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REITs:
BUILDING
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November 22, 2016

VIA OVERNIGHT DELIVERY AND E-MAIL

Ms. Tuawana Pinkston
Internal Revenue Service
Room 6526
1111 Constitution Avenue N.W.
Washington, D.C. 20224

Re: Comments – Form 1120-REIT

Dear Ms. Pinkston:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity, pursuant to a notice published September 28, 2016, 81 F.R. 66743, to provide the following comments with respect to reducing the burden on taxpayers from the Form 1120-REIT. NAREIT is the worldwide representative voice for REITs, or Real Estate Investment Trusts, and publicly traded real estate companies with an interest in U.S. real estate and capital markets.

NAREIT believes that, if adopted, the comments set forth below would enhance the quality, utility and clarity of the information to be collected and would minimize the burden of the collection of information on respondents.

Please note that the comments set forth below are substantially similar to those submitted by NAREIT on both December 23, 2013, and March 19, 2012, pursuant to notices published October 25, 2013, 78 F.R. 64057, and February 16, 2012, 77 F.R. 9301, respectively.

We request that the Department of the Treasury and the Internal Revenue Service modify the Form 1120-REIT and its instructions as follows:
1) Part III of Form 1120-REIT Should Be Modified to Calculate a REIT's Gross Income for Purposes of Section 857(b)(5)[1]. Part III of Form 1120-REIT calculates the tax imposed by section 857(b)(5) for failure to meet the REIT gross income tests in sections 856(c)(2) and (c)(3). However, the 2015 version of Part III of Form 1120-REIT begins with "real estate investment trust taxable income" from Part I of Form 1120-REIT, which, in certain cases, may be based on net income, particularly from partnerships. For clarity, and to ensure greater uniformity in taxpayer reporting, Part III should be modified so that its calculation is based on the REIT's gross income as computed under Section

[1] All section references herein are to the Internal Revenue Code of 1986, as amended (the Code), or to the Treasury Regulations issued under the Code.

856(c)(2) and 856(c)(3), which is different than the computation of REIT taxable income in Part I.

For example, with respect to a REIT that is a partner in a partnership, Treas. Reg. § 1.856-3(g) provides that such REIT is deemed to own the assets and be entitled to the income of the partnership in accordance with its capital interest in the partnership. In other words, a REIT partner calculates its gross income from the partnership in proportion to its capital interest, rather than based on its Schedule K-1. Similarly, Line 5 of Part I of the 1120-REIT requires the reporting of "capital gain net income." However, because Part III of the Form 1220-REIT calculates the failure to satisfy the **gross income** REIT tests, Part III should use gross income from capital gains, rather than capital gain net income.

Because the current Form 1120-REIT appears to base its calculation in Part III on net, rather than gross, income, it adds an additional burden on taxpayers attempting to comply with section 857(b)(5) and attempting to complete the Form 1120-REIT. Many REITs must submit additional schedules. Accordingly, it would be helpful to provide a separate line for gross income from partnerships; gross income from capital gains; etc.

2) Modification of Part III of Form 1120-REIT Also Should Exclude Income from Hedging Transactions under Section 856(c)(5)(G) for Purposes of Section 857(b)(5). Because income from hedging transactions referred to in section 856(c)(5)(G) is excluded from a REIT's gross income for purposes of the gross income tests under Section 856(c)(2) and 856(c)(3), Part III of Form 1120-REIT similarly should exclude such income in its calculation of whether the REIT failed to meet the REIT gross income tests of sections 856(c)(2) and (c)(3). Specifically, section 856(c)(5)(G) income should be excluded from the calculation in Line 5 of Part III by replacing "1c" in Line 5, Part III with "2b".

