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national policy
bulletin

National Association of Real Estate Investment Trusts®

SENATE FINANCE COMMITTEE ADOPTS TWO REIT IMPROVEMENTS

The Senate Finance Committee approved S. 1637 yesterday. Named the Jumpstart Our Business Strength (JOBS) Act, it would significantly reform the way the United States taxes domestic taxpayers operating abroad and foreign taxpayers operating and investing in the United States. For a detailed description of S. 1637 as passed by the Finance Committee, CLICK HERE. S. 1637 incorporates two proposals contained in S. 1568, the NAREIT-supported Real Estate Investment Trust Improvement Act of 2003 (RIA). For more information on the RIA, CLICK HERE.

The first RIA provision in S. 1637 would remove a major barrier to non-U.S. investment in publicly traded U.S. REITs. Under current law, foreigners who receive REIT capital gain dividends are treated as operating a business in the United States and therefore must file U.S. tax returns even if they have no other U.S. tax obligations. Further, foreign institutions that receive REIT capital gains distributions possibly are subject to another layer of U.S. taxes under the so-called "branch profit" taxation rules.

Treating foreign REIT investors as if they operated a U.S. business is inconsistent with the rest of current tax law affecting REITs. Generally, the United States does not tax a non-U.S. shareholder that sells shares of a U.S. corporation. Although the U.S. does impose tax on foreigners' sales of shares in U.S. real estate corporations, no tax is imposed on the sales of shares of a publicly traded real estate company (including REITs) if the investor owns 5% or less. Further, a U.S. company (including REITs) paying a dividend to a foreigner collects a 30% tax, or a lower rate if provided by a treaty.

S. 1637 would treat REIT capital gains distributions the same as ordinary dividends so long as: (1) the shares of the REIT are publicly traded on a U.S. securities market; and (2) the shareholder receiving the capital gains distribution owns 5% or less of the distributing REIT. Thus, foreign investors receiving such capital gains distributions would not have to file a U.S. tax return or pay the "branch profits" tax merely because they receive such dividends. The REIT making these distributions would withhold U.S. taxes at a 30% rate (instead of the 35% rate required on capital gains distributions under current law), unless the shareholder is a resident of a country with a bilateral tax treaty that prescribes a lower rate. For a detailed chart summarizing these tax rates, CLICK HERE.

The other RIA proposal adopted by S. 1637 would allow timber REITs to use a safe harbor to clarify that certain transactions are not treated as dealer sales subject to a 100% tax rate. This safe

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harbor would be very similar to one in the Tax Code since 1976 for REITs receiving rental income.

Both of these REIT provisions included in S. 1637 would be effective for taxable years beginning after the date of enactment.

The REIT provisions in S. 1637 also are contained in H.R. 1890, which has been co-sponsored by over three quarters of the House Ways and Means Committee. The Ways and Means Committee also is expected to consider an international tax reform bill before Congress recesses this year. This is because the World Trade Organization has ruled that certain provisions in the Internal Revenue Code are an illegal subsidy and that the European Union can impose $4 billion in annual tariffs unless these provisions are repealed. S. 1637 would replace the illegal subsidies with other rules, and the House of Representatives is under pressure to pass a bill also repealing them. However, it is likely that the European Union will not impose tariffs if either the House or Senate passes a bill in 2003, even if final legislation is not enacted until next year.

It is not clear whether the Senate will approve S. 1637 this year, although Finance Committee Chairman Chuck Grassley (R-IA) has said that he will urge the Senate Leadership to do so. NAREIT will seek to add the rest of the RIA provisions in any international tax reform legislation considered by either body.

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