

104TH CONGRESS
1ST SESSION

H. R. 2121

To amend the Internal Revenue Code of 1986 to simplify certain provisions applicable to real estate investment trusts.

IN THE HOUSE OF REPRESENTATIVES

JULY 26, 1995

Mr. SHAW (for himself, Mr. MATSUI, Mr. CRANE, Mr. THOMAS, Mrs. JOHNSON of Connecticut, Mr. ZIMMER, Mr. PORTMAN, Mr. STARK, Mr. JACOBS, Mr. LEVIN, Mr. CARDIN, and Ms. DUNN of Washington) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to simplify certain provisions applicable to real estate investment trusts.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Real Estate Investment Trust Tax Simplification Act of
6 1995”.

7 (b) AMENDMENT OF 1986 CODE.—Except as other-
8 wise expressly provided, whenever in this Act an amend-
9 ment or repeal is expressed in terms of an amendment

1 to, or repeal of, a section or other provision, the reference
2 shall be considered to be made to a section or other provi-
3 sion of the Internal Revenue Code of 1986.

4 **TITLE I—REMOVAL OF TAX**
5 **TRAPS FOR THE UNWARY**

6 **SEC. 101. CLARIFICATION OF LIMITATION ON MAXIMUM**
7 **NUMBER OF SHAREHOLDERS.**

8 (a) RULES RELATING TO DETERMINATION OF OWN-
9 ERSHIP.—

10 (1) FAILURE TO ISSUE SHAREHOLDER DEMAND
11 LETTER NOT TO DISQUALIFY REIT.—Section 857(a)
12 (relating to requirements applicable to real estate in-
13 vestment trusts) is amended by striking paragraph
14 (2) and by redesignating paragraph (3) as para-
15 graph (2).

16 (2) SHAREHOLDER DEMAND LETTER REQUIRE-
17 MENT; PENALTY.—Section 857 (relating to taxation
18 of real estate investment trusts and their bene-
19 ficiaries) is amended by redesignating subsection (f)
20 as subsection (g) and by inserting after subsection
21 (e) the following new subsection:

22 “(f) REAL ESTATE INVESTMENT TRUSTS TO ASCER-
23 TAIN OWNERSHIP.—

24 “(1) IN GENERAL.—Each real estate invest-
25 ment trust shall each taxable year comply with regu-

1 lations prescribed by the Secretary for the purposes
2 of ascertaining the actual ownership of the outstand-
3 ing shares, or certificates of beneficial interest, of
4 such trust.

5 “(2) FAILURE TO COMPLY.—

6 “(A) IN GENERAL.—If a real estate invest-
7 ment trust fails to comply with the require-
8 ments of paragraph (1) for a taxable year, such
9 trust shall pay (on notice and demand by the
10 Secretary and in the same manner as tax) a
11 penalty of \$25,000.

12 “(B) INTENTIONAL DISREGARD.—If any
13 failure under paragraph (1) is due to inten-
14 tional disregard of the requirement under para-
15 graph (1), the penalty under subparagraph (A)
16 shall be \$50,000.

17 “(C) FAILURE TO COMPLY AFTER NO-
18 TICE.—The Secretary may require a real estate
19 investment trust to take such actions as the
20 Secretary determines appropriate to ascertain
21 actual ownership if the trust fails to meet the
22 requirements of paragraph (1). If the trust fails
23 to take such actions, the trust shall pay (on no-
24 tice and demand by the Secretary and in the
25 same manner as tax) an additional penalty

1 equal to the penalty determined under subpara-
2 graph (A) or (B), whichever is applicable.

3 “(D) REASONABLE CAUSE.—No penalty
4 shall be imposed under this paragraph with re-
5 spect to any failure if it is shown that such fail-
6 ure is due to reasonable cause and not to willful
7 neglect.”

