

108TH CONGRESS
1ST SESSION

H. R. 1890

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

IN THE HOUSE OF REPRESENTATIVES

APRIL 30, 2003

Mr. McCRERY (for himself, Mr. CARDIN, Mr. SHAW, Mr. RANGEL, Mr. HOUGHTON, Mr. STARK, Mr. HERGER, Mr. MATSUI, Mr. CAMP, Mr. KLECZKA, Mr. RAMSTAD, Mr. LEWIS of Georgia, Mr. SAM JOHNSON of Texas, Mr. NEAL of Massachusetts, Ms. DUNN, Mr. BECERRA, Mr. PORTMAN, Mr. POMEROY, Mr. ENGLISH, Mr. SANDLIN, Mr. HAYWORTH, Mrs. JONES of Ohio, Mr. WELLER, Mr. MCINNIS, Mr. FOLEY, Mr. CANTOR, and Mr. LEVIN) 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.**

4 This Act may be cited as the “Real Estate Invest-
5 ment Trust Improvement Act of 2003”.

1 **SEC. 2. AMENDMENT OF 1986 CODE.**

2 Except as otherwise expressly provided, whenever in
 3 the Act an amendment or repeal is expressed in terms of
 4 an amendment to, or repeal of, a section or other provi-
 5 sion, the reference shall be considered to be made to a
 6 section or other provision of the Internal Revenue Code
 7 of 1986.

8 **TITLE I—REIT CORRECTIONS**

9 **SEC. 101. REVISIONS TO REIT ASSET TEST.**

10 (a) EXPANSION OF STRAIGHT DEBT SAFE HAR-
 11 BOR.—Section 856 (defining real estate investment trust)
 12 is amended—

13 (1) in subsection (c) by striking paragraph (7),
 14 and

15 (2) by adding at the end the following new sub-
 16 section:

17 “(m) SAFE HARBOR IN APPLYING SUBSECTION
 18 (c)(4).—

19 “(1) IN GENERAL.—In applying subclause (III)
 20 of subsection (c)(4)(B)(iii), except as otherwise de-
 21 termined by the Secretary in regulations, the fol-
 22 lowing shall not be considered securities held by the
 23 trust:

24 “(A) Straight debt securities of an issuer
 25 which meet the requirements of paragraph (2).

1 “(B) Any loan to an individual or an es-
2 tate.

3 “(C) Any section 467 rental agreement (as
4 defined in section 467(d)), other than with a
5 person described in subsection (d)(2)(B).

6 “(D) Any obligation to pay rents from real
7 property (as defined in subsection (d)(1)).

8 “(E) Any security issued by a State or any
9 political subdivision thereof, the District of Co-
10 lumbia, a foreign government or any political
11 subdivision thereof, or the Commonwealth of
12 Puerto Rico, but only if the determination of
13 any payment received or accrued under such se-
14 curity does not depend in whole or in part on
15 the profits of any entity not described in this
16 subparagraph or payments on any obligation
17 issued by such an entity,

18 “(F) Any security issued by a real estate
19 investment trust.

20 “(G) Any other arrangement as deter-
21 mined by the Secretary.

22 “(2) SPECIAL RULES RELATING TO STRAIGHT
23 DEBT SECURITIES.—

24 “(A) IN GENERAL.—For purposes of para-
25 graph (1)(A), securities meet the requirements

1 of this paragraph if such securities are straight
2 debt, as defined in section 1361(c)(5) (without
3 regard to subparagraph (B)(iii) thereof).

4 “(B) SPECIAL RULES RELATING TO CER-
5 TAIN CONTINGENCIES.—For purposes of sub-
6 paragraph (A), any interest or principal shall
7 not be treated as failing to satisfy section
8 1361(c)(5)(B)(i) solely by reason of the fact
9 that the time of payment of such interest or
10 principal is subject to a contingency, but only
11 if—

12 “(i) any such contingency does not
13 have the effect of changing the effective
14 yield to maturity, as determined under sec-
15 tion 1272, other than a change in the an-
16 nual yield to maturity which either—

17 “(I) does not exceed the greater
18 of $\frac{1}{4}$ of 1 percent or 5 percent of the
19 annual yield to maturity, or

20 “(II) results solely from a default
21 or the exercise of a prepayment right
22 by the issuer of the debt, or

23 “(ii) neither the aggregate issue price
24 nor the aggregate face amount of the
25 issuer’s debt instruments held by the trust

1 exceeds \$1,000,000 and not more than 12
2 months of unaccrued interest can be re-
3 quired to be prepaid thereunder.

