



GLOBAL FUNDS TAX ADVISORY – REAL ESTATE

Proposed regulations under sections 892 and 897

Tax Alert

Overview

On December 29, 2022, the IRS and the Department of the Treasury released [proposed regulations](#) under sections 892 (the exemption from US tax for foreign governments and sovereign wealth funds) and 897 (The Foreign Investment in Real Property Tax Act) (the “Proposed Regulations”) regarding the treatment of certain entities, including qualified foreign pension funds (QFPFs), under section 892 and the determination of whether a qualified investment entity (a QIE, which term includes a real estate investment trust (REIT)) is “domestically controlled” under section 897(h)(4). On the same day, the IRS and the Department of the Treasury also released final regulations under section 897(l) (the exemption from US tax on gains from US real property interests held by QFPFs), along with associated withholding tax provisions in sections 1441, 1445, and 1446 (the “Final QFPF Regulations”), and separately reopened the comment period for proposed regulations issued under section 892 on November 3, 2011, and corrected on November 23, 2011.

Proposed regulations under section 892

The Proposed Regulations provide a new rule that a controlled entity of a foreign government, not otherwise engaged in commercial activities, that is a US real property holding corporation under section 897(c)(2) will not be treated as a controlled commercial entity if the entity is either (i) a foreign corporation that is a qualified holder under Treasury Regulation (“Treas. Reg.”) § 1.897(l)-1(d) or (ii) a corporation that is a US real property holding corporation under section 897(c)(2) solely by reason of its direct or indirect ownership of one or more other corporations that are not controlled by the foreign government. These changes should resolve the so-called “basketing” issue confronted by many sovereign wealth funds that invest in US real estate funds.

The Proposed Regulations apply to taxable years ending on or after December 29, 2022. However, taxpayers may rely on them until the date they become final.

Proposed regulations under section 897

The Proposed Regulations clarify that QFPFs (including qualified controlled entities (QCEs)) and international organizations are treated as foreign persons for determining whether a QIE is “domestically controlled” under section 897(h)(4).

The Proposed Regulations also propose new rules for determining the direct or indirect holders of QIE stock for purposes of section 897(h)(4). Under the new rules, “non-look-through persons” (generally, individuals, foreign corporations, certain domestic corporations, tax-exempts, publicly traded partnerships, international organizations, QFPFs/QCEs) are considered to be the direct or indirect holders of QIE stock. “Look-through persons” (generally, partnerships, trusts, S corporations, RICs, REITs, “foreign-owned” US corporations) are generally not treated as direct or indirect holders of QIE stock. Instead, the shareholders, partners, or beneficiaries of the “look-through person” are treated, proportionately, as the direct or indirect holders of the QIE stock. Rules are provided for tiered “look-through persons.” A US corporation is treated as “foreign-owned” if 25% or more of the fair market value of its stock is held directly or indirectly by foreign persons. The “look-through” of “foreign owned” domestic corporations is inconsistent with a prior private letter ruling and thus with the approach taken by many practitioners.

The Proposed Regulations under section 897 generally are effective for transactions occurring on or after the date the Proposed Regulations are published as final but may be relevant for determining the direct or indirect holders of a QIE during its tracking period that has begun before such date.

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