

Peruvian-Americans graduate every year with degrees in law, medicine, engineering, and accounting.

The Peruvian-Americans have been so successful in their educational endeavors because they believe in hard work, sometimes attending classes at night while working full time during the day. In fact, the number of Peruvians on the rolls of social services is almost nonexistent. They have demonstrated that a fair chance to prove their value coupled with the dedication to hard work are the ingredients to a prosperous life.

Furthermore, the Peruvians believe dedication to the family is the essential element in building strong community relationships where parents can care for their children and ensure that they have the best opportunities available to advance in life. For instance, when faced with financial difficulties Peruvian-Americans have displayed their self reliance. Instead of turning to the Federal Government, the Peruvians have established a network of community organizations including volunteers, civic associations, and churches which offer medical care and other forms of assistance to the residents. They provide the strength, reassurance, and tangible advantages that are necessary to succeed. In short, it is the community where Peruvians go when in need of assistance.

Finally, Mr. Speaker, the success of the Peruvian community has had a positive impact on the lives of the people of my congressional district. They provide brilliant examples of the same values that propelled my parents—and millions of other immigrants—to succeed in America. I believe it is all of these qualities that make the Peruvian community such an asset to the people I represent. I am proud to join them on this day of celebration.

THE REAL ESTATE INVESTMENT TRUST SIMPLIFICATION ACT OF 1995

HON. E. CLAY SHAW, JR.

OF FLORIDA

IN THE HOUSE OF REPRESENTATIVES

Friday, July 28, 1995

Mr. SHAW. Mr. Speaker, I rise today to draw my colleagues' attention to an important piece of legislation, H.R. 2121, the Real Estate Investment Trust Simplification Act of 1995 [REITSA], a bill to amend portions of the Internal Revenue Code dealing with real estate investment trusts, or REIT's. The legislation responds to the need for simplification in the regulation of the day-to-day operation of REIT's. REITSA is cosponsored by Mr. MATSUI, Mr. CRANE, Mr. THOMAS, Mrs. JOHNSON, of Connecticut, Mr. ZIMMER, Mr. PORTMAN, Mr. STARK, Mr. JACOBS, Mr. LEVIN, Mr. CARDIN, Mr. DUNN, and Mr. SAM JOHNSON of Texas.

In 1960, Congress created REIT's to function as the real estate equivalent of the regulated investment company, or mutual fund. As such, they permit small investors to participate in real estate projects that the investors could not undertake individually and with the assistance of experienced management. Over time, the REIT industry has matured into its intended role with the greatest stride made in this decade.

This development of the REIT industry is a result of a number of factors. As important as

any other were the changes Congress enacted in 1986 to the REIT rules themselves and the tax landscape in general. With respect to the general provisions, throughout the 1980's limited partnerships used the offer of multiple dollars of tax paper losses for each invested dollar to attract investors away from solid investments like REITs, which seek to provide investors with consistent distributions from economically feasible real estate investments but provide no opportunity to receive a pass-through of tax motivated losses. Accordingly, the elimination of those tax loss loopholes led investors to look for income-producing investment opportunities.

Also included in the 1986 tax legislation were important modifications to the REIT provisions of the Code. Among the changes made as part of that modernization of the REIT tax laws, the first in a decade and most recent comprehensive revision of the REIT laws, the most significant was the change allowing REIT's to directly provide to tenants those services customary in the leasing of real estate as had been permitted to pension plans and other tax-exempt entities engaged in the leasing of real property. Prior to that change, a REIT was required to use an independent contractor to provide those services.

These legislative changes and the lack of credit to recapitalize America's real estate produced a suitable environment for the substantial growth in the REIT industry and the fulfillment of Congress' original hopes for the REIT vehicle.

