

105TH CONGRESS  
1ST SESSION

# S. 898

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

JUNE 12, 1997

Mr. HATCH (for himself, Mr. BAUCUS, Mr. MACK, and Mr. D'AMATO) 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 1997”.

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 adding “and” at the  
 13 end of paragraph (1), by striking paragraph (2), and  
 14 by redesignating paragraph (3) as paragraph (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 received or accrued directly or indirectly by the  
19 real estate investment trust for—

20 “(i) services furnished or rendered by  
21 the trust to the tenants of such property,  
22 or

23 “(ii) managing or operating such  
24 property.

1           “(B) DISQUALIFICATION OF ALL AMOUNTS  
 2           WHERE MORE THAN DE MINIMIS AMOUNT.—If  
 3           the amount described in subparagraph (A) with  
 4           respect to a property exceeds 1 percent of all  
 5           amounts received or accrued during such tax-  
 6           able year directly or indirectly by the real estate  
 7           investment trust with respect to such property,  
 8           the impermissible tenant service income of the  
 9           trust with respect to the property shall include  
 10          all such amounts.

11          “(C) EXCEPTIONS.—For purposes of sub-  
 12          paragraph (A)—

13               “(i) services furnished or rendered, or  
 14               management or operation provided,  
 15               through an independent contractor from  
 16               whom the trust itself does not derive or re-  
 17               ceive any income shall not be treated as  
 18               furnished, rendered, or provided by the  
 19               trust, and

20               “(ii) there shall not be taken into ac-  
 21               count any amount which would be excluded  
 22               from unrelated business taxable income  
 23               under section 512(b)(3) if received by an  
 24               organization described in section  
 25               511(a)(2).

1           “(D) AMOUNT ATTRIBUTABLE TO IMPER-  
 2           MISSIBLE SERVICES.—For purposes of subpara-  
 3           graph (A), the amount treated as received for  
 4           any service (or management or operation) shall  
 5           not be less than 150 percent of the direct cost  
 6           of the trust in furnishing or rendering the serv-  
 7           ice (or providing the management or operation). ”

8           “(E) COORDINATION WITH LIMITA-  
 9           TIONS.—For purposes of paragraphs (2) and  
 10          (3) of subsection (c), amounts described in sub-  
 11          paragraph (A) shall be included in the gross in-  
 12          come of the corporation, trust, or association.”

13 **SEC. 103. ATTRIBUTION RULES APPLICABLE TO TENANT**  
 14 **OWNERSHIP.**

15          Section 856(d)(5) (relating to constructive ownership  
 16 of stock) is amended by adding at the end the following:  
 17 “For purposes of paragraph (2)(B), section 318(a)(3)(A)  
 18 shall be applied under the preceding sentence in the case  
 19 of a partnership by taking into account only partners who  
 20 own (directly or indirectly) 25 percent or more of the cap-  
 21 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 redesign-  
 8 nating 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 with its annual report for the taxable  
 25 year), but the amount so includible by any



1 shareholder shall not exceed that part of  
2 the amount subjected to tax in subpara-  
3 graph (A)(ii) which he would have received  
4 if all of such amount had been distributed  
5 as capital gain dividends by the trust to  
6 the holders of such shares at the close of  
7 its taxable year.

8 “(ii) For purposes of this title, every  
9 such shareholder shall be deemed to have  
10 paid, for his taxable year under clause (i),  
11 the tax imposed by subparagraph (A)(ii)  
12 on the amounts required by this subpara-  
13 graph to be included in respect of such  
14 shares in computing his long-term capital  
15 gains for that year; and such shareholder  
16 shall be allowed credit or refund as the  
17 case may be, for the tax so deemed to have  
18 been paid by him.

19 “(iii) The adjusted basis of such  
20 shares in the hands of the shareholder  
21 shall be increased with respect to the  
22 amounts required by this subparagraph to  
23 be included in computing his long-term  
24 capital gains, by the difference between the  
25 amount of such includible gains and the

1 tax deemed paid by such shareholder in re-  
 2 spect of such shares under clause (ii).

3 “(iv) In the event of such designation,  
 4 the tax imposed by subparagraph (A)(ii)  
 5 shall be paid by the real estate investment  
 6 trust within 30 days after the close of its  
 7 taxable year.

8 “(v) The earnings and profits of such  
 9 real estate investment trust, and the earn-  
 10 ings and profits of any such shareholder  
 11 which is a corporation, shall be appro-  
 12 priately adjusted in accordance with regu-  
 13 lations prescribed by the Secretary.

14 “(vi) As used in this subparagraph,  
 15 the terms ‘shares’ and ‘shareholders’ shall  
 16 include beneficial interests and holders of  
 17 beneficial interests, respectively.”