8 (b) COMPLIANCE WITH CLOSELY HELD PROHIBI-
9 TION.—

10 (1) IN GENERAL.—Section 856 (defining real
11 estate investment trust) is amended by adding at the
12 end the following new subsection:

13 “(k) REQUIREMENT THAT ENTITY NOT BE CLOSELY
14 HELD TREATED AS MET IN CERTAIN CASES.—A corpora-
15 tion, trust, or association—

16 “(1) which for a taxable year meets the require-
17 ments of section 857(f)(1), and

18 “(2) which does not know, or exercising reason-
19 able diligence would not have known, whether the
20 entity failed to meet the requirement of subsection
21 (a)(6),

22 shall be treated as having met the requirement of sub-
23 section (a)(6) for the taxable year.”

24 (2) CONFORMING AMENDMENT.—Paragraph (6)
25 of section 856(a) is amended by inserting “subject

1 to the provisions of subsection (k),” before “which
2 is not”.

3 **SEC. 102. DE MINIMIS RULE FOR TENANT SERVICES IN-**
4 **COME.**

5 (a) IN GENERAL.—Paragraph (2) of section 856(d)
6 (defining rents from real property) is amended by striking
7 subparagraph (C) and the last sentence and inserting:

8 “(C) any impermissible tenant service in-
9 come (as defined in paragraph (7)).”

10 (b) IMPERMISSIBLE TENANT SERVICE INCOME.—
11 Section 856(d) is amended by adding at the end the fol-
12 lowing new paragraph:

13 “(7) IMPERMISSIBLE TENANT SERVICE IN-
14 COME.—For purposes of paragraph (2)(C)—

15 “(A) IN GENERAL.—The term ‘impermiss-
16 sible tenant service income’ means, with respect
17 to any real or personal property, any amount
18 (other than amounts described in subparagraph
19 (B) or (C) of paragraph (1)) received or ac-
20 crued directly or indirectly by the real estate in-
21 vestment trust for—

22 “(i) services furnished or rendered by
23 the trust to the tenants of such property,
24 or

1 “(ii) managing or operating such
2 property.

3 “(B) DISQUALIFICATION OF ALL AMOUNTS
4 WHERE MORE THAN DE MINIMIS AMOUNT.—If
5 the amount described in subparagraph (A) with
6 respect to a property exceeds 1 percent of all
7 amounts received or accrued directly or indi-
8 rectly by the real estate investment trust with
9 respect to such property, the impermissible ten-
10 nant service income of the trust with respect to
11 the property shall include all such amounts.

12 “(C) EXCEPTIONS.—For purposes of sub-
13 paragraph (A)—

14 “(i) services furnished or rendered, or
15 management or operation provided,
16 through an independent contractor from
17 whom the trust itself does not derive or re-
18 ceive any income shall not be treated as
19 furnished, rendered, or provided by the
20 trust, and

21 “(ii) there shall not be taken into ac-
22 count any amount which would be excluded
23 from unrelated business taxable income
24 under section 512(b)(3) if received by an

1 organization described in section
2 512(a)(2).

3 “(D) AMOUNT ATTRIBUTABLE TO IMPER-
4 MISSIBLE SERVICES.—For purposes of subpara-
5 graph (A), the amount treated as received for
6 any service (or management or operation) shall
7 not be less than 150 percent of the actual direct
8 cost of the trust in furnishing or rendering the
9 service (or providing the management or oper-
10 ation).

11 “(E) COORDINATION WITH LIMITA-
12 TIONS.—For purposes of paragraphs (2) and
13 (3) of subsection (c), amounts described in sub-
14 paragraph (A) shall be included in the gross in-
15 come of the corporation, trust, or association.”

16 **SEC. 103. ATTRIBUTION RULES APPLICABLE TO TENANT**
17 **OWNERSHIP.**

18 Section 856(d)(5) (relating to constructive ownership
19 of stock) is amended by adding at the end the following:
20 “For purposes of paragraph (2)(B), section 318(a)(3)(A)
21 shall be applied under the preceding sentence in the case
22 of a partnership by taking into account only partners who
23 own (directly or indirectly) 25 percent or more of the cap-
24 ital interest, or the profits interest, in the partnership.”