4 “(C) SPECIAL RULES RELATING TO COR-
5 PORATE OR PARTNERSHIP ISSUERS.—In the
6 case of an issuer which is a corporation or a
7 partnership, securities that otherwise would be
8 described in paragraph (1)(A) shall be consid-
9 ered not to be so described if the trust holding
10 such securities and any of its controlled taxable
11 REIT subsidiaries (as defined in subsection
12 (d)(8)(A)(iv)) hold any securities of the issuer
13 which—

14 “(i) are not described in paragraph
15 (1) (prior to the application of paragraph
16 (1)(C)), and

17 “(ii) have an aggregate value greater
18 than 1 percent of the issuer’s outstanding
19 securities.

20 “(3) LOOK-THROUGH RULE FOR PARTNERSHIP
21 SECURITIES.—

22 “(A) IN GENERAL.—For purposes of ap-
23 plying subclause (III) of subsection
24 (c)(4)(B)(iii)—

1 “(i) a trust’s interest as a partner in
2 a partnership (as defined in section
3 7701(a)(2)) shall not be considered a secu-
4 rity, and

5 “(ii) the trust shall be deemed to own
6 its proportionate share of each of the as-
7 sets of the partnership.

8 “(B) DETERMINATION OF TRUST’S INTER-
9 EST IN PARTNERSHIP ASSETS.—For purposes
10 of subparagraph (A), with respect to any tax-
11 able year beginning after the date of the enact-
12 ment of this subparagraph—

13 “(i) the trust’s interest in the partner-
14 ship assets shall be the trust’s propor-
15 tionate interest in any securities issued by
16 the partnership (determined without re-
17 gard to subparagraph (A)(i) and para-
18 graph (4), but not including securities de-
19 scribed in paragraph (1)), and

20 “(ii) the value of any debt instrument
21 shall be the adjusted issue price thereof, as
22 defined in section 1272(a)(4).

23 “(4) CERTAIN PARTNERSHIP DEBT INSTRU-
24 MENTS NOT TREATED AS A SECURITY.—For pur-

1 poses of applying subclause (III) of subsection
2 (c)(4)(B)(iii)—

3 “(A) any debt instrument issued by a part-
4 nership and not described in paragraph (1)
5 shall not be considered a security to the extent
6 of the trust’s interest as a partner in the part-
7 nership, and

8 “(B) any debt instrument issued by a part-
9 nership and not described in paragraph (1)
10 shall not be considered a security if at least 75
11 percent of the partnership’s gross income (ex-
12 cluding gross income from prohibited trans-
13 actions) is derived from sources referred to in
14 subsection (c)(3).

15 “(5) SECRETARIAL GUIDANCE.—The Secretary
16 is authorized to provide guidance (including through
17 the issuance of a written determination, as defined
18 in section 6110(b)) that an arrangement shall not be
19 considered a security held by the trust for purposes
20 of applying subclause (III) of subsection
21 (c)(4)(B)(iii) notwithstanding that such arrangement
22 otherwise could be considered a security under sub-
23 paragraph (F) of subsection (e)(5).”.

1 **SEC. 102. CLARIFICATION OF APPLICATION OF LIMITED**
2 **RENTAL EXCEPTION.**

3 Subparagraph (A) of section 856(d)(8) (relating to
4 special rules for taxable REIT subsidiaries) is amended
5 to read as follows:

6 “(A) LIMITED RENTAL EXCEPTION.—

7 “(i) IN GENERAL.—The requirements
8 of this subparagraph are met with respect
9 to any property if at least 90 percent of
10 the leased space of the property is rented
11 to persons other than taxable REIT sub-
12 sidiaries of such trust and other than per-
13 sons described in paragraph (2)(B).

