

110TH CONGRESS
1ST SESSION

S. 2002

To amend the Internal Revenue Code of 1986 to simplify certain provisions applicable to real estate investment trusts, and for other purposes.

IN THE SENATE OF THE UNITED STATES

AUGUST 3, 2007

Mr. HATCH (for himself, Mr. SALAZAR, Mr. SMITH, and Mr. KERRY) 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, and for other purposes.

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 “REIT Investment Di-
5 versification and Empowerment Act of 2007”.

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

7 Except as otherwise expressly provided, whenever in
8 the Act an amendment or repeal is expressed in terms of
9 an amendment to, or repeal of, a section or other provi-

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

4 **TITLE I—FOREIGN CURRENCY**
 5 **AND OTHER QUALIFIED AC-**
 6 **TIVITIES**

7 **SEC. 101. REVISIONS TO REIT INCOME TESTS.**

8 (a) ADDITION OF PERMISSIBLE INCOME CAT-
 9 EGORIES.—Section 856(c) (relating to limitations) is
 10 amended—

11 (1) by striking “and” at the end of paragraph
 12 (2)(G) and by inserting after paragraph (2)(H) the
 13 following new subparagraphs:

14 “(I) passive foreign exchange gains; and

15 “(J) any other item of income or gain as
 16 determined by the Secretary;”, and

17 (2) by striking “and” at the end of paragraphs
 18 (3)(H) and (3)(I) and by inserting after paragraph
 19 (3)(I) the following new subparagraphs:

20 “(J) real estate foreign exchange gains;

21 and

22 “(K) any other item of income or gain as
 23 determined by the Secretary; and”.

24 (b) RULES REGARDING FOREIGN CURRENCY TRANS-
 25 ACTIONS.—Section 856 (defining real estate investment

1 trust) is amended by adding at the end the following new
2 subsection:

3 “(n) RULES REGARDING FOREIGN CURRENCY
4 TRANSACTIONS.—With respect to any taxable year—

5 “(1) REAL ESTATE FOREIGN EXCHANGE
6 GAINS.—For purposes of subsection (c)(3)(J), the
7 term ‘real estate foreign exchange gains’ means—

8 “(A) foreign currency gains (as defined in
9 section 988(b)(1)) which are attributable to—

10 “(i) any item described in subsection
11 (c)(3) (other than in subparagraph (J)
12 thereof),

13 “(ii) the acquisition or ownership of
14 obligations secured by mortgages on real
15 property or on interests in real property
16 (other than foreign currency gains attrib-
17 utable to any item described in clause (i)),
18 or

19 “(iii) becoming or being the obligor
20 under obligations secured by mortgages on
21 real property or on interests in real prop-
22 erty (other than foreign currency gains at-
23 tributable to any item described in clause
24 (i)),

1 “(B) gains described in section 987 attrib-
2 utable to a qualified business unit (as defined
3 by section 989) of the real estate investment
4 trust, but only if such qualified business unit
5 meets the requirements under—

6 “(i) subsection (c)(3) (without regard
7 to subparagraph (J) thereof) for the tax-
8 able year, and

9 “(ii) subsection (c)(4)(A) at the close
10 of each quarter that the real estate invest-
11 ment trust has directly or indirectly held
12 the qualified business unit, and

13 “(C) any other foreign currency gains as
14 determined by the Secretary.

15 “(2) PASSIVE FOREIGN EXCHANGE GAINS.—For
16 purposes of subsection (c)(2)(I), the term ‘passive
17 foreign exchange gains’ means—

18 “(A) real estate foreign exchange gains,

19 “(B) foreign currency gains (as defined in
20 section 988(b)(1)) which are not described in
21 subparagraph (A) and which are attributable to
22 any item described in subsection (c)(2) (other
23 than in subparagraph (I) thereof), and

24 “(C) any other foreign currency gains as
25 determined by the Secretary.”.