1 **TITLE II—CONFORMITY WITH**
2 **REGULATED INVESTMENT**
3 **COMPANY RULES**

4 **SEC. 201. CREDIT FOR TAX PAID BY REIT ON RETAINED**
5 **CAPITAL GAINS.**

6 (a) GENERAL RULE.—Paragraph (3) of section
7 857(b) (relating to capital gains) is amended by redesi-
8 gning subparagraph (D) as subparagraph (E) and by in-
9 serting after subparagraph (C) the following new subpara-
10 graph:

11 “(D) TREATMENT BY SHAREHOLDERS OF
12 UNDISTRIBUTED CAPITAL GAINS.—

13 “(i) Every shareholder of a real estate
14 investment trust at the close of the trust’s
15 taxable year shall include, in computing his
16 long-term capital gains in his return for
17 his taxable year in which the last day of
18 the trust’s taxable year falls, such amount
19 as the trust shall designate in respect of
20 such shares in a written notice mailed to
21 its shareholders at any time prior to the
22 expiration of 60 days after the close of its
23 taxable year (or mailed to its shareholders
24 or holders of beneficial interests with its
25 annual report for the taxable year), but the

1 amount so includible by any shareholder
2 shall not exceed that part of the amount
3 subjected to tax in subparagraph (A)(ii)
4 which he would have received if all of such
5 amount had been distributed as capital
6 gain dividends by the trust to the holders
7 of such shares at the close of its taxable
8 year.

9 “(ii) For purposes of this title, every
10 such shareholder shall be deemed to have
11 paid, for his taxable year under clause (i),
12 the tax imposed by subparagraph (A)(ii)
13 on the amounts required by this subpara-
14 graph to be included in respect of such
15 shares in computing his long-term capital
16 gains for that year; and such shareholders
17 shall be allowed credit or refund as the
18 case may be, for the tax so deemed to have
19 been paid by him.

20 “(iii) The adjusted basis of such
21 shares in the hands of the holder shall be
22 increased with respect to the amounts re-
23 quired by this subparagraph to be included
24 in computing his long-term capital gains,
25 by the difference between the amount of

1 such includible gains and such holder's
2 credit or refund determined under clause
3 (ii).

4 “(iv) In the event of such designation,
5 the tax imposed by subparagraph (A)(ii)
6 shall be paid by the real estate investment
7 trust within 30 days after the close of its
8 taxable year.

9 “(v) The earnings and profits of such
10 real estate investment trust, and the earn-
11 ings and profits of any such shareholder
12 which is a corporation, shall be appro-
13 priately adjusted in accordance with regu-
14 lations prescribed by the Secretary.

15 “(vi) As used in this subparagraph,
16 the terms ‘shares’ and ‘shareholders’ shall
17 include beneficial interests and holders of
18 beneficial interest, respectively.”

19 (b) CONFORMING AMENDMENTS.—

20 (1) Clause (i) of section 857(b)(7)(A) is amend-
21 ed by striking “subparagraph (B)” and inserting
22 “subparagraph (B) or (D)”.

23 (2) Clause (iii) of section 852(b)(3)(D) is
24 amended by striking “by 65 percent” and all that
25 follows and inserting “by the difference between the

1 amount of such includible gains and such holder's
2 credit or refund determined under clause (ii)."

3 **SEC. 202. REPEAL OF 30-PERCENT GROSS INCOME RE-**
4 **QUIREMENT.**

5 (a) GENERAL RULE.—Subsection (c) of section 856
6 (relating to limitations) is amended—

7 (1) by adding “and” at the end of paragraph

8 (3),

9 (2) by striking paragraphs (4) and (8), and

10 (3) by redesignating paragraphs (5), (6), and

11 (7) as paragraphs (4), (5), and (6), respectively.

12 (b) CONFORMING AMENDMENTS.—

13 (1) Paragraph (5) of section 857(b) is amended

14 by striking “section 856(c)(7)” and inserting “sec-

15 tion 856(c)(6)”.

16 (2) Subparagraph (C) of section 857(b)(6) is

17 amended by striking “section 856(c)(6)(B)” and in-

18 serting “section 856(c)(5)(B)”.