14 “(ii) RENTS MUST BE SUBSTANTIALLY
15 COMPARABLE.—Clause (i) shall apply only
16 to the extent that the amounts paid to the
17 trust as rents from real property (as de-
18 fined in paragraph (1) without regard to
19 paragraph (2)(B)) from such property are
20 substantially comparable to such rents paid
21 by the other tenants of the trust’s property
22 for comparable space.

23 “(iii) TIMES FOR TESTING RENT COM-
24 PARABILITY.—The substantial com-
25 parability requirement of clause (ii) shall
26 be treated as met with respect to a lease

1 to a taxable REIT subsidiary of the trust
2 if such requirement is met under the terms
3 of the lease—

4 “(I) at the time such lease is en-
5 tered into,

6 “(II) at the time of each exten-
7 sion of the lease, including a failure to
8 exercise a right to terminate, and

9 “(III) at the time of any modi-
10 fication of the lease between the trust
11 and the taxable REIT subsidiary if
12 the rent under such lease is effectively
13 increased pursuant to such modifica-
14 tion.

15 With respect to subclause (III), if the tax-
16 able REIT subsidiary of the trust is a con-
17 trolled taxable REIT subsidiary of the
18 trust, the term ‘rents from real property’
19 shall not in any event include rent under
20 such lease to the extent of the increase in
21 such rent on account of such modification.

22 “(iv) CONTROLLED TAXABLE REIT
23 SUBSIDIARY.—For purposes of clause (iii),
24 the term ‘controlled taxable REIT sub-
25 sidiary’ means, with respect to any real es-

1 tate investment trust, any taxable REIT
2 subsidiary of such trust if such trust owns
3 directly or indirectly—

4 “(I) stock possessing more than
5 50 percent of the total voting power
6 of the outstanding stock of such sub-
7 sidiary, or

8 “(II) stock having a value of
9 more than 50 percent of the total
10 value of the outstanding stock of such
11 subsidiary.

12 “(v) CONTINUING QUALIFICATION
13 BASED ON THIRD PARTY ACTIONS.—If the
14 requirements of clause (i) are met at a
15 time referred to in clause (iii), such re-
16 quirements shall continue to be treated as
17 met so long as there is no increase in the
18 space leased to any taxable REIT sub-
19 sidiary of such trust or to any person de-
20 scribed in paragraph (2)(B).

21 “(vi) CORRECTION PERIOD.—If there
22 is an increase referred to in clause (v) dur-
23 ing any calendar quarter with respect to
24 any property, the requirements of clause
25 (iii) shall be treated as met during the

1 quarter and the succeeding quarter if such
2 requirements are met at the close of such
3 succeeding quarter.”.

4 **SEC. 103. DELETION OF CUSTOMARY SERVICES EXCEPTION.**

5 Subparagraph (B) of section 857(b)(7) (relating to
6 redetermined rents) is amended by striking clause (ii) and
7 by redesignating clauses (iii), (iv), (v), (vi), and (vii) as
8 clauses (ii), (iii), (iv), (v), and (vi), respectively.

9 **SEC. 104. CONFORMITY WITH GENERAL HEDGING DEFINI-**
10 **TION.**

11 (a) DEFINITION.—Subparagraph (G) of section
12 856(e)(5) (relating to treatment of certain hedging instru-
13 ments) is amended to read as follows:

14 “(G) TREATMENT OF CERTAIN HEDGING
15 INSTRUMENTS.—Except to the extent provided
16 by regulations, any income of a real estate in-
17 vestment trust from a hedging transaction (as
18 defined in clause (ii) or (iii) of section
19 1221(b)(2)(A)) which is clearly identified pur-
20 suant to section 1221(a)(7), including gain
21 from the sale or disposition of such a trans-
22 action, shall not constitute gross income under
23 paragraph (2) to the extent that the transaction
24 hedges any indebtedness incurred or to be in-

1 curred by the trust to acquire or carry real es-
2 tate assets.”.

3 **SEC. 105. CONFORMITY WITH REGULATED INVESTMENT**
4 **COMPANY RULES.**

5 Clause (i) of section 857(b)(5)(A) (relating to imposi-
6 tion of tax in case of failure to meet certain requirements)
7 is amended by striking “90 percent” and inserting “95
8 percent”.

