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The Real Estate Roundtable

July 26, 2024

The Honorable Janet Yellen
 Secretary
 U.S. Department of the Treasury
 1500 Pennsylvania Ave., NW
 Washington, DC 20220

Re: Request for Guidance on the Definition of Domestically Controlled Qualified Investment Entities (Treasury Regulation Section 1.897-1(c)(3))

Dear Secretary Yellen:

The Real Estate Roundtable requests additional guidance with respect to the Treasury Department’s recently published final regulations defining a domestically controlled qualified investment entity (“QIE”) under Treasury Regulation section 1.897-1(c)(3) (the “Final Regulations”).¹

As anticipated and feared, initial feedback suggests the Final Regulations are deterring inbound foreign investment in U.S. real estate and the United States’ ability to attract much-needed equity capital for new housing construction and other productive real estate and infrastructure development. Moreover, the impact is occurring at a time when banks have severely reduced their commercial real estate lending and financing costs for capital-intensive real estate projects are significantly elevated.

The Final Regulations include a potentially helpful transition rule (the “Transition Rule”) that allows an existing QIE to ignore the “Look-Through Rule” applicable to a direct or indirect shareholder of a QIE that is a “foreign-controlled domestic corporation” (“FCDC” or “FCDC Look-Through Rule”).² In particular we request additional guidance on an existing QIE’s compliance with respect to the conditions of the Transition Rule. The additional guidance is necessary and time-sensitive to enable a QIE to make a timely determination with respect to its direct or indirect ownership of “US real property interests” (“USRPI(s)”) ³ under the conditions of the Transition Rule. QIEs, in the form of “real estate investments trusts” (“REIT(s)”), often hold their USRPIs indirectly through one or more subsidiaries in the form of partnerships and corporations. In their current form, the Final Regulations do not clearly define “direct or indirect” ownership of USRPIs for this purpose.

¹ T.D. 9992 (Apr. 24, 2024). Under section 897(h)(2), the stock of a “domestically controlled” QIE is not considered a USRPI. For this purpose, a QIE generally includes a REIT or “regulated investment company” and is considered “domestically controlled” if less than 50 percent of value of it its stock is held “directly or indirectly” by foreign persons. §897(h)(4). Unless otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended (the “Code”), or to the Treasury Regulations (“Treas. Reg.”) promulgated thereunder.

² Treas. Reg. §1.897-1(c)(3)(vi).

³ A foreign person generally is subject to US tax on the disposition of a USRPI, as defined in section 897(c)(1). §897(a).

The Final Regulations provide a new FCDC Look-Through Rule with respect to determining whether a QIE is “domestically controlled,” generally effective for dispositions of stock of a QIE on or after April 25, 2024.⁴ In particular, for purposes of the determination, the QIE takes into account certain indirect ownership of stock by foreign persons held through FCDCs.⁵ The Transition Rule generally allows an existing QIE⁶ to ignore the FCDC Look-Through Rule with respect to FCDCs for a period of 10 years provided the QIE continues to meet certain specified conditions with respect to limiting (i) “directly or indirectly” acquired USRPIs (no more than 20 percent of the aggregate fair market value of the USRPIs held “directly or indirectly” by the QIE as of the date of filing) (“Asset Test”) and (ii) changes in ownership of its stock (no more than a 50 percentage point increase in aggregate held directly or indirectly by certain “non-look-through persons” on the date of filing).⁷

For purposes of the Asset Test, the fair market value of the USRPIs held directly and indirectly by a QIE on April 24, 2024 is the value of such property interests as calculated under section 851(b)(3) or 856(c)(4) as of the close of the most recent quarter of the QIE’s taxable year before April 24, 2024. For this purpose, the fair market value of any property acquired after the close of the most recent quarter of the QIE’s taxable year before April 24, 2024, whether acquired before or after April 24, 2024, is determined on the date of such acquisition using a reasonable method, provided the QIE consistently uses the same method with respect to all of its USRPIs.⁸

Further Guidance on “Directly or Indirectly”⁹

It is common for REITs to hold their USRPIs indirectly through a variety of legal entities and under joint-venture arrangements with third-parties. A REIT may or may not be in a controlling or majority position with respect to the entity directly holding the USRPI. In addition, parties to the arrangement, including the REIT, may contribute USRPIs or other assets to entities

⁴ Treas. Reg. §1.897-1(c)(3)(iii)(B) (FCDC Look-Through Rule), Treas. Reg. §1.897-1(a)(2) (applicability date).

⁵ Domestically controlled status is tested generally for a period of 5 years ending on the date of sale of the QIE’s stock. §897(c)(1)(A).

⁶ QIEs in existence on the date the Final Regulations were filed.

