computing the current earnings and profits.

The following illustrates the application of the provision:

Example.—Assume the same facts as in the above example. Under the provision, as under present law, in the first taxable year, the earnings and profits of the REIT were $98 and the shareholders take into account $98 dividend income and $2 is a return of capital. Under the provision, in each of the next four years, the earnings and profits are $98 (i.e., section 857(d)(1) does not apply) so that the shareholders take into account $98 of dividend income in each year and $2 is a return of capital each year.

For purposes of the REIT's deduction for dividends paid, present law remains unchanged so that the REIT's taxable income will be reduced to zero in each of the taxable years.

Effective Date

The provision is effective for taxable years beginning after December 31, 2015.

10. Treatment of certain services provided by taxable REIT subsidiaries (sec. 321 of the Act and sec. 857 of the Code)

Present Law

Taxable REIT subsidiaries

A TRS generally can engage in any kind of business activity except that it is not permitted directly or indirectly to operate either a lodging facility or a health care facility, or to provide 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.

REITs are subject to a tax equal to 100 percent of redetermined rents, redetermined deductions, and excess interest. These are defined generally as the amounts of specified REIT transactions with a TRS of the REIT, to the extent such amounts differ from an arm's length amount.

Prohibited transactions tax

REITs are subject to a prohibited transaction tax ("PTT") of 100 percent of the net income derived from prohibited transactions.[933] For this purpose, a prohibited transaction is a sale or other disposition of property by the REIT that is stock in trade of a taxpayer or other property that would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held for sale to customers by the taxpayer in the ordinary course of his trade or business and is not foreclosure property. The PTT for a REIT does not apply to a sale of property which is a real estate asset if the REIT satisfies certain criteria in section 857(b)(6)(C) or (D).

Section 857(b)(6)(C) provides that a prohibited transaction does not include a sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) and which is described in section 1221(a)(1) if (1) the REIT has held the property for not less than two years; (2) aggregate expenditures made by the REIT, or any partner of the REIT, during the two year period preceding the date of sale which are includible in the basis of the property do not exceed 30 percent of the net selling price of the property; (3) either: (A) the REIT does not make more than seven sales of property[934] during the taxable year, or (B) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property[935] sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the REIT as of the beginning of the taxable year, or (C) the fair market value of property[936] sold during the taxable year does not exceed 10 percent of the aggregate fair market value of all the assets of the REIT as of the beginning of the taxable year; (4) in the case of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the REIT has held the property for not less than two years for production of rental income; and (5) if the requirement of (3)(A) above is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the REIT does not derive or receive any income.

Section 857(b)(6)(D) provides that a prohibited transaction does not include a sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) and which is described in section 1221(a)(1) if (1) the REIT has held the property for not less than two years in connection with the trade or business of producing timber; (2) the aggregate expenditures made by the REIT, or any partner of the REIT, during the two year period preceding the date

[933] Sec. 857(b)(6).
[934] Sales of foreclosure property or sales to which section 1033 applies are excluded.
[935] Sales of foreclosure property or sales to which section 1033 applies are excluded.
[936] Sales of foreclosure property or sales to which section 1033 applies are excluded.

of sale which (A) are includible in the basis of the property (other than timberland acquisition expenditures), and (B) are directly related to operation of the property for the production of timber or for the preservation of the property for use as a timberland, do not exceed 30 percent of the net selling price of the property; (3) the aggregate expenditures made by the REIT, or a partner of the REIT, during the two year period preceding the date of sale which (A) are includible in the basis of the property (other than timberland acquisition expenditures), and (B) are not directly related to operation of the property for the production of timber or for the preservation of the property for use as a timberland, do not exceed five percent of the net selling price of the property; (4) either: (A) the REIT does not make more than seven sales of property [937] during the taxable year, or (B) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property [938] sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the REIT as of the beginning of the taxable year, or (C) the fair market value of property [939] sold during the taxable year does not exceed 10 percent of the aggregate fair market value of all the assets of the REIT as of the beginning of the taxable year; (5) if the requirement of (4)(A) above is not satisfied, substantially all of the marketing expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the REIT does not derive or receive any income, or, in the case of a sale on or before the termination date, a TRS; and (6) the sales price of the property sold by the trust is not based in whole or in part on income or profits derived from the sale or operation of such property.

Foreclosure property

Under current law, certain income and gain derived from foreclosure property satisfies the 95-percent and 75-percent REIT income tests.[940] Property will cease to be foreclosure property, however, if used in a trade or business conducted by the REIT, other than through an independent contractor from which the REIT itself does not derive or receive any income, more than 90 days after the day on which the REIT acquired such property.[941]

Explanation of Provision

For purposes of the exclusion from the prohibited transactions excise tax, the provision modifies the requirement of section 857(b)(6)(C)(v), that substantially all of the development expenditures with respect to the property were made through an independent contractor from whom the REIT itself does not derive or receive any income, to allow a TRS to have developed the property.[942]

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[937] Sales of foreclosure property or sales to which section 1033 applies are excluded.
[938] Sales of foreclosure property or sales to which section 1033 applies are excluded.
[939] Sales of foreclosure property or sales to which section 1033 applies are excluded.
[940] Sec. 856(c)(2)(F) and (3)(F).
[941] Sec. 856(e)(4)(C).
[942] The requirement limiting the amount of expenditures added to basis that the REIT, or a partner of the REIT, may make within two years prior to the sale, as well as other requirements for the exclusion, are retained.

The provision also allows a TRS to make marketing expenditures with respect to property under section 857(b)(6)(C)(v) or 857(b)(6)(D)(v) without causing property that is otherwise eligible for the prohibited transaction exclusion to lose such qualification.

The provision allows a TRS to operate foreclosure property without causing loss of foreclosure property status, under section 856(e)(4)(C).

The items subject to the 100-percent excise tax on certain non-arm's-length transactions between a TRS and a REIT are expanded to include "redetermined TRS service income." Such income is defined as gross income of a TRS of a REIT attributable to services provided to, or on behalf of, such REIT (less the deductions properly allocable thereto) to the extent the amount of such income (less such deductions) would be increased on distribution, apportionment, or allocation under section 482 (but for the exception from section 482 if the 100-percent excise tax applies). The term does not include gross income attributable to services furnished or rendered to a tenant of the REIT (or deductions properly attributable thereto), since that income is already subject to a separate provision of the 100-percent excise tax rules.

Effective Date

The provision is effective for taxable years beginning after December 31, 2015.

11. Exception from FIRPTA for certain stock of REITs; exception for interests held by foreign retirement and pension funds (secs. 322 and 323 of the Act and secs. 897 and 1445 of the Code) [943]

Present Law

General rules relating to FIRPTA

A foreign person that is not engaged in the conduct of a trade or business in the United States generally is not subject to any U.S. tax on capital gain from U.S. sources, including capital gain from the sale of stock or other capital assets.[944]

However, the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") [945] generally treats a foreign person's gain or loss from the disposition of a U.S. real property interest ("USRPI") as income that is effectively connected with the conduct of a U.S. trade or business, and thus taxable at the income tax rates applica-

[943] The Senate Committee on Finance reported S.915 on April 14, 2015 (S. Rep. No. 114–25). Section 2 of that bill contained a provision similar to section 322 of the Protecting Americans from Tax Hikes Act of 2015 (Division Q of Pub. L. No. 114–113).

[944] Secs. 871(b) and 882(a). Property is treated as held by a person for use in connection with the conduct of a trade or business in the United States, even if not so held at the time of sale, if it was so held within 10 years prior to the sale. Sec. 864(c)(7). Also, all gain from an installment sale is treated as from the sale of property held in connection with the conduct of such a trade or business if the property was so held during the year in which the installment sale was made, even if the recipient of the payments is no longer engaged in the conduct of such trade or business when the payments are received. Sec. 864(c)(6).

[945] Pub. L. No. 96–499. The rules governing the imposition and collection of tax under FIRPTA are contained in a series of provisions enacted in 1980 and subsequently amended. See secs. 897, 1445, 6039C, and 6652(f).

ble to U.S. persons, including the rates for net capital gain.[946] With certain exceptions, if a foreign corporation distributes a USRPI, gain is recognized on the distribution (including a distribution in redemption or liquidation) of a USRPI, in an amount equal to the excess of the fair market value of the USRPI (as of the time of distribution) over its adjusted basis.[947] A foreign person subject to tax on FIRPTA gain is required to file a U.S. tax return under the normal rules relating to receipt of income effectively connected with a U.S. trade or business.[948]

The payor of amounts that FIRPTA treats as effectively connected with a U.S. trade or business ("FIRPTA income") to a foreign person generally is required to withhold U.S. tax from the payment.[949] Withholding generally is 10 percent of the sales price, in the case of a direct sale by the foreign person of a USRPI (but withholding is not required in certain cases, including on any sale of stock that is regularly traded on an established securities market[950]), and 10 percent of the amount realized by the foreign shareholder in the case of certain distributions by a corporation that is or has been a U.S. real property holding corporation ("USRPHC") during the applicable testing period.[951] The withholding is generally 35 percent of the amount of a distribution to a foreign person of net proceeds attributable to the sale of a USRPI from an entity such as a partnership, REIT, or RIC.[952] The foreign person can request a refund with its U.S. tax return, if appropriate, based on that person's total U.S. effectively connected income and deductions (if any) for the taxable year.

