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Tax Update

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Proposed Treasury Regulations Remove the “Look-Through” Rule for Domestic C Corporations for Purposes of the Domestically Controlled REIT Qualification Test

Domestic C corporations will now count as domestic shareholders for purposes of the Domestically Controlled REIT Qualification Test.

On October 20, 2025, the IRS and Treasury issued proposed regulations removing the “look-through” rule for a domestic C corporation for purposes of determining whether a real estate investment trust (a REIT)^[1] qualifies as a “domestically controlled qualified investment entity” (a DREIT) and the proposed regulations, the “2025 Proposed Regulations”). The 2025 Proposed Regulations would modify certain provisions of the final regulations issued by the IRS and Treasury on April 25, 2024 (the “2024 Final Regulations”), [detailed in our previous Client Alert](#).

Background

Subject to certain exceptions discussed below, section 897^[2] and related sections added to the Code by the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) require foreign persons that recognize gain from the sale or disposition of a United States real property interest (a USRPI) to file U.S. federal income tax returns reporting that gain and pay U.S. federal income

tax on that gain at regular graduated rates, even if the gain is not otherwise effectively connected with the conduct of a U.S. trade or business.

The definition of a USRPI is broad. In addition to including a wide array of interests in U.S. real estate (which itself is defined broadly) and in disregarded entities and certain partnerships that own U.S. real estate, USRPIs include equity interests in domestic corporations that are or have been during a specified look-back period United States real property holding corporations (USRPHCs).^[3] Generally, a USRPHC is any corporation, including a REIT, if the value of its USRPIs represents at least 50 percent of the aggregate value of its real estate (both U.S. and non-U.S.) and business assets.^[4]

Even though an equity interest in a domestic USRPHC generally is a USRPI, section 897(h)(2) provides that an interest in a DREIT is not a USRPI. Under section 897(h)(4), a REIT is a DREIT if less than 50 percent of the value of its stock is held “directly or indirectly” by “foreign persons” at all times during the shorter of (1) the 5-year period ending on the relevant determination date and (2) the period during which the REIT was in existence (the “Testing Period”). Importantly, gain recognized by a foreign person on the disposition of an interest in a DREIT is not subject to U.S. federal income tax under FIRPTA, even if the DREIT is a USRPHC.^[5] Foreign persons seeking to invest in U.S. real estate generally prefer a DREIT structure because they can exit the investment via a sale of DREIT stock without being subject to FIRPTA.

Previous Regulations

Prior to December 2022, informal IRS guidance treated a domestic C corporation as a non-foreign owner of a REIT for purposes of determining DREIT status.^[6] However, in December 2022 the IRS and Treasury issued proposed regulations (the “2022 Proposed Regulations”) that included a broad look-through rule for purposes of determining when the stock of a REIT owned by one person was treated as held “indirectly” by another person for DREIT testing purposes (the “Look-Through Rule”).^[7] The Look-Through Rule applied to various types of passthrough and quasi-passthrough entities, including REITs, partnerships (other than publicly traded partnerships), S corporations, and RICs.

The Look-Through Rule in the 2022 Proposed Regulations also applied to any non-publicly traded domestic C corporation if foreign persons held directly or indirectly 25 percent or more of the value of the domestic C corporation’s outstanding stock, applying certain look-through rules (a “foreign-owned domestic corporation”).^[8] Thus, under the 2022 Proposed Regulations, a foreign-owned domestic corporation was not treated as a domestic owner of a REIT; rather, ownership of the REIT’s stock was imputed to the owners of the foreign-owned domestic corporation to determine if the REIT qualified as a DREIT. The 2022 Proposed Regulations applied to dispositions of interests in REITs that occurred after the date on which the 2022 Proposed Regulations were finalized. However, the preamble indicated that “the IRS may challenge positions” taken by taxpayers that were contrary to the 2022 Proposed Regulations prior to the regulations’ being finalized.^[9]

