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

IN THE SENATE OF THE UNITED STATES

MAY 14, 1999

Mr. Mack (for himself, Mr. Graham, Mr. Hatch, Mr. Conrad, Mr. Nickles, Mr. Kerrey, Mr. Gramm, Mr. Bryan, Mr. Chafee, Mr. Baucus, Mr. Murkowski, Mr. Breaux, Mr. Jeffords, Mr. Robb, Mr. Coverdell, Mr. Rockefeller, Mr. Helms, Mr. Torricelli, and Mrs. Hutchison) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

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

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

SECTION 1. SHORT TITLE.

(a) Short Title.—This Act may be cited as the “Real Estate Investment Trust Modernization Act of 1999”.

(b) Amendment of 1986 Code.—Except as other-
wise expressly provided, whenever in this Act an amend-
ment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

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

SEC. 101. MODIFICATIONS TO ASSET DIVERSIFICATION TEST.

Subparagraph (B) of section 856(c)(4) is amended to read as follows:

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

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

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

“(II) the trust does not hold securities possessing more than 10 percent of the
total voting power of the outstanding securities of any 1 issuer, and

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

SEC. 102. TREATMENT OF INCOME AND SERVICES PROVIDED BY TAXABLE REIT SUBSIDIARIES.

(a) Income From Taxable REIT Subsidiaries Not Treated as Impermissible Tenant Service Income.—Clause (i) of section 856(d)(7)(C) (relating to exceptions to impermissible tenant service income) is amended by inserting “or through a taxable REIT subsidiary of such trust” after “income”.

(b) Certain Income From Taxable REIT Subsidiaries Not Excluded From Rents From Real Property.—

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

“(8) Special rule for taxable reit subsidiaries.—For purposes of this subsection, amounts paid to a real estate investment trust by a taxable REIT subsidiary of such trust shall not be
excluded from rents from real property by reason of paragraph (2)(B) if the requirements of subpara-
graph (A) or (B) are met.

“(A) LIMITED RENTAL EXCEPTION.—The requirements of this subparagraph are met with respect to any property if at least 90 percent of the leased space of the property is rented to persons other than taxable REIT subsidiaries of such trust and other than persons described in section 856(d)(2)(B). The preceding sentence shall apply only to the extent that the amounts paid to the trust as rents from real property (as defined in paragraph (1) without regard to paragraph (2)(B)) from such property are sub-
stantially comparable to such rents made by the other tenants of the trust’s property for com-
parable space.

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

For purposes of paragraph (8)(B)—

“(A) In general.—The term ‘eligible independent contractor’ means, with respect to any qualified lodging facility, any independent contractor if, at the time such contractor enters into a management agreement or other similar service contract with the taxable REIT subsidiary to operate the facility, such contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities for any person who is not a related person with respect to the real estate investment trust or the taxable REIT subsidiary.

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

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

“(iii) The real estate investment trust receives income from such person with respect to another property that is attributable to a lease of such other property to such person that was in effect as on the later of—

“(I) January 1, 1999, or

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

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

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

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

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

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

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

“(i) IN GENERAL.—The term ‘qualified lodging facility’ means any lodging facility unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility.
“(ii) LODGING FACILITY.—The term ‘lodging facility’ means a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis.

“(iii) CUSTOMARY AMENITIES AND FACILITIES.—The term ‘lodging facility’ includes customary amenities and facilities operated as part of, or associated with, the lodging facility so long as such amenities and facilities are customary for other properties of a comparable size and class owned by other owners unrelated to such real estate investment trust.

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

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

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 856(d)(2) is amended by inserting “except as provided in paragraph (8),” after “(B)”. 
SEC. 103. TAXABLE REIT SUBSIDIARY.

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

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

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

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

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

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

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

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

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

The preceding sentence shall not apply to a qualified
REIT subsidiary (as defined in subsection (i)(2)).

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

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

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

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

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

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

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

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 856(i) is amended by adding at the end the following new sentence: “Such term shall not include a taxable REIT subsidiary.”

SEC. 104. LIMITATION ON EARNINGS STRIPPING.

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

“(C) any interest paid or accrued (directly or indirectly) by a taxable REIT subsidiary (as defined in section 856(l)) of a real estate investment trust to such trust.”.
SEC. 105. 100 PERCENT TAX ON IMPROPERLY ALLOCATED AMOUNTS.

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

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

“(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year of the real estate investment trust a tax equal to 100 percent of redetermined rents, redetermined deductions, and excess interest.

“(B) REDETERMINED RENTS.—

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

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

“(iii) Exception for de minimis amounts.—Clause (i) shall not apply to amounts described in section 856(d)(7)(A) with respect to a property to the extent such amounts do not exceed the one percent threshold described in section 856(d)(7)(B) with respect to such property.

“(iv) Exception for comparably priced services.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

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

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

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

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

“(vi) Exception for certain services based on subsidiary’s income from the services.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if the gross income of such subsidiary from such service is not less than 150 percent of such subsidiary’s direct cost in furnishing or rendering the service.

“(vii) Exceptions granted by Secretary.—The Secretary may waive the tax otherwise imposed by subparagraph (A) if the trust establishes to the satisfaction of the Secretary that rents charged to tenants were established on an arms’ length basis even though a taxable REIT subsidiary of the trust provided services to such tenants.