USRPHCs and five-percent public shareholder exception

USRPIs include not only interests in real property located in the United States or the U.S. Virgin Islands, but also stock of a USRPHC, generally defined as any domestic corporation, unless the taxpayer establishes that the fair market value of the corporation's USRPIs was less than 50 percent of the combined fair market value of all its real property interests (U.S. and worldwide) and all its assets used or held for use in a trade or business, at all times during a "testing period," which is the shorter of the duration of the taxpayer's ownership of the stock after June 18, 1980, or the five-year period ending on the date of disposition of the stock.[953]

Under an exception, even if a corporation is a USRPHC, a shareholder's shares of a class of stock that is regularly traded on an established securities market are not treated as USRPIs if the shareholder holds (applying attribution rules) no more than five percent

[946] Sec. 897(a).
[947] Sec. 897(d). In addition, such gain may also be subject to the branch profits tax at a 30-percent rate (or lower treaty rate).
[948] In addition, section 6039C authorizes regulations that would require a return reporting foreign direct investments in U.S. real property interests. No such regulations have been issued, however.
[949] Sec. 1445(a).
[950] Sec. 1445(b)(6).
[951] Sec. 1445(e)(3). Withholding at 10 percent of a gross amount may also apply in certain other circumstances under regulations. See sec. 1445(e)(4) and (5).
[952] Sec. 1445(e)(6) and Treasury regulations thereunder. The Treasury Department is authorized to issue regulations that would reduce the 35 percent withholding on distributions to 20 percent during the time that the maximum income tax rate on dividends and capital gains of U.S. persons is 20 percent.
[953] Sec. 897(c)(1) and (2).

of that class of stock at any time during the testing period.[954] Among other things, the relevant attribution rules require attribution between a corporation and a shareholder that owns five percent or more in value of the stock of such corporation.[955] The attribution rules also attribute stock ownership between spouses and between children, grandchildren, parents, and grandparents.

FIRPTA rules for foreign investment through REITs and RICs

Special FIRPTA rules apply to foreign investment through a "qualified investment entity," which includes any REIT and certain RICs that invest largely in USRPIs (including stock of one or more REITs).[956]

Stock of domestically controlled qualified investment entities not a USRPI

If a qualified investment entity is "domestically controlled" (defined to mean that less than 50 percent in value of the qualified investment entity has been owned (directly or indirectly) by foreign persons during the relevant testing period[957]), stock of such entity is not a USRPI and a foreign shareholder can sell the stock of such entity without being subject to tax under FIRPTA, even if the stock would otherwise be stock of a USRPHC. Treasury regulations provide that for purposes of determining whether a REIT is domestically controlled, the actual owner of REIT shares is the "person who is required to include in his return the dividends received on the stock."[958] The IRS has issued a private letter ruling concluding that the term "directly or indirectly" for this purpose does not require looking through corporate entities that, in the facts of the ruling, were represented to be fully taxable domestic corporations for U.S. federal income tax purposes "and not otherwise a REIT, RIC, hybrid entity, conduit, disregarded entity, or other flow-through or look-through entity."[959]

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[954] Sec. 897(c)(3). The constructive ownership attribution rules are specified in section 897(c)(6)(C).

[955] If a person owns, directly or indirectly, five percent or more in value of the stock in a corporation, such person is considered as owning the stock owned directly or indirectly by or for such corporation, in that proportion which the value of the stock such person so owns bears to the value of all the stock in such corporation. Sec. 318(c)(2)(C) as modified by section 897(c)(6)(C). Also, if five percent or more in value of the stock in a corporation is owned directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person. Sec. 318(c)(3)(C) as modified by section 897(c)(6)(C).

[956] Sec. 897(h)(4)(A)(i). The provision including certain RICs in the definition of qualified investment entity previously expired December 31, 2014. Section 133 of the Protecting Americans from Tax Hikes Act of 2015 (Division Q of Pub. L. No. 114–113) reinstated the provision and made it permanent as of January 1, 2015, as described above in item 22 of Title I.A.

[957] The testing period for this purpose if the shorter of (i) the period beginning on June 19, 1980, and ending on the date of disposition or distribution, as the case may be, (ii) the five-year period ending on the date of the disposition or distribution, as the case may be, or (iii) the period during which the qualified investment entity was in existence. Sec. 897(h)(4)(D).

[958] Treas. Reg. sec. 1.897–1(c)(2)(i) and –8(b).

[959] PLR 200923001. A private letter ruling may be relied upon only by the taxpayer to which it is issued. However, private letter rulings provide some indication of administrative practice.

FIRPTA applies to qualified investment entity (REIT and certain RIC) distributions attributable to gain from sale or exchange of USRPIs, except for distributions to certain five-percent or smaller shareholders

A distribution by a REIT or other qualified investment entity, to the extent attributable to gain from the entity's sale or exchange of USRPIs, is treated as FIRPTA income.[960] The FIRPTA character is retained if the distribution occurs from one qualified investment entity to another, through a tier of REITs or RICs.[961] An IRS notice (Notice 2007–55) states that this rule retaining the FIRPTA income character of distributions attributable to the sale of USRPIs applies to any distributions under sections 301, 302, 331, and 332 (i.e., to dividend distributions, distributions treated as sales or exchanges of stock by the investor, and both nonliquidating and liquidating distributions) and that the IRS will issue regulations to that effect.[962]

There is an exception to this rule in the case of distributions to certain public shareholders. If an investor has owned no more than five percent of a class of stock of a REIT or other qualified investment entity that is regularly traded on an established securities market located in the United States during the one-year period ending on the date of the distribution, then amounts attributable to gain from entity sales or exchanges of USRPIs can be distributed to such a shareholder without being subject to FIRPTA tax.[963] Such distributions that are dividends are treated as dividends from the qualified investment entity,[964] and thus generally would be subject to U.S. dividend withholding tax (as reduced under any applicable treaty), but are not treated as income effectively connected with the conduct of a U.S. trade or business. An IRS Chief Counsel advice memorandum concludes that such distributions which are made in complete liquidation of a REIT are not treated as dividends from the qualified investment entity and thus generally would not be subject to U.S. dividend withholding tax (in addition to not being treated as income effectively connected with the conduct of a U.S. trade or business).[965]

Explanation of Provision

Exception from FIRPTA for certain REIT stock

In the case of REIT stock only, the provision increases from five percent to 10 percent the maximum stock ownership a shareholder may have held, during the testing period, of a class of stock that is publicly traded, to avoid having that stock be treated as a USRPI on disposition.

[960] Sec. 897(h)(1).

[961] In 2006, the Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA"), Pub. L. No. 109–222, sec. 505, specified the retention of this FIRPTA character on a distribution to an upper-tier qualified investment entity, and added statutory withholding requirements.

[962] Notice 2007–55, 2007–2 C.B.13. The Notice also states that in the case of a foreign government investor, because FIRPTA income is treated as effectively connected with the conduct of a U.S. trade or business, proceeds distributed by a qualified investment entity from the sale of USRPIs are not exempt from tax under section 892. The Notice cites and compares existing temporary regulations and indicates that Treasury will apply those regulations as well to certain distributions. See Temp. Treas. Reg. secs. 1.892–3T, 1.897–9T(e), and 1.1445–10T(b).

[963] Sec. 897(h)(1), second sentence.

[964] Secs. 852(b)(3)(E) and 857(b)(3)(F).

[965] AM 2008–003, February 15, 2008.

The provision likewise increases from five percent to 10 percent the percentage ownership threshold that, if not exceeded, results in treating a distribution to holders of publicly traded REIT stock, attributable to gain from sales of exchanges of USRPIs, as a dividend, rather than as FIRPTA gain.

The attribution rules of section 897(c)(6)(C) retain the present-law rule that requires attribution between a shareholder and a corporation if the shareholder owns more than five percent of a class of stock of the corporation. The attribution rules now apply, however, to the determination of whether a person holds more than 10 percent of a class of publicly traded REIT stock.

The provision also provides that REIT stock held by a qualified shareholder, including stock held indirectly through one or more partnerships, is not a U.S real property interest in the hands of such qualified shareholder, except to the extent that an investor in the qualified shareholder (other than an investor that is a qualified shareholder) holds more than 10 percent of that class of stock of the REIT (determined by application of the constructive ownership rules of section 897(c)(6)(C)). Thus, so long as the "more than 10 percent" rule is not exceeded, a qualified shareholder may own and dispose of any amount of stock of a REIT (including stock of a privately-held, non-domestically controlled REIT that is owned by such qualified shareholder) without the application of FIRPTA.

If an investor in the qualified shareholder (other than an investor that is a qualified shareholder) directly, indirectly, or constructively holds more than 10 percent of such class of REIT stock (an "applicable investor"), then a percentage of the REIT stock held by the qualified shareholder equal to the applicable investor's percentage ownership of the qualified shareholder is treated as a USRPI in the hands of the qualified shareholder and is subject to FIRPTA. In that case, an amount equal to such percentage multiplied by the disposition proceeds and REIT distribution proceeds attributable to underlying USRPI gain is treated as FIRPTA gain in the hands of the qualified shareholder.

The provision is intended to override in certain cases one of the conclusions reached in AM 2008–003. Specifically, the provision contains special rules with respect to certain distributions that are treated as a sale or exchange of REIT stock under section 301(c)(3), 302, or 331 with respect to a qualified shareholder. Any such amounts attributable to an applicable investor are ineligible for the FIRPTA exception for qualified shareholders, and thus are subject to FIRPTA. Any such amounts attributable to other investors are treated as a dividend received from a REIT for purposes of U.S. dividend withholding tax and the application of income tax treaties, notwithstanding their general treatment under the Code.

A qualified shareholder is defined as a foreign person that (i) either is eligible for the benefits of a comprehensive income tax treaty which includes an exchange of information program and whose principal class of interests is listed and regularly traded on one or more recognized stock exchanges (as defined in such comprehensive income tax treaty), or is a foreign partnership that is created or organized under foreign law as a limited partnership in a jurisdiction that has an agreement for the exchange of information with respect to taxes with the United States and has a class of limited partner-

ship units representing greater than 50 percent of the value of all the partnership units that is regularly traded on the NYSE or NASDAQ markets, (ii) is a qualified collective investment vehicle (as defined below), and (iii) maintains records on the identity of each person who, at any time during the foreign person's taxable year, is the direct owner of 5 percent or more of the class of interests or units (as applicable) described in (i), above.

