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TAXPAYER REFUND ACT OF 1999

R E P O R T

of the

COMMITTEE ON FINANCE
UNITED STATES SENATE

to accompany

S. 1429

together with

MINORITY VIEWS

A Bill to Provide for Reconciliation Pursuant to Section 104
of the Concurrent Resolution on the Budget for Fiscal Year 2000

July __, 1999.--Ordered to be printed

C. Provisions Relating to REITs
(secs. 1021-1026, 1031, 1041, 1051, 1061 and 1071 of the bill and secs. 852, 856, and 857 of the Code)

Present Law

Real estate investment trust ("REITs") are treated, in substance, as pass-through entities under present law. Pass-through status is achieved by allowing the REIT a deduction for dividends paid to its shareholders. REITs are restricted to investing in passive investments primarily in real estate and securities. Specifically, a REIT is required to receive at least 95 percent of its income from real property rents and from securities. Amounts received as impermissible "tenant services income" are not treated as rents from real property. In general, such amounts are for services rendered to tenants that are not "customarily furnished" in connection with the rental of real property. Special rules permit amounts to be received from certain "foreclosure property," treated as such for 3 years after the property is acquired by the REIT in foreclosure after a default (or imminent default) on a lease of such property or on indebtedness which such property secured.

A REIT is not treated as providing services that produce impermissible tenant services income if such services are provided by an independent contractor from whom the REIT does not derive or receive any income. An independent contractor is defined as a person who does not own, directly or indirectly, more than 35 percent of the shares of the REIT. Also, no more than 35 percent of the total shares of stock of an independent contractor (or of the interests in assets or net profits, if not a corporation) can be owned directly or indirectly by persons owning 35 percent or more of the interests in the REIT.

A REIT is limited in the amount that it can own in other corporations. Specifically, a REIT cannot own securities (other than Government securities and certain real estate assets) in an amount greater than 25 percent of the value of REIT assets. In addition, it cannot own securities of any one issuer representing more than 5 percent of the total value of REIT assets or more than 10 percent of the voting securities of any corporate issuer. Under an exception to this rule, a REIT can own 100 percent of the stock of a corporation, but in that case the income and assets of such corporation are treated as income and assets of the REIT. Securities for purposes of these rules are defined by reference to the Investment Company Act of 1940.[108]

A REIT is generally required to distribute 95 percent of its income before the end of its taxable year, as deductible dividends paid to shareholders. This rule is similar to a rule for regulated investment companies ("RICs") that requires distribution of 90 percent of income. Both REITS and RICs can make certain "deficiency dividends" after the close of the taxable year, and have these treated as made before the end of the year. The regulations applicable to REITS state that a distribution will be treated as a "deficiency dividend" and thus as made before the end of the prior taxable year, only to the extent the earnings and profits for that year exceed the amount of

[108] 15 U.S.C. 80a-1 and following.

distributions actually made during the taxable year.

A REIT that has been or has combined with a C corporation will be disqualified if, as of the end of its taxable year, it has accumulated earnings and profits from a non-REIT year. A similar rule applies to regulated investment companies ("RICs"). In the case of a REIT, any distribution made in order to comply with this requirement is treated a being first from pre-REIT accumulated earnings and profits. RICs do not have a similar ordering rule.

In the case of a RIC, under a provision entitled "procedures similar to deficiency dividend procedures", any distribution made within a specified period after determination that the investment company did not qualify as a RIC for the taxable year will, "for purposes of applying [the earnings and profits rule that forbids a RIC to have non-RIC earnings and profits] to subsequent taxable years", be treated as applying to the RIC for the non-RIC year. The REIT rules do not specify any particular separate treatment of distributions made after the end of the taxable year for purposes of the earnings and profits rule. Treasury regulations under the REIT provisions state that "distribution procedures similar to those ... for regulated investment companies apply to non-REIT earnings and profits of a real estate investment trust."

Reasons for Change

The Committee believes that a 10-percent value, as well as a 10-percent vote test, is appropriate to test the permitted relationship of a REIT to the entities in which it invests. The Committee is concerned that a REIT may invest in an entity in which it owns virtually all the value (e.g., through preferred stock) while owning a small amount of the vote. The remainder of the voting power might be held by persons related to the REIT such as its officers, directors, or employees. The REIT might effectively be the beneficiary of virtually all the earnings of the entity, through its preferred stock ownership. Also, the REIT might hold significant debt in the entity. If the entity is a corporation, this might significantly reduce the corporate tax that the corporation might pay. If the entity is a partnership engaged in activities that would generate nonqualified income for the REIT if done directly, the REIT might use a significant debt investment in the partnership to reduce the amount of nonqualified income it would report from the partnership while still receiving a significant income stream through the debt.