18 (b) CONFORMING AMENDMENTS.—

19 (1) Clause (i) of section 857(b)(7)(A) is amend-  
 20 ed by striking “subparagraph (B)” and inserting  
 21 “subparagraph (B) or (D)”.

22 (2) Clause (iii) of section 852(b)(3)(D) is  
 23 amended by striking “by 65 percent” and all that  
 24 follows and inserting “by the difference between the  
 25 amount of such includible gains and the tax deemed

1       paid by such shareholder in respect of such shares  
2       under clause (ii).”

3   **SEC. 202. REDUCTION OF DISTRIBUTION REQUIREMENT.**

4       Clauses (i) and (ii) of section 857(a)(1)(A) are each  
5   amended by striking “95 percent (90 percent for taxable  
6   years beginning before January 1, 1980)” and inserting  
7   “90 percent”.

8                           **TITLE III—OTHER**  
9                           **SIMPLIFICATION**

10   **SEC. 301. MODIFICATION OF EARNINGS AND PROFITS**

11                           **RULES FOR DETERMINING WHETHER REIT**  
12                           **HAS EARNINGS AND PROFITS FROM NON-**  
13                           **REIT YEAR.**

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

16                       “(3) DISTRIBUTIONS TO MEET REQUIREMENTS  
17       OF SUBSECTION (a)(2)(B).—Any distribution which  
18       is made in order to comply with the requirements of  
19       subsection (a)(2)(B)—

20                       “(A) shall be treated for purposes of this  
21       subsection and subsection (a)(2)(B) as made  
22       from the earliest accumulated earnings and  
23       profits (other than earnings and profits to  
24       which subsection (a)(2)(A) applies) rather than

1 the most recently accumulated earnings and  
 2 profits, and

3 “(B) to the extent treated under subpara-  
 4 graph (A) as made from accumulated earnings  
 5 and profits, shall not be treated as a distribu-  
 6 tion for purposes of subsection (b)(2)(B).”

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

8 (a) GRACE PERIODS.—

9 (1) INITIAL PERIOD.—Paragraph (2) of section  
 10 856(e) (relating to special rules for foreclosure prop-  
 11 erty) is amended by striking “on the date which is  
 12 2 years after the date such trust acquired such prop-  
 13 erty” and inserting “as of the close of the 3d taxable  
 14 year following the taxable year in which such trust  
 15 acquired such property”.

16 (2) EXTENSION.—Paragraph (3) of section  
 17 856(e) is amended—

18 (A) by striking “or more extensions” and  
 19 inserting “extension”, and

20 (B) by striking the last sentence and in-  
 21 serting: “Any such extension shall not extend  
 22 the grace period beyond the close of the 3d tax-  
 23 able year following the last taxable year in the  
 24 period under paragraph (2).”

1       (b) REVOCATION OF ELECTION.—Paragraph (5) of  
2 section 856(e) is amended by striking the last sentence  
3 and inserting: “A real estate investment trust may revoke  
4 any such election for a taxable year by filing the revocation  
5 (in the manner provided by the Secretary) on or before  
6 the due date (including any extension of time) for filing  
7 its return of tax under this chapter for the taxable year.  
8 If a trust revokes an election for any property, no election  
9 may be made by the trust under this paragraph with re-  
10 spect to the property for any subsequent taxable year.”

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

14       “For purposes of subparagraph (C), property shall  
15 not be treated as used in a trade or business by rea-  
16 son of any activities of the real estate investment  
17 trust with respect to such property to the extent  
18 that such activities would not result in amounts re-  
19 ceived or accrued, directly or indirectly, with respect  
20 to such property being treated as other than rents  
21 from real property.”

1 **SEC. 303. SPECIAL FORECLOSURE RULE FOR HEALTH CARE**  
 2 **PROPERTIES.**

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

6 “(6) SPECIAL RULE FOR QUALIFIED HEALTH  
 7 CARE PROPERTIES.—For purposes of this sub-  
 8 section—

9 “(A) ACQUISITION BY LEASE TERMI-  
 10 NATIONS.—The term ‘foreclosure property’  
 11 shall include any qualified health care property  
 12 acquired by a real estate investment trust as  
 13 the result of the termination or expiration of a  
 14 lease of such property.

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

20 “(i) the qualified health care property  
 21 shall cease to be foreclosure property on  
 22 the date which is 2 years after the date  
 23 such trust acquired such property, and

24 “(ii) if the real estate investment  
 25 trust establishes to the satisfaction of the  
 26 Secretary that an extension of the grace

1 period in clause (i) is necessary to the or-  
2 derly leasing or liquidation of the trust's  
3 interest in such qualified health care prop-  
4 erty, the Secretary may grant 1 or more  
5 extensions of the grace period for such  
6 qualified health care property.