A qualified collective investment vehicle is defined as a foreign person that (i) would be eligible for a reduced rate of withholding under the comprehensive income tax treaty described above, even if such entity holds more than 10 percent of the stock of such REIT,[966] (ii) is publicly traded, is treated as a partnership under the Code, is a withholding foreign partnership, and would be treated as a USRPHC if it were a domestic corporation, or (iii) is designated as such by the Secretary of the Treasury and is either (a) fiscally transparent within the meaning of section 894, or (b) required to include dividends in its gross income, but is entitled to a deduction for distributions to its investors.

The provision also contains rules with respect to partnership allocations of USRPI gains to applicable investors. If an applicable investor's proportionate share of USRPI gain for the taxable year exceeds such partner's distributive share of USRPI gain for the taxable year then such partner's distributive share of non-USRPI income or gain is recharacterized as USRPI gain for the taxable year in the amount that the distributive share of USRPI gain exceeds the proportionate share of USRPI gain. For purposes of these partnership allocation rules, USRPI gain is defined to comprise the net of gain recognized on disposition of a USRPI, distributions from a REIT that are treated as USRPI gain, and loss from the disposition of USRPIs. An investor's proportionate share of USRPI gain is determined based on the applicable investor's largest proportionate share of income or gain for the taxable year, and if such proportionate amount may vary during the existence of the partnership, such share is the highest share the applicable investor may receive.

Domestically controlled qualified investment entity

The provision redefines the term "domestically controlled qualified investment entity" to provide a number of new rules and presumptions relating to whether a qualified investment entity is domestically controlled. First, a qualified investment entity shall be permitted to presume that holders of less than five percent of a class of stock regularly traded on an established securities market in the United States are U.S. persons throughout the testing period, except to the extent that the qualified investment entity has actual knowledge that such persons are not U.S. persons. Second, any stock in the qualified investment entity held by another qualified investment entity (I) which has issued any class of stock that is regularly traded on an established stock exchange, or (II) which is a RIC that issues redeemable securities (within the meaning of section 2 of the Investment Company Act of 1940) shall be treated

[966] The qualified collective investment vehicle must be eligible for a reduced rate of withholding under a provision in the dividends article of the relevant treaty dealing specifically with dividends paid by REITs. For example, the U.S. income tax treaties with Australia and the Netherlands provide such a reduced rate of withholding under certain circumstances.

as held by a foreign person unless such other qualified investment entity is domestically controlled (as determined under the new rules) in which case such stock shall be treated as held by a U.S. person. Finally, any stock in a qualified investment entity held by any other qualified investment entity not described in (I) or (II) of the preceding sentence shall only be treated as held by a U.S. person to the extent that the stock of such other qualified investment entity is (or is treated under the new provision as) held by a U.S. person.

Exception for interests held by foreign retirement and pension funds

The provision exempts from the rules of section 897 any USRPI held directly (or indirectly through one or more partnerships) by, or to any distribution received from a real estate investment trust by, a qualified foreign pension fund or by a foreign entity wholly-owned by a qualified foreign pension fund. A qualified foreign pension fund means any trust, corporation, or other organization or arrangement [967] (A) which is created or organized under the law of a country other than the United States, (B) which is established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees (or persons designated by such employees) of one or more employers in consideration for services rendered,[968] (C) which does not have a single participant or beneficiary with a right to more than five percent of its assets or income, (D) which is subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which it is established or operates, and (E) with respect to which, under the laws of the country in which it is established or operates, (i) contributions to such organization or arrangement that would otherwise be subject to tax under such laws are deductible or excluded from the gross income of such entity or taxed at a reduced rate, or (ii) taxation of any investment income of such organization or arrangement is deferred or such income is taxed at a reduced rate.

The provision also makes conforming changes to section 1445 to eliminate withholding on sales by qualified foreign pension funds (and their wholly-owned foreign subsidiaries) of USRPIs.

The Secretary of the Treasury may provide such regulations as are necessary to carry out the purposes of the provision.

Effective Date

The provision to extend exceptions from FIRPTA for certain REIT stock applies to dispositions and distributions on or after the date of enactment (December 18, 2015).

The provision to modify the definition of a domestically controlled qualified investment entity is effective on the date of enactment (December 18, 2015).

[967] Foreign pension funds may be structured in a variety of ways, and may comprise one or more separate entities. The word "arrangement" encompasses such alternative structures.

[968] Multi-employer and government-sponsored public pension funds that provide pension and pension-related benefits may satisfy this prong of the definition. For example, such pension funds may be established for one or more companies or professions, or for the general working public of a foreign country.

The exception for interests held by foreign retirement and pension funds generally applies to dispositions and distributions after the date of enactment (December 18, 2015).

12. Increase in rate of withholding of tax on dispositions of United States real property interests (sec. 324 of the Act and sec. 1445 of the Code)[969]

Present Law

A purchaser of a USRPI from any person is obligated to withhold 10 percent of gross purchase price unless certain exceptions apply.[970] The obligation does not apply if the transferor furnishes an affidavit that the transferor is not a foreign person. Even absent such an affidavit, the obligation does not apply to the purchase of publicly traded stock.[971] Also, the obligation does not apply to the purchase of stock of a nonpublicly traded domestic corporation, if the corporation furnishes the transferee with an affidavit stating the corporation is not and has not been a USRPHC during the applicable period (unless the transferee has actual knowledge or receives a notification that the affidavit is false).[972]

Treasury regulations[973] generally provide that a domestic corporation must, within a reasonable period after receipt of a request from a foreign person holding an interest in it, inform that person whether the interest constitutes a USRPI.[974] No particular form is required. The statement must be dated and signed by a responsible corporate officer who must verify under penalties of perjury that the statement is correct to his knowledge and belief. If a foreign investor requests such a statement, then the corporation must provide a notice to the IRS that includes the name and taxpayer identification number of the corporation as well as the investor, and indicates whether the interest in question is a USRPI. However, these requirements do not apply to a domestically controlled REIT or to a corporation that has issued any class of stock which is regularly traded on an established securities market at any time during the calendar year. In such cases a corporation may voluntarily choose to comply with the notice requirements that would otherwise have applied.[975]

In addition to these exceptions that might be determined at the entity level, even if a corporation is a USRPHC, its stock is not a USRPI in the hands of the seller if the stock is of a class that is publicly traded and the foreign shareholder disposing of the stock has not owned (applying attribution rules) more than five percent of such class of stock during the relevant period.

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[969] The Senate Committee on Finance reported S.915 on April 14, 2015 (S. Rep. No. 114–25). Section 3 of that bill contained an identical provision.

[970] Sec. 1445.

[971] Sec. 1445(b)(6).

[972] Sec. 1445(b)(3). Other exceptions also apply. Sec. 1445(b).

[973] Treas. Reg. Sec. 1.897–2(h).

[974] As described previously, stock of a U.S. corporation is not generally a USRPI unless it is stock of a USRPHC. However, all U.S. corporate stock is deemed to be such stock, unless it is shown that the corporation's U.S. real property interests do not amount to the relevant 50 percent or more of the corporation's relevant assets. Also, even if a REIT is a USRPHC, if it is domestically controlled its stock is not a USRPI.

[975] Treas. Reg. sec. 1.897–2(h)(3).

Explanation of Provision

The provision generally increases the rate of withholding of tax on dispositions and certain distributions of URSPIs, from 10 percent to 15 percent. There is an exception to this higher rate of withholding (retaining the 10 percent withholding tax rate under present law) for sales of residences intended for personal use by the acquirer, with respect to which the purchase price does not exceed $1,000,000. Thus, if the present law exception for personal residences (where the purchase price does not exceed $300,000) does not apply, the 10 percent withholding rate is retained so long as the purchase price does not exceed $1,000,000.

Effective Date

The provision applies to dispositions after the date which is 60 days after the date of enactment (December 18, 2015).

13. Interests in RICs and REITs not excluded from definition of United States real property interests (sec. 325 of the Act and sec. 897 of the Code)[976]

Present Law

An interest in a corporation is not a USRPI if (1) as of the date of disposition of such interest, such corporation did not hold any USRPIs and (2) all of the USRPIs held by such corporation during the shorter of (i) the period of time after June 18, 1980, during which the taxpayer held such interest, or (ii) the five-year period ending on the date of disposition of such interest, were either disposed of in transactions in which the full amount of the gain (if any) was recognized, or ceased to be USRPIs by reason of the application of this rule to one or more other corporations (the so-called "cleansing rule").[977]

Explanation of Provision

Under the provision, the cleansing rule applies to stock of a corporation only if neither such corporation nor any predecessor of such corporation was a RIC or a REIT at any time during the shorter of the period after June 18, 1980 during which the taxpayer held such stock, or the five-year period ending on the date of the disposition of such stock.

Effective Date

The provision applies to dispositions on or after the date of enactment (December 18, 2015).

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[976] The Senate Committee on Finance reported S.915 on April 14, 2015 (S. Rep. No. 114–25). Section 6 of that bill contained an identical provision.

[977] Sec. 897(c)(1)(B).

