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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

December 9, 2013

VIA ELECTRONIC SUBMISSION www.regulations.gov (IRSREG–161948–05)

Courier's Desk
Internal Revenue Service
CC:PA:LPD:PR [REG–161948–05]
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Proposed Regulations on the Importation of Net Built-in Losses ([REG–161948–05]) (the Proposed Regulations)

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity to commend the Treasury Department and Internal Revenue Service for issuing the Proposed Regulations under sections 334(b)(1)(B) and 362(e)(1) of the Internal Revenue Code of 1986 (the Code), which apply to certain nonrecognition transfers of property with a built in loss (BIL Property) to corporations that are subject to federal income tax, and to offer our suggestions with respect to these regulations.

NAREIT® is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

EXECUTIVE SUMMARY

As further described below, sections 334(b)(1)(B) and 362(e)(1) provide an exception to the general rule of sections 334(b)(1), 362(a) and 362(b), under which a transferee of property in certain nonrecognition transactions generally takes a carryover basis in transferred property. Generally, section 362(e)(1) requires a transferee to mark-to-market its basis in BIL Property transferred in certain nonrecognition transactions if, among other things, the transferor would not be subject to tax on a hypothetical sale of the property.

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NAREIT agrees with the Treasury Department's recognition that REITs are in fact taxable corporations subject to federal income tax, and that applying a look-through rule to determine whether a REIT's shareholders would be taxable on a hypothetical sale of transferred property would be completely unworkable, particularly for REITs with listed or publicly registered securities who may have thousands of shares held in "street name." Thus, NAREIT appreciates the Proposed Regulations' recognition that a look-through rule to REIT shareholders should apply only in the case of a plan to avoid the application of the Proposed Regulations (the Anti-Abuse Rule). However, in order to give effect to the inclusion of the Anti-Abuse Rule in the Proposed Regulations, NAREIT recommends that the Treasury Department interpret it narrowly. Second, NAREIT respectfully requests Treasury to clarify that that the Anti-Abuse Rule should be the sole means for the IRS to question the normal operation of section 362 in the case of REITs. Finally, NAREIT requests that final regulations correct what appear to be certain incorrect citations in the Proposed Regulations.

DISCUSSION

A. <u>Background</u>

1. *Anti-Loss Importation Rules Generally*

Generally speaking, a transferee of property in a transaction governed by section 332, 351 or 368 takes a carryover basis in the transferred property. However, in the American Jobs Creation Act of 2004 (Pub. L. 108-357, 188 Stat. 1418), Congress enacted sections 334(b)(1)(B) and 362(e), which limit the ability of taxpayers to duplicate net built-in loss in certain nonrecognition transactions. Specifically, in the case of BIL property, sections 334(b)(1)(B) and 362(e)(1) (the anti-loss importation provisions) require the transferee to reduce its basis in the BIL property to fair market value.

The Proposed Regulations seek to implement sections 334(b)(1)(B) and 362(e)(1). These provisions provide that if, in connection with the transfer of BIL Property in a section 332 liquidation, section 351 transaction or certain reorganizations; 1) the transferor's gain or loss on a disposition of the property immediately before the transfer would not be subject to federal income tax; and, 2) if, on a hypothetical sale of the transferred property immediately after the transfer, the transferee's gain or loss would be subject to federal income tax, the property is "importation property," and the transferee's basis in the transferred property will be marked to market to equal to the property's fair market value.

Notably, section 362(e)(1) requires that the transferred property meet the definition of "importation property" for its mark-to-market, loss disallowance rule to apply. On the other hand, a separate provision, section 362(e)(2)[1] applies to the transfer of BIL Property in a section 351 transaction when the transferred property does not meet the definition of "importation property." Thus, section 362(e)(2) applies merely if BIL Property is transferred in a section 351

[1] Final regulations relating to certain aspects of section 362(e)(2) were issued on September 3, 2013 by T.D. 9633, 78 F.R. 54156-54168.

transaction, regardless of whether either transferor or transferee would be subject to federal income tax on a sale of the property. If section 362(e)(2) applies, the transferor and transferee can elect for the transferor to reduce its basis in the transferee's stock under section 362(e)(2)(C) in lieu of the transferee's reducing its basis in the BIL property.