7 Any such extension shall not extend the grace  
8 period beyond the date which is 6 years after  
9 the date such trust acquired such qualified  
10 health care property.

11 “(C) INCOME FROM INDEPENDENT CON-  
12 TRACTORS.—For purposes of applying para-  
13 graph (4)(C) with respect to qualified health  
14 care property which is foreclosure property, in-  
15 come derived or received by the trust from an  
16 independent contractor shall be disregarded to  
17 the extent such income is attributable to—

18 “(i) leases existing on the date the  
19 real estate investment trust acquired the  
20 qualified health care property, or

21 “(ii) leases extended or entered into  
22 after the trust acquired such property from  
23 lessees pursuant to terms set forth in such  
24 existing leases or on terms under which the  
25 trust receives a substantially similar or

1           lesser benefit in comparison to the previous  
2           lease for such property.

3           “(D) QUALIFIED HEALTH CARE PROP-  
4           PERTY.—The term ‘qualified health care prop-  
5           erty’ means any real property (including inter-  
6           ests therein), and any personal property inci-  
7           dent to such real property, which—

8                   “(i) is a health care facility, or

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

11           For purposes of the preceding sentence, the  
12           term ‘health care facility’ means a hospital,  
13           nursing facility, assisted living facility, or other  
14           licensed health care facility which extends medi-  
15           cal or nursing or ancillary services to patients  
16           and which, immediately before the termination,  
17           expiration, default, or breach of the lease of or  
18           mortgage secured by such facility, was operated  
19           by a provider of such services which was eligible  
20           for participation in the Medicare program  
21           under title XVIII of the Social Security Act  
22           with respect to such facility.”

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

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



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

“(i) payment to a real estate invest-  
ment trust under an interest rate swap or  
cap agreement, option, futures contract,  
forward rate agreement, or any similar fi-  
nancial instrument, entered into by the  
trust in a transaction to reduce the inter-  
est rate risks with respect to any indebted-  
ness incurred or to be incurred by the  
trust to acquire or carry real estate assets,  
and

“(ii) gain from the sale or other dis-  
position of any instrument described in  
clause (i),

shall be treated as income qualifying under  
paragraph (2).”

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

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

(1) by striking subparagraph (B),

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

1           (3) by redesignating subparagraph (C) (as  
2           amended by paragraph (2)) as subparagraph (B),  
3           and

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

6                   “(C) the amount (if any) by which—

7                           “(i) the amounts includible in gross  
8                           income with respect to instruments to  
9                           which section 860E(a) or 1272 applies, ex-  
10                          ceed

11                           “(ii) the amount of money and the  
12                           fair market value of other property re-  
13                           ceived during the taxable year under such  
14                           instruments, and

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

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

18           (a) IN GENERAL.—Clause (iii) of section  
19 857(b)(6)(C) (relating to certain sales not to constitute  
20 prohibited transactions) is amended by striking “(other  
21 than foreclosure property)” each place it appears and in-  
22 serting “(other than exempt property)”.

23           (b) EXEMPT PROPERTY.—Subparagraph (D) of sec-  
24 tion 857(b)(6) is amended by adding at the end the follow-  
25 ing new clause:

1 “(viii) The term ‘exempt property’  
 2 means—  
 3 “(I) foreclosure property, and  
 4 “(II) property which, while held  
 5 by the real estate investment trust,  
 6 was compulsorily or involuntarily con-  
 7 verted (within the meaning of section  
 8 1033).”

9 **SEC. 307. SHARED APPRECIATION MORTGAGES.**

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

15 “(4) **COORDINATION WITH 4-YEAR HOLDING PE-**  
 16 **RIOD.**—

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

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

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

3 “(iii) the disposition is required by the  
 4 court or is pursuant to a plan approved by  
 5 the court.

6 “(B) EXCEPTION.—Subparagraph (A)  
 7 shall not apply if—

8 “(i) the secured property was acquired  
 9 by the trust with the intent to evict or  
 10 foreclose, or

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

14 (b) CLARIFICATION OF DEFINITION OF SHARED AP-  
 15 PRECIATION PROVISION.—Clause (ii) of section  
 16 856(j)(5)(A) is amended by striking “gain” each place it  
 17 appears and inserting “gain or appreciation in value”.

18 **SEC. 308. WHOLLY OWNED SUBSIDIARIES.**

19 Section 856(i)(2) (defining qualified REIT subsidi-  
 20 ary) is amended by striking “at all times during the period  
 21 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.

○