14. Dividends derived from RICs and REITs ineligible for deduction for United States source portion of dividends from certain foreign corporations (sec. 326 of the Act and sec. 245 of the Code)[978]

Present Law

A corporation is generally allowed to deduct a portion of the dividends it receives from another corporation. The deductible amount is a percentage of the dividends received. The percentage depends on the level of ownership that the corporate shareholder has in the corporation paying the dividend. The dividends-received deduction is 70 percent of the dividend if the recipient owns less than 20 percent of the stock of the payor corporation, 80 percent if the recipient owns at least 20 percent but less than 80 percent of the stock of the payor corporation, and 100 percent if the recipient owns 80 percent or more of the stock of the payor corporation.[979]

Dividends from REITs are not eligible for the corporate dividends received deduction.[980] Dividends from a RIC are eligible only to the extent attributable to dividends received by the RIC from certain other corporations, and are treated as dividends from a corporation that is not 20-percent owned.[981]

Dividends received from a foreign corporation are not generally eligible for the dividends-received deduction. However, section 245 provides that if a U.S. corporation is a 10-percent shareholder of a foreign corporation, the U.S. corporation is generally entitled to a dividends-received deduction for the portion of dividends received that are attributable to the post-1986 undistributed U.S. earnings of the foreign corporation. The post-1986 undistributed U.S. earnings are measured by reference to earnings of the foreign corporation effectively connected with the conduct of a trade or business within the United States, or received by the foreign corporation from an 80-percent-owned U.S. corporation.[982] A 2013 IRS chief counsel advice memorandum advised that dividends received by a 10-percent U.S. corporate shareholder from a foreign corporation controlled by the shareholder are not eligible for the dividends-received deduction if the dividends were attributable to interest income of an 80-percent owned RIC.[983] Treasury regulations section 1.246–1 states that the deductions provided in sections "243 . . . 244 . . . and 245 (relating to dividends received from certain foreign corporations)" are not allowable with respect to any dividend received from certain entities, one of which is a REIT.

[978] The Senate Committee on Finance reported S.915 on April 14, 2015 (S. Rep. No. 114–25). Section 7 of that bill contained an identical provision.

[979] Sec. 243.

[980] Secs. 243(d)(3) and 857(c)(1).

[981] Secs. 243(d)(2) and 854(b)(1)(A) and (C).

[982] Sec. 245

[983] IRS CCA 201320014. The situation addressed in the memorandum involved a controlled foreign corporation that had terminated its "CFC" status before year end, through a transfer of stock to a partnership. The advice was internal IRS advice to the Large Business and International Division. Such advice is not to be relied upon or cited as precedent by taxpayers, but may offer some indication of administrative practice.

Explanation of Provision

Under the provision, for purposes of determining whether dividends from a foreign corporation (attributable to dividends from an 80-percent owned domestic corporation) are eligible for a dividends-received deduction under section 245, dividends from RICs and REITs are not treated as dividends from domestic corporations.

Effective Date

The provision applies to dividends received from RICs and REITs on or after the date of enactment (December 18, 2015). No inference is intended with respect to the proper treatment under section 245 of dividends received from RICs or REITs before such date.

C. Additional Provisions

1. Provide special rules concerning charitable contributions to, and public charity status of, agricultural research organizations (sec. 331 of the Act and secs. 170(b) and 501(h) of the Code)[984]

Present Law

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code") is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[985] Certain organizations are classified as public charities per se, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations (including medical research organizations), certain organizations providing assistance to colleges and universities, and governmental units.[986] Other organizations qualify as public charities because they are broadly publicly supported or support specific public charities. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants or other contributions from governmental units or the general public.[987] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (*e.g.*, fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[988] A supporting organization, i.e., an organization that

[984] The Senate Committee on Finance reported S. 906 on April 14, 2015 (S. Rep. No. 114–19).

[985] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[986] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[987] Treas. Reg. sec. 1.170A–9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A–9(f)(3).

[988] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and fur-

Continued

SECTION-BY-SECTION SUMMARY OF THE PROPOSED "PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015"

TITLE I – EXTENDERS

Subtitle A –Permanent Extensions

PART 1 – Tax Relief for Families and Individuals

Section 101. Enhanced child tax credit made permanent. The child tax credit (CTC) is a $1,000 credit. To the extent the CTC exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). Until 2009, the threshold dollar amount was $10,000 indexed for inflation from 2001 (which would be roughly $14,000 in 2015). Since 2009, however, this threshold amount has been set at an unindexed $3,000 and is scheduled to expire at the end of 2017, returning to the $10,000 (indexed for inflation) amount. The provision permanently sets the threshold amount at an unindexed $3,000.

Section 102. Enhanced American opportunity tax credit made permanent. The Hope Scholarship Credit is a credit of $1,800 (indexed for inflation) for various tuition and related expenses for the first two years of post-secondary education. It phases out for AGI starting at $48,000 (if single) and $96,000 (if married filing jointly) – these amounts are also indexed for inflation. The American Opportunity Tax Credit (AOTC) takes those permanent provisions of the Hope Scholarship Credit and increases the credit to $2,500 for four years of post-secondary education, and increases the beginning of the phase-out amounts to $80,000 (single) and $160,000 (married filing jointly) for 2009 to 2017. The provision makes the AOTC permanent.

Section 103. Enhanced earned income tax credit made permanent. Low- and moderate-income workers may be eligible for the earned income tax credit (EITC). For 2009 through 2017, the EITC amount has been temporarily increased for those with three (or more) children and the EITC marriage penalty has been reduced by increasing the income phase-out range by $5,000 (indexed for inflation) for those who are married and filing jointly. The provision makes these provisions permanent.

Section 104. Extension and modification of deduction for certain expenses of elementary and secondary school teachers. The provision permanently extends the above-the-line

deduction (capped at $250) for the eligible expenses of elementary and secondary school teachers. Beginning in 2016, the provision also modifies the deduction to index the $250 cap to inflation and include professional development expenses.

Section 105. Extension of parity for exclusion from income for employer-provided mass transit and parking benefits. The provision permanently extends the maximum monthly exclusion amount for transit passes and van pool benefits so that these transportation benefits match the exclusion for qualified parking benefits. These fringe benefits are excluded from an employee's wages for payroll tax purposes and from gross income for income tax purposes.

Section 106. Extension of deduction of State and local general sales taxes. The provision permanently extends the option to claim an itemized deduction for State and local general sales taxes in lieu of an itemized deduction for State and local income taxes. The taxpayer may either deduct the actual amount of sales tax paid in the tax year, or alternatively, deduct an amount prescribed by the Internal Revenue Service (IRS).

PART 2 – Incentives for Charitable Giving

Section 111. Extension and modification of special rule for contributions of capital gain real property made for conservation purposes. The provision permanently extends the charitable deduction for contributions of real property for conservation purposes. The provision also permanently extends the enhanced deduction for certain individual and corporate farmers and ranchers. The provision modifies the deduction beginning in 2016 to permit Alaska Native Corporations to deduct donations of conservation easements up to 100 percent of taxable income.

Section 112. Extension of tax-free distributions from individual retirement plans for charitable purposes. The provision permanently extends the ability of individuals at least 70½ years of age to exclude from gross income qualified charitable distributions from Individual Retirement Accounts (IRAs). The exclusion may not exceed $100,000 per taxpayer in any tax year.

Section 113. Extension and modification of charitable deduction for contributions of food inventory. The provision permanently extends the enhanced deduction for charitable contributions of inventory of apparently wholesome food for non-corporate business taxpayers. The provision modifies the deduction beginning in 2016 by increasing the limitation on deductible contributions of food inventory from 10 percent to 15 percent of the taxpayer's AGI (15 percent of taxable income (as modified by the provision) in the case of a C corporation) per year. The provision also modifies the deduction to provide special rules for valuing food inventory.

Section 114. Extension of modification of tax treatment of certain payments to controlling exempt organizations. The provision permanently extends the modification of the tax treatment of certain payments by a controlled entity to an exempt organization.

Section 115. Extension of basis adjustment to stock of S corporations making charitable contributions of property. The provision permanently extends the rule providing that a

shareholder’s basis in the stock of an S corporation is reduced by the shareholder’s pro rata share of the adjusted basis of property contributed by the S corporation for charitable purposes.

PART 3 – Incentives for Growth, Jobs, Investment, and Innovation

Section 121. Extension and modification of research credit. The provision permanently extends the research and development (R&D) tax credit. Additionally, beginning in 2016 eligible small businesses ($50 million or less in gross receipts) may claim the credit against alternative minimum tax (AMT) liability, and the credit can be utilized by certain small businesses against the employer’s payroll tax (i.e., FICA) liability.

Section 122. Extension and modification of employer wage credit for employees who are active duty members of the uniformed services. The provision permanently extends the 20-percent employer wage credit for employees called to active military duty. Beginning in 2016, the provision modifies the credit to apply to employers of any size, rather than employers with 50 or fewer employees, as under current law.

Section 123. Extension of 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements. The provision permanently extends the 15-year recovery period for qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

Section 124. Extension and modification of increased expensing limitations and treatment of certain real property as section 179 property. The provision permanently extends the small business expensing limitation and phase-out amounts in effect from 2010 to 2014 ($500,000 and $2 million, respectively). These amounts currently are $25,000 and $200,000, respectively. The special rules that allow expensing for computer software and qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) also are permanently extended. The provision modifies the expensing limitation by indexing both the $500,000 and $2 million limits for inflation beginning in 2016 and by treating air conditioning and heating units placed in service in tax years beginning after 2015 as eligible for expensing. The provision further modifies the expensing limitation with respect to qualified real property by eliminating the $250,000 cap beginning in 2016.

Section 125. Extension of treatment of certain dividends of regulated investment companies. The provision permanently extends provisions allowing for the pass-through character of interest-related dividends and short-term capital gains dividends from regulated investment companies (RICs) to foreign investors.

Section 126. Extension of exclusion of 100 percent of gain on certain small business stock. The provision extends the temporary exclusion of 100 percent of the gain on certain small business stock for non-corporate taxpayers to stock acquired and held for more than five years. This provision also permanently extends the rule that eliminates such gain as an AMT preference item.