1 (c) ADDITION TO REIT HEDGING RULE.—Subpara-
2 graph (G) of section 856(c)(5) is amended to read as fol-
3 lows:

4 “(G) TREATMENT OF CERTAIN HEDGING
5 INSTRUMENTS.—Except to the extent as deter-
6 mined by the Secretary—

7 “(i) any income of a real estate in-
8 vestment trust from a hedging transaction
9 (as defined in clause (ii) or (iii) of section
10 1221(b)(2)(A)) which is clearly identified
11 pursuant to section 1221(a)(7), including
12 gain from the sale or disposition of such a
13 transaction, shall not constitute gross in-
14 come under paragraphs (2) and (3) to the
15 extent that the transaction hedges any in-
16 debtedness incurred or to be incurred by
17 the trust to acquire or carry real estate as-
18 sets, and

19 “(ii) any income of a real estate in-
20 vestment trust from a transaction entered
21 into by the trust primarily to manage risk
22 of currency fluctuations with respect to
23 any item described in paragraph (2) or (3),
24 including gain from the termination of
25 such a transaction, shall not constitute

1 gross income under paragraphs (2) and
2 (3), but only if such transaction is clearly
3 identified as such before the close of the
4 day on which it was acquired, originated,
5 or entered into (or such other time as the
6 Secretary may prescribe).”.

7 (d) **AUTHORITY TO EXCLUDE ITEMS OF INCOME**
8 **FROM REIT INCOME TESTS.**—Section 856(c)(5) is
9 amended by adding at the end the following new subpara-
10 graph:

11 “(H) **SECRETARIAL AUTHORITY TO EX-**
12 **CLUDE OTHER ITEMS OF INCOME.**—The Sec-
13 retary is authorized to determine whether any
14 item of income or gain which does not otherwise
15 qualify under paragraph (2) or (3) may be con-
16 sidered as not constituting gross income solely
17 for purposes of this part.”.

18 **SEC. 102. REVISIONS TO REIT ASSET TESTS.**

19 (a) **CLARIFICATION OF VALUATION TEST.**—The first
20 sentence in the matter following section
21 856(c)(4)(B)(iii)(III) is amended by inserting “(including
22 a discrepancy caused solely by the change in the foreign
23 currency exchange rate used to value a foreign asset)”
24 after “such requirements”.

1 (b) CLARIFICATION OF PERMISSIBLE ASSET CAT-
2 EGORY.—Section 856(c)(5), as amended by section
3 101(d), is amended by adding at the end the following new
4 subparagraph:

5 “(I) CASH.—The term ‘cash’ includes for-
6 eign currency if the real estate investment trust
7 or its qualified business unit (as defined in sec-
8 tion 989) uses such foreign currency as its
9 functional currency (as defined in section
10 985(b)).”.

11 **SEC. 103. CONFORMING FOREIGN CURRENCY REVISIONS.**

12 (a) NET INCOME FROM FORECLOSURE PROPERTY.—
13 Clause (i) of section 857(b)(4)(B) is amended to read as
14 follows:

15 “(i) gain (including any foreign cur-
16 rency gain, as defined in section 988(b)(1))
17 from the sale or other disposition of fore-
18 closure property described in section
19 1221(a)(1) and the gross income for the
20 taxable year derived from foreclosure prop-
21 erty (as defined in section 856(e)), but
22 only to the extent such gross income is not
23 described in (or, in the case of foreign cur-
24 rency gain, not attributable to gross in-

1 come described in) section 856(c)(3) other
2 than subparagraph (F) thereof, over”.

3 (b) NET INCOME FROM PROHIBITED TRANS-
4 ACTIONS.—Clause (i) of section 857(b)(6)(B) is amended
5 to read as follows:

6 “(i) the term ‘net income derived from
7 prohibited transactions’ means the excess
8 of the gain (including any foreign currency
9 gain, as defined in section 988(b)(1)) from
10 prohibited transactions over the deductions
11 (including any foreign currency loss, as de-
12 fined in section 988(b)(2)) allowed by this
13 chapter which are directly connected with
14 prohibited transactions;”.