⁷ Treas. Reg. §1.897-1(c)(3)(vi)(A). For this purpose, a direct or indirect acquisition of a USRPI, or of stock of a QIE pursuant to a written agreement that was (subject to customary conditions) binding before April 24, 2024, and all times thereafter, or pursuant to a tender offer announced before April 24, 2024, that is subject to section 14(e) of the Securities and Exchange Act of 1934 (15 U.S.C. 78n(e)) and 17 CFR 240.14e-1 through 240.14e-8 (Regulation 14E), is treated as occurring on April 24, 2024 (the “Binding Commitment Rule”).

⁸ Treas. Reg. §1.897-1(c)(3)(vi)(D).

⁹ Our comments here are exclusively directed to the Treasury’s intended meaning, in the transition rule of the new regulations, of the words “directly or indirectly.” A completely separate issue exists as to whether the regulations properly interpreted or applied the statutory words “directly or indirectly” in Section 897(h)(4)(C) to impose a new rule looking through a holder of QIE stock that is a domestic corporation, for purposes of determining whether the QIE is domestically controlled. We continue to respectfully assert, as our prior comments indicated, that the Treasury has misinterpreted or misapplied the statutory term “directly or indirectly.” That is a different issue, however, from what Treasury intended when it uses those words in the new regulations or how the IRS would interpret those words in the new regulations.

in question or cause such entities to distribute USRPIs or other assets, in each case, possibly in transactions governed by nonrecognition provisions of the Code. These fact patterns raise questions about the attribution of USRPIs to the REIT from other entities for purposes of determining the REIT's ownership of USRPIs as of April 24, 2024 and acquisitions thereof after April 24, 2024.

For purposes of determining “directly or indirectly” held or acquired USRPIs with respect to a QIE under the Asset Test, we request that formal guidance be issued to make clear that the existing rules provided in Regulation section 1.897-2(e)¹⁰ are to be taken into account (the “USRPHC Rules”). We are aware that Treasury and IRS officials have stated publicly that they believe such Regulation applies for purposes of these determinations. While these informal statements are helpful, taxpayers and their advisors are not able to rely on them. The following are a few examples illustrating the possible application of Regulation section 1.897-2(e).

“Directly or Indirectly” Held

Assume a QIE holds a “controlling interest” in a corporation (including another QIE) that holds USRPIs. Applying Regulation section 1.897-2(e) for purposes of the Asset Test, the QIE would be treated as holding its proportionate share of each USRPI held by the corporation, while the interest held by the QIE in the corporation would be ignored. Alternatively, assume that the QIE does not hold a controlling interest in the corporation. Applying Regulation section 1.897-2(e) for purposes of the Asset Test, only the interest held by the QIE would be taken into account, provided the interest is itself a USRPI.

“Directly or Indirectly” Acquired

Assume a QIE acquires a 50 percent interest in a partnership that holds 50 percent of the value of all of the stock of a domestically controlled REIT. According to Regulation section 1.897-2(e), the QIE first is treated as holding a proportionate share of any assets of the partnership. Thus, the interest in the partnership is ignored by the QIE and the QIE is considered to hold 25 percent of the stock of the domestically controlled REIT (for the sake of clarity, the assets of the corporation are not treated as held proportionately by the partnership). Under the Asset Test, since the QIE does not have a controlling interest in the domestically controlled REIT, the QIE would not take into account its proportionate share of the assets held by the domestically controlled REIT and thus would not be considered to have acquired a USRPI.

For purposes of the determining whether a QIE has directly or indirectly acquired a USRPI, we understand that Treasury and IRS are of the view that for such purpose, it does not matter whether the acquisition qualifies for a nonrecognition provision of the Code. For example, the acquisition of real property that is qualifying “replacement property” in a section 1031 exchange nevertheless is an acquisition of a USRPI for purposes of the Asset Test. Assuming this result is your position, we believe the rules should make this clear and provide some helpful examples such as the

¹⁰ Rules regarding the treatment of interests held by a corporation in partnerships, trusts, estates, and other corporations for purposes of determining the corporation's status as a “United States real property holding corporation” under section 897(c)(2) and Treas. Reg. §1.897-2.

following which illustrate the position with respect to nonrecognition for purposes of the Asset Test.

Nonrecognition

Assume a QIE contributes a USRPI to a corporation for 80 percent of all of the stock (itself a USRPI) in a transaction that qualifies for nonrecognition under section 351. Under the rules of Regulation section 1.897-2(e), since the USRPI was transferred to a “controlled corporation” of the QIE, the QIE is deemed to own its proportionate share of the USRPI contributed to the corporation and the QIE’s acquired interest in the stock of the corporation is not considered an acquisition of a USRPI for purposes of the Asset Test.

Assume further X, an unrelated party, simultaneously contributed property A (a USRPI) to the corporation for stock. Under the Asset Test, the QIE would be considered to have acquired its proportionate share of property A, which is a USRPI.