Section 127. Extension of reduction in S-corporation recognition period for built-in gains tax. The provision permanently extends the rule reducing to five years (rather than ten years) the period for which an S corporation must hold its assets following conversion from a C corporation to avoid the tax on built-in gains.

Section 128. Extension of subpart F exception for active financing income. The provision permanently extends the exception from subpart F income for active financing income.

PART 4 – Incentives for Real Estate Investment

Section 131. Extension of temporary minimum low-income housing tax credit rates for non-Federally subsidized buildings. The provision permanently extends application of the 9-percent minimum credit rate for the low-income housing tax credit for non-Federally subsidized new buildings.

Section 132. Extension of military housing allowance exclusion for determining whether a tenant in certain counties is low-income. The provision permanently extends the exclusion of military basic housing allowances from the calculation of income for determining eligibility as a low-income tenant for purposes of low-income housing tax credit buildings.

Section 133. Extension of RIC qualified investment entity treatment under FIRPTA. The provision permanently extends the treatment of RICs as qualified investment entities and, therefore, not subject to withholding under the Foreign Investment in Real Property Tax Act (FIRPTA).

Subtitle B – Extensions through 2019

Section 141. Extension of new markets tax credit. The provision authorizes the allocation of $3.5 billion of new markets tax credits for each year from 2015 through 2019.

Section 142. Extension and modification of work opportunity tax credit. The provision extends through 2019 the work opportunity tax credit. The provision also modifies the credit beginning in 2016 to apply to employers who hire qualified long-term unemployed individuals (i.e., those who have been unemployed for 27 weeks or more) and increases the credit with respect to such long-term unemployed individuals to 40 percent of the first $6,000 of wages.

Section 143. Extension and modification of bonus depreciation. The provision extends bonus depreciation for property acquired and placed in service during 2015 through 2019 (with an additional year for certain property with a longer production period). The bonus depreciation percentage is 50 percent for property placed in service during 2015, 2016 and 2017 and phases down, with 40 percent in 2018, and 30 percent in 2019. The provision continues to allow taxpayers to elect to accelerate the use of AMT credits in lieu of bonus depreciation under special rules for property placed in service during 2015. The provision modifies the AMT rules beginning in 2016 by increasing the amount of unused AMT credits that may be claimed in lieu of bonus depreciation. The provision also modifies bonus depreciation to include qualified

improvement property and to permit certain trees, vines, and plants bearing fruit or nuts to be eligible for bonus depreciation when planted or grafted, rather than when placed in service.

Section 144. Extension of look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules. The provision extends through 2019 the look-through treatment for payments of dividends, interest, rents, and royalties between related controlled foreign corporations.

Subtitle C – Extensions through 2016

PART 1 – Tax Relief for Families and Individuals

Section 151. Extension and modification of exclusion from gross income of discharge of qualified principal residence indebtedness. The provision extends through 2016 the exclusion from gross income of a discharge of qualified principal residence indebtedness. The provision also modifies the exclusion to apply to qualified principal residence indebtedness that is discharged in 2017, if the discharge is pursuant to a written agreement entered into in 2016.

Section 152. Extension of mortgage insurance premiums treated as qualified residence interest. The provision extends through 2016 the treatment of qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction. This deduction phases out ratably for a taxpayer with AGI of $100,000 to $110,000.

Section 153. Extension of above-the-line deduction for qualified tuition and related expenses. The provision extends through 2016 the above-the-line deduction for qualified tuition and related expenses for higher education. The deduction is capped at $4,000 for an individual whose AGI does not exceed $65,000 ($130,000 for joint filers) or $2,000 for an individual whose AGI does not exceed $80,000 ($160,000 for joint filers).

PART 2 – Incentives for Growth, Jobs, Investment, and Innovation

Section 161. Extension of Indian employment tax credit. The provision extends through 2016 the Indian employment tax credit. The Indian employment credit provides a credit on the first $20,000 of qualified wages paid to each qualified employee who works on an Indian reservation.

Section 162. Extension and modification of railroad track maintenance credit. The provision extends through 2016 the railroad track maintenance tax credit. The provision modifies the credit to apply to expenditures for maintaining railroad track owned or leased as of January 1, 2015 (rather than January 1, 2005, as under current law).

Section 163. Extension of mine rescue team training credit. The provision extends through 2016 the mine rescue team training tax credit. Employers may take a credit equal to the lesser of 20 percent of the training program costs incurred, or $10,000.

Section 164. Extension of qualified zone academy bonds. The provision authorizes the issuance of $400 million of qualified zone academy bonds during 2016. The bond proceeds are used for school renovations, equipment, teacher training, and course materials at a qualified zone academy, provided that private entities have promised to donate certain property and services to the academy with a value equal to at least 10 percent of the bond proceeds.

Section 165. Extension of classification of certain race horses as 3-year property. The provision extends the 3-year recovery period for race horses to property placed in service during 2015 or 2016.

Section 166. Extension of 7-year recovery period for motorsports entertainment complexes. The provision extends the 7-year recovery period for motorsport entertainment complexes to property placed in service during 2015 or 2016.

Section 167. Extension and modification of accelerated depreciation for business property on an Indian reservation. The provision extends accelerated depreciation for qualified Indian reservation property to property placed in service during 2015 or 2016. The provision also modifies the deduction to permit taxpayers to elect out of the accelerated depreciation rules.

Section 168. Extension of election to expense mine safety equipment. The provision extends the election to expense mine safety equipment to property placed in service during 2015 or 2016.

Section 169. Extension of special expensing rules for certain film and television productions. The provision extends through 2016 the special expensing provision for qualified film, television, and live theater productions. In general, only the first $15 million of costs may be expensed.

Section 170. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico. The provision extends through 2016 the eligibility of domestic gross receipts from Puerto Rico for the domestic production deduction.

Section 171. Extension and modification of empowerment zone tax incentives. The provision extends through 2016 the tax benefits for certain businesses and employers operating in empowerment zones. Empowerment zones are economically distressed areas, and the tax benefits available include tax-exempt bonds, employment credits, increased expensing, and gain exclusion from the sale of certain small-business stock. The provision modifies the incentive beginning in 2016 by allowing employees to meet the enterprise zone facility bond employment requirement if they are residents of the empowerment zone, an enterprise community, or a qualified low-income community within an applicable nominating jurisdiction.

Section 172. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands. The provision extends the $13.25 per proof gallon excise tax cover-over amount paid to the treasuries of Puerto Rico and the U.S. Virgin Islands to rum imported into the United States during 2015 or 2016. Absent the extension, the cover-over amount would be $10.50 per proof gallon.

Section 173. Extension of American Samoa economic development credit. The provision extends through 2016 the existing credit for taxpayers currently operating in American Samoa.

Section 174. Moratorium on medical device excise tax. The provision provides for a two-year moratorium on the 2.3-percent excise tax imposed on the sale of medical devices. The tax will not apply to sales during calendar years 2016 and 2017.

PART 3 – Incentives for Energy Production and Conservation

Section 181. Extension and modification of credit for nonbusiness energy property. The provision extends through 2016 the credit for purchases of nonbusiness energy property. The provision allows a credit of 10 percent of the amount paid or incurred by the taxpayer for qualified energy improvements, up to $500.

Section 182. Extension of credit for alternative fuel vehicle refueling property. The provision extends through 2016 the credit for the installation of non-hydrogen alternative fuel vehicle refueling property. (Under current law, hydrogen-related property is eligible for the credit through 2016.) Taxpayers are allowed a credit of up to 30 percent of the cost of the installation of the qualified alternative fuel vehicle refueling property.

Section 183. Extension of credit for 2-wheeled plug-in electric vehicles. The provision extends through 2016 the 10-percent credit for plug-in electric motorcycles and 2-wheeled vehicles (capped at $2,500).

Section 184. Extension of second generation biofuel producer credit. The provision extends through 2016 the credit for cellulosic biofuels producers.

Section 185. Extension of biodiesel and renewable diesel incentives. The provision extends through 2016 the existing $1.00 per gallon tax credit for biodiesel and biodiesel mixtures, and the small agri-biodiesel producer credit of 10 cents per gallon. The provision also extends through 2016 the $1.00 per gallon production tax credit for diesel fuel created from biomass. The provision extends through 2016 the fuel excise tax credit for biodiesel mixtures.

Section 186. Extension and modification of production credit for Indian coal facilities. The provision extends through 2016 the $2 per ton production tax credit for coal produced on land owned by an Indian tribe, if the facility was placed in service before 2009. A coal facility is allowed only nine years of credit. The provision modifies the credit beginning in 2016 by removing the placed-in-service-date limitation, removing the nine-year limitation, and allowing the credit to be claimed against the AMT.

Section 187. Extension and modification of credits with respect to facilities producing energy from certain renewable resources. The provision extends the production tax credit for certain renewable sources of electricity to facilities for which construction has commenced by the end of 2016.

Section 188. Extension of credit for energy-efficient new homes. The provision extends through 2016 the tax credit for manufacturers of energy-efficient residential homes. An eligible contractor may claim a tax credit of $1,000 or $2,000 for the construction or manufacture of a new energy efficient home that meets qualifying criteria.

Section 189. Extension of special allowance for second generation biofuel plant property. The provision extends through 2016 the 50-percent bonus depreciation for cellulosic biofuel facilities.

Section 190. Extension of energy efficient commercial buildings deduction. The provision extends through 2016 the above-the-line deduction for energy efficiency improvements to lighting, heating, cooling, ventilation, and hot water systems of commercial buildings.