3) Part III Should Include a Line for Taxable Income that is Excluded from Gross Income. Section 856(c)(5)(J) grants the IRS authority to exclude certain taxable income from the REIT gross income tests. The IRS has issued a number of private letter rulings to taxpayers under this authority. *See*, e.g., PLRs 201418022 (patronage dividends excluded from the REIT gross income tests); 201418037 (certain amounts received in bankruptcy litigation excluded from REIT gross income tests); 201122016 (interest and costs recovered in eminent domain litigation excluded from REIT gross income tests). This category of income will appear in Part I of Form 1120-REIT, but it should be excluded from the calculation of gross income in Part III (similar to how Line 2a of Part III in the 2015 Form 1120-REIT excludes hedging income for purposes of the 95% gross income test calculation).

4) A "Part V" Should Require Calculation of the Section 1374 Tax on "Built-in Gains." In certain situations, REITs must pay tax on C corporation "built-in gains" pursuant to section 337(d) (referencing section 1374). The Form 1120-REIT currently does not include a place to calculate and report that tax.

5) Suggested Modifications to Instructions to Form 1120-REIT.

a. References to Taxable REIT Subsidiary (TRS) Limitation Should Be Updated. On page 2 of the Instructions to Form 1120-REIT, after "July 30, 2008" the following should be inserted "and before December 31, 2017." This modification is necessary as a result of changes made in the Protecting Americans from Tax Hikes Act of 2015 (PATH Act).

b. Maintain Reference to 5-Year Recognition Period for Built-in Gains (BIG). Page 1 of the Instructions to the Form 1120-REIT states: "Built-in gains tax. The recognition period for the built-in gains tax has been permanently changed to 5 years." The PATH Act enacted a permanent 5-year recognition period for S corporations (applicable to REITs through long-standing regulations), effective for taxable years beginning after December 31, 2014. The IRS issued temporary regulations in June 2016 that would change the 5-year recognition period for REITs to the former 10-year recognition period previously applicable to both S corporations and REITs. In response to these regulations, NAREIT submitted a comment letter urging conformity to the S corporation 5-year recognition period. Further, the Chairmen and the Ranking Members of the House Ways & Means and Senate Finance Committee sent a letter to Treasury Secretary Lew that stated their belief that Congress intended that REITs and RICs use the same 5-year BIG recognition period as S corporations, and they asked the Treasury Department to amend the regulations to reflect such legislative intent. At a hearing for these regulations on November 9, 2016, a Treasury Department official stated publicly "we anticipate issuing final regulations that would modify the recognition period for REITs and RICs to conform to the 5 year recognition period that S Corporations are subject to under Section 1374." Given the IRS' stated plan to issue final regulations using a 5-year recognition period for REITs, the existing reference to the 5-year BIG recognition period for REITs in the Form 1120-REIT instructions should be maintained.

c. Clarify How the Passive Loss Limitations of Section 469 and At Risk Limitations of Section 465 Apply to a REIT. The instructions to Form 1120-REIT provide as follows:

"Passive activity limitations. Limitations on passive activity losses and credits (for the first tax year as a REIT) under section 469 apply to REITs that are closely held (as defined in section 856(h)). REITs subject to the passive activity limitations must complete Form 8810 to compute their allowable passive activity loss and credit."

Because of slight variations between the "closely held" determinations under section 465 and 469 as well as the determination under section 856(h), it is possible that a REIT may be "closely held" under sections 465 and 469, but not under section 856(h). This result could occur due to the application of partnership attribution rules or the absence of a "look-through" in the case of certain pension shareholders under sections 465 and 469. The Form 1120-REIT instructions indicate that, in such case, a REIT could claim fully passive activity losses because the REIT is not "closely held" under section 856(h). If this result is not intended, the REIT would have inappropriately claimed such passive activity losses as a result of reliance on the Form 1120-REIT instructions. Accordingly, it would reduce the burden of compliance with Form 1120-

REIT if the instructions would clarify the application of the passive activity loss and at-risk rules in the case of a REIT that is "closely held" under section 465 and 469, but not section 856(h).

Thank you for the opportunity to submit these comments.

Please feel free to contact me at 202-739-9446 or dbernstein@nareit.com if you would like to discuss these issues in greater detail.

Respectfully submitted,

Dara F. Bernstein
Vice President & Senior Tax Counsel

cc: Helen Hubbard, Esq.
David Silber, Esq.
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