The Committee believes, however, that certain types of activities that are related to the REIT's real estate investments should be permitted to be performed under the control of the REIT, through the establishment of a "taxable REIT subsidiary". One such type of activity is the provision of certain tenant services that might not be considered customary simply because they are relatively new or "cutting-edge" services that the REIT wishes to have provided in order to retain the competitive value of its properties. The Committee believes it will be simplifying for the REIT to be able to use the taxable REIT subsidiary, so that any uncertainty whether a particular service will be considered "customary" would not affect the REIT's qualification as a REIT. Another type of activity is the performance of real estate management and operation, generally for third parties. A REIT may have developed expertise in such activities with respect to its own properties, and suchexpertise could efficiently be made available to third parties.

The Committee believes it is desirable to obtain information regarding the extent of use of the new taxable REIT subsidiaries and the amount of corporate Federal income tax that such subsidiaries are paying.

The Committee also believes that a number of other simplifying changes are desirable, including allowing limited operation of health care facilities after a lease terminates; simplifying the determination whether an entity is an independent contractor; and modifying and conforming certain RIC and REIT distribution rules.

Explanation of Provision

Taxable REIT subsidiaries

Under the provision, a REIT generally cannot own more than 10 percent of the total value of securities of a single issuer, in addition to the present law limit of the REIT's ownership to no more than 10 percent of the outstanding voting securities of a single issuer.

For purposes of the new 10-percent value test, securities are defined to exclude safe harbor debt owned by a REIT (as defined for purposes of sec. 1361(c)(5)(B)(i) and (ii)) if the obligor on the debt is an individual. Such debt would also generally be excluded if the REIT (and any taxable REIT subsidiary of such REIT) owns no other securities of a non-individual issuer. In the case of a REIT that owns securities of a partnership, safe harbor debt is excluded from the definition of securities only if the REIT owns at least 20-percent or more of the profits interest in the partnership. The purpose of the partnership rule requiring a 20 percent profits interest is to assure that if the partnership produces income that would be disqualified income to the REIT, the REIT will be treated as receiving a significant portion of that income directly, even though it may also derive qualified interest income through its safe harbor debt interest.

An exception to the limitations on ownership of securities of a single issuer applies in the case of a "taxable REIT subsidiary" that meets certain requirements. To qualify as a taxable REIT subsidiary, both the REIT and the subsidiary corporation must join in an election. In addition, any corporation (other than a REIT or a qualified REIT subsidiary under section 856(i) that does not properly elect with the REIT to be a taxable REIT subsidiary) of which a taxable REIT subsidiary owns, directly or indirectly, more than 35 percent of the vote or value is automatically treated as a taxable REIT subsidiary. Securities (as defined in the Investment Company Act of 1940) of taxable REIT subsidiaries could not exceed 25 percent of the total value of a REIT's assets.

A taxable REIT subsidiary can engage in certain business activities that under present law could disqualify the REIT because, but for the proposal, the taxable REIT subsidiary's activities and relationship with the REIT could prevent certain income from qualifying as rents from real property. Specifically, the subsidiary can provide services to tenants of REIT property (even if such services were not considered services customarily furnished in connection with the rental of real property), and can manage or operate properties, generally for third parties, without causing amounts received or accrued directly or indirectly by REIT for such activities to fail to be treated as rents from real property.

However, the subsidiary cannot directly or indirectly operate or manage a lodging or healthcare facility. Nevertheless, it can lease a qualified lodging facility (e.g, a hotel) from the REIT (provided no gambling revenues were derived by the hotel or on its premises); and the rents paid are treated as rents from real property so long as the lodging facility was operated by an independent contractor for a fee. The subsidiary can bear all expenses of operating the facility and receive all the net revenues, minus the independent contractor's fee.

For purposes of the rule that an independent contractor may operate a qualified lodging facility, an independent contractor will qualify so long as, at the time it enters into the management agreement with the taxable REIT subsidiary, it is actively engaged in the trade or business of operating qualified lodging facilities for any person who is not related to the REIT or the taxable REIT subsidiary. The REIT may receive income from such an independent contractor with respect to certain pre-existing leases.