Section 191. Extension of special rule for sales or dispositions to implement FERC or State electric restructuring policy for qualified electric utilities. The provision extends through 2016 a rule that permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale (rather than entirely in the year of sale) if the amount realized from such sale is used to purchase exempt utility property within the applicable period.

Section 192. Extension of excise tax credits relating to alternative fuels. The provision extends through 2016 the 50 cents per gallon alternative fuel tax credit and alternative fuel mixture tax credit.

Section 193. Extension of credit for new qualified fuel cell motor vehicles. The provision extends through 2016 the credit for purchases of new qualified fuel cell motor vehicles. The provision allows a credit of between $4,000 and $40,000 depending on the weight of the vehicle for the purchase of such vehicles.

TITLE II – PROGRAM INTEGRITY

Section 201. Modification of filing dates of returns and statements relating to employee wage information and nonemployee compensation to improve compliance. The provision requires forms W-2, W-3, and returns or statements to report non-employee compensation (e.g., Form 1099-MISC), to be filed on or before January 31 of the year following the calendar year to which such returns relate. The provision also provides additional time for the IRS to review refund claims based on the earned income tax credit and the refundable portion of the child tax credit in order to reduce fraud and improper payments. The provision is effective for returns and statements relating to calendar years after the date of enactment (e.g., filed in 2017).

Section 202. Safe harbor for de minimis errors on information returns and payee statements. The provision establishes a safe harbor from penalties for the failure to file correct information returns and for failure to furnish correct payee statements by providing that if the error is $100 or less ($25 or less in the case of errors involving tax withholding), the issuer of the information return is not required to file a corrected return and no penalty is imposed. A recipient of such a return (e.g., an employee who receives a Form W-2) can elect to have a

corrected return issued to them and filed with the IRS. The provision is effective for returns and statements required to be filed after December 31, 2016.

Section 203. Requirements for the issuance of ITINs. The provision provides that the IRS may issue taxpayer identification numbers (ITIN) if the applicant provides the documentation required by the IRS either (a) in person to an IRS employee or to a community-based certified acceptance agent (as authorized by the IRS), or (b) by mail. The provision requires that individuals who were issued ITINs before 2013 are required to renew their ITINs on a staggered schedule between 2017 and 2020. The provision also provides that an ITIN will expire if an individual fails to file a tax return for three consecutive years. The provision also directs the Treasury Department and IRS to study the current procedures for issuing ITINs with a goal of adopting a system by 2020 that would require all applications to be filed in person. The provision is effective for requests for ITINs made after the date of enactment.

Section 204. Prevention of retroactive claims of earned income credit after issuance of social security number. The provision prohibits an individual from retroactively claiming the earned income tax credit by amending a return (or filing an original return if he failed to file) for any prior year in which he did not have a valid social security number. The provision applies to returns, and any amendment or supplement to a return, filed after the date of enactment.

Section 205. Prevention of retroactive claims of child tax credit. The provision prohibits an individual from retroactively claiming the child tax credit by amending a return (or filing an original return if he failed to file) for any prior year in which the individual or a qualifying child for whom the credit is claimed did not have an ITIN. The provision applies to returns, and any amendment or supplement to a return, filed after the date of enactment.

Section 206. Prevention of retroactive claims of American opportunity tax credit. The provision prohibits an individual from retroactively claiming the American Opportunity Tax Credit by amending a return (or filing an original return if he failed to file) for any prior year in which the individual or a student for whom the credit is claimed did not have an ITIN. The provision applies to returns, and any amendment or supplement to a return, filed after the date of enactment.

Section 207. Procedures to reduce improper claims. The provision expands the paid-preparer due diligence requirements with respect to the earned income tax credit, and the associated $500 penalty for failures to comply, to cover returns claiming the child tax credit and American Opportunity Tax Credit. The provision also requires the IRS to study the effectiveness of the due diligence requirements and whether such requirements should apply to taxpayer who file online or by filing a paper form. The provision applies to tax years beginning after December 31, 2015.

Section 208. Restrictions on taxpayers who improperly claimed credits in prior year. The provision expands the rules under current law, which bar individuals from claiming the earned income tax credit for ten year if they are convicted of fraud and for two years if they are found to have recklessly or intentionally disregarded the rules, to apply to the child tax credit and American Opportunity Tax Credit. The provision adds math error authority, which permits the

IRS to disallow improper credits without a formal audit if the taxpayer claims the credit in a period during which he is barred from doing so due to fraud or reckless or intentional disregard. The provision applies to tax years beginning after December 31, 2015.

Section 209. Treatment of credits for purposes of certain penalties. The provision applies the 20-percent penalty for erroneous claims under current law to the refundable portion of credits (reversing the Tax Court decision in *Rand v. Commissioner*). The provision also eliminates the exception from the penalty for erroneous refunds and credits that currently applies to the earned income tax credit, and the provision provides reasonable-cause relief from the penalty. The provision generally applies to returns filed after December 31, 2015.

Section 210. Increase the penalty applicable to paid tax preparers who engage in willful or reckless conduct. The provision expands the penalty for tax preparers who engage in willful or reckless conduct, which is currently the greater of $5,000 or 50 percent of the preparer's income with respect to the return, by increasing the 50 percent amount to 75 percent. The provision applies to returns prepared for tax years ending after the date of enactment.

Section 211. Employer identification number required for American opportunity tax credit. The provision requires a taxpayer claiming the American opportunity tax credit to report the employer identification number (EIN) of the educational institution to which the taxpayer makes qualified payments under the credit. The provision applies to tax years beginning after December 31, 2015, and expenses paid after such date for education furnished in academic periods beginning after such date.

Section 212. Higher education information reporting only to include qualified tuition and related expenses actually paid. The provision reforms the reporting requirements for Form 1098-T so that educational institutions are required to report only qualified tuition and related expenses actually paid, rather than choosing between amounts paid and amounts billed, as under current law. The provision applies to expenses paid after December 31, 2015 for education furnished in academic periods beginning after such date.

TITLE III – MISCELLANEOUS PROVISIONS

Subtitle A – Family Tax Relief

Section 301. Exclusion for amounts received under the Work Colleges Program. The provision exempts from gross income any payments from certain work-learning-service programs that are operated by a work college as defined in section 448(e) of the Higher Education Act of 1965. The provision is effective for amounts received in tax years beginning after date of enactment.

Section 302. Improvements to section 529 accounts. The provision expands the definition of qualified higher education expenses for which tax-preferred distributions from 529 accounts are eligible to include computer equipment and technology. The provision modifies 529-account rules to treat any distribution from a 529 account as coming only from that account, even if the

individual making the distribution operates more than one account. The provision treats a refund of tuition paid with amounts distributed from a 529 account as a qualified expense if such amounts are re-contributed to a 529 account within 60 days. The provision is effective for distributions made or refunds after 2014, or in the case of refunds after 2014 and before the date of enactment, for refunds re-contributed not later than 60 days after date of enactment.

Section 303. Elimination of residency requirement for qualified ABLE programs. The provision allows ABLE accounts (tax-preferred savings accounts for disabled individuals), which currently may be located only in the State of residence of the beneficiary, to be established in any State. This will allow individuals setting up ABLE accounts to choose the State program that best fits their needs, such as with regard to investment options, fees, and account limits. The provision is effective for tax years beginning after December 31, 2014

Section 304. Exclusion for wrongfully incarcerated individuals. The provision allows an individual to exclude from gross income civil damages, restitution, or other monetary awards that the taxpayer received as compensation for a wrongful incarceration. A "wrongfully incarcerated individual" is either: (1) an individual who was convicted of a criminal offense under Federal or state law, who served all or part of a sentence of imprisonment relating to such offense, and who was pardoned, granted clemency, or granted amnesty because of actual innocence of the offense; or (2) an individual for whom the conviction for such offense was reversed or vacated and for whom the indictment, information, or other accusatory instrument for such offense was dismissed or who was found not guilty at a new trial after the conviction was reversed or vacated. The provision applies to tax years beginning before, on, or after the date of enactment.

Section 305. Clarification of special rule for certain governmental plans. The provision extends the special rule under current law for certain benefits paid by accident or health plans of a public retirement system to such benefits paid by plans established by or on behalf of a State or political subdivision. To qualify, such plans must have been authorized by a State legislature or received a favorable ruling from the IRS that the trust's income is not includible in gross income under either section 115 or section 501(c)(9) of the tax code, and on or before January 1, 2008, have provided for payment of medical benefits to a deceased participant's beneficiary. The provision is effective for payments after the date of enactment.

Section 306. Rollovers permitted from other retirement plans into simple retirement accounts. The provision allows a taxpayer to roll over amounts from an employer-sponsored retirement plan (e.g., 401(k) plan) to a SIMPLE IRA, provided the plan has existed for at least two years. The provision applies to contributions made after the date of enactment.

Section 307. Technical amendment relating to rollover of certain airline payment amounts. The provision clarifies the effective dates of Public Law 113-243 to allow certain airline employees to contribute amounts received in certain bankruptcies to an IRA without being subject to the annual contribution limit. The provision is effective as if included in Public Law 113-243.

Section 308. Treatment of early retirement distributions for nuclear materials couriers, United States Capitol Police, Supreme Court Police, and diplomatic security special agents. The provision extends the relief under current law, which provides an exception to the 10-percent penalty on withdrawals from retirement accounts before age 50 for public safety officer, to include nuclear materials couriers, United States Capitol Police, Supreme Court Police, and diplomatic security special agents. The provision is effective for distributions after December 31, 2015.

Section 309. Prevention of extension of tax collection period for members of the Armed Forces who are hospitalized as a result of combat zone injuries. The provision requires that the collection period for members of the Armed Forces hospitalized for combat zone injuries may not be extended by reason of any period of continuous hospitalization or the 180 days after hospitalization. Accordingly, the collection period expires 10 years after assessment, plus the actual time spent in a combat zone. The provision applies to taxes assessed before, on, or after the date of the enactment.

