

Client Alert

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IRS Treats Subpart F Income Inclusions of Offshore TRSs as Qualifying Income for the REIT 95% Gross Income Test

New favorable guidance from the IRS (Revenue Procedure 2018-48, or the “Revenue Procedure”) clarifies that subpart F inclusions of foreign taxable REIT subsidiaries (“TRSs”) are treated as qualifying income for the 95% income test applicable to REITs. Subpart F income is passive-type income that foreign subsidiaries are required to pass through to their domestic parent on an annual basis if it is not otherwise distributed by the subsidiary during the year in which it is earned.

This published guidance expands on a series of private letter rulings that the IRS has issued to various REITs regarding subpart F inclusions of foreign TRSs. Although some of the private letter rulings looked through to the nature of the TRS’s underlying income in reaching a favorable conclusion regarding the income test treatment of subpart F inclusions, the revenue procedure indicates that such a look-through is not required and treats all subpart F inclusions as qualifying income under the 95% income test. REITs can now rely on the Revenue Procedure without having to seek a private letter ruling or an opinion of counsel.

The Revenue Procedure also covers certain other types of income associated with foreign TRSs. For example, it holds that (1) passive foreign investment company inclusions are qualifying income for purposes of the 95% income test and (2) foreign currency gain from previously taxed earnings and profits that is required to be taken into account under Internal Revenue Code section 986(c) does not constitute gross income for the 95% test.

This guidance is effective for taxable years beginning after September 13, 2018. However, a REIT may choose to apply these rules to prior years.

If you would like more information about this newly issued Revenue Procedure, please contact one of the attorneys listed below.

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