The 2022 Proposed Regulations were finalized by the 2024 Final Regulations on April 25, 2024. The 2024 Final Regulations generally maintained the Look-Through Rule for domestic C corporations, but increased the threshold of foreign ownership that would cause a domestic C corporation to be a foreign-controlled domestic C corporation from 25 percent or more to more than 50 percent.^[10] Generally, the Look-Through Rule and other provisions of the 2024 Final Regulations applied to transactions (e.g., sales of REIT shares) occurring on or after April 25, 2024.^[11] Importantly, however, the 2024 Final Regulations did not apply the Look-Through Rule to existing REITs until April 24, 2034, provided certain requirements were satisfied (the “Transition Rule”).^[12]

2025 Proposed Regulations

The 2025 Proposed Regulations eliminate the Look-Through Rule entirely for domestic C corporations. As a result, a domestic C corporation that owns REIT stock is treated as a non-foreign person in determining whether that REIT is a DREIT, regardless of the domestic C corporation’s ownership. The 2025 Proposed Regulations make conforming changes to Treas. Reg. § 1.897-1(c) to account for the removal of the Look-Through Rule for domestic C corporations, including eliminating the Transition Rule.

Effective Date

The 2025 Proposed Regulations, upon finalization, would apply to all transactions occurring on or after October 19, 2025 and, if a taxpayer chooses, to transactions occurring on or after April 25, 2024 (or before April 25, 2024 as a result of a check-the-box election filed on or after April 25, 2024).^[13] The preamble to the 2025 Proposed Regulations provides that taxpayers may rely on the 2025 Proposed Regulations for transactions occurring before the date the 2025 Proposed Regulations are finalized. As a result, taxpayers can effectively elect to treat domestic C corporations as non-foreign owners of REIT stock for purposes of DREIT qualification.

Takeaways

- Investment in U.S. real estate will be more attractive to foreign investors due to simpler DREIT administration and reduced legal uncertainty.
- Gibson Dunn can assist sponsors and investors in structuring U.S. real estate investments using DREITs.
- Sponsors and investors should evaluate whether existing REITs that may have lost or not qualified for DREIT status under the 2024 Final Regulations now qualify under the 2025 Proposed Regulations.
- Sponsors and investors should consider evaluating the impact of the 2025 Proposed Regulations to transactions occurring before April 25, 2024.
- Sponsors and investors in existing REITs should consider lifting any limitations on the acquisition of new USRPIs put in place to comply with the former Transition Rule.

[1] The rules also apply to certain registered investment companies (RICs). In our discussion, however, we focus on REITs and DREITs because foreign persons are more likely to invest in U.S. real estate through REITs than through RICs.

[2] Unless indicated otherwise, all “section” references are to the Internal Revenue Code of 1986, as amended (the “Code”), and all “Treas. Reg. §” references are to the Treasury regulations promulgated under the Code.

[3] Section 897(c)(4)(B), (c)(1)(A)(ii).

[4] Section 897(c)(2).

[5] Section 897(h)(2).

[6] See, e.g., PLR 200923001. See our [previous Client Alert](#) for a discussion of the available guidance before the promulgation of the Proposed Regulations.

[7] Prop. Treas. Reg. § 1.897-1(c)(3)(ii)(B) (2022).

[8] Prop. Treas. Reg. § 1.897-1(c)(3)(v)(B) (2022).

[9] 87 F.R. 80103 (Dec. 29, 2022)

[10] Although the 2022 Proposed Regulations refer to these entities as “foreign-owned domestic corporations,” the 2024 Final Regulations refer to these entities as “foreign-controlled domestic corporations.” 89 F.R. 31621 (April 25, 2024); Treas. Reg. § 1.897-1(c)(3)(v)(B).

[11] Treas. Reg. § 1.897-1(a)(2).

[12] Treas. Reg. § 1.897-1(c)(3)(vi).

[13] Prop. Treas. Reg. § 1.897-1(a)(2).

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Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding this proposed legislation. To learn more about these issues or discuss how they might impact your business, please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any member of the firm’s [Tax](#), [Tax Controversy and Litigation](#), or [Real Estate Investment Trust](#)

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