1 **TITLE III—OTHER**
2 **SIMPLIFICATION**

3 **SEC. 301. MODIFICATION OF EARNINGS AND PROFITS**
4 **RULES FOR DETERMINING WHETHER REIT**
5 **HAS EARNINGS AND PROFITS FROM NON-**
6 **REIT YEAR.**

7 Subsection (d) of section 857 is amended by adding
8 at the end the following new paragraph:

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

13 “(A) shall be treated for purposes of this
14 subsection as made from the earliest accumu-
15 lated earnings and profits (other than earnings
16 and profits to which subsection (a)(2)(A) ap-
17 plies) rather than the most recently accumu-
18 lated earnings and profits, and

19 “(B) shall not be treated as a distribution
20 for purposes of subsection (b)(2)(B).”

21 **SEC. 302. TREATMENT OF FORECLOSURE PROPERTY.**

22 (a) GRACE PERIODS.—

23 (1) INITIAL PERIOD.—Paragraph (2) of section
24 856(e) (relating to special rules for foreclosure prop-
25 erty) is amended by striking “on the date which is

1 2 years after the date the trust acquired such prop-
2 erty” and inserting “as of the close of the 3d taxable
3 year following the taxable year in which the trust ac-
4 quired such property”.

5 (2) EXTENSION.—Paragraph (3) of section
6 856(e) is amended—

7 (A) by striking “or more extensions” and
8 inserting “extension”, and

9 (B) by striking the last sentence and in-
10 sserting: “Any such extension shall not extend
11 the grace period beyond the close of the 3d tax-
12 able year following the last taxable year in the
13 period under paragraph (2).”

14 (b) REVOCATION OF ELECTION.—Paragraph (5) of
15 section 856(e) is amended by striking the last sentence
16 and inserting: “A real estate investment trust may revoke
17 any such election for a taxable year by filing the revocation
18 (in the manner provided in regulations by the Secretary)
19 on or before the due date (including any extension of time)
20 for filing its return of tax under this chapter for the tax-
21 able year. If a trust revokes an election for any property,
22 no election may be made by the trust under this paragraph
23 with respect to the property for any subsequent taxable
24 year.”

1 (c) CERTAIN ACTIVITIES NOT TO DISQUALIFY PROP-
2 ERTY.—Paragraph (4) of section 856(e) is amended by
3 adding at the end the following new flush sentence:

4 “For purposes of subparagraph (C), property shall
5 not be treated as used in a trade or business by rea-
6 son of any activities of the real estate investment
7 trust with respect to such property to the extent
8 that such activities would not result in amounts re-
9 ceived or accrued, directly or indirectly, with respect
10 to such property being treated as other than rents
11 from real property.”

12 **SEC. 303. SPECIAL FORECLOSURE RULES FOR HEALTH**
13 **CARE PROPERTIES.**

14 Section 856(e) (relating to special rules for fore-
15 closure property) is amended by adding at the end the fol-
16 lowing new paragraph:

17 “(6) SPECIAL RULES FOR QUALIFIED HEALTH
18 CARE PROPERTIES.—For purposes of this sub-
19 section—

20 “(A) ACQUISITION BY LEASE TERMI-
21 NATIONS.—The term ‘foreclosure property’
22 shall include any qualified health care property
23 acquired by a real estate investment trust as
24 the result of the termination or expiration of a
25 lease of such property.

1 “(B) INCOME FROM INDEPENDENT CON-
2 TRACTORS.—For purposes of applying para-
3 graph (4)(C) with respect to qualified health
4 care property which is foreclosure property, in-
5 come derived or received by the trust from an
6 independent contractor shall be disregarded to
7 the extent such income is attributable to other
8 property.

9 “(C) QUALIFIED HEALTH CARE PROP-
10 ERTY.—The term ‘qualified health care prop-
11 erty’ means any real property (including inter-
12 ests therein), and any personal property inci-
13 dent to such real property, which—

14 “(i) is a health care facility, or

15 “(ii) is necessary or incidental to the
16 use of a health care facility.”