From 1990 to present, the industry has grown from a market capitalization of approximately \$9 billion to nearly \$50 billion. Fueling that growth has been the introduction of some of America's leading real estate companies to the family of long existing, viable REIT's. As a result, the majority of today's REIT's are owners of quality, income-producing real estate. Thus, hundreds of thousands of individuals that own REIT shares through direct investment, plus the many more who are interest holders in the growing number of mutual funds or pension funds investing in REIT's, have become participants in the recapitalization of tens of billions of dollars of America's best real estate investments. Likewise, investors in mortgage REIT's have the opportunity to participate in the ever growing market for securitized mortgages, further contributing to the recapitalization of quality real estate.

The benefits of the growth in the REIT industry were addressed in a recent Urban Land Institute White Paper titled "The REIT Renaissance." That white paper concluded that "[f]rom an overall economic standpoint, the real estate industry and the economy should be well served by the expansion of the REIT industry—the broadening of participation in real estate ownership, the investment in market information and research that the public market will bring, and the more timely responsiveness to market signals that will result from better information and market analysis."

To assist the continued growth of this important industry, was developed to address areas in the existing tax regime that present significant, yet unnecessary, barriers to the use of the REIT vehicle. The proposals represent a modernization of the most complex parts of the regulatory structure under which REIT's operate, while leaving intact the basic underlying ownership, income, asset, and distribution

tests introduced in the original REIT legislation.

SUMMARY OF KEY PROVISIONS

A. Title I contains three proposals to remove unnecessary "traps for the unwary." These proposals would address current requirements that are not necessary to satisfy Congressional objectives, that carry a disproportionate penalty for even unintentional oversights, or that are impracticable in today's environment. Title I's overriding intention is not to penalize a REIT's many small investors by stripping the REIT of its tax status as a result of an act that does not violate Congress' underlying intent in creating the REIT vehicle.

Section 101. Shareholder Demand Letter. The potential disqualification for a REIT's failure to send shareholder demand letters should be replaced with a reporting penalty. Under present law, regulations require that a REIT send letters to certain shareholders within 30 days of the close of the REIT's taxable year. The letters demand from its shareholders of record, a written statement identifying the "actual owner" of the stock. A REIT's failure to comply with the notification requirement may result in a loss of REIT status.

The failure to send-so-called demand letters may result in the disqualification of a REIT with thousands of shareholders that easily satisfies the substantive test because of a purely technical violation. As a result of disqualification, a REIT would be compelled to pay taxes for all open years, thereby depriving their shareholders of income generated in compliance with all of the REIT rules. Fortunately, the Internal Revenue Service has not enforced any such technical disqualifications and instead has entered into closing agreements with several REITs. The proposal would alleviate the need to enter into such closing agreements on a prospective basis.

H.R. 2121 provides that a REIT's failure to comply with the demand letter regulations would not, by itself, disqualify a REIT if it otherwise establishes that it satisfies the substantive ownership rules. But under these circumstances, a \$25,000 penalty (\$50,000 for intentional violations) would be imposed for any year in which the REIT did not comply with the shareholder demand regulations and the REIT would be required, when requested by the IRS, to send curative demand letters or face an additional penalty equal to the amounts related above. In addition, to protect a REIT that meets the regulations, but is otherwise unable to discover the actual ownership of its shares, the bill provides that a REIT would be deemed to satisfy the share ownership rules if it complies with the demand letter regulations and does not know, or have reason to know, of an actual violation of the ownership rules.

Section 102. De Minimis Rule for Tenant Services Income. The uncertainty related to qualifying services for a REIT should be addressed by a reasonable de minimis test. In 1986, Congress modernized the REITs' independent contractor rules to allow them to directly furnish to tenants those services customary in the management of rental property. However, certain problems persist. Under existing law, a REIT's receipt of any amount of revenue as a result of providing an impermissible service to tenants with respect to a property may disqualify all rents received with respect to that property. For example, if a REIT's employee assists a tenant in moving in or out of an apartment complex (a potentially impermissible service), technically the IRS could contend that all the income from the apartment complex is disqualified, even though the REIT received no direct revenue for the provided

service. Similar concerns might arise if a REIT provided wheelchairs at a mall on a no-cost basis. The disqualifications of a large property's rent could seriously threaten, or even terminate, the REIT's qualified status.