Also, the subsidiary generally cannot not provide to any person rights to any brand name under which hotels or healthcare facilities are operated. An exception applies to rights provided to an independent contractor to operate or manage a lodging facility, if the rights are held by the subsidiary as licensee or franchisee, and the lodging facility is owned by the subsidiary or leased to it by the REIT.

Interest paid by a taxable REIT subsidiary to the related REIT is subject to the earnings stripping rules of section 163(j). Thus the taxable REIT subsidiary cannot deduct interest in any year that would exceed 50 percent of the subsidiary's adjusted gross income.

If any amount of interest, rent, or other deductions of the taxable REIT subsidiary for amounts paid to the REIT is determined to be other than at arm's length ("redetermined" items) , an excise tax of 100 percent is imposed on the portion that was excessive. "Safe harbors" are provided for certain rental payments where the amounts are de minimis, there is specified evidence that charges to unrelated parties are substantially comparable, certain charges for services from the taxable REIT subsidiary are separately stated, or the subsidiary's gross income from the service is not less than 150 percent of the subsidiary's direct cost in furnishing the service.

In determining whether rents are arm's length rents, the fact that such rents do not meet the requirements of the specified safe harbors shall not be taken into account. In addition, rent received by a REIT shall not fail to qualify as rents from real property by reason of the fact that all or any portion of such rent is redetermined for purposes of the excise tax.

The Commissioner of Internal Revenue is to conduct a study to determine how many taxable REIT subsidiaries are in existence and the aggregate amount of taxes paid by such subsidiaries. The Commissioner shall submit a report to the Congress describing the results of such study.

<u>Health Care REITS</u>

The provision permits a REIT to own and operate a health care facility for at least two years, and treat it as permitted "foreclosure" property, if the facility is acquired by the termination or expiration of a lease of the property. Extensions of the 2 year period can be granted.

Conformity with regulated investment company rules

Under the provision, the REIT distribution requirements are modified to conform to the rules for regulated investment companies. Specifically, a REIT is required to distribute only 90 percent, rather than 95 percent, of its income.

Definition of independent contractor

If any class of stock of the REIT or the person being tested as an independent contractor is regularly traded on an established securities market, only persons who directly or indirectly own 5 percent or more of such class of stock shall be counted in determining whether the 35 percent ownership limitations have been exceeded.

Modification of earnings and profits rules for RICs and REITS

The rule allowing a RIC to make a distribution after a determination that it had failed RIC status, and thus meet the requirement of no non-RIC earnings and profits in subsequent years, is modified to clarify that, when the reason for the determination is that the RIC had non-RIC earnings and profits in the initial year, the procedure would apply to permit RIC qualification in the initial year to which such determination applied, in addition to subsequent years.

The RIC earnings and profits rules are also modified to provide an ordering rule similar to the REIT rule, treating a distribution to meet the requirements of no non-RIC earnings and profits as coming first from the earliest earnings and profits accumulated in any year for which the RIC did not qualify as a RIC. In addition, the REIT deficiency dividend rules are modified to apply the same earnings and profits ordering rule to such dividends as other REIT dividends.

Effective Date

The provision is generally effective for taxable years beginning after December 31, 2000. The provision with respect to modification of earnings and profits rules is effective for distributions after December 31, 2000.

In the case of the provisions relating to permitted ownership of securities of an issuer, special transition rules apply. The new rules forbidding a REIT to own more than 10 percent of the value of securities of a single issuer do not apply to a REIT with respect to securities held directly or indirectly by such REIT on July 12, 1999, or acquired pursuant to the terms of written binding contract in effect on that date and at all times thereafter until the acquisition. Also, securities received in a tax-free exchange or reorganization, with respect to or in exchange for such grandfathered securities would be grandfathered. This transition ceases to apply to securities of a corporation as of the first day after July 12, 1999 on which such corporation engages in a substantial new line of business, or acquires any substantial asset, other than pursuant to a binding contract in effect on such date and at all times thereafter, or in a reorganization or transaction in which gain or loss is not recognized by reason of section 1031 or 1033 of the Code. If a corporation makes an election to become a taxable REIT subsidiary, effective before January 1, 2004 and at a time when the REIT's ownership is grandfathered under these rules, the election is treated as a reorganization under section 368(a)(1)(A) of the Code.

