

Real Estate Tax Alert



IRS issues proposed regulations on Built-in Gains Tax

The Internal Revenue Service recently issued proposed regulations regarding the circumstances in which a real estate investments trust (“REIT”) will be subject to corporate level tax on the built-in gains in property received by the REIT from a C Corporation (the “BIG tax”). The proposed regulations address certain issues that REITs have faced in connection with the application of the BIG tax. First, the proposed regulations provide an exception from the BIG tax for certain property transfers from a C corporation to a REIT under Section 1031 (which covers like-kind exchanges) and 1033 (which covers involuntary conversions). The proposed regulations also provide that property transferred from a tax exempt entity will not be subject to the tax unless the tax exempt entity would have been subject to UBIT on the sale of the property.

Property transfers to REIT in a like kind exchange or involuntary conversions

Under current regulations, if property owned by a C corporation becomes the property of a REIT (“BIG property”) in either a conversion of the C corporation to a REIT or in a transaction in which gain is not recognized (“a BIG transaction”), then, unless the C corporation elects deemed sale treatment, the REIT would be subject to tax at regular corporate rates on certain built-in gains of the BIG property sold within 10 years after the BIG transaction. Built-in gain is generally the gain that would have been recognized in connection with the sale of property on the day it was acquired from the C corporation.

If the C Corporation makes a deemed sale election with respect to the BIG property, net built-in gains would be recognized immediately (as if the C Corporation sold the BIG property to an unrelated party at fair market value), and the gain would be includible on C Corporation’s tax return.

Because a C corporation will not recognize gain on property transferred to a REIT in a like-kind exchange under Code § 1031 or an involuntary conversion under Code § 1033 there has been concern that the property received by a REIT in these transactions could be subject to the BIG tax even though a C corporation generally would receive an asset that would have the same basis as the property transferred (and therefore no gain would escape corporate taxation and such gain escaping corporate taxation is the purpose of the BIG tax). The proposed regulations address this concern by providing an exception from the general rule for transactions in which a C Corporation does not recognize net built-in gain in a qualified like-kind exchange or involuntary conversions.

Contributions by tax exempt entities

As noted above, the BIG tax may apply to certain transfers of property by a C corporation to a REIT. Because tax-exempt entities are often C corporations, contributions by tax exempt entities could be subject to the BIG tax even if the tax exempt corporation would not have been subject to tax on a sale of the underlying property. While a tax-exempt corporation contributing assets to a REIT would be able to make a deemed sale election (and assuming it is not subject to tax on the gain, would be willing to do so), in circumstances where a partnership has both taxable and tax-exempt corporate partners, tax-exempt corporations may prefer a deemed sale election (as they might not be subject to tax on any gain) while taxable corporations may not want to make such an election (and become subject to tax in connection with the contribution). As the regulations provide that the deemed sale election is made with respect to all C Corporation partners, a partnership was often forced to weigh the conflicting interests of its partners with respect to whether to make a deemed sale election. The proposed regulations seek to cure this conflict by carving out tax-exempt partners from being considered C Corporations for purposes of the BIG tax.

For additional information concerning this issue, please contact:

Adam Feuerstein

703-918-6802

Adam.s.feuerstein@us.pwc.com

PwC Real Estate Tax Practice – National and Regional Contacts:

National

Paul Ryan

US RE Tax Leader
New York
646-471-8419
paul.ryan@us.pwc.com

Regional

Atlanta

Dennis Goginsky

678-419-8528
dennis.goginsky@us.pwc.com

Tim Trifilo

678-419-1740
timothy.j.trifilo@us.pwc.com

Boston

Timothy Egan

617-530-7120
timothy.s.egan@us.pwc.com

Laura Hewitt

617-530-5331
laura.a.hewitt@us.pwc.com

Rachel Kelly

617-530-7208
rachel.d.kelly@us.pwc.com

Chicago

Jill Loftus

312-298-3294
jill.h.loftus@us.pwc.com

Alan Naragon

312-298-3228
alan.naragon@us.pwc.com

Los Angeles

Adam Handler

213-356-6499
adam.handler@us.pwc.com

Phil Sutton

213-830-8245
philip.c.sutton@us.pwc.com

New York

Eugene Chan

646-471-0240
eugene.chan@us.pwc.com

Dan Crowley

646-471-5123
dan.crowley@us.pwc.com

Martin Doran

646-471-8010
martin.doran@us.pwc.com

James Guiry

646-471-3620
james.m.guiry@us.pwc.com

Sean Kanousis

646-471-4858
sean.richman.kanousis@us.pwc.com

Christine Lattanzio

646-471-8463
christine.a.lattanzio@us.pwc.com

James Oswald

646-471-4671
james.a.oswald@us.pwc.com

Oliver Reichel*

971 (2) 694 6946
oliver.reichel@us.pwc.com

John Sheehan

646-471-6206
john.f.sheehan@us.pwc.com

Steve Tyler

646-471-7904
steve.tyler@us.pwc.com

David Voss

646-471-7462
david.m.voss@us.pwc.com

San Francisco

Warren Glettner

415-498-6070
warren.glettner@us.pwc.com

Kevin Nishioka

415-498-7086
kevin.s.nishioka@us.pwc.com

Neil Rosenberg

415-498-6222
neil.rosenberg@us.pwc.com

Washington DC

Karen Bowles

703-918-1576
karen.bowles@us.pwc.com

Adam Feuerstein

703-918-6802
adam.s.feuerstein@us.pwc.com

Kelly Nobis

703-918-3104
kelly.s.nobis@us.pwc.com

Shannon Stafford

703-918-3031
shannon.m.stafford@us.pwc.com

* Currently resident in Abu Dhabi

www.pwc.com/us/assetmanagement

© 2012 PricewaterhouseCoopers LLP, a Delaware limited liability partnership. All rights reserved. PwC refers to the US member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

Solicitation

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.