

105TH CONGRESS
2D SESSION

S. 1871

To provide that the exception for certain real estate investment trusts from the treatment of stapled entities shall apply only to existing property, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 26, 1998

Mr. ROTH (for himself and Mr. MOYNIHAN) introduced the following bill;
which was read twice and referred to the Committee on Finance

A BILL

To provide that the exception for certain real estate investment trusts from the treatment of stapled entities shall apply only to existing property, 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. TERMINATION OF EXCEPTION FOR CERTAIN**
4 **REAL ESTATE INVESTMENT TRUSTS FROM**
5 **THE TREATMENT OF STAPLED ENTITIES.**

6 (a) IN GENERAL.—Notwithstanding paragraph (3) of
7 section 136(c) of the Tax Reform Act of 1984 (relating
8 to stapled stock; stapled entities), the REIT gross income
9 provisions shall be applied by treating the activities and

1 gross income of members of the stapled REIT group prop-
 2 erly allocable to any nonqualified real property interest
 3 held by the exempt REIT or any stapled entity which is
 4 a member of such group (or treated under subsection (c)
 5 as held by such REIT or stapled entity) as the activities
 6 and gross income of the exempt REIT in the same manner
 7 as if the exempt REIT and such group were 1 entity.

8 (b) NONQUALIFIED REAL PROPERTY INTEREST.—
 9 For purposes of this section—

10 (1) IN GENERAL.—The term “nonqualified real
 11 property interest” means, with respect to any ex-
 12 empt REIT, any interest in real property acquired
 13 after March 26, 1998, by the exempt REIT or any
 14 stapled entity.

15 (2) EXCEPTION FOR BINDING CONTRACTS,
 16 ETC.—Such term shall not include any interest in
 17 real property acquired after March 26, 1998, by the
 18 exempt REIT or any stapled entity if—

19 (A) the acquisition is pursuant to a written
 20 agreement which was binding on such date and
 21 at all times thereafter on such REIT or stapled
 22 entity, or

23 (B) the acquisition is described on or be-
 24 fore such date in a public announcement or in

1 a filing with the Securities and Exchange Com-
2 mission.

3 (3) IMPROVEMENTS AND LEASES.—

4 (A) IN GENERAL.—Except as otherwise
5 provided in this paragraph, the term “non-
6 qualified real property interest” shall not in-
7 clude—

8 (i) any improvement to land owned or
9 leased by the exempt REIT or any member
10 of the stapled REIT group, and

11 (ii) any repair to, or improvement of,
12 any improvement owned or leased by the
13 exempt REIT or any member of the sta-
14 pled REIT group,

15 if such ownership or leasehold interest is a
16 qualified real property interest.

17 (B) LEASES.—Such term shall not include
18 any lease of a qualified real property interest.

19 (C) TERMINATION WHERE CHANGE IN
20 USE.—

21 (i) IN GENERAL.—Subparagraph (A)
22 shall not apply to any improvement placed
23 in service after December 31, 1999, which
24 is part of a change in the use of the prop-
25 erty to which such improvement relates un-

less the cost of such improvement does not exceed 200 percent of—

(I) the cost of such property, or

(II) if such property is substituted basis property (as defined in section 7701(a)(42) of the Internal Revenue Code of 1986), the fair market value of the property at the time of acquisition.

(ii) BINDING CONTRACTS.—For purposes of clause (i), an improvement shall be treated as placed in service before January 1, 2000, if such improvement is placed in service before January 1, 2004, pursuant to a binding contract in effect on December 31, 1999, and at all times thereafter.

(4) TREATMENT OF ENTITIES WHICH ARE NOT STAPLED, ETC. ON MARCH 26, 1998.—Notwithstanding any other provision of this section, all interests in real property held by an exempt REIT or any stapled entity with respect to such REIT (or treated under subsection (c) as held by such REIT or stapled entity) shall be treated as nonqualified real property interests unless—

1 (A) such stapled entity was a stapled en-
 2 tity with respect to such REIT as of March 26,
 3 1998, and at all times thereafter, and

4 (B) as of March 26, 1998, and at all times
 5 thereafter, such REIT was a real estate invest-
 6 ment trust.

7 (5) QUALIFIED REAL PROPERTY INTEREST.—
 8 The term “qualified real property interest” means
 9 any interest in real property other than a non-
 10 qualified real property interest.