E. Treatment of Leasehold Improvements
(sec. 1091 of the bill and sec. 168 of the Code)

Present Law

Depreciation of leasehold improvements

Depreciation allowances for property used in a trade or business generally are determined under the modified Accelerated Cost Recovery System ("MACRS") of section 168. Depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease (sec. 168(i)(8)).[109] This rule applies regardless whether the lessor or lessee places the leasehold improvements in service.[110] If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service (secs. 168(b)(3), (c)(1), (d)(2), and (i)(6)).[111]

Treatment of dispositions of leasehold improvements

A lessor of leased property that disposes of a leasehold improvement which was made by the lessor for the lessee of the property may take the adjusted basis of the improvement into account for purposes of determining gain or loss if the improvement is irrevocably disposed of or

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[109] The Tax Reform Act of 1986 modified the Accelerated Cost Recovery System ("ACRS") to institute MACRS. Prior to the adoption of ACRS by the Economic Recovery Act of 1981, taxpayers were allowed to depreciate the various components of a building as separate assets with separate useful lives. The use of component depreciation was repealed upon the adoption of ACRS. The Tax Reform Act of 1986 also denied the use of component depreciation under MACRS.

[110] Former Code sections 168(f)(6) and 178 provided that in certain circumstances, a lessee could recover the cost of leasehold improvements made over the remaining term of the lease. These provisions were repealed by the Tax Reform Act of 1986.

[111] If the improvement is characterized as tangible personal property, ACRS or MACRS depreciation is calculated using the shorter recovery periods and accelerated methods applicable to such property. The determination of whether certain improvements are characterized as tangible personal property or as nonresidential real property often depends on whether or not the improvements constitute a "structural component" of a building (as defined by Treas. Reg. sec. 1.48-1(e)(1)). See, for example, Metro National Corp., 52 TCM 1440 (1987); King Radio Corp., 486 F.2d 1091 (10th Cir., 1973); Mallinckrodt, Inc., 778 F.2d 402 (8th Cir., 1985) (with respect various leasehold improvements).

abandoned by the lessor at the termination of the lease.[112] This rule conforms the treatment of lessors and lessees with respect to leasehold improvements disposed of at the end of a term of lease. For purposes of applying this rule, it is expected that a lessor must be able to separately account for the adjusted basis of the leasehold improvement that is irrevocably disposed of or abandoned. This rule does not apply to the extent section 280B applies to the demolition of a structure, a portion of which may include leasehold improvements.[113]

Reasons for Change

The Committee believes that costs that relate to the leasing of property should not be recovered beyond the term of the lease to the extent the costs do not provide a future benefit beyond that term. Although lease terms differ, the Committee believes that lease terms for commercial real estate typically are shorter than the present-law 39-year recovery period. In the interests of simplicity and administrability, a uniform period for recovery of leasehold improvements is desirable. The Committee bill therefore shortens the recovery period for leasehold improvements to 15 years.

Explanation of Provision

The provision provides that 15-year property for purposes of the depreciation rules of section 168 includes qualified leasehold improvement property. The straight line method is required to be used with respect to qualified leasehold improvement property.

Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. The improvement must be made under or pursuant to a lease either by the lessee (or sublessee) of that portion of the building, or by the lessor of that portion of the building. That portion of the building is to be occupied exclusively by the lessee (or any sublessee). The original use of the qualified leasehold improvement property must begin with the lessee, and must begin after December 31, 2000. The improvement must be placed in service more than three years after the date the building was first placed in service.

Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefitting a common area, or the internal structural framework of the building.

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[112] The conference report describing this provision mistakenly states that the provision applies to improvements that are irrevocably disposed of or abandoned by the *lessee* (rather than the *lessor*) at the termination of the lease.

[113] Under present law, section 280B denies a deduction for any loss sustained on the demolition of any structure.

No special rule is specified for the class life of qualified leasehold improvement property. Therefore, the general rule that the class life for nonresidential real and residential rental property is 40 years applies.

For purposes of the provision, a commitment to enter into a lease is treated as a lease, and the parties to the commitment are treated as lessor and lessee, provided the lease is in effect at the time the qualified leasehold improvement property is placed in service. A lease between related persons is not considered a lease for this purpose.