Interestingly, at the same time a REIT could be severely punished for providing services to tenants or their visitors, the REIT rules properly provide that up to 5 percent of a REIT's gross income may come from providing services to non-tenants. Thus, under present law a REIT is better off providing services to nontenants than providing the same services to tenants.

In addition to the potential disqualification of rents, the absence of a de minimus rule requires the REIT to spend significant time and energy in monitoring every action of its employees, and significant dollars in attorney fees to determine whether each potential action is an impermissible service. The uncertainty regarding the permissibility of services also requires that the IRS to expend considerable resources in responding to private ruling requests.

To lessen the burden of monitoring each REIT employee's every action and to eliminate unnecessary disqualification of tenant rents, this bill provides for a de minimus exception. The exception would treat small amounts of revenue resulting from an impermissible service in a manner similar to revenue received from providing services to non-tenants, and protect the classification of rents from the affected property as qualifying REIT income. The de minimus exception is equal to 1 percent of the gross income from the affected property. The de minimus exception is based on gross income to be consistent with the REIT's income tests, and is set at 1 percent to reflect an amount large enough to provide the requisite safe harbor (note that it is 1 percent of the income from an affected property, regardless how small, and not all properties owned by the REIT), yet small enough not to encourage disregard of the independent contractor rule. Because many of the services in question will not result in a direct receipt of gross income, the bill provides a mechanism for establishing the gross income received relative to an impermissible service. The gross income is deemed at least equal to the direct costs of the service (i.e. labor, cost of goods) multiplied by 150 percent.

For example, in the case of a REIT providing wheelchairs at a mall, the cost of the wheelchairs would be multiplied by 150 percent to achieve the gross income realized from the impermissible service. If that and any other gross income related to impermissible services provided to tenants of that mall does not exceed 1 percent of the mall's gross income for the year, the impermissible service income would be classified as non-qualifying income. However, rents received from tenants of the mall would not be disqualified.

A REIT's actions are still policed under this change. First, if a REIT's gross income from impermissible services exceed 1 percent of the gross income from the affected property, that income and the rents from that property would be disqualified as under current law. Second, as previously noted, a REIT's gross income from non-qualifying sources is limited to 5 percent of total gross income. Accordingly, gross income from impermissible sources that does not exceed the 1 percent threshold would be included in that small basket, thereby placing a second check on the REIT's activities.

Section 103. Attribution Rules Applicable To Tenant Ownership. Unintended double attribution under section 318 should be minimized, while preserving the intended purpose of the attribution rule. The attribution rules of section 318 are interjected to ensure that

a REIT does not receive rents from a 10 percent or more related party, in which case the rents are deemed disqualified income for the REIT gross income tests. While the intention of that rule is proper, a quirk in the application of section 318 to REITs as called for under section 856(d)(2) may result in the disqualification of a REIT's rent when no actual direct or indirect relationship exists between the REIT and tenant.

Under section 318(a)(3)(A), stock owned directly or indirectly, by a partner is considered owned by the partnership. In addition, under section 318(a)(3)(C), a corporation is considered as owning stock that is owned, directly or indirectly, by or for a person who also owns more than 10 percent (in the case of REITs) of the stock in such corporation. Those attribution rules may create an unintended result when several persons who collectively own 10 percent of a REIT's tenant, also own collectively 10 percent of the REIT. So long as those persons are unrelated, because their individual interests in both the REIT and tenant do not equal 10 percent the REIT is not deemed to own 10 percent of the tenant. However, if those persons obtain interests, regardless of how small, in the same partnership the REIT will be deemed to own 10 percent of the tenant. This results from the partnership's deemed ownership of the partners' stock in both tenant and the REIT. Further, because the partnership becomes a deemed 10 percent owner of the REIT under section 318(a)(3)(A), REIT is deemed the 10 percent owner of tenant under section 318(a)(3)(C).

