

CLIENT ALERT

IRS Proposes to Remove the Domestic Corporation Look-Through Rule for Measuring Domestic Control of REITs

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The Internal Revenue Service has issued proposed regulations (the “[Proposed Regulations](#)”)¹ that would remove the domestic corporation look-through rule that was adopted in final regulations published on April 24, 2024 (the “[2024 Final Regulations](#)”)² for purposes of determining whether a REIT is “domestically controlled” (a “[DC-REIT](#)”). Taxpayers generally may rely on the Proposed Regulations before they are finalized.

Under Sections 897(a) and 1445 of the Internal Revenue Code (the “[Code](#)”), gain or loss of a foreign person from the disposition of a United States real property interest (“[USRPI](#)”) generally is treated as income effectively connected with a U.S. trade or business and subject to U.S. federal income taxation and withholding (“[FIRPTA Taxation](#)”). Although an interest in a REIT or other United States real property holding corporation is generally treated as a USRPI, an interest in a DC-REIT is not treated as a USRPI. Thus, a sale or other disposition of a DC-

¹ The Proposed Regulations are available [here](#).

² For our prior client alert describing the 2024 Final Regulations, click [here](#).

REIT is not subject to FIRPTA Taxation. Under Section 897(h)(4)(B) of the Code, to qualify as “domestically controlled,” the REIT must, at all times during the “testing period” (generally, the prior five-year period or, if shorter, the period during which the entity has been in existence), have had less than 50% of the value of its stock held “directly or indirectly” by foreign persons.

The 2024 Final Regulations adopted a limited “look-through” approach for purposes of determining a REIT’s indirect foreign ownership, which took into account stock of a REIT held indirectly through certain “look-through persons.” The 2024 Final Regulations treated a non-publicly traded domestic C corporation that was more than 50% foreign-owned as a “look-through person” (the “domestic corporation look-through rule”). The Proposed Regulations would remove the domestic corporation look-through rule. This change is in response to criticism that the domestic corporation look-through rule was not consistent with the statutory text and purpose of the DC-REIT exception, as well as concerns with the practical difficulties of tracing upstream ownership. As a result, all domestic C corporations would be treated as “non-look-through persons” and therefore considered U.S. persons for determining a REIT’s DC-REIT status, regardless of their level of foreign ownership.

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