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Feb. 18, 2020

Via: www.regulations.gov

Internal Revenue Service
Attn: CC:PA:LPD:PR (REG-122180-18) Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Certain Employee Remuneration under Internal Revenue Code Section 162(m)

Dear Sir or Madam:

Nareit appreciates the opportunity to offer our comments on proposed regulations under section 162(m) [1] (Proposed Regulations). Nareit is the trade association that serves as the worldwide representative voice for real estate investment trusts (REITs) [2] and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community. Nareit is providing this comment on behalf of our members that are publicly-held corporations subject to the section 162(m) deduction limitation.

Executive Summary

The Proposed Regulations would significantly change the application of section 162(m) for a publicly-held REIT that receives services from its operating partnership. Under the Proposed Regulations, the section 162(m) deduction limit would apply to compensation paid for services rendered to the partnership in which the publicly-held REIT is a partner. This change, unless modified, is proposed to take effect for the 2019 calendar year notwithstanding that the Proposed Regulations were published on Dec. 20, 2019. Unless modified, the final rule would apply retroactively, albeit with a limited binding contract exception.

If the Internal Revenue Service and the Department of the Treasury have determined that such a significant change in the interpretation of section 162(m) is necessary, such change should, at minimum, apply prospectively and include a transition period. Specifically, the final rule should include a prospective effective date that is no earlier than tax years beginning after the publication of the final regulation and provide an additional transition period of up to seven years, with a 10 year transition

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[1] Unless otherwise noted, references to “section” in this letter refer to sections of the Internal Revenue Code of 1986, as amended (the Code).
[2] All U.S. REITs own approximately $3 trillion in gross assets, public U.S. REITs account for $2 trillion in gross assets, and stock-exchange listed REITs have an equity market capitalization of over $1 trillion. In addition, more than 80 million Americans invest in REIT stocks through their 401(k) and other investment funds.

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period for those REITs that received private letter rulings confirming the IRS' views on how section 162(m) applied to employees of partnerships providing services to publicly-held companies. A significant transition period is appropriate for REITs considering the 27-year history during which REITs, their tax advisors, and the Internal Revenue Service Office of Chief Counsel interpreted section 162(m) as not applying to compensation paid for services performed for a REIT's operating partnership. The need for a prospective effective date and transition period is warranted given that the partnership rule in the Proposed Regulation is an interpretive change rather than a rule mandated by the 2017 tax reform legislation.

In addition, under the Proposed Regulations, section 162(m) could apply to the compensation expense of a partnership that is owned less than 80% by a publicly-held REIT, even though section 162(m) would not apply to limit the compensation expense of a corporate subsidiary that is owned less than 80% by the publicly-held REIT. Nareit recommends that the application of section 162(m) to partnerships should be limited only to partnerships owned at least 80% by the REIT or other members of the REIT's affiliated group, in order to not penalize operating partnership structures and to be consistent with the application of section 162(m) to corporate subsidiaries of a publicly-held REIT or other publicly-held corporation.

Historical Application of Section 162(m) and Exclusion of Partnerships

Section 162(m) imposes a $1 million deduction limit for compensation paid to covered employees of a publicly-held corporation. Section 162(m) was first enacted in the Omnibus Budget Reconciliation Act of 1993 (Pub. L. 103-66). The original proposed regulations, which were published on Dec. 20, 1993, defined a publicly-held corporation to include "an affiliated group of corporations, as defined in section 1504 (determined without regard to section 1504(b))."[3] Final regulations were published on Dec. 19, 1995, with no further change to this definition of the affiliated group.

By defining the affiliated group under section 1504, the Internal Revenue Service and the Department of the Treasury chose to exclude from the section 162(m) deduction limit those compensation payments attributed to a partnership's trade or business. Section 1504 limits the affiliated group to one or more chains of includible corporations connected through stock ownership. Because section 1504 does not include an entity organized as a partnership, it has been the case since the 1993 proposed regulations that compensation deductions for services rendered to a partnership are not subject to section 162(m).

The exclusion of partnership affiliates from the $1 million deduction limitation has been recognized in multiple private letter rulings issued by the Internal Revenue Service. For example, in PLRs 200614002, 200727008, 200725014, and 200837024, the IRS addressed the application of section 1504 in the context of a REIT that was structured as a publicly-held corporation that owned an operating partnership. Each REIT's covered employees provided only a small portion of their services to the REIT and most of

[3] Prop. Treas. Reg. §1.162-27(c)(1)(ii) (1993).

their services to the partnership. In each of the rulings, the IRS concluded that the section 162(m) deduction limitation was inapplicable to compensation paid by the partnership for services provided to the partnership.

The rulings reflect a straightforward application of the section 1504 affiliated group rule under the section 162(m) regulations. Tax practitioners have long viewed the outcome of the rulings as settled law.

Tax Cuts and Jobs Act Amendments

The law generally known as the Tax Cuts and Jobs Act of 2017 (Pub. L. 115-97) amended section 162(m) to expand the scope of the deduction limit in several respects, including modifying the definition of publicly-held corporations, modifying the definition of covered employees, and eliminating the exception for performance-based compensation for tax years beginning in 2018 and thereafter. Although the definition of a publicly-held corporation subject to section 162(m) was modified to include additional classes of public issuers under the Securities and Exchange Act of 1934, Congress made no amendments to the definition of the affiliated group and the regulatory definition referencing section 1504. Nothing in the legislative history to the Tax Cuts and Jobs Act suggests that Congress intended to broaden section 162(m) to include deductions for compensation for services rendered to a partnership, to reject the section 1504 affiliated group as the appropriate definition of a publicly-held corporation, or to otherwise reverse the outcomes in the letter rulings previously issued to REITs.