15 **TITLE II—TAXABLE REIT**
16 **SUBSIDIARIES**

17 **SEC. 201. CONFORMING TAXABLE REIT SUBSIDIARY ASSET**
18 **TEST.**

19 Section 856(c)(4)(B)(ii) is amended by striking “20
20 percent” and inserting “25 percent”.

21 **TITLE III—DEALER SALES**

22 **SEC. 301. HOLDING PERIOD UNDER SAFE HARBOR.**

23 Section 857(b)(6) (relating to income from prohibited
24 transactions) is amended—

1 (1) by striking “4 years” in subparagraphs
2 (C)(i), (C)(iv), and (D)(i) and inserting “2 years”,

3 (2) by striking “4-year period” in subpara-
4 graphs (C)(ii), (D)(ii), and (D)(iii) and inserting “2-
5 year period”, and

6 (3) by striking “real estate asset” and all that
7 follows through “if” in the matter preceding clause
8 (i) of subparagraphs (C) and (D), respectively, and
9 inserting “real estate asset (as defined in section
10 856(c)(5)(B)) and which is described in section
11 1221(a)(1) if”.

12 **SEC. 302. DETERMINING VALUE OF SALES UNDER SAFE**
13 **HARBOR.**

14 Section 857(b)(6) is amended—

15 (1) by striking the semicolon at the end of sub-
16 paragraph (C)(iii) and inserting “, or (III) the fair
17 market value of property (other than sales of fore-
18 closure property or sales to which section 1033 ap-
19 plies) sold during the taxable year does not exceed
20 10 percent of the fair market value of all of the as-
21 sets of the trust as of the beginning of the taxable
22 year;”, and

23 (2) by adding “or” at the end of subclause (II)
24 of subparagraph (D)(iv) and by adding at the end
25 of such subparagraph the following new subclause:

1 “(III) the fair market value of prop-
2 erty (other than sales of foreclosure prop-
3 erty or sales to which section 1033 applies)
4 sold during the taxable year does not ex-
5 ceed 10 percent of the fair market value of
6 all of the assets of the trust as of the be-
7 ginning of the taxable year.”.

8 **TITLE IV—HEALTH CARE REITS**

9 **SEC. 401. CONFORMITY FOR HEALTH CARE FACILITIES.**

10 (a) RELATED PARTY RENTALS.—Subparagraph (B)
11 of section 856(d)(8) (relating to special rule for taxable
12 REIT subsidiaries) is amended to read as follows:

13 “(B) EXCEPTION FOR CERTAIN LODGING
14 FACILITIES AND HEALTH CARE PROPERTY.—

15 The requirements of this subparagraph are met
16 with respect to an interest in real property
17 which is a qualified lodging facility or a quali-
18 fied health care property (as defined in sub-
19 section (e)(6)(D)(i)) leased by the trust to a
20 taxable REIT subsidiary of the trust if the
21 property is operated on behalf of such sub-
22 sidiary by a person who is an eligible inde-
23 pendent contractor. For purposes of this sec-
24 tion, a taxable REIT subsidiary is not consid-
25 ered to be operating or managing a qualified

1 health care property or qualified lodging facility
2 solely because it directly or indirectly possesses
3 a license, permit or similar instrument enabling
4 it to do so.”.

5 (b) ELIGIBLE INDEPENDENT CONTRACTOR.—Sub-
6 paragraphs (A) and (B) of section 856(d)(9) (relating to
7 eligible independent contractor) are amended to read as
8 follows:

9 “(A) IN GENERAL.—The term ‘eligible
10 independent contractor’ means, with respect to
11 any qualified lodging facility or qualified health
12 care property (as defined in subsection
13 (e)(6)(D)(i)), any independent contractor if, at
14 the time such contractor enters into a manage-
15 ment agreement or other similar service con-
16 tract with the taxable REIT subsidiary to oper-
17 ate such qualified lodging facility or qualified
18 health care property, such contractor (or any
19 related person) is actively engaged in the trade
20 or business of operating qualified lodging facili-
21 ties or qualified health care properties, respec-
22 tively, for any person who is not a related per-
23 son with respect to the real estate investment
24 trust or the taxable REIT subsidiary.

1 “(B) SPECIAL RULES.—Solely for purposes
2 of this paragraph and paragraph (8)(B), a per-
3 son shall not fail to be treated as an inde-
4 pendent contractor with respect to any qualified
5 lodging facility or qualified health care property
6 (as so defined) by reason of the following:

7 “(i) The taxable REIT subsidiary
8 bears the expenses for the operation of
9 such qualified lodging facility or qualified
10 health care property pursuant to the man-
11 agement agreement or other similar service
12 contract.