11 (c) TREATMENT OF PROPERTY HELD BY 10-PER-
 12 CENT SUBSIDIARIES.—For purposes of this section—

13 (1) IN GENERAL.—Any exempt REIT and any
 14 stapled entity shall be treated as holding their pro-
 15 portionate shares of each interest in real property
 16 held by any 10-percent subsidiary entity of the ex-
 17 empt REIT or stapled entity, as the case may be.

18 (2) PROPERTY HELD BY 10-PERCENT SUBSIDI-
 19 ARIES TREATED AS NONQUALIFIED.—

20 (A) IN GENERAL.—Except as provided in
 21 subparagraph (B), any interest in real property
 22 held by a 10-percent subsidiary entity of an ex-
 23 empt REIT or stapled entity shall be treated as
 24 a nonqualified real property interest.

1 (B) EXCEPTION FOR INTERESTS IN REAL
2 PROPERTY HELD ON MARCH 26, 1998, ETC.—In
3 the case of an entity which was a 10-percent
4 subsidiary entity of an exempt REIT or stapled
5 entity on March 26, 1998, and at all times
6 thereafter, an interest in real property held by
7 such subsidiary entity shall be treated as a
8 qualified real property interest if such interest
9 would be so treated if held directly by the ex-
10 empt REIT or the stapled entity.

11 (3) REDUCTION IN QUALIFIED REAL PROPERTY
12 INTERESTS IF INCREASE IN OWNERSHIP OF SUBSIDI-
13 ARY.—If, after March 26, 1998, an exempt REIT or
14 stapled entity increases its ownership interest in a
15 subsidiary entity to which paragraph (2)(B) applies
16 above its ownership interest in such subsidiary entity
17 as of such date, the additional portion of each inter-
18 est in real property which is treated as held by the
19 exempt REIT or stapled entity by reason of such in-
20 creased ownership shall be treated as a nonqualified
21 real property interest.

22 (4) SPECIAL RULES FOR DETERMINING OWNER-
23 SHIP.—For purposes of this subsection—

1 (A) percentage ownership of an entity shall
 2 be determined in accordance with subsection
 3 (e)(4),

4 (B) interests in the entity which are ac-
 5 quired by the exempt REIT or stapled entity in
 6 any acquisition described in an agreement, an-
 7 nouncement, or filing described in subsection
 8 (b)(2) shall be treated as acquired on March
 9 26, 1998, and

10 (C) except as provided in guidance pre-
 11 scribed by the Secretary, any change in propor-
 12 tionate ownership which is attributable solely to
 13 fluctuations in the relative fair market values of
 14 different classes of stock shall not be taken into
 15 account.

16 (d) TREATMENT OF PROPERTY SECURED BY MORT-
 17 GAGE HELD BY EXEMPT REIT OR MEMBER OF STAPLED
 18 REIT GROUP.—

19 (1) IN GENERAL.—In the case of any non-
 20 qualified obligation held by an exempt REIT or any
 21 member of the stapled REIT group, the REIT gross
 22 income provisions shall be applied by treating the ex-
 23 empt REIT as having impermissible tenant service
 24 income equal to—

1 (A) the interest income from such obliga-
 2 tion which is properly allocable to the property
 3 described in paragraph (2), and

4 (B) the income of any member of the sta-
 5 pled REIT group from services described in
 6 paragraph (2) with respect to such property.

7 If the income referred to in subparagraph (A) or (B)
 8 is of a 10-percent subsidiary entity, only the portion
 9 of such income which is properly allocable to the ex-
 10 empt REIT's or the stapled entity's interest in the
 11 subsidiary entity shall be taken into account.

12 (2) NONQUALIFIED OBLIGATION.—Except as
 13 otherwise provided in this subsection, the term “non-
 14 qualified obligation” means any obligation secured
 15 by a mortgage on an interest in real property if the
 16 income of any member of the stapled REIT group
 17 for services furnished with respect to such property
 18 would be impermissible tenant service income were
 19 such property held by the exempt REIT and such
 20 services furnished by the exempt REIT.

21 (3) EXCEPTION FOR CERTAIN MARKET RATE
 22 OBLIGATIONS.—Such term shall not include any ob-
 23 ligation—

24 (A) payments under which would be treat-
 25 ed as interest if received by a REIT, and

1 (B) the rate of interest on which does not
 2 exceed an arm's length rate.