9 **SEC. 106. PROHIBITED TRANSACTIONS PROVISIONS.**

10 (a) EXPANSION OF PROHIBITED TRANSACTION SAFE
11 HARBOR.—Section 857(b)(6) (relating to income from
12 prohibited transactions) is amended by redesignating sub-
13 paragraphs (D) and (E) as subparagraphs (E) and (F),
14 respectively, and by inserting after subparagraph (C) the
15 following new subparagraph:

16 “(D) CERTAIN SALES NOT TO CONSTITUTE
17 PROHIBITED TRANSACTIONS.—For purposes of
18 this part, the term ‘prohibited transaction’ does
19 not include a sale of property which is a real es-
20 tate asset (as defined in section 856(c)(5)(B))
21 if—

22 “(i) the trust held the property for
23 not less than 4 years in connection with
24 the trade or business of producing timber,

1 “(ii) the aggregate expenditures made
2 by the trust, or a partner of the trust, dur-
3 ing the 4-year period preceding the date of
4 sale which—

5 “(I) are includible in the basis of
6 the property (other than timberland
7 acquisition expenditures), and

8 “(II) are directly related to oper-
9 ation of the property for the produc-
10 tion of timber or for the preservation
11 of the property for use as timberland,
12 do not exceed 30 percent of the net selling
13 price of the property,

14 “(iii) the aggregate expenditures made
15 by the trust, or a partner of the trust, dur-
16 ing the 4-year period preceding the date of
17 sale which—

18 “(I) are includible in the basis of
19 the property (other than timberland
20 acquisition expenditures), and

21 “(II) are not directly related to
22 operation of the property for the pro-
23 duction of timber, or for the preserva-
24 tion of the property for use as

1 timberland, do not exceed 5 percent of
2 the net selling price of the property,

3 “(iv)(I) during the taxable year the
4 trust does not make more than 7 sales of
5 property (other than sales of foreclosure
6 property or sales to which section 1033 ap-
7 plies), or

8 “(II) the aggregate adjusted bases (as
9 determined for purposes of computing
10 earnings and profits) of property (other
11 than sales of foreclosure property or sales
12 to which section 1033 applies) sold during
13 the taxable year does not exceed 10 per-
14 cent of the aggregate bases (as so deter-
15 mined) of all of the assets of the trust as
16 of the beginning of the taxable year,

17 “(v) in the case that the requirement
18 of clause (iv)(I) is not satisfied, substan-
19 tially all of the marketing expenditures
20 with respect to the property were made
21 through an independent contractor (as de-
22 fined in section 856(d)(3)) from whom the
23 trust itself does not derive or receive any
24 income, and

1 “(vi) the sales price of the property
2 sold by the trust to its taxable REIT sub-
3 sidiary is not based in whole or in part on
4 the income or profits of the subsidiary or
5 the income or profits that the subsidiary
6 derives from the sale or operation of such
7 property.”.

8 **SEC. 107. EFFECTIVE DATES.**

9 (a) IN GENERAL.—Except as provided in subsection
10 (b), the amendments made by this title shall apply to tax-
11 able years beginning after December 31, 2000.

12 (b) SECTIONS 103 THROUGH 106.—The amend-
13 ments made by sections 103, 104, 105 and 106 shall apply
14 to taxable years beginning after the date of the enactment
15 of this Act.

16 **TITLE II—FIRPTA CORRECTION**

17 **SEC. 201. MODIFICATION OF THE TREATMENT OF CERTAIN**
18 **REIT DISTRIBUTIONS ATTRIBUTABLE TO**
19 **GAIN FROM SALES OR EXCHANGES OF**
20 **UNITED STATES REAL PROPERTY INTERESTS.**

21 (a) IN GENERAL.—Paragraph (1) of section 897(h)
22 (relating to look-through of distributions) is amended by
23 inserting before the period at the end the following: “, ex-
24 cept that any distribution by a REIT with respect to any
25 class of stock which is regularly traded on an established

1 securities market located in the United States shall not
2 be treated as gain recognized from the sale or exchange
3 of a United States real property interest if the shareholder
4 did not own more than 5 percent of such class of stock
5 during the taxable year.”.