2. *Proposed Regulations not Applicable to REITs Absent Tax Avoidance Plan*

If the transferor is a partnership, S corporation, or grantor trust, the determination of whether the transferor would be subject to tax on sale is made with reference to the transferor's partners, shareholders, or owners. The preamble to the Proposed Regulations states that "[c]ertain domestic corporations are also able to shift tax consequences by distributing income or gain from a property sale," and these corporations include REITs, mutual funds and cooperatives. Nevertheless, the preamble states that:

> The IRS and the Treasury Department are concerned that disregarding the effects of this shifting of tax liability would in certain circumstances undermine the anti-importation provisions. However, the IRS and the Treasury Department are also concerned that applying a look-through rule in all such cases would present **a significant administrative burden**.
>
> Accordingly, the proposed regulations contain an anti-avoidance rule that applies to … REITs … that directly or indirectly transfer property (including through other such entities) in a section 362 transaction, if the property had been directly or indirectly transferred to or acquired by the entity **as part of a plan to avoid the application of the anti-importation provisions**. … When the anti-avoidance rule applies, the domestic entity, which, **absent application of the anti-avoidance rule, would be treated under these regulations as subject to Federal income tax**, is treated as subject to a look-through rule. Under the look-through rule, the entity is presumed to distribute the proceeds of the hypothetical sale (which, for this purpose, are presumed to be an amount greater than zero), and, to the fullest extent permitted by the terms of its organizing instrument, it is presumed to make the distributions to persons that would not take distributions from the entity into account in determining a Federal income tax liability.

(Emphasis added).

B. Recommendations

1. *Clarify that Section 362 is the Sole Mechanism for the IRS to Reduce Stock Basis in Connection with the Nonrecognition Transfer of BIL Property*

Under the Proposed Regulations, section 362(e)(1)'s loss disallowance rule would not apply to a section 351 transfer by a REIT to another entity absent a plan to avoid the Proposed Regulations (the Anti-Abuse Rule, as noted above). As a result, such a transfer could be subject to section 362(e)(2). If so, the REIT and the transferee could make an election for the REIT to reduce its

basis in the stock of the transferee in lieu of the transferee's reducing its basis in the transferred property.

NAREIT commends the Treasury Department for recognizing both that REITs are subject to corporate income tax and that applying a look-through rule to determine whether REIT shareholders, particularly public REIT shareholders whose identity is unlikely to be known by the REIT, would be administratively burdensome and unworkable. In order to ensure that the inclusion of the Anti-Abuse Rule in the Proposed Regulations is meaningful, NAREIT recommends that the Treasury Department interpret the Anti-Abuse Rule narrowly.

Further, NAREIT also believes that the Anti-Abuse Rule should be the sole means for the IRS to question the normal operation of section 362 in the case of REITs. The Proposed Regulations' preamble indicates that this is the intent of the Treasury Department:

> Since the enactment of the anti-loss importation provisions, a number of questions have arisen concerning their application. The principal concern has been the determination of whether property is importation property, but various other questions (discussed subsequently in this preamble) have also been raised regarding the application of the anti-loss importation provisions and their interaction with other rules of law. To address these issues, the proposed regulations provide a framework for identifying importation property and determining whether the transfer of the property is a transaction subject to the anti-loss importation provisions (designated a "loss importation transaction" under the proposed regulations).[2]

Also Prop. Treas. Reg. § 1.362-3(b)(1) itself indicates the exclusive jurisdiction of the regulations by stating:

> **Notwithstanding any other provision of law**, Acquiring's basis in importation property (as defined in paragraph (c)(2) of this section) acquired in a loss importation transaction (as defined in paragraph (c)(3) of this section) is equal to the value of the property immediately after the transaction.

(Emphasis added).

NAREIT is particularly concerned that the IRS may assert that basis of property with a built in loss, which is properly transferred to a subsidiary in an exchange pursuant to which a section 362(e)(2) election to reduce stock basis by a REIT shareholder can be made, would be reduced by the IRS under some other rule of law such as section 482. Doing so effectively would override the section 362(e)(2) election - notwithstanding that the transferred property would not constitute "importation property," and the requirements of section 362(e)(2) would be met.

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[2] Preamble to Prop. Treas. Regs. 78 Fed. Reg. 54972 (Sept. 9, 2013).