13 “(ii) The taxable REIT subsidiary re-
14 ceives the revenues from the operation of
15 such qualified lodging facility or qualified
16 health care property, net of expenses for
17 such operation and fees payable to the op-
18 erator pursuant to such agreement or con-
19 tract.

20 “(iii) The real estate investment trust
21 receives income from such person with re-
22 spect to another property that is attrib-
23 utable to a lease of such other property to
24 such person that was in effect as of the
25 later of—

1 “(I) January 1, 1999, or
2 “(II) the earliest date that any
3 taxable REIT subsidiary of such trust
4 entered into a management agreement
5 or other similar service contract with
6 such person with respect to such
7 qualified lodging facility or qualified
8 health care property.”.

9 (c) TAXABLE REIT SUBSIDIARIES.—The last sen-
10 tence of section 856(l)(3) is amended—

11 (1) by inserting “or a health care facility” after
12 “a lodging facility”, and

13 (2) by inserting “or health care facility” after
14 “such lodging facility”.

15 **TITLE V—FOREIGN REITS**

16 **SEC. 501. STOCK OF FOREIGN REITS AS REAL ESTATE AS-** 17 **SETS.**

18 (a) IN GENERAL.—The first sentence in section
19 856(c)(5)(B) is amended by inserting “or in a qualified
20 foreign REIT” after “this part”.

21 (b) QUALIFIED FOREIGN REIT.—Section 856(c) is
22 amended by adding at the end the following new para-
23 graph:

1 “(8) QUALIFIED FOREIGN REIT.—For purposes
2 of this subsection, the term ‘qualified foreign REIT’
3 means a corporation, trust, or association—

4 “(A) treated as a corporation under section
5 7701(a)(3),

6 “(B) the shares or certificates of beneficial
7 interests of which are regularly traded on an es-
8 tablished securities market, and

9 “(C) which is organized in a country under
10 rules that the Secretary determines meet the
11 following criteria:

12 “(i) At least 75 percent of the entity’s
13 assets must qualify as real estate assets
14 (determined without regard to shares or
15 transferable certificates of beneficial inter-
16 est in such entity), as determined at the
17 close of the entity’s prior taxable year.

18 “(ii) The entity either receives a divi-
19 dends paid deduction comparable to section
20 561 or is exempt from corporate level tax.

21 “(iii) The entity is required to dis-
22 tribute at least 85 percent of its annual
23 taxable income (as computed in the juris-
24 diction in which it is organized) to the

1 holders of its shares or certificates of bene-
2 ficial interest on an annual basis.

3 In determining whether the rules of a country
4 meet the criteria of a qualified foreign REIT,
5 the Secretary shall take into account non-statu-
6 tory rules such as stock exchange listing re-
7 quirements as well as existing practices result-
8 ing from market preferences, and may take into
9 account situations that in the judgment of the
10 Secretary present a significant opportunity for
11 a foreign REIT to generate an amount of in-
12 come that is not compatible with the principles
13 underlying section 856(c)(3).”.

14 **SEC. 502. DIVIDENDS FROM FOREIGN REITS.**

15 Section 856(c)(3)(D) is amended by inserting “and
16 in qualified foreign REITs” after “this part”.

17 **TITLE VI—EFFECTIVE DATES**

18 **SEC. 601 EFFECTIVE DATES.**

19 (a) IN GENERAL.—Except as otherwise provided in
20 this section, the amendments made by this Act shall apply
21 to taxable years beginning after the date of the enactment
22 of this Act.

23 (b) REIT INCOME TESTS.—

1 (1) The amendment made by section 101(a)
2 and (b) shall apply to gains and items of income rec-
3 ognized after the date of the enactment of this Act.

4 (2) The amendment made by section 101(c)
5 shall apply to transactions entered into after the
6 date of the enactment of this Act.

7 (3) The amendment made by section 101(d)
8 shall apply after the date of the enactment of this
9 Act.

10 (c) CONFORMING FOREIGN CURRENCY REVISIONS.—

11 (1) The amendment made by section 103(a)
12 shall apply to gains recognized after the date of the
13 enactment of this Act.

14 (2) The amendment made by section 103(b)
15 shall apply to gains and deductions recognized after
16 the date of the enactment of this Act.

17 (d) DEALER SALES.—The amendments made by
18 Title III shall apply to sales made after the date of the
19 enactment of this Act.

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