3 (4) EXCEPTION FOR EXISTING OBLIGATIONS.—

4 Such term shall not include any obligation—

5 (A) which is secured on March 26, 1998,
 6 by an interest in real property, and

7 (B) which is held on such date by the ex-
 8 empt REIT or any entity which is a member of
 9 the stapled REIT group on such date and at all
 10 times thereafter,

11 but only so long as such obligation is secured by
 12 such interest. The preceding sentence shall not cease
 13 to apply by reason of the refinancing of the obliga-
 14 tion if (immediately after the refinancing) the prin-
 15 cipal amount of the obligation resulting from the re-
 16 financing does not exceed the principal amount of
 17 the refinanced obligation (immediately before the re-
 18 financing).

19 (5) TREATMENT OF ENTITIES WHICH ARE NOT
 20 STAPLED, ETC. ON MARCH 26, 1998.—A rule similar
 21 to the rule of subsection (b)(4) shall apply for pur-
 22 poses of this subsection.

23 (6) INCREASE IN AMOUNT OF NONQUALIFIED
 24 OBLIGATIONS IF INCREASE IN OWNERSHIP OF SUB-

1 SIDIARY.—A rule similar to the rule of subsection
2 (c)(3) shall apply for purposes of this subsection.

3 (7) COORDINATION WITH SUBSECTION (a).—
4 This subsection shall not apply to the portion of any
5 interest in real property that the exempt REIT or
6 stapled entity holds or is treated as holding under
7 this section without regard to this subsection.

8 (e) DEFINITIONS.—For purposes of this section—

9 (1) REIT GROSS INCOME PROVISIONS.—The
10 term “REIT gross income provisions” means—

11 (A) paragraphs (2), (3), and (6) of section
12 856(c) of the Internal Revenue Code of 1986,
13 and

14 (B) section 857(b)(5) of such Code.

15 (2) EXEMPT REIT.—The term “exempt REIT”
16 means a real estate investment trust to which sec-
17 tion 269B of the Internal Revenue Code of 1986
18 does not apply by reason of paragraph (3) of section
19 136(c) of the Tax Reform Act of 1984.

20 (3) STAPLED REIT GROUP.—The term “stapled
21 REIT group” means, with respect to an exempt
22 REIT, the group consisting of—

23 (A) all entities which are stapled entities
24 with respect to the exempt REIT, and

1 (B) all entities which are 10-percent sub-
 2 sidiary entities of the exempt REIT or any such
 3 stapled entity.

4 (4) 10-PERCENT SUBSIDIARY ENTITY.—

5 (A) IN GENERAL.—The term “10-percent
 6 subsidiary entity” means, with respect to any
 7 exempt REIT or stapled entity, any entity in
 8 which the exempt REIT or stapled entity (as
 9 the case may be) directly or indirectly holds at
 10 least a 10-percent interest.

11 (B) EXCEPTION FOR CERTAIN C CORPORA-
 12 TION SUBSIDIARIES OF REITS.—A corporation
 13 which would, but for this subparagraph, be
 14 treated as a 10-percent subsidiary of an exempt
 15 REIT shall not be so treated if such corpora-
 16 tion is taxable under section 11 of the Internal
 17 Revenue Code of 1986.

18 (C) 10-PERCENT INTEREST.—The term
 19 “10-percent interest” means—

20 (i) in the case of an interest in a cor-
 21 poration, ownership of 10 percent (by vote
 22 or value) of the stock in such corporation,

23 (ii) in the case of an interest in a
 24 partnership, ownership of 10 percent of the

1 assets or net profits interest in the part-
2 nership, and

3 (iii) in any other case, ownership of
4 10 percent of the beneficial interests in the
5 entity.

6 (5) OTHER DEFINITIONS.—Terms used in this
7 section which are used in section 269B or section
8 856 of such Code shall have the respective meanings
9 given such terms by such section.

10 (f) GUIDANCE.—The Secretary may prescribe such
11 guidance as may be necessary or appropriate to carry out
12 the purposes of this section, including guidance to prevent
13 the avoidance of such purposes and to prevent the double
14 counting of income.

15 (g) EFFECTIVE DATE.—This section shall apply to
16 taxable years ending after March 26, 1998.

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