Treas. Reg. § 1.482-1(f)(1)(iii) states that the authority of the district director to reallocate items extends to nonrecognition transactions, specifically including section 351 exchanges. It provides one example that appears to be a summary of a case cited in the regulation: *National Securities Corp. v Commissioner*, 137 F.2d 600 (3rd Cir. 1943), *cert. denied*, 320 U.S. 794 (1943). In that case a parent corporation held stock in a bankrupt corporation that had lost about 94% of its value. The parent sold some of the stock, thus indicating its intent to dispose of it, and conveyed the rest to a subsidiary that sold the stock and recognized the loss within the year. The parent had excess losses and could not use the additional losses.

The *National Securities* Court of Appeals stated: "[t]he parent made the investment in Standard stock in 1929, held on to the stock as an investment until 1936, concluded to rid its own portfolio at a time when the stock had become well-nigh valueless and then, instead of selling on the market, taking its loss and marking "finis" to a most unprofitable venture, transferred the stock to its wholly owned subsidiary. It seems most reasonable to treat the loss as one which had in fact been sustained by the parent rather than by its subsidiary." *National Securities Corp. v Commissioner*, 137 F.2d at 602-3.

Obviously the facts in that case were unique and highly suspect, and application of section 482 in general should be limited to cases in which the transferred property was "well-nigh" worthless, and the transferor had effectively already sustained the loss before the transfer. Nevertheless, when, in addition, a transferor that is a REIT has acquired the property from other parties in a transaction that might be asserted to be part of a plan subject to the Anti-Abuse Rule in the Proposed Regulations, that rule should be applied to the exclusion of section 482. Therefore, when it is decided that there was no plan of avoidance, the normal basis rule and election should stand without the IRS' interposing other objections.

Not only are facts in *National Securities Corp*. unique, by enacting section 362(e)(2), Congress specifically authorized a corporation with BIL Property that transfers such property to another corporation in a section 351 transaction to elect with the transferee entity to reduce its basis in the transferee's stock if the rules of section 362(e)(2) are met. If the IRS could apply section 482 to eliminate the section 362(e)(2) election, Congress' enactment of the section 362(e)(2) election would be nullified. Under the general rules of statutory construction, "where there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one, regardless of the priority of enactment.'" *Radzanower v. Touche Ross & Co.,* 426 U.S. 148, 153 (1976), *quoting Morton v. Mancari,* 426 U.S. 148, 550-551 (1974).

2. *Correction of References*

Proposed Treasury Regulation § 1.362-3(d)(4) provides look-through treatment in the case of certain tax avoidance transactions when determining whether gain or loss would be taken into account in determining a Federal income tax liability.

Prop. Treas. Reg. § 1.362-3(d)(4)(ii) provides:

> Notwithstanding paragraph (d)(1) of this section, if a transferor is described in both paragraphs (d)(4)(**ii**)(A) and (d)(4)(**ii**)(B) of this section –
> (A) The transferor is treated as though it distributes the proceeds of the hypothetical sale (which, for this purpose, are presumed to be an amount greater than zero);
> (B) To the fullest extent possible under the transferor's organizing instrument, taking into account the beneficiaries or owners of interests (as applicable) in the transferor, the deemed distribution is treated as made to a distributee or distributees that would not take distributions from the transferor into account in determining a Federal income tax liability; and…

(Emphasis added).

Neither paragraphs (d)(4)(ii)(A) nor (d)(4)(ii)(B) describe the transferor, and the references to those paragraphs appears to be circular. It appears that the references in the first sentence of Prop. Treas. Reg. § 1.362-3(d)(4)(ii) should be to paragraphs (d)(4)(**i**)(A) (a transferor that is a REIT, mutual fund, trust, or cooperative) and (d)(4)(**i**)(B)(such transferor then transfers property transferred to it as part of a plan to avoid the Proposed Regulations). If so, we recommend that the final regulations correct these references.

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Thank you for the opportunity to submit these comments. Please contact me at (202) 739-9408 or tedwards@nareit.com or Dara Bernstein, NAREIT's Senior Tax Counsel at (202) 739-9446 or dbernstein@nareit.com, if you would like to discuss these issues in greater detail.

Respectfully submitted,

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