“(viii) No inference with respect to rents not within exceptions.—In determining whether rents are subject to
reduction upon distribution, apportionment, or allocation under section 482 for purposes of subparagraph (B), the fact that rents from real property do not meet the requirements of clauses (ii) through (vii) shall not be taken into account; and such determination, in the case of rents not meeting such requirements, shall be made as if such clauses had not been enacted.

“(ix) No inference as to whether redetermined rent is rent from real property.—Rent received by a real estate investment trust shall not fail to qualify as rents from real property under section 856(d) by reason of the fact that all or any portion of such rent is determined to be redetermined rent.

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

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

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

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

(b) Amount Subject to Tax Not Required To Be Distributed.—Subparagraph (E) of section 857(b)(2) (relating to real estate investment trust taxable income) is amended by striking “paragraph (5)” and inserting “paragraphs (5) and (7)”.

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SEC. 106. EFFECTIVE DATE.

(a) IN GENERAL.—The amendments made by this title shall apply to taxable years beginning after the date of enactment of this Act.

(b) TRANSITIONAL RULES RELATED TO SECTION 101.—

(1) EXISTING ARRANGEMENTS.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amendment made by section 101 shall not apply to a real estate investment trust with respect to—

(i) securities of a corporation held directly or indirectly by such trust on April 28, 1999,

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

(iii) securities acquired directly or indirectly by such trust as part of a reorganization (as defined in section 368(a)(1) of the Internal Revenue Code of 1986) with respect to such trust if such securities are described in clause (i) or (ii) with respect to any other real estate investment trust.
(B) NEW TRADE OR BUSINESS OR SUBSTANTIAL NEW ASSETS.—Subparagraph (A) shall cease to apply to securities of a corporation as of the first day after April 28, 1999, on which such corporation engages in a substantial new line of business, or acquires any substantial asset, other than—

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

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

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

(2) TAX-FREE CONVERSION.—If—

(A) at the time of an election for a corporation to become a taxable REIT subsidiary, the amendment made by section 101 does not apply to such corporation by reason of paragraph (1), and
such election first takes effect during
the 3-year period beginning on the date of the
enactment of this Act,
such election shall be treated as a reorganization
qualifying under section 368(a)(1)(A) of such Code.

TITLE II—HEALTH CARE REITS

SEC. 201. HEALTH CARE REITS.

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

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

“(A) ACQUISITION AT EXPIRATION OF
LEASE.—The term ‘foreclosure property’ shall
include any qualified health care property ac-
dquired by a real estate investment trust as the
result of the termination of a lease of such
property (other than a termination by reason of
a default, or the imminence of a default, on the
lease).

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

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

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

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

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

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

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

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

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

“(D) QUALIFIED HEALTH CARE PROPERTY.—

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

“(I) is a health care facility, or

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

“(ii) Health care facility.—For
purposes of clause (i), the term ‘health
care facility’ means a hospital, nursing fa-
cility, assisted living facility, congregate
care facility, qualified continuing care facil-
ity (as defined in section 7872(g)(4)), or
other licensed facility which extends med-
ical or nursing or ancillary services to pa-
tients and which, immediately before the
termination, expiration, default, or breach
of the lease of or mortgage secured by
such facility, was operated by a provider of
such services which was eligible for partici-
pation in the medicare program under title
XVIII of the Social Security Act with re-
spect to such facility.”

(b) Effective Date.—The amendment made by
this section shall apply to taxable years beginning after
the date of enactment of this Act.
TITLE III—CONFORMITY WITH
REGULATED INVESTMENT
COMPANY RULES

SEC. 301. CONFORMITY WITH REGULATED INVESTMENT
COMPANY RULES.

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

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

(c) EFFECTIVE DATE.—The amendments made by
this section shall apply to taxable years beginning after
the date of enactment of this Act.
TITLE IV—CLARIFICATION OF DEFINITION OF INDEPENDENT CONTRACTOR

SEC. 401. CLARIFICATION OF DEFINITION OF INDEPENDENT CONTRACTOR.

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

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

(b) Effective Date.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.
TITLE V—MODIFICATION OF
EARNINGS AND PROFITS RULES

SEC. 501. MODIFICATION OF EARNINGS AND PROFITS
RULES.

(a) Rules for Determining Whether Regulated Investment Company Has Earnings and
Profits From Non-RIC Year.—Subsection (c) of section 852 is amended by adding at the end the following
new paragraph:

“(3) Distributions to Meet Requirements
of Subsection (a)(2)(B).—Any distribution which
is made in order to comply with the requirements of
subsection (a)(2)(B)—

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

“(B) to the extent treated under subpara-
graph (A) as made from accumulated earnings
and profits, shall not be treated as a distribu-
tion for purposes of subsection (b)(2)(D) and
section 855.”.
(b) Clarification of Application of REIT Spillover Dividend Rules to Distributions to Meet Qualification Requirement.—Subparagraph (B) of section 857(d)(3) is amended by inserting before the period “and section 858”.

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

(d) Effective Date.—The amendments made by this section shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.