

104<sup>TH</sup> CONGRESS  
1<sup>ST</sup> SESSION

# S. 1297

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

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## IN THE SENATE OF THE UNITED STATES

SEPTEMBER 29 (legislative day, SEPTEMBER 25), 1995

Mr. HATCH introduced the following bill; which was read twice and referred to the Committee on Finance

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## 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  
10 to, or repeal of, a section or other provision, the reference

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

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

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

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

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

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

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

23 “(1) IN GENERAL.—Each real estate invest-  
 24 ment trust shall each taxable year comply with regu-  
 25 lations prescribed by the Secretary for the purposes

1 of ascertaining the actual ownership of the outstand-  
2 ing shares, or certificates of beneficial interest, of  
3 such trust.

4 “(2) FAILURE TO COMPLY.—

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

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

16 “(C) FAILURE TO COMPLY AFTER NO-  
17 TICE.—The Secretary may require a real estate  
18 investment trust to take such actions as the  
19 Secretary determines appropriate to ascertain  
20 actual ownership if the trust fails to meet the  
21 requirements of paragraph (1). If the trust fails  
22 to take such actions, the trust shall pay (on no-  
23 tice and demand by the Secretary and in the  
24 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 ‘impermis-  
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          ant 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 **TITLE III—OTHER**  
4 **SIMPLIFICATION**

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

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

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

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

21 "(B) shall not be treated as a distribution  
22 for purposes of subsection (b)(2)(B)."

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

24 (a) GRACE PERIODS.—

1           (1) INITIAL PERIOD.—Paragraph (2) of section  
2           856(e) (relating to special rules for foreclosure prop-  
3           erty) is amended by striking “on the date which is  
4           2 years after the date the trust acquired such prop-  
5           erty” and inserting “as of the close of the 3d taxable  
6           year following the taxable year in which the trust ac-  
7           quired such property”.

8           (2) EXTENSION.—Paragraph (3) of section  
9           856(e) is amended—

10                   (A) by striking “or more extensions” and  
11                   inserting “extension”, and

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

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

1 with respect to the property for any subsequent taxable  
2 year.”

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

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

14 **SEC. 303. SPECIAL FORECLOSURE RULES FOR HEALTH**  
15 **CARE PROPERTIES.**

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

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

22 “(A) ACQUISITION BY LEASE TERMI-  
23 NATIONS.—The term ‘foreclosure property’  
24 shall include any qualified health care property  
25 acquired by a real estate investment trust as

1 the result of the termination or expiration of a  
2 lease of such property.

3 “(B) GRACE PERIOD.—For purposes of  
4 qualified health care property of a real estate  
5 investment trust qualifying as ‘foreclosure prop-  
6 erty’ under subparagraph (A), the qualified  
7 health care property shall cease to be fore-  
8 closure property on the date which is 2 years  
9 after the date such trust acquired such prop-  
10 erty.

11 “(C) EXTENSIONS.—If the real estate in-  
12 vestment trust establishes to the satisfaction of  
13 the Secretary that an extension of the grace pe-  
14 riod in subparagraph (B) is necessary to the or-  
15 derly leasing or liquidation of the trust’s inter-  
16 est in such qualified health care property, the  
17 Secretary may grant one or more extensions of  
18 the grace period for such qualified health care  
19 property. Any such extension shall not extend  
20 the grace period beyond the date which is 6  
21 years after the date such trust acquired such  
22 qualified health care property.

23 “(D) INCOME FROM INDEPENDENT CON-  
24 TRACTORS.—For purposes of applying para-  
25 graph (4)(C) with respect to qualified health

1 care property which is foreclosure property, in-  
2 come derived or received by the trust from an  
3 independent contractor shall be disregarded to  
4 the extent such income is attributable to—

5 “(i) leases existing on the date the  
6 real estate investment trust acquired the  
7 qualified health care property, or

8 “(ii) leases extended or entered into  
9 after the trust acquired such property from  
10 lessees pursuant to terms set forth in such  
11 existing leases or on terms under which the  
12 trust receives a substantially similar or  
13 lesser benefit in comparison to the previous  
14 lease for such property.