6 (b) EFFECTIVE DATE.—The amendment made by
7 this section shall apply to taxable years beginning after
8 the date of the enactment of this Act.

9 **TITLE III—REIT SAVINGS**
10 **PROVISIONS**

11 **SEC. 301. REVISIONS TO REIT PROVISIONS.**

12 (a) RULES OF APPLICATION FOR FAILURE TO SAT-
13 ISFY SECTION 856(c)(4).—Section 856(c) (relating to def-
14 inition of real estate investment trust), as amended by sec-
15 tion 101, is amended by inserting after paragraph (6) the
16 following new paragraph:

17 “(7) RULES OF APPLICATION FOR FAILURE TO
18 SATISFY PARAGRAPH (4).—

19 “(A) DE MINIMIS FAILURE.—A corpora-
20 tion, trust, or association that fails to meet the
21 requirements of paragraph (4)(B)(iii) for a par-
22 ticular quarter shall nevertheless be considered
23 to have satisfied the requirements of such para-
24 graph for such quarter if—

1 “(i) such failure is due to the owner-
2 ship of assets the total value of which does
3 not exceed the lesser of—

4 “(I) 1 percent of the total value
5 of the trust’s assets at the end of the
6 quarter for which such measurement
7 is done, and

8 “(II) \$10,000,000, and

9 “(ii)(I) the corporation, trust, or asso-
10 ciation, following the identification of such
11 failure, disposes of assets in order to meet
12 the requirements of such paragraph within
13 6 months after the last day of the quarter
14 in which the corporation, trust or associa-
15 tion’s identification of the failure to satisfy
16 the requirements of such paragraph oc-
17 curred or such other time period prescribed
18 by the Secretary and in the manner pre-
19 scribed by the Secretary, or

20 “(II) the requirements of such para-
21 graph are otherwise met within the time
22 period specified in subclause (I).

23 “(B) FAILURES EXCEEDING DE MINIMIS
24 AMOUNT.—A corporation, trust, or association
25 that fails to meet the requirements of para-

1 graph (4) for a particular quarter shall never-
2 theless be considered to have satisfied the re-
3 quirements of such paragraph for such quarter
4 if—

5 “(i) such failure involves the owner-
6 ship of assets the total value of which ex-
7 ceeds the de minimis standard described in
8 subparagraph (A)(i) at the end of the
9 quarter for which such measurement is
10 done,

11 “(ii) following the corporation, trust,
12 or association’s identification of the failure
13 to satisfy the requirements of such para-
14 graph for a particular quarter, a descrip-
15 tion of each asset that causes the corpora-
16 tion, trust, or association to fail to satisfy
17 the requirements of such paragraph at the
18 close of such quarter of any taxable year is
19 set forth in a schedule for such quarter
20 filed in accordance with regulations pre-
21 scribed by the Secretary,

22 “(iii) the failure to meet the require-
23 ments of such paragraph for a particular
24 quarter is due to reasonable cause and not
25 due to willful neglect,

1 “(iv) the corporation, trust, or asso-
2 ciation pays a tax computed under sub-
3 paragraph (C), and

4 “(v)(I) the corporation, trust, or asso-
5 ciation disposes of the assets set forth on
6 the schedule specified in clause (ii) within
7 6 months after the last day of the quarter
8 in which the corporation, trust or associa-
9 tion’s identification of the failure to satisfy
10 the requirements of such paragraph oc-
11 curred or such other time period prescribed
12 by the Secretary and in the manner pre-
13 scribed by the Secretary, or

14 “(II) the requirements of such para-
15 graph are otherwise met within the time
16 period specified in subclause (I).

17 “(C) TAX.—For purposes of subparagraph
18 (B)(iv)—

19 “(i) TAX IMPOSED.—If a corporation,
20 trust, or association elects the application
21 of this subparagraph, there is hereby im-
22 posed a tax on the failure described in sub-
23 paragraph (B) of such corporation, trust,
24 or association. Such tax shall be paid by
25 the corporation, trust, or association.

