Transcript of IRS Hearing on Property Transfers to REITs, RICs

DATED NOV. 9, 2016

SUMMARY BY TAX ANALYSTS

The transcript is available of a November 9 IRS hearing on proposed regulations (REG-126452-15) affecting the repeal of the *General Utilities* doctrine by the Tax Reform Act of 1986.

FULL TEXT PUBLISHED BY TAX ANALYSTS

"CERTAIN TRANSFERS OF PROPERTY TO REGULATED INVESTMENT COMPANIES [RICS] AND REAL ESTATE INVESTMENT TRUSTS [REITS]"

UNITED STATES DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

PUBLIC HEARING ON PROPOSED REGULATIONS

[REG-126452-15]

Washington, D.C.
Wednesday, November 9, 2016

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TONY EDWARDS
National Association of Real Estate Investment Trusts

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PROCEEDINGS

(10:00 a.m.)

MR. DIAMOND-JONES: Welcome to the hearing on temporary and proposed regulations under Section 337(d) regarding certain transfers of property to regulated investment companies and real estate investment trusts.

Before we begin the hearing I'd like to introduce our panel. To my left is Lisa Fuller, a Special Counsel in the Office of Associate Chief Counsel (Corporate) at the IRS. To her left is Brett York, an Attorney Advisor with the Tax Legislative Counsel in the Department of the Treasury. And my name is Austin Diamond-Jones and I'm an attorney here with Chief Counsel (Corporate).

We have one scheduled speaker today. The speaker will have 10 minutes total in which to present as indicated by the light there. A yellow light will come on when there are three minutes remaining and a blinking red light will indicate that time has expired. If anyone on the panel asks a questions time will pause and you'll have the chance to answer the question before moving on and it won't count against your time.

With that I'd like to welcome our speaker for today, Mr. Tony Edwards with the National Association of Real Estate Investment Trusts.

MR. EDWARDS: Thank you for the opportunity to testify today regarding Treasury Decision 90770.

As you said, I'm Tony Edwards, I'm the Executive Vice President and General Counsel of NAREIT.

In the Tax Reform Act of 1986 Congress sought the balance to somewhat conflicting tax policy objectives. First, in overturning the holding of the Supreme Court Case, General Utilities and Operating Company v. Helvering, Congress intended to impose an entity level tax when assets leave corp exclusion, for example, in a liquidation, and second, Congress' long-time support of S Corporations, which by their very nature are not usually taxed at the entity level. The solution Congress reached, and has maintained since then, is to impose a corporate level tax on the so-called built-in gains of assets of C Corporations that elects S Corporation status only if those assets are sold in a time period set by Congress, which it specified in the 1986 Act at 10 years.

After the 1986 Tax Act was enacted tax policy makers realized that the same conflicting tax policy objectives could arise when C Corporations elect REIT or RICs status since both REITs and RICs are not subject to entity level

taxation to the extent that they distribute dividends. Accordingly, in 1988 Congress enacted Section 337(d) that delegated to the Treasury Department the authority to prescribe regulations to ensure that the purposes of the anti-General Utilities repeal rules were carried out, including through the use of REITs and RICs.

The government responded promptly soon after the passage of the 1988 legislation by issuing IRS Notice 8819 in which it said that it intended to issue regulations under which REITs and RICs would be subject to corporate level tax when they receive assets of C Corporations with a carryover basis unless they elect, "To be subject to rules similar to the rules of Section 1374 of the Code". Accordingly, the government prudently decided from the very start of its built-in gain issue that REITs should use the same built-in gain recognition period, 10 years in 1988, as S Corporations. This decision was appropriate for many reasons, including the fact that there was a substantial amount of rental real estate then and now owned through S Corporations and indeed would be puzzling to subjective the same activity to different rules, and both S Corporations and REITs are generally taxed only at the shareholder level.

Over the next three decades the IRS and Treasury widely treated a built-in gain recognition period of S Corporations and REITs in (inaudible) manner. When the Section 337(d) regs were finally issued in 2001 and then later amended in 2002 and 2003, the government filed the lead of its 1988 Notice and prescribed the same 10 year recognition period for both REITs and S Corporations. When Congress shortened the built-in gain recognition period for S Corporations on a temporary basis to 7 years, that was in 2009-10, and then 5 years in 2011-14, the IRS appropriately matched those recognition periods for REITs in both private letter rulings and explicit instructions to IRS Form 1120-REIT.

When the regulations were amended again in 2013 the Section 1374 baseline was once again used. Based on this consistent parity between S Corporations and REITs regarding the built-in gain recognition period, it was no surprise to us that when in December Congress in the Path Act made the 5 year recognition period for S Corporations permanent, Congress acknowledged in contemporaneous legislative history that C Corporations that elect REIT or RIC status are subject to Section 1374 "As if they were an S Corporation". Since Congress just decided that the built-in gain recognition period for S Corporations will now permanently be 5 years, this "as if" language could in our mind only be interpreted as extending 5 years to REITs and RICs.

We were surprised then when the temporary regulations that are the subject of this hearing were issued and we learned that the Treasury Department and the IRS decided to ignore almost 30 years of interpretation by Congress, the Executive Branch, and taxpayers, and revert back to a 10 year recognition period. We were also perplexed that this change in policy was included in temporary regulations without benefit of input that normally would be expected through the regulatory process.

The Congressional reaction to this change of policy was swift. Congressman Dave Reichert from Washington State was the prime mover for several years to make permanent the S Corporation 5 year recognition period for built-in gains. In fact, the Path Act incorporated his bill, which was widely cosponsored on a bipartisan basis. Only 5 weeks after the temporary regulations were issued Mr. Reichert stated in the Congressional records that the Path Act legislative history, "makes clear that Congress intended that the permanent relief for built-in gains should also apply to REITs and mutual funds". As if the Path Act legislative history and Mr. Reichert's statement were not enough to clarify Congressional intent, in a letter dated October 18, the Chairman and ranking members of the tax writing committees wrote Secretary Lew that the temporary regulations "are inconsistent with Congressional intent and

longstanding practice that REITs, RICs, and S Corporations be subject to the same 5 year built-in gains recognition period".

Consistent with the tax committee's letter we respectfully request that the temporary regulations be immediately amended to provide that REITs must use the same built-in gain recognition period as S Corporations, which under current law is 5 years. It is once again time for parity between REITs and S Corporations to be restored.

Thank you and I would be pleased to answer any questions you might have.

MR. DIAMOND-JONES: Thank you.

MR. EDWARDS: Thank you.

MR. DIAMOND-JONES: That was our only scheduled speaker for today. We do have a limited amount of time remaining if any other attendees would like to offer brief comments.

If not, then before concluding we have an announcement we'd like to make. Brett?

MR. YORK: Yes, thank you. Having heard no comments otherwise here in response to comments received, including at today's hearing, and from members of Congress, regarding the length of the recognition period set forth in the temporary regulations, 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. We continue to study the temporary and proposed regulations and welcome further comment on other aspects of those regulations.

MR. DIAMOND-JONES: If nobody else has anything, this concludes this hearing.

(Whereupon, at 10:07 a.m., the HEARING was adjourned.)

DOCUMENT ATTRIBUTES

CODE SECTIONS	SECTION 336 -- GENERAL LIQUIDATIONS RULE SECTION 337 -- NONRECOGNITION SECTION 355 -- CONTROLLED FIRM STOCK SECTION 856 -- REAL ESTATE TRUSTS SECTION 1374 -- S CORPORATION BUILT-IN GAINS
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