The Proposed Regulations' New Rule for Partnerships

The Proposed Regulations retain the same section 1504 definition of a public company affiliate that has been in place since the original definition was proposed in 1993. Notwithstanding, the Proposed Regulations would impose a new definition of "compensation" that is subject to the deduction limit. Under Prop. Treas. Reg. §1.162-33(c)(3)(ii), compensation of a covered employee "includes an amount equal to a publicly held corporation's distributive share of a partnership's deduction for compensation expense attributable to the remuneration paid by the partnership for services performed by a covered employee of the publicly held corporation." Example 3 at Prop. Treas. Reg. §1.162-33(c)(3)(iv)(D) illustrates the application of the rule.

The Proposed Regulations do not address the principle that compensation paid by a partnership to its employees is for services rendered in the trade or business of the partnership. As discussed above, the partnership is not an entity that is deemed to be a publicly-held corporation. One would expect, as has been the case since the enactment of section 162(m), that a public REIT partner would continue to be entitled to its distributive share of the partnership's compensation deductions and, since the partnership is not deemed to be a publicly-held corporation, no deduction limitation would apply to the REIT partner's distributable share. This analysis is consistent with the basic principles of section 162, which provide compensation deductions to the trade or business being served. See, e.g., Revenue Ruling 84-68, 1984-

1 C.B. 31 (parent may not deduct bonuses attributable to services performed for subsidiary); *Young & Rubicam*, 187 Ct. Cl. 635 (1969); *Columbian Rope*, 42 T.C. 800 (1964).

In light of the authorities, the Proposed Regulations' application of the deduction limit to partnership compensation is a surprising and novel interpretation of the statute. It is neither an interpretation that is mandated by the statutory changes in the Tax Cuts and Jobs Act nor a fact pattern discussed in any legislative history. REITs have not needed to analyze compensation paid by an operating partnership (and its subsidiaries) for purposes of section 162(m). Imposing such a rule for 2019 when the Proposed Regulations were issued on Dec. 20, 2019 creates a significant burden. Such a change does not merely affect the tax return to be filed for 2019. The change affects a REIT's calculation of required distributions to shareholders and the character of those distributions to be reported on a Form 1099 to shareholders, which had to be calculated and finalized well in advance of the Jan. 31, 2020 due date. A limited written binding contract rule for 2019 is not sufficient.

Historically, the IRS and Treasury have recognized that transition rules are appropriate when new compensation deduction rules are imposed. Taxpayers who first became subject to section 162(m) were typically afforded several years to come into compliance under Treas. Reg. §1.162-27(f). In the context of partnership regulations, more recent examples of longer transition periods include the seven year transition period in the section 752 regulations concerning recourse liabilities,[4] and the 10 year transition period in the section 7704 publicly traded partnership (PTP) regulations for income from minerals and natural resources,[5] which also contains a special rule for publicly traded partnerships that had obtained private letter rulings on the subject.[6] If the Internal Revenue Service and the Department of the Treasury intend to finalize this new interpretation of "compensation" subject to section 162(m), REITs similarly should be afforded a multi-year transition of up to seven years beginning in taxable years after the publication of the final rule.

The case for transitional relief is particularly compelling for those REITs that received private letter rulings confirming the IRS' views on how section 162(m) applies to employees of partnerships that provide services to publicly-held companies, and we request an even longer transition period for those REITs. To encourage taxpayers to submit requests for private letter rulings that provide a good window to the Internal Revenue Service on issues that should be addressed for proper tax administration, we recommend that taxpayers that received private letter rulings in this area be provided a longer transitional period, e.g. 10 years as was provided in the PTP regulations referenced above.

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[4] Treas. Reg. § 1.752-2(l)(3).
[5] Treas. Reg. § 1.7704-4(g)(1).
[6] Treas. Reg. § 1.7704-4(g)(2)(i). In other non-partnership examples, significant transition periods have also been afforded to taxpayers. See. e.g., Treas. Reg. § 1.1060-1(a)(2)(i) (five-year delay in effective date for asset acquisition involving insurance business); Treas. Reg. § 1.382-2(b)(2)(ii) (special rule for certain convertible preferred stock issued before and shortly after promulgation of regulation).

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In addition, under the Proposed Regulations, section 162(m) can apply to the compensation expense of a partnership that is owned less than 80% by a publicly-held REIT, even though section 162(m) would not apply to limit the compensation expense of a corporate subsidiary owned less than 80% by the publicly-held REIT. This outcome penalizes publicly-held REITs that have 79%-owned operating partnerships in comparison to their publicly-held counterparts that have 79%-owned corporate subsidiaries. There is no apparent policy reason why the compensation deductions should be limited in the former but not in the latter.

Nareit recommends that the application of section 162(m) to partnerships should be limited only to partnerships owned at least 80% (by capital and profits) by the REIT or other members of the REIT's affiliated group, in order to not penalize operating partnership structures and to level the playing field with the application of section 162(m) to corporate subsidiaries of a publicly-held REIT or other publicly-held corporation.

Please contact me (at tedwards@nareit.com or 202/739-9408); Cathy Barre, Nareit's Executive Vice President & General Counsel (at cbarre@nareit.com or 202/739-9422); or Dara Bernstein, Nareit's Senior Vice President & Tax Counsel (at dbernstein@nareit.com or 202/739-9446) if you would like to discuss this letter in greater detail.

Respectfully submitted,

Tony M. Edwards
Senior Executive Vice President

Cc:
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