15 “(E) QUALIFIED HEALTH CARE PROP-  
16 erty.—The term ‘qualified health care prop-  
17 erty’ means any real property (including inter-  
18 ests therein), and any personal property inci-  
19 dent to such real property, which—

20 “(i) is a hospital, outpatient medical  
21 clinic, nursing facility, assisted living facil-  
22 ity, or other licensed health care facility  
23 which extends medical or nursing or ancil-  
24 lary services to patients and which, imme-  
25 diately before the termination, expiration,

1 or breach of the lease of or mortgage se-  
2 cured by such facility, was operated by a  
3 provider of such services which was eligible  
4 for participation in the medicare program  
5 under title XVIII of the Social Security  
6 Act with respect to such facility, or

7 “(ii) is necessary or incidental to the  
8 use of such a health care facility.”

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

10 Section 856(c)(6)(G) (relating to treatment of certain  
11 interest rate agreements) is amended to read as follows:

12 “(G) TREATMENT OF CERTAIN HEDGING  
13 INSTRUMENTS.—Except to the extent provided  
14 by regulations, any—

15 “(i) payment to a real estate invest-  
16 ment trust under an interest rate swap or  
17 cap agreement, option, futures contract,  
18 forward rate agreement, or any similar fi-  
19 nancial instrument, entered into by the  
20 trust in a transaction to hedge any indebt-  
21 edness incurred or to be incurred by the  
22 trust to acquire or carry real estate assets,  
23 and

24 “(ii) gain from the sale or other dis-  
25 position of any such investment,



1 shall not be taken into account under para-  
2 graphs (2), (3), and (4).

3 **SEC. 305. EXCESS NONCASH INCOME.**

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

6 (1) by striking subparagraph (B),

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

9 (3) by redesignating subparagraph (C) (as  
10 amended by paragraph (2)) as subparagraph (B),  
11 and

12 (4) by adding at the end the following new sub-  
13 paragraphs:

14 “(C) the amount (if any) by which—

15 “(i) the amounts includible in gross  
16 income with respect to instruments to  
17 which section 860E(a) or 1272 applies,  
18 exceed

19 “(ii) the amount of money and the  
20 fair market value of other property re-  
21 ceived during the taxable year under such  
22 instruments, and

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

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

2 Clause (iii) of section 857(b)(6)(C) (relating to cer-  
3 tain sales not to constitute prohibited transactions) is  
4 amended—

5 (1) by striking “(other than foreclosure prop-  
6 erty)” in subclauses (I) and (II) and inserting  
7 “(other than sales of foreclosure property or sales to  
8 which section 1033 applies)”, and

9 (2) by striking “(as determined for purposes of  
10 computing earnings and profits)” in subclause (II)  
11 and inserting “(determined without regard to any  
12 adjustment for depreciation or amortization)”.

13 **SEC. 307. SHARED APPRECIATION MORTGAGES.**

14 (a) **BANKRUPTCY SAFE HARBOR.**—Section 856(j)  
15 (relating to treatment of shared appreciation mortgages)  
16 is amended by redesignating paragraph (4) as paragraph  
17 (5) and by inserting after paragraph (3) the following new  
18 paragraph:

19 “(4) **COORDINATION WITH 4-YEAR HOLDING**  
20 **PERIOD.**—

21 “(A) **IN GENERAL.**—For purposes of sec-  
22 tion 857(b)(6)(C), if a real estate investment  
23 trust is treated as having sold secured property  
24 under paragraph (3)(A), the trust shall be  
25 treated as having held such property for at  
26 least 4 years if—

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

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

6 “(iii) the disposition is required by the  
7 court or is pursuant to a plan approved by  
8 the court.

9 “(B) EXCEPTION.—Subparagraph (A)  
10 shall not apply if—

11 “(i) the secured property was acquired  
12 by the trust with the intent to evict or  
13 foreclose, or

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

17 (b) CLARIFICATION OF DEFINITION OF SHARED AP-  
18 PRECIATION PROVISION.—Clause (ii) of section  
19 856(j)(5)(A) is amended by inserting “or appreciation in  
20 value” after “gain” each place it appears.

21 **SEC. 308. WHOLLY OWNED SUBSIDIARIES.**

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

1       **TITLE IV—EFFECTIVE DATE**

2   **SEC. 401. EFFECTIVE DATE.**

3       The amendments made by this Act shall apply to tax-  
4 able years beginning after the date of the enactment of  
5 this Act.

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