1 “(ii) TAX COMPUTED.—The amount
2 of the tax imposed by clause (i) shall be
3 the greater of—

4 “(I) \$50,000, or

5 “(II) the amount determined
6 (pursuant to regulations promulgated
7 by the Secretary) by multiplying the
8 net income generated by the assets
9 described in the schedule specified in
10 subparagraph (B)(ii) for the period
11 specified in clause (iii) by the highest
12 rate of tax specified in section 11.

13 “(iii) PERIOD.—For purposes of
14 clause (ii)(II), the period described in this
15 clause is the period beginning on the first
16 date that the failure to satisfy the require-
17 ments of such paragraph (4) occurs as a
18 result of the ownership of such assets and
19 ending on the earlier of the date on which
20 the trust disposes of such assets or the end
21 of the first quarter when there is no longer
22 a failure to satisfy such paragraph (4).

23 “(iv) ADMINISTRATIVE PROVISIONS.—
24 For purposes of subtitle F, the taxes im-
25 posed by this subparagraph shall be treat-

1 ed as excise taxes with respect to which the
2 deficiency procedures of such subtitle
3 apply.”.

4 (b) MODIFICATION OF RULES OF APPLICATION FOR
5 FAILURE TO SATISFY SECTIONS 856(c)(2) OR
6 856(c)(3).—Paragraph (6) of section 856(c) (relating to
7 definition of real estate investment trust) is amended by
8 striking subparagraphs (A) and (B), by redesignating sub-
9 paragraph (C) as subparagraph (B), and by inserting be-
10 fore subparagraph (B) (as so redesignated) the following
11 new subparagraph:

12 “(A) following the corporation, trust, or
13 association’s identification of the failure to meet
14 the requirements of paragraph (2) or (3), or of
15 both such paragraphs, for any taxable year, a
16 description of each item of its gross income de-
17 scribed in such paragraphs is set forth in a
18 schedule for such taxable year filed in accord-
19 ance with regulations prescribed by the Sec-
20 retary, and”.

21 (c) REASONABLE CAUSE EXCEPTION TO LOSS OF
22 REIT STATUS IF FAILURE TO SATISFY REQUIRE-
23 MENTS.—Subsection (g) of section 856 (relating to termi-
24 nation of election) is amended—

1 (1) in paragraph (1) by inserting before the pe-
2 riod at the end of the first sentence the following:
3 “unless paragraph (5) applies”, and

4 (2) by adding at the end the following new
5 paragraph:

6 “(5) ENTITIES TO WHICH PARAGRAPH AP-
7 PLIES.—This paragraph applies to a corporation,
8 trust, or association—

9 “(A) which is not a real estate investment
10 trust to which the provisions of this part apply
11 for the taxable year due to one or more failures
12 to comply with one or more of the provisions of
13 this part (other than subsection (c)(6) or (c)(7)
14 of section 856),

15 “(B) such failures are due to reasonable
16 cause and not due to willful neglect, and

17 “(C) if such corporation, trust, or associa-
18 tion pays (as prescribed by the Secretary in
19 regulations and in the same manner as tax) a
20 penalty of \$50,000 for each failure to satisfy a
21 provision of this part due to reasonable cause
22 and not willful neglect.”.

23 (d) DEDUCTION OF TAX PAID FROM AMOUNT RE-
24 QUIRED TO BE DISTRIBUTED.—Subparagraph (E) of sec-
25 tion 857(b)(2) is amended by striking “(7)” and inserting

1 “(7) of this subsection, section 856(c)(7)(B)(iii), and sec-
2 tion 856(g)(1).”.

3 (e) EXPANSION OF DEFICIENCY DIVIDEND PROCE-
4 DURE.—Subsection (e) of section 860 is amended by strik-
5 ing “or” at the end of paragraph (2), by striking the pe-
6 riod at the end of paragraph (3) and inserting “; or”, and
7 by adding at the end the following new paragraph:

8 “(4) a statement by the taxpayer attached to its
9 amendment or supplement to a return of tax for the
10 relevant tax year.”.

11 (f) EFFECTIVE DATE.—The amendments made by
12 this section shall apply to taxable years beginning after
13 date of enactment.

○