

MEMO# 26078

April 24, 2012

IRS Releases Proposed Regulations on Transfers from C Corporations to RICs and REITs

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TO: TAX COMMITTEE No. 24-12 RE: IRS RELEASES PROPOSED REGULATIONS ON TRANSFERS FROM C CORPORATIONS TO RICS AND REITS

The Internal Revenue Service (“IRS”) and Treasury Department have released proposed regulations on certain transfers of property from C corporations to regulated investment companies (“RICs”) and real estate investment trusts (“REITs”) under section 337(d). [\[1\]](#) The proposed regulations would amend existing regulations that were designed to carry out the repeal of the General Utilities doctrine.

Under current law, if property of a C corporation becomes the property of a RIC or REIT in a conversion transaction, then, absent a deemed sale election, the RIC or REIT generally will be subject to tax on the net built-in gain in the converted property under the rules of section 1374 and the underlying regulations, as if the RIC or REIT were an S corporation.

The proposed regulations would provide an exception from this general rule for a transfer of property by a C corporation to a RIC or REIT to the extent that the transfer qualifies for non-recognition treatment under either section 1031 or 1033. In such a transaction, the C corporation’s basis in the property it receives is derived from its basis in the transferred property, and thus reflects any built-in gain. Similarly, the RIC or REIT’s basis in the converted property has no relation to the C corporation’s basis in such property. The proposed regulations are limited to transfers under sections 1031 and 1033; Treasury and the IRS are not proposing to extend this treatment to all exchanged basis transactions, such as exchanges that would otherwise qualify for non-recognition treatment under section 351.

The proposed regulations also would amend the current regulations to provide that the definition of a C corporation excludes tax-exempt entities within the meaning of Treas. Reg. § 1.337(d)-4(c)(2). As a result, transfers of property by a tax-exempt entity to a RIC or REIT, or by a partnership to a RIC or REIT to the extent of a tax-exempt partner’s distributive share of the gain in the transferred property, generally will not be subject to section 1374 treatment. For this purpose, an entity will not be considered tax-exempt to the extent it

would be subject to tax under the Internal Revenue Code (e.g., it would be taxed on unrelated business income under section 511) with respect to any gain resulting from a deemed sale election, if such election were made under Treas. Reg. § 1.337(d)-7(c)(5) with respect to the transfer.

The IRS and Treasury Department have requested comments on the proposed regulations by July 16, 2012. If you believe that the Institute should comment on these proposed regulations, please provide any comments to me (202-371-5432 or kgibian@ici.org) no later than Monday, June 18, 2012.

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endnotes

[1] The proposed regulations (REG-139991-08) can be found in the Federal Register [here](#).

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