Subtitle B– Real Estate Investment Trusts

Section 311. Restriction on tax-free spinoffs involving REITs. The provision provides that a spin-off involving a REIT will qualify as tax-free only if immediately after the distribution both the distributing and controlled corporation are REITs. In addition, neither a distributing nor a controlled corporation would be permitted to elect to be treated as a REIT for ten years following a tax-free spin-off transaction. The provision applies to distributions on or after December 7, 2015, but shall not apply to any distribution pursuant to a transaction described in a ruling request initially submitted to the IRS on or before such date, which request has not been withdrawn and with respect to which a ruling has not been issued or denied in its entirety as of such date.

Section 312. Reduction in percentage limitation on assets of REIT which may be taxable REIT subsidiaries. The provision modifies the rules with respect to a REIT's ownership of a taxable REIT subsidiary (TRS), which is taxed as a corporation. Under the provision, the securities of one or more TRSs held by a REIT may not represent more than 20 percent (rather than 25 percent under current law) of the value of the REIT's assets. The provision is effective for tax years beginning after 2017.

Section 313. Prohibited transaction safe harbors. The provision provides for an alternative three-year averaging safe harbor for determining the percentage of assets that a REIT may sell annually. In addition, the provision clarifies that the safe harbor is applied independent of whether the real estate asset is inventory property. The provision generally is effective for tax years beginning after the date of enactment. However, the clarification of the safe harbor takes effect as if included in the Housing Assistance Tax Act of 2008.

Section 314. Repeal of preferential dividend rule for publicly offered REITs. The provision repeals the preferential dividend rule for publicly offered REITs. The provision is effective for distributions in tax years beginning after 2014.

Section 315. Authority for alternative remedies to address certain REIT distribution failures. The provision provides the IRS with authority to provide an appropriate remedy for a preferential dividend distribution by non-publicly offered REITs in lieu of treating the dividend as not qualifying for the REIT dividend deduction and not counting toward satisfying the requirement that REITs distribute 90 percent of their income every year. Such authority applies if the preferential distribution is inadvertent or due to reasonable cause and not due to willful neglect. The provision applies to distributions in tax years beginning after 2015.

Section 316. Limitations on designation of dividends by REITs. The provision provides that the aggregate amount of dividends that could be designated by a REIT as qualified dividends or capital gain dividends will not exceed the dividends actually paid by the REIT. The provision is effective for distributions in tax years beginning after 2014.

Section 317. Debt instruments of publicly offered REITs and mortgages treated as real estate assets. The provision provides that debt instruments issued by publicly offered REITs, as well as interests in mortgages on interests in real property, are treated as real estate assets for purposes of the 75-percent asset test. Income from debt instruments issued by publicly offered REITs are treated as qualified income for purposes of the 95-percent income test, but not the 75-percent income test (unless they already are treated as qualified income under current law). In addition, not more than 25 percent of the value of a REIT's assets is permitted to consist of such debt instruments. The provision is effective for tax years beginning after 2015.

Section 318. Asset and income test clarification regarding ancillary personal property. The provision provides that certain ancillary personal property that is leased with real property is treated as real property for purposes of the 75-percent asset test. In addition, an obligation secured by a mortgage on such property is treated as real property for purposes of the 75-percent income and asset tests, provided the fair market value of the personal property does not exceed 15 percent of the total fair market value of the combined real and personal property. The provision is effective for tax years beginning after 2015.

Section 319. Hedging provisions. The provision expands the treatment of REIT hedges to include income from hedges of previously acquired hedges that a REIT entered to manage risk associated with liabilities or property that have been extinguished or disposed. The provision is effective for tax years beginning after 2015.

Section 320. Modification of REIT earnings and profits calculation to avoid duplicate taxation. The provision provides that current (but not accumulated) REIT earnings and profits for any tax year are not reduced by any amount that is not allowable in computing taxable income for the tax year and was not allowable in computing its taxable income for any prior tax year (e.g., certain amounts resulting from differences in the applicable depreciation rules). The provision applies only for purposes of determining whether REIT shareholders are taxed as receiving a REIT dividend or as receiving a return of capital (or capital gain if a distribution exceeds a shareholder's stock basis). The provision is effective for tax years beginning after 2015.

Section 321. Treatment of certain services provided by taxable REIT subsidiaries. The provision provides that a taxable REIT subsidiary (TRS) is permitted to provide certain services to the REIT, such as marketing, that typically are done by a third party. In addition, a TRS is permitted to develop and market REIT real property without subjecting the REIT to the 100-percent prohibited transactions tax. The provision also expands the 100-percent excise tax on non-arm's length transactions to include services provided by the TRS to its parent REIT. The provision is effective for tax years beginning after 2015.

Section 322. Exception from FIRPTA for certain stock of REITs. The provision increases from 5 percent to 10 percent the maximum stock ownership a shareholder may have held in a publicly traded corporation to avoid having that stock treated as a U.S. real property interest on disposition. In addition, the provision allows certain publicly traded entities to own and dispose of any amount of stock treated as a U.S. real property interest, including stock in a REIT, without triggering FIRPTA withholding. However, an investor in such an entity that holds more than 10 percent of such stock is still subject to withholding. The provision applies to dispositions and distributions on or after the date of enactment.

Section 323. Exception for interests held by foreign retirement or pension funds. The provision exempts any U.S. real property interest held by a foreign pension fund from FIRPTA withholding. The provision applies to dispositions and distributions after the date of enactment.

Section 324. Increase in rate of withholding of tax on dispositions of United States real property interests. The provision provides that the rate of withholding on dispositions of United States real property interests is increased from 10 percent to 15 percent. The increased rate of withholding, however, does not apply to the sale of a personal residence where the amount realized is $1 million or less. The provision is effective for dispositions occurring 60 days after the date of enactment.

Section 325. Interests in RICs and REITs not excluded from definition of United States real property interests. The provision provides that the "cleansing rule" (which applies to corporations that either have no real estate or have paid tax on their real-estate transactions) applies only to interests in a corporation that is not a qualified investment entity. In addition, the proposal provides that the cleansing rule applies to stock of a corporation only if neither the corporation nor any predecessor of such corporation was a regulated investment company (RIC) or REIT at any time during the shorter of (a) the period after June 18, 1980 during which the taxpayer held such stock, or (b) the five-year period ending on the date of the disposition of the stock. The provision applies to dispositions on or after the date of enactment.

Section 326. Dividends derived from RICs and REITs ineligible for deduction for United States source portion of dividends from certain foreign corporations. The provision provides that for purposes of determining whether dividends from a foreign corporation (attributable to dividends from an 80-percent owned domestic corporation) are eligible for a dividend received deduction, dividends from RICs and REITs are not treated as dividends from domestic corporations, even if the RIC or REIT owns shares in a foreign corporation. The provision applies to dividends received from RIC and REITs on or after the date of enactment of this Act.

Subtitle C – Additional Provisions

Section 331. Deductibility of charitable contributions to agricultural research organizations. The provision provides that charitable contributions to an agricultural research organization are subject to the higher individual limits (generally up to 50 percent of the taxpayer's contribution base) if the organization commits to use the contribution for agricultural research before January 1 of the fifth calendar year that begins after the date of the contribution. In addition, agricultural research organizations are treated as public charities *per se*, without regard to their sources of financial support. The provision is effective for contributions made on or after the date of enactment.

Section 332. Removal of bond requirements and extending filing periods for certain taxpayers with limited excise tax liability. The provision allows producers of alcohol that reasonably expect to be liable for not more than $50,000 per year in alcohol excise taxes to pay such taxes on a quarterly basis rather than twice per month (and those reasonably expecting to be liable for not more than $1,000 per year to pay such taxes annually, rather than on a quarterly basis). The provision also exempts such producers from bonding requirements with the IRS. The provision is effective 90 days after the date of enactment.

Section 333. Modifications to alternative tax for certain small insurance companies. The provision increases the maximum amount of annual premiums that certain small property and casualty insurance companies can receive and still elect to be exempt from tax on their underwriting income, and instead be taxed only on taxable investment income. The provision increases the maximum amount from $1.2 million to $2.2 million for calendar years beginning after 2015, and indexes it to inflation thereafter. To ensure that this special rule is not abused, the provision also requires that no more than 20 percent of net written premiums (or if greater, direct written premiums) for a tax year is attributable to any one policyholder. Alternatively, a company would be eligible for the exception if each owner of the insured business or assets has no greater an interest in the insurer than he or she has in the business or assets, and each owner holds no smaller an interest in the business than his or her interest in the insurer. The provision is effective for tax years beginning after 2016.

Section 334. Treatment of timber gains. The provision provides that C corporation timber gains are subject to a tax rate of 23.8 percent. The provision is effective for tax year 2016.

Section 335. Modification of definition of hard cider. The provision defines hard cider for purposes of alcohol excise taxes as a wine with an alcohol content of between 0.5 percent and 8.5 percent alcohol by volume, with a carbonation level that does not exceed 6.4 grams per liter, which is derived primarily from apples, apple juice concentrate, pears, or pear juice concentrate, in combination with water. The provision is effective for articles removed from the distillery or bonding facility during calendar years beginning after 2015.

Section 336. Church Plan Clarification. The provision prevents the IRS from aggregating certain church plans together for purposes of the non-discrimination rules, which prevent highly compensated participants from receiving disproportionate benefits under the plan, and it provides

flexibility for church plans to decide which other church plans with which they associate. The provision also prevents certain grandfathered church defined-benefit plans from having to meet certain requirements relating to maximum benefit accruals, and it allows church plans to offer auto-enroll accounts similar to 401(k)s. Additionally, the provision make it easier for church plans to engage in certain reorganizations and allows church plans to invest in collective trusts. The provision generally is effective on or after the date of enactment.

