

February 23, 2023

The Honorable Ron Wyden
Chairman
Committee on Finance
U.S. Senate

The Honorable Jason Smith
Chairman
Committee on Ways and Means
U.S. House of Representatives

The Honorable Michael D. Crapo
Ranking Member
Committee on Finance
U.S. Senate

The Honorable Richard E. Neal
Ranking Member
Committee on Ways and Means
U.S. House of Representatives

Dear Chairmen Wyden and Smith and Ranking Members Crapo and Neal:

A recently proposed, retroactive IRS proposal would rewrite decades of existing tax law, overrule and supersede Congressional intent, and potentially stifle real estate's access to foreign capital. The undersigned real estate organizations respectfully request that you urge the Treasury Department and IRS to withdraw immediately their proposed look-through rule for determining whether a qualified investment entity is domestically controlled.

The look-through proposal in the new Foreign Investment in Real Property Tax Act (FIRPTA) regulations ([REG-100442-22](#)) unveiled by Treasury and the IRS in the final days of last year (Dec. 29) is irreparably flawed for three reasons. First, it could disrupt real estate's access to capital at a time of rising rates and economic vulnerability—putting property values, jobs, and communities at risk. Second, the proposal exceeds Treasury's authority and circumvents the legislative process by overriding decades of well-settled, existing law and contradicting clear statements of congressional intent. Third, by applying retroactively—and in certain ways, applying before it is even finalized—the rule is grossly unfair to current real estate investors who played by the rules and sends a damaging message to potential future investors that U.S. tax law is neither stable nor predictable.

Today, the real estate industry faces significant external challenges: a rapid rise in interest rates, a slowing economy, and structural changes in demand related to work-from-home and other trends. In this environment, foreign capital can and should continue to serve as a critical source of equity financing for affordable housing, energy-saving improvements, industrial parks, infrastructure projects, hotels, shopping centers, and much more.

The look-through rule would change longstanding tax law and effectively impose new taxes on investment structures that have been used for decades by governments, insurance companies, and other institutional or large foreign investors when deploying capital in the United States. Large, long-term investments can take years to properly organize and finance. Surprising investors with sudden, retroactive changes to well-settled tax rules is a recipe to discourage business and investment in the United States, not only now but for years to come.

When Congress enacted FIRPTA in 1980—a capital gains tax regime that only applies to foreign investment in U.S. real estate and not to other asset classes—it created an important

outlet to ensure the United States' ability to continue attracting foreign capital for job-creating real estate and infrastructure projects. The outlet exempts disposition of domestically controlled real estate investment trust (DC REIT) stock from FIRPTA when less than half of its stock (by value) is owned by foreign persons. Forty years of Treasury regulations and rulings, as well as subsequent legislation and statements of legislative intent, have solidified the DC REIT regime and created a stable and predictable legal framework in a segment of the marketplace that depends heavily on tax certainty. The DC REIT rules have allowed many U.S. real estate businesses to flourish by continuing to attract foreign investment for projects that boost job growth, increase affordable housing, and improve communities.

Under the proposed regulation, for the first time, the government would “look through” a taxpaying U.S. C corporation that is a shareholder of a REIT and treat the domestic corporation as a “foreign person” if it has foreign shareholders. This action is contrary to basic corporate tax principles established by the U.S. Supreme Court 80 years ago that are still in effect. Such “look through” is generally done only when expressly required by statute, which is not the case here. It is also a fundamental departure from past FIRPTA regulations and rulings.

In 1984, Treasury regulations defined a DC REIT. Twenty-five years later, the IRS confirmed the proper application of the 1984 regulations in a 2009 private letter ruling. In 2013, the Senate Finance Committee actually considered and rejected a draft proposal along the lines of the proposed regulation. Most recently, in the 2015 PATH Act, Congress rejected a comprehensive look-through approach and enacted a set of look-through rules for DC REIT determinations that chose only to look through to the owners of a REIT. It declined to take the much more drastic and unprecedented step of looking through a taxpaying U.S. C corporation.

The Congressional policy is the rational and appropriate policy – income passes through REITs in the form of dividends to the REIT's underlying shareholders. Conversely, non-REIT C corporations recognize income and pay tax at the entity level. A domestic C corporation shareholder of a REIT is not evading or escaping tax on the DC REIT's ordinary or capital gain income. The proposed regulations override and supersede this repeatedly affirmed Congressional policy.

Making matters worse, the look-through rule would apply retroactively by subjecting prior investments to FIRPTA tax when interests are sold. Moreover, the regulations could have an immediate, damaging impact in the marketplace because the IRS has indicated it may challenge taxpayers today who take positions contrary to the proposed regulations.

Commercial real estate's contribution to the nation's economy is enormous. The current total value of America's commercial real estate exceeds \$20.7 trillion. Today, the commercial real estate industry directly employs 8.5 million workers, and millions more in related fields. Property taxes generate over 70 percent of local tax revenue, helping pay for schools, roads, law enforcement and other essential public services. Over \$900 billion of savings is invested in commercial real estate by pension funds, educational endowments, and charitable foundations.

Over the past 20 years, the United State has been a preferred location for foreign capital seeking to invest in real estate due to its stability, its resilient economy and the certainty regarding the flow and taxation of capital into and out of real estate investments. Foreign capital is a vital source of equity investment for transformational real estate and infrastructure projects and a growing contributor to real estate financing in smaller, regional markets such as Austin, Charlotte, Orlando, Denver, Nashville, Seattle, Phoenix, and many others.

Now, various factors, such as the rapid rise in interest rates, concerns about a global economic slowdown and the trailing impacts of the pandemic (*e.g.*, work from home and increasing vacancies in urban centers and elsewhere), have combined to put considerable pressure on the U.S. real estate industry. This combined pressure creates challenges for the industry that require readily available capital sources if the industry is to meet and overcome these challenges.

The proposed look-through rule, if not swiftly withdrawn, would only add to the pressure, restricting access to an important source of capital by making U.S. real estate a less attractive investment for foreign investors, thereby extending the challenges for the industry itself.

Treasury's proposed look-through rule is not an enforcement of the law but a retroactive rewriting of the law that should be withdrawn. We respectfully request that Members of Congress convey to the Treasury Secretary and IRS Commissioner that the proposed FIRPTA look-through rule would undermine agreed-upon tax laws and policies in a manner that deviates from Congressional intent and threatens U.S. economic stability and growth.

Sincerely,

The Real Estate Roundtable
AFIRE
American Hotel & Lodging Association
American Resort Development Association
American Seniors Housing Association
BOMA International
CCIM Institute
ICSC
Institute for Portfolio Alternatives
Institute of Real Estate Management
Nareit
National Apartment Association
National Association of REALTORS®
National Multifamily Housing Council
National Rental Home Council

CC: Members of the Senate Committee on Finance
Members of the House Committee on Ways and Means