There are also fact patterns that raise critical questions about whether and when to treat capitalized expenditures as acquisitions of USRPIs by the REIT for purposes of the Asset Test: (1) property that is a USRPI held by an existing REIT which may have ongoing construction or substantial renovation pursuant to a binding obligation with a third-party service provider as of April 24, 2024, and (2) an existing REIT that held a building on April 24, 2024 which may subsequently incur expenditures that are subject to capitalization under section 263A or similar principles.

For purposes of determining whether a QIE has made an acquisition of a USRPI under these circumstances, we understand from informal public comments that Treasury and IRS are of the view that the existing rules under Regulation section 1.263A-10 defining “unit of property” (“Unit of Property Rule”) are to be taken into account. We believe incorporating into the Final Regulations the Unit of Property Rule, together with the Binding Commitment Rule, is consistent with Treasury’s expressed intention that the impact of the FCDC Look-Through Rule be limited with respect to existing structures and pre-existing business arrangements.¹¹ For purposes of determining “directly or indirectly” held or acquired USRPIs with respect to a QIE under the Asset Test, we request guidance to make clear that the existing rules provided in Regulation section 1.263-10 are taken into account.

The following are examples illustrating the application of the Unit of Property Rule to the Asset Test.

Capitalization of Expenditures

Assume a QIE had entered into a construction contract before April 24, 2024 that contemplated the construction of an apartment building on the QIE’s land. Under the Unit of Property Rule, the “production period” of the apartment building would have been considered to have commenced before April 24, 2024 and ended with its completion on June 1, 2025 . The apartment building is a single “unit of property” and for this purpose the “accumulated production expenditures” for a unit of real property include the costs that directly benefit or are incurred by reason of the production of the apartment building. For purposes of the Asset Test, although the apartment building was completed after April

¹¹ TD 9992, Preamble (IV. Applicability Date and Transition Rules).

24, 2024, because it is a unit of property whose production period began before April 24, 2024 pursuant to a binding construction contract, neither the completion of the apartment building nor any accumulated production period expenditures incurred after April 24, 2024 would be considered an acquisition of a USRPI by the QIE after April 24, 2024.

In the spirit of your indicated intent that the FCDC Look-Through Rule not affect pre-existing business arrangements, we believe the following example should apply. Assume on a date before April 24, 2024, a QIE entered into a binding joint venture arrangement (a partnership for federal tax purposes) with a third-party to acquire land for the purpose of developing and constructing an apartment building. The joint venture acquired the land and incurred zoning and permitting costs before April 24, 2024. The joint venture, however, had not entered into a construction contract nor had commenced construction as of April 24, 2024. The joint venture completed the apartment building on June 1, 2025, which together with the land, constitutes a single unit of property. Since (1) the joint venture arrangement was entered into and the land was acquired before April 24, 2024, and (2) the apartment building construction costs are included with the land as a single unit of property, we request final guidance confirming that the joint venture partnership's completion of the apartment building after April 24, 2024 would not constitute an acquisition of a USRPI by the QIE after April 24, 2024.

Timely guidance is a high priority for the industry. Today, the real estate industry – in large part conducting business through REITs – faces significant external challenges: a rapid rise in interest rates, an uncertain economy, and structural changes in demand related to work-from-home and other trends. Faced with this difficult business environment and an historically strong US dollar, foreign capital must continue to serve as a critical source of equity financing for affordable housing, energy-saving improvements, industrial parks, infrastructure projects, hotels, shopping centers, and a troubled office sector. Many REITs are governed by the Transition Rule, while many others may be unsure of its application until they are able to confirm their understanding of direct and indirect ownership as of April 24, 2024 under the new “look-through rules.” In addition, many of the REITs in question are structured as open-end real estate funds that are subject to periodic redemption requests, for which domestically controlled REIT status must be understood for purposes of properly withholding FIRPTA tax on the redemption proceeds.

Accordingly, we respectfully request guidance in the form of a Treasury Decision containing correcting amendments to the Final Regulations. To date, the Treasury Department has been very forthcoming and helpful with sharing their unofficial views and comments in a variety of forums. We believe that the requested correcting amendments are appropriate as clarifications to the Transition Rule, which, it should be noted was not contained in the proposed regulations¹² and as a result did not enjoy the benefit of specific notice and comment. Providing these views and comments in authoritative guidance would be welcomed by the industry and provide comfort to REITs and other withholding agents with respect to complying with the condition of the Transition Rule.

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¹² REG-100442-22 (Dec. 29, 2022).

The Honorable Janet Yellen

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We appreciate your thoughtful attention to the issues discussed herein. If you have any questions or would like to discuss further these comments, please contact Ryan McCormick of The Real Estate Roundtable (rmccormick@rer.org, PH: 202-639-8400). Thank you in advance for your consideration of these comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey D. DeBoer". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

Jeffrey D. DeBoer

President and Chief Executive Officer