In essence, the REIT becomes the deemed 10 percent owner of its tenant as a result of a variation of the partner-to-partner attribution that section 318(a)(5)(C) specifically was enacted to prevent. It is only through the combination of the partners' various interests in the REIT and tenant that a disqualification of the rents occurs. This is true regardless of the purpose for the partnership's existence. The partners may have no knowledge of the other's existence and may be partners in a huge limited partnership completely unrelated to the REIT.

H.R. 2121 addresses this problem by modifying the application of section 318(a)(3)(A) (attribution to the partnership) only for purposes of section 856(d)(2), so that attribution would occur only when a partner holds a 25 percent or greater interest in the partnership. This threshold presumes that such a partner will have knowledge of the other persons holding interest in the partnership, and will have an opportunity to determine if those persons hold an interest in the REIT. By not suspending the double attribution entirely, the bill prevents the potentially abusive practice of placing a "dummy" partnership between the REIT and those persons holding interests in the tenant.

B. Title II of REITSA contains two proposals that would assist in carrying out Congress' original intent to create a real estate vehicle analogous to regulated investment companies.

Section 201. Credit For Tax Paid by REIT On Retained Capital Gains. Current law taxes a REIT that retains capital gains, and imposes a second level of tax on the REIT shareholders when later they receive the capital gain distribution. REITSA reform provides for the REIT rules to be modified to correspond with the mutual fund rules governing the taxation of retained capital gains by passing through a credit to shareholders for capital gains taxes paid at the corporate (REIT) level. This modification is necessary to prevent the unintended depletion of a REIT's capital base when it sells property at a taxable gain. Accordingly, the REIT could acquire a replacement property without in-

curring costly charges associated with a stock offering or debt.

Section 202. Repeal of the 30 Percent Gross Income Requirement. H.R. 2121 calls for the repeal of the 30 percent gross income test because the effective management of a REIT's portfolio and is not needed to ensure that a REIT remains a long-term investor in real property. RICs have a similar anti-churning provision known as the "short-short" rule. The Tax Simplification and Technical Corrections Act of 1994 (H.R. 3419), as passed by the House of Representatives on May 17, 1994, would have repealed that rule for RICs.

Unlike RICs, REITs also face the imposition of a 100 percent tax on property held for sale in the ordinary course of business (dealer property). Thus, repeal of the REIT 30 percent test would not open the playing field for REITs to become speculators in real property. Instead, the repeal helps to ensure that a REIT will not lose its status if a REIT sells non-dealer property when market conditions are most favorable.

C. Title III of REITSA would simplify several technical problems that REITs face in their organization and day-to-day operations. Many of these proposals would build on simplifications that Congress has adopted over the years.

Section 301. Modification Of Earnings And Profits Rules For Determining Whether REIT Has Earnings And Profits From Non-REIT Year. Only for purposes of the requirement that a REIT distribute all pre-REIT earnings and profits ("E&P") within its first taxable year as a REIT, a REIT's distributions should be deemed to carry out all pre-REIT earnings before shareholders are considered to be receiving REIT E&P. Under existing law, a REIT must not only distribute 95 percent of its REIT taxable income to shareholders but it must in its first year distribute all pre-REIT year E&P. If the company mistakenly underestimates the amount of E&P generated while operating as a REIT it may fail to satisfy those requirements because the ordering rules controlling the distribution of E&P currently provide that distributions first carry out the most recently accumulated E&P. Thus, if a REIT distributes the pre-REIT E&P and the expected REIT E&P in its first REIT taxable year, the year-end receipt of any unanticipated income would result in the reclassification of a portion of the distribution intended to pass out the pre-REIT E&P.

While REITs have methods available to make distributions after the close of their taxable year that relate back to assure satisfaction of the 95 percent income distribution requirement, those methods can not be used to cure a failure to distribute pre-REIT E&P after the close of the REIT's taxable year. Accordingly, by allowing the REIT's distributions to first carry out the pre-REIT E&P, the REIT could satisfy both distribution requirements by using one of the deferred distribution methods to distributed the unanticipated income discussed in the example.