17 **SEC. 304. PAYMENTS UNDER HEDGING INSTRUMENTS.**

18 Section 856(c)(5)(G) (relating to treatment of certain
19 interest rate agreements), as redesignated by section 202,
20 is amended to read as follows:

21 “(G) TREATMENT OF CERTAIN HEDGING
22 INSTRUMENTS.—Except to the extent provided
23 by regulations, any—

24 “(i) payment to a real estate invest-
25 ment trust under an interest rate swap or

1 cap agreement, option, futures contract,
2 forward rate agreement, or any similar fi-
3 nancial instrument, entered into by the
4 trust in a transaction to hedge any indebt-
5 edness incurred or to be incurred by the
6 trust to acquire or carry real estate assets,
7 and
8 “(ii) gain from the sale or other dis-
9 position of any such investment,
10 shall be treated as income qualifying under
11 paragraph (2).”

12 **SEC. 305. EXCESS NONCASH INCOME.**

13 Section 857(e)(2) (relating to determination of
14 amount of excess noncash income) is amended—

15 (1) by striking subparagraph (B),

16 (2) by striking the period at the end of sub-
17 paragraph (C) and inserting a comma,

18 (3) by redesignating subparagraph (C) (as
19 amended by paragraph (2)) as subparagraph (B),
20 and

21 (4) by adding at the end the following new sub-
22 paragraphs:

23 “(C) the amount (if any) by which—

24 “(i) the amounts includible in gross
25 income with respect to instruments to

1 which section 860E(a) or 1272 applies, ex-
2 ceed

3 “(ii) the amount of money and the
4 fair market value of other property re-
5 ceived during the taxable year under such
6 instruments, and

7 “(D) amounts includible in income by rea-
8 son of cancellation of indebtedness.”

9 **SEC. 306. PROHIBITED TRANSACTION SAFE HARBOR.**

10 Clause (iii) of section 857(b)(6)(C) (relating to cer-
11 tain sales not to constitute prohibited transactions) is
12 amended—

13 (1) by striking “(other than foreclosure prop-
14 erty)” in subclauses (I) and (II) and inserting
15 “(other than sales of foreclosure property or sales to
16 which section 1033 applies)”, and

17 (2) by striking “(as determined for purposes of
18 computing earnings and profits)” in subclause (II)
19 and inserting “(determined without regard to any
20 adjustment for depreciation or amortization)”.

21 **SEC. 307. SHARED APPRECIATION MORTGAGES.**

22 (a) BANKRUPTCY SAFE HARBOR.—Section 856(j)
23 (relating to treatment of shared appreciation mortgages)
24 is amended by redesignating paragraph (4) as paragraph

1 (5) and by inserting after paragraph (3) the following new
2 paragraph:

3 “(4) COORDINATION WITH 4-YEAR HOLDING PE-
4 RIOD.—

5 “(A) IN GENERAL.—For purposes of sec-
6 tion 857(b)(6)(C), if a real estate investment
7 trust is treated as having sold secured property
8 under paragraph (3)(A), the trust shall be
9 treated as having held such property for at
10 least 4 years if—

11 “(i) the secured property is sold or
12 otherwise disposed of pursuant to a case
13 under title 11 of the United States Code,

14 “(ii) the seller is under the jurisdic-
15 tion of the court in such case, and

16 “(iii) the disposition is required by the
17 court or is pursuant to a plan approved by
18 the court.

19 “(B) EXCEPTION.—Subparagraph (A)
20 shall not apply if—

21 “(i) the secured property was acquired
22 by the trust with the intent to evict or
23 foreclose, or

1 “(ii) the trust knew or had reason to
2 know that default on the obligation de-
3 scribed in paragraph (5)(A) would occur.”

4 (b) CLARIFICATION OF DEFINITION OF SHARED AP-
5 PRECIATION PROVISION.—Clause (ii) of section
6 856(j)(5)(A) is amended by inserting “or appreciation in
7 value” after “gain” each place it appears.

8 **SEC. 308. WHOLLY OWNED SUBSIDIARIES.**

9 Section 856(i)(2) (defining qualified REIT subsidi-
10 ary) is amended by striking “at all times during the period
11 such corporation was in existence”.

12 **TITLE IV—EFFECTIVE DATE**

13 **SEC. 401. EFFECTIVE DATE.**

14 The amendments made by this Act shall apply to tax-
15 able years beginning after the date of the enactment of
16 this Act.

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