Proskauer

Proposed Regulations Remove Look-Through Rule for Domestically Controlled REITs

Tax Talks on **October 21, 2025**

I. Introduction

On October 20, 2025, the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") issued proposed regulations (the "Proposed Regulations") that would helpfully revoke the current "look-through rule" for domestic C corporation shareholders to determine whether a "real estate investment trust" (a "REIT") is "domestically controlled". Accordingly, under the Proposed Regulations, a domestic C corporation shareholder is treated as a domestic person for purposes of determining whether a REIT is domestically controlled. Ownership interests in domestically controlled REITs are not treated as "United States real property interests" ("USRPIs")[1], and non-U.S. persons that sell interests in them are not subject to U.S. federal income tax on the gain. The Proposed Regulations permit taxpayers to rely on the Proposed Regulations before they are finalized and, if the Proposed Regulations are finalized as proposed, they would be retroactive to transactions occurring on or after April 25, 2024 (effectively nullifying the current regulations, which were finalized on April 24, 2024, and reverting to the rules prior to the current regulations).

II. Background

Section 897 of the Code[2] subjects a non-U.S. person to U.S. tax on any gain recognized upon a disposition of a USRPI at regular U.S. tax rates. Equity interests in a "domestically controlled qualified investment entity" (which includes a domestically controlled REIT) are not USRPIs.[3] Therefore, a non-U.S. investor may sell shares in a domestically controlled REIT without being subject to U.S. income tax under section 897.

On April 24, 2024, Treasury and the IRS issued final regulations (the "2024 Final Regulations") that applied a rule under which domestic C corporation REIT shareholders that are "foreign-controlled domestic corporations"[4] would be looked through to their non-U.S. owners in determining whether a REIT is domestically controlled. Accordingly, the 2024 Final Regulations limited the ability of foreign investors to invest in a domestic blocker to cause a REIT to be domestically controlled. The 2024 Final Regulations are described in more detail in our prior blog post.

III. The Proposed Regulations

The Proposed Regulations effectively retroactively revoke the look-through rule for foreign-controlled domestic corporations contained in the 2024 Final Regulations and treat all domestic C corporations as U.S. persons for purposes of determining whether a REIT is domestically controlled. U.S. taxpayers are permitted to rely on the Proposed Regulations before they are finalized and, if finalized, the Proposed Regulations would apply retroactively.

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[1] A USRPI includes real property located in the United States or the Virgin Islands, and also equity interests in a domestic "United States real property holding corporation", which is generally a corporation whose assets consist of 50% or more USRPIs by value.

[2] All references to section are to the Internal Revenue Code of 1986, as amended.

[3] A REIT is domestically controlled if less than 50% of its stock by value is held "directly or indirectly" by foreign persons (i.e., more than 50% of its stock is held by U.S. persons) at all times during the period during which the REIT was in existence or, if shorter, the five-year period ending on the date of a sale of shares in the REIT.

[4] A foreign-controlled domestic corporation is a non-public domestic corporation that is more than 50% owned, directly or indirectly (by value) by non-U.S. owners.

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