Effective Date

The provision is effective for qualified leasehold improvement property placed in service after December 31, 2002.

6. Modify estimated tax rules for closely held REIT dividends (sec. 1316 of the bill and sec. 6655 of the Code)

Present Law

If a person has a direct interest or a partnership interest in income producing assets (such as securities generally, or mortgages) that produce income throughout the year, that person's estimated tax payments must reflect the quarterly amounts expected from the asset.

However, a dividend distribution of earnings from a REIT is considered for estimated tax purposes when the dividend is paid. Some corporations have established closely held REITS that hold property (e.g. mortgages) that if held directly by the controlling entity would produce income throughout the year. The REIT may make a single distribution for the year, timed such that it need not be taken into account under the estimated tax rules as early as would be the case if the assets were directly held by the controlling entity. The controlling entity thus defers the payment of estimated taxes.

Reasons for Change

The Committee is concerned that REITs may be used to defer estimated taxes. Income producing property might be acquired in or transferred to a REIT, and a dividend paid from the REIT only at the end of the year. So long as the dividend is paid by year end (or within a certain period after year end), the REIT pays no tax on the dividend, while the shareholder of the REIT does not include the payment in income until the dividend is paid. Thus, the income from the assets is not counted in the earlier quarters of the year, for purposes of the shareholder's estimated tax.

The Committee is concerned that this type of situation is most likely to occur in cases where the REIT is relatively closely held and may be used to structure payments for the benefit of significant shareholders. In such situations, the Committee believes that persons who are significant shareholders in the REIT should be able to obtain sufficient information regarding the quarterly income of the REIT to determine their share of that income for estimated tax purposes.

Explanation of Provision

In the case of a REIT that is closely held, any person owning at least 10 percent of the vote or value of the REIT is required to accelerate the recognition of year-end dividends attributable to the closely held REIT, for purposes of such person's estimated tax payments. A closely held REIT is defined as one in which at least 50 percent of the vote or value is owed by five or fewer persons. Attribution rules apply to determine ownership.

No inference is intended regarding the treatment of any transaction prior to the effective date.

Effective Date

The provision is effective for estimated tax payments due on or after September 15, 1999.

10. Modify treatment of closely-held REITs (sec 1320 of the bill and sec. 856 of the Code)

Present Law

In general, a real estate investment trust ("REIT") is an entity that receives most of its income from passive real estate related investments and that receives pass-through treatment for income that is distributed to shareholders. If an electing entity meets the qualifications for REIT status, the portion of its income that is distributed to the investors each year generally is taxed to the investors without being subjected to tax at the REIT level.

A REIT must satisfy a number of tests on a year-by-year basis that relate to the entity's: (1) organizational structure; (2) source of income; (3) nature of assets; and (4) distribution of income.

Under the organizational structure test, except for the first taxable year for which an entity elects to be a REIT, the beneficial ownership of the entity must be held by 100 or more persons. Generally, no more than 50 percent of the value of the REIT's stock can be owned by five or fewer individuals during the last half of the taxable year. Certain attribution rules apply in making this determination. No similar rule applies to corporate ownership of a REIT. Certain transactions have been structured to attempt to achieve special tax benefits for an entity that controls a REIT.

Reasons for Change

The Committee is aware of a number of situations in which a closely held REIT may be used as a conduit to recharacterize items of income. Some cases causing concern have already been addressed by legislation (e.g., "liquidating reits," which attempted to eliminate tax on income for a period of years) or by regulations (e.g., "step-down preferred" stock, which attempted to provide a corporate borrower with a deduction for payment of principal as well as interest on a loan).

Despite these actions, the Committee is concerned that closely-held REITs may still be used to obtain other tax benefits, chiefly from the ability to recharacterize the income earned by the REIT as a dividend to the REIT owners, as well as to control the timing of such a dividend. Therefore, the provision adds new ownership restrictions designed to limit opportunities for inappropriate income recharacterization.

In certain limited cases, the Committee believes that additional time to satisfy the new requirements should be granted to enable the REIT to establish an operating history before bringing the REIT public. The Committee believes that, in addition to other indicia, evidence of significant and steady growth of the REIT is an important component in demonstrating an intent to bring the REIT public.