Section 302. Treatment Of Foreclosure Property. Rules related to foreclosure property should be modernized. For property acquired through foreclosure on a loan or default on a lease, under present law a REIT can elect foreclosure property treatment. That election provides the REIT with 3 special conditions to assist it in taking over the property and seeking its re-leasing or sale. First, a REIT is permitted to conduct a trade or business using property acquired through foreclosure for 90 days after it acquires such property, provided the REIT makes a foreclosure property election. After the 90-day period, the REIT must use an independent contractor to conduct the trade or business

(a party from whom the REIT does not receive income). Second, a REIT may hold foreclosure property for resale to customers without being subject to the 100 percent prohibited transaction tax (although subject to the highest corporate taxes). Third, non-qualifying income from foreclosure property (from activities conducted by the REIT or independent contractor after 90 days) is not considered for purposes of the REIT gross income tests, but generally is subject to the highest corporate tax rate. The foreclosure property election is valid for 2 years, but may be extended for 2 additional terms (a total of 6 years) with IRS consent.

Under H.R. 2121, the election procedure would be modified in the following ways: (1) the initial election and one renewal period would last for 3 years; (2) the initial election would remain effective until the last day of the third taxable year following the election (instead of exactly two years from the date of election); and (3) a one-time election out of foreclosure property status would be made available to accommodate situations when a REIT desires to discontinue foreclosure property status.

In addition, the independent contractor rule under the election would be modernized so that it worked in the same manner as the general independent contractor rule. Currently a REIT may provide to tenants of non-foreclosure property services customary in the leasing of real property. However, this previous modernization of the independent contractor rule was not made to the rules governing the required use of independent contractors for foreclosure property.

Section 303. Special Foreclosure Rules For Health Care Properties. In the case of health care REITs, H.R. 2121 provides that a REIT would not violate the independent contractor requirement if the REIT receives rents from a lease to that independent contractor as a tenant at a second health care facility. This change recognizes the limited number of health care providers available to serve as an independent contractor on a property acquired by the REIT in foreclosure, and the REIT's likely inability to simply close the facility due to the nature of the facilities inhabitants. In addition, the health care rules would extend the foreclosure property rules to expirations or terminations of health care REIT leases, since similar issues arise in those circumstances.

Section 304. Payments Under Hedging Instruments. H.R. 2121 would extend the REIT variable interest hedging rule to permit a REIT to treat as qualifying any income from the hedge of any REIT liability secured by real property or used to acquire or improve real property. This provision would apply to hedging a REIT's unsecured corporate debenture.

Section 305. Excess Noncash Income. H.R. 2121 would expand the use of the excess noncash income exclusion currently provided under the REIT distribution rules. The bill would (1) extend the exclusion to include most forms of phantom income and (2) make the exclusion available accrual basis REITs. Under the exclusion, listed forms of phantom income would be excluded from the REIT 95 percent distribution requirement. However, the income would be taxed at the REIT level if the REIT did not make sufficient distributions.

Section 306. Prohibited Transaction Safe Harbor. H.R. 2121 would correct a problem in the wording of Congress' past liberalization of the safe harbor from the 100 percent excise tax on prohibited transactions, i.e., sales of property in the ordinary course of business. The adverse effect of accumulated depreciation on the availability of the safe harbor, which punishes REITs that hold their properties for longer terms, would be mitigated,

In addition, involuntary conversions of property no longer would count against the permitted 7 sales of property under the safe harbor.

Section 307. Shared Appreciation Mortgages ("SAM"). In general, section 856(j) provides that a REIT may receive income based on a borrower's sale of the underlying property. However, the character of that income is determined by the borrower's actions. The SAM provision would be modified and clarified so that a REIT lender would not be penalized by a borrower's bankruptcy (an event beyond its control) and would clarify that a SAM could be based on appreciation in value as well as gain.

Section 308. Wholly Owned Subsidiaries. In 1986, Congress realized the usefulness of a REIT holding properties in subsidiaries to limit its liability exposure. H.R. 2121 would codify a recent IRS private letter ruling position providing that a REIT may treat a wholly-owned subsidiary as a qualified REIT subsidiary even if the subsidiary previously had been owned by a non-REIT entity. For example, this bill would allow a REIT to treat a corporation as a qualified REIT subsidiary when it purchases for cash and/or stock all the stock of a non-REIT C corporation.