Subtitle D – Revenue Provisions

Section 341. Updated ASHRAE standards for energy efficient commercial buildings deduction. The provision modifies the deduction for energy efficient commercial buildings by updating the energy efficiency standards to reflect new standards of the American Society of Heating, Refrigerating, and Air Conditioning Engineers beginning in 2016.

Section 342. Excise tax credit equivalency for liquefied petroleum gas and liquefied natural gas. The provision converts the measurement of the alternative fuel excise tax credit for liquefied natural gas and liquefied petroleum gas from 50 cents per gallon to 50 cents per energy equivalent of a gallon of diesel fuel, which is approximately 29 cents per gallon for liquefied natural gas and approximately 36 cents per gallon for liquefied petroleum gas. The provision is effective for fuel sold or used after 2015.

Section 343. Exclusion from gross income of certain clean coal power grants to non-corporate taxpayers. The provision excludes from gross income certain clean power grants received under the Energy Policy Act of 2005 by an eligible taxpayer that is not a corporation. The provision requires an eligible taxpayer to reduce the basis of tangible depreciable property related to such grants by the amount excluded. The provision requires eligible taxpayers to make payments to the Treasury equal to 1.18 percent of amounts excluded under the provision. The provision is effective for grants received in tax years after 2011.

Section 344. Clarification of valuation rule for early termination of certain charitable remainder unitrusts. The provision clarifies the valuation method for the early termination of certain charitable remainder unitrusts. The provision is effective for the termination of trusts after the date of enactment.

Section 345. Prevention of transfer of certain losses from tax indifferent parties. The provision modifies the related-party loss rules, which generally disallow a deduction for a loss on the sale or exchange of property to certain related parties or controlled partnerships, to prevent losses from being shifted from a tax-indifferent party (e.g., a foreign person not subject to U.S. tax) to another party in whose hands any gain or loss with respect to the property would be subject to U.S. tax. The provision generally is effective for sales and exchanges of property acquired after 2015.

Section 346. Treatment of certain persons as employers with respect to motion picture projects. The provision allows motion picture payroll services companies to be treated as the employer of their film and television production workers for Federal employment tax purposes. The provision is effective for remuneration paid after 2015.

TITLE IV – TAX ADMINISTRATION

Subtitle A – Internal Revenue Service Reforms

Section 401. Duty to ensure that IRS employees are familiar with and act in accord with certain taxpayer rights. The provision amends the tax code to require the IRS Commissioner to ensure that IRS employees are familiar with and act in accordance with the taxpayer bill of rights, which includes the right to:

1. be informed;
2. quality service;
3. pay no more than the correct amount of tax;
4. challenge the position of the IRS and be heard;
5. appeal a decision of the IRS in an independent forum;
6. finality;
7. privacy;
8. confidentiality;
9. retain representation;
10. a fair and just tax system.

The provision is effective on the date of enactment.

Section 402. IRS employees prohibited from using personal email accounts for official business. The provision prohibits employees of the IRS from using a personal email account to conduct any official business, codifying an already established agency policy barring use of personal email accounts by IRS employees for official governmental business. The provision is effective on the date of enactment.

Section 403. Release of information regarding the status of certain investigations. The provision allows taxpayers who have been victimized by the IRS, for example, through the unauthorized disclosure of private tax information, to find out basic facts, such as whether the case is being investigated or whether the case has been referred to the Justice Department for prosecution. The provision applies to disclosures made on or after the date of enactment.

Section 404. Administrative appeal relating to adverse determinations of tax-exempt status of certain organizations. The provision requires the IRS to create procedures under which a 501(c) organization facing an adverse determination may request administrative appeal to the IRS Office of Appeals. This includes determinations relating to the initial or continuing classification of (1) an organization as tax-exempt under section 501(a); (2) an organization under section 170(c)(2); (3) a private foundation under section 509(a); or (4) a private operating foundation under section 4942(j)(3). The provision applies to determinations made after May 19, 2014.

Section 405. Organizations required to notify Secretary of intent to operate under 501(c)(4). The provision provides for a streamlined recognition process for organizations seeking tax exemption under section 501(c)(4). The process requires 501(c)(4) organizations to file is a simple one-page notice of registration with the IRS within 60 days of the organization's formation. The current, voluntary 501(c)(4) application process will be eliminated. Within 60

days after an application is submitted, the IRS is required to provide a letter of acknowledgement of the registration, which the organization can use to demonstrate its exempt status, typically with state and local tax authorities.

Section 406. Declaratory judgments for 501(c)(4) and other exempt organizations. The provision permits 501(c)(4) organizations and other exempt organizations to seek review in Federal court of any revocation of exempt status by the IRS. The provision applies to pleadings filed after the date of enactment.

Section 407. Termination of employment of Internal Revenue Service employees for taking official actions for political purposes. The provision makes clear that taking official action for political purposes is an offense for which the employee should be terminated. The bill amends the Internal Revenue Service Restructuring and Reform Act of 1998 to expand the grounds for termination of employment of an IRS employee to include performing, delaying, or failing to perform any official action (including an audit) by an IRS employee for the purpose of extracting personal gain or benefit for a political purpose. The provision takes effect on the date of enactment.

Section 408. Gift tax not to apply to contributions to certain exempt organizations. The provision treats transfers to organizations exempt from tax under section 501(c)(4), (c)(5), and (c)(6) of the tax code as exempt from the gift tax. The provision applies to transfers made after the date of enactment.

Section 409. Extend Internal Revenue Service authority to require truncated Social Security numbers on Form W-2. The provision requires employers to include an "identifying number" for each employee, rather than an employee's SSN, on Form W-2. This change will permit the Department of the Treasury to promulgate regulations requiring or permitting a truncated SSN on Form W-2. The provision is effective on the date of enactment.

Section 410. Clarification of enrolled agent credentials. The provision permits enrolled agents approved by the IRS to use the designation "enrolled agent," "EA," or "E.A." The provision is effective on the date of enactment.

Section 411. Partnership audit rules. The provision corrects and clarifies certain technical issues in the partnership audit rules enacted in the Bipartisan Budget Act of 2015.

Subtitle B – United States Tax Court

PART 1 – Taxpayer Access to United States Tax Court

Section 421. Filing period for interest abatement cases. The provision permits a taxpayer to seek review by the Tax Court of a claim for interest abatement when the IRS has failed to issue a final determination. The provision applies to claims for interest abatement filed after the date of enactment.

Section 422. Small tax case election for interest abatement cases. The provision expands the current-law procedures for the Tax Court to consider small tax cases (i.e., cases with amount in dispute that are under $50,000) to include the review of IRS decisions not to abate interest, provided the amount of interest for which abatement is sought does not exceed $50,000. The provision applies to cases pending and cases commenced after the date of enactment.

Section 423. Venue for appeal of spousal relief and collection cases. The provision clarifies that Tax Court decisions in cases involving spousal relief and collection cases are appealable to the U.S. Court of Appeals for the circuit in which an individual's legal residence is located or in which a business' principal place of business or principal office of agency is located. The provision applies to Tax Court petitions filed after the date of enactment.

Section 424. Suspension of running of period for filing petition of spousal relief and collection cases. The provision suspends the statute of limitations in cases involving spousal relief or collections when a bankruptcy petition has been filed and a taxpayer is prohibited from filing a petition for review by the Tax Court. Under the provision, the suspension is for the period during which the taxpayer is prohibited from filing such a petition, plus 60 days. The provision applies to Tax Court petitions filed after the date of enactment.

Section 425. Application of Federal rules of evidence. The provision requires the Tax Court to conduct its proceedings in accordance with the Federal Rules of Evidence (rather than the rules of evidentiary rules applied by the United States District Court of the District of Columbia, as under current law). The provision applies to proceedings commenced after the date of enactment.

PART 2 – United States Tax Court Administration

Section 431. Judicial conduct and disability procedures. The provision authorizes the Tax Court to establish procedures for the filing of complaints with respect to the conduct of any judge or special trial judge of the Tax Court and for the investigation and resolution of such complaints. The provision applies to proceedings commenced 180 days after the date of enactment.

Section 432. Administration, judicial conference, and fees. The provision extends to the Tax Court the same general management, administrative, and expenditure authorities that are available to Article III courts and the Court of Appeals for Veterans Claims. The provision also permits the Tax Court to conduct an annual judicial conference and charge reasonable registration fees. Additionally, the provision authorizes the Tax Court to deposit certain fees into a special fund held by the Treasury Department, with such funds available for the operation and maintenance of the Tax Court. The provision is effective on the date of enactment.

PART 3 – Clarification Relating to United States Tax Court

Section 441. Clarification relating to United States Tax Court. The provision clarifies that the Tax Court is not an agency of, and shall be independent of, the Executive Branch. The provision is effective upon the date of enactment.

TITLE V – TRADE-RELATED PROVISIONS

Section 501. Modification of effective date of provisions relating to tariff classification of recreational performance outer wear. The provision delays implementation of changes in the classification of certain recreation performance outerwear products that would inadvertently increase tariffs on some of those products.

Section 502. Agreement by Asia-Pacific Economic Co-operation members to reduce rates of duty on certain environmental goods. The provision ensures that the reduction of tariffs on certain environmental goods to fulfill an agreement by members of the Asia-Pacific Economic Cooperation (APEC) forum is implemented in accordance with the Trade Priorities and Accountability Act of 2015.

TITLE VI –BUDGETARY EFFECTS

Section 601. Budgetary effects. The provision provides for the bill’s treatment for PAYGO purposes.