Explanation of Provision

The provision imposes as an additional requirement for REIT qualification that, except for the first taxable year for which an entity elects to be a REIT, no one person can own stock of a REIT possessing 50 percent or more of the combined voting power of all classes of voting stock or 50 percent or more of the total value of shares of all classes of stock of the REIT. For purposes of determining a person's stock ownership, rules similar to attribution rules for REIT qualification under present law apply (secs. 856(d)(5) and 856(h)(3)). The provision does not apply to ownership by a REIT of 50 percent or more of the stock (vote or value) of another REIT.

An exception applies for a limited period to certain "incubator REITs". An incubator REIT is a corporation that elects to be treated as an incubator REIT and that meets all the following other requirements. (1) it has only voting common stock outstanding, (2) not more than 50 percent of the corporation's real estate assets consist of mortgages, (3) from not later than the beginning of the last half of the second taxable year, at least 10 percent of the corporation's capital is provided by lenders or equity investors who are unrelated to the corporation's largest shareholder, (4), the corporation must annually increase the value of real estate assets by at least 10 percent, (5) the directors of the corporation must adopt a resolution setting forth an intent to engage in a going public transaction, and (6) no predecessor entity (including any entity from which the electing incubator REIT acquired assets in a transaction in which gain or loss was not recognized in whole or in part) had elected incubator REIT status.

The new ownership requirement does not apply to an electing incubator REIT until the end of the REIT's third taxable year; and can be extended for an additional two taxable years if the REIT so elects. However, a REIT cannot elect the additional two year extension unless the REIT agrees that if it does not engage in a going public transaction by the end of the extended eligibility period, it shall pay Federal income taxes for the two years of the extended period as if it had not made an incubator REIT election and had ceased to qualify as a REIT for those two taxable years. In such case, the corporation shall file appropriate amended returns within 3 months of the close of the extended eligibility period. Interest would be payable, but no substantial underpayment penalties would apply except in cases where there is a finding that incubator REIT status was elected for a principal purpose other than as part of a reasonable plan to engage in a going public transaction. Notification of shareholders and any other person whose tax position would reasonably be expected to be affected is also required.

If an electing incubator REIT does not elect to extend its initial 2-year extended eligibility period and has not engaged in a going public transaction by the end of such period, it must satisfy the new control requirements as of the beginning of its fourth taxable year (i.e., immediately after the close of the last taxable year of the two-year initial extension period) or it will be required to notify its shareholders and other persons that may be affected by its tax status, and pay Federal income tax as a corporation that has ceased to qualify as a REIT at that time.

If the Secretary of the Treasury determines that an incubator REIT election was filed for a principal purpose other than as part of a reasonable plan to undertake a going public transaction, an excise tax of $20,000 is imposed on each of the corporation's directors for each taxable year for which the election was in effect.

For purposes of determining whether a corporation has met the requirement that it annually increase the value of its real estate assets by 10 percent, the following rules shall apply. First, values shall be based on cost and properly capitalizable expenditures with no adjustment for depreciation. Second, the test shall be applied by comparing the value of assets at the end of the first taxable year with those at the end of the second taxable year and by similar successive taxable year comparisons during the eligibility period. Third, if a corporation fails the 10 percent comparison test for one taxable year, it may remedy the failure by increasing the value of real estate assets by 25 percent in the following taxable year, provided it meets all the other eligibility period requirements in that following taxable year.

A going public transaction is defined as either (1) a public offering of shares of stock of the incubator REIT, (2) a transaction, or series of transactions, that result in the incubator REIT stock being regularly traded on an established securities market (as defined in section 897) and being held by shareholders unrelated to persons who held such stock before it began to be so regularly traded, or (3) any transaction resulting in ownership of the REIT by 200 or more persons (excluding the largest single shareholder) who in the aggregate own least 50 percent of the stock of the REIT. Attribution rules apply in determining ownership of stock.

Effective Date

The provision is effective for taxable years ending after July 14, 1999. Any entity that elects (or has elected) REIT status for a taxable year including July 14, 1999, and which is both a controlled entity and has significant business assets or activities on such date, will not be subject to the proposal. Under this rule, a controlled entity with significant business assets or activities on July 14, 1999, can be grandfathered even if it makes its first REIT election after that date with its return for the taxable year including that date.

For purposes of the transition rules, the significant business assets or activities in place on July 14, 1999, must be real estate assets and activities of a type that would be qualified real estate assets and would produce qualified real estate related income for a REIT.