DEPARTMENTS OF VETERANS AFFAIRS AND HOUSING AND URBAN DEVELOPMENT, AND INDEPENDENT AGENCIES APPROPRIATIONS ACT, 1996

SPEECH OF

HON. NANCY PELOSI

OF CALIFORNIA

IN THE HOUSE OF REPRESENTATIVES

Thursday, July 27, 1995

The House in Committee of the Whole House on the State of the Union had under consideration the bill (H.R. 2099) making appropriations for the Departments of Veterans Affairs and Housing and Urban Development, and for sundry independent agencies, boards, commissions, corporations, and offices for the fiscal year ending September 30, 1996, and for other purposes:

Ms. PELOSI. Mr. Chairman, I rise today in support of the amendment offered by Congressmen DEFazio, ROHRBACHER, STARK, and METCALF to reduce the funding for the Selective Service by \$17 million in fiscal year 1996. This \$17 million savings would then be transferred to the Veterans' Administration medical care account.

Mr. Speaker, not only would this amendment save millions of dollars annually; it would also streamline Government, reduce paperwork, and reduce the regulatory burden on U.S. citizens. Indeed, if a national security threat to the United States were serious enough to require a draft, the Department of Defense would have a recruit pool of hundreds of thousands of young men and women from the Reserve component and delayed entry, as well as hundreds of thousands of patriotic volunteers.

The savings that this important amendment will realize will instead be applied to the VA medical care account where the need is far greater. Our Nation's veterans have suffered greatly during the 104th Congress and this amendment addresses their most basic need: quality medical care.

Mr. Speaker, throughout the history of our Republic, we have continually asked the men

and women of our Armed Forces to make tremendous sacrifices on our behalf. It is critically important that we repay them for their sacrifice and uphold the promises we made to these veterans to care for them as they grow older.

In the context of a \$1.6 trillion Federal budget, the savings gained by this amendment may seem small. But they stand for the continued commitment we have toward caring for our veterans.

My colleagues, the DeFazio-Rohrabacher-Stark amendment represents the realization that the cold war has ended and so too the need for draft registration activities. More importantly, it signals our continued budgetary commitment to the medical care account at the VA and to our veterans.

I urge my colleagues to vote "Yes" on this amendment.

TRIBUTE TO MABLE WATKINS-CASS

HON. BOBBY L. RUSH

OF ILLINOIS

IN THE HOUSE OF REPRESENTATIVES

Friday, July 28, 1995

Mr. RUSH. Mr. Speaker, I rise today to pay tribute to Mrs. Mable Watkins-Cass, who on Sunday, June 30, 1995, will celebrate the occasion of her 60th birthday.

Mrs. Cass is a longtime resident of the city of Chicago. Born in Holly Springs, MS to the union of Mr. Windom Jones and the late Mrs. Ann Speights-Anderson, she came to Chicago in her formative years with her parents. Mrs. Cass is the proud mother of four children and the grandmother of five.

Mrs. Cass attended the Chicago public schools where she graduated from the Lucy Flowers Vocational High School. Additionally, she worked dutifully as an employee of the public school system, until her retirement in 1982.

A deeply devoted Christian woman, Mrs. Cass has served faithfully for the past 25 years as a member of the Gospel Temple Missionary Baptist Church on the southside of Chicago, under the leadership of the late Rev. Dr. Jethro Gayles and the Rev. Bishop Smith. She has also been an active member of the National Baptist Convention and the Illinois Baptist State Convention.

Over the years, Mrs. Cass has been very active in civic and community affairs. Many of these activities include work with her block club organizations and the local electoral process.

Mr. Speaker, Mrs. Mable Watkins-Cass has dedicated her life to helping others. Her commitment and contributions to people have made her both, admired and respected. I am privileged that in my lifetime our paths have crossed. I am honored to call her a friend and I am proud to enter these words into the RECORD.