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Kirkland Alert

Treasury and IRS Issue New Taxpayer-Favorable Proposed Regulations on Domestically Controlled REITs

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On October 20, 2025, the U.S. Department of Treasury and the Internal Revenue Service (IRS) proposed new regulations that would amend the final regulations issued on April 24, 2024, and positively impact the ability of real estate investment trusts (REITs) and private equity funds investing through REIT structures to raise foreign capital. Taxpayers may choose to rely on the new proposed regulations before they are finalized.

Background

In general, the Foreign Investment in Real Property Tax Act (FIRPTA) rules under Section 897 impose tax (backstopped by withholding requirements) and filing obligations on foreign persons that dispose of U.S. real property interests (USRPIs).[1] Stock of a "domestically controlled" REIT is *not* considered a USRPI, such that the disposition of such stock by a foreign person is not subject to taxation under FIRPTA. A REIT is domestically controlled if less than 50% of the REIT's stock value is held, directly or indirectly, by foreign persons at all times during the applicable testing period (i.e., the lesser of the five years preceding the applicable stock disposition or the REIT's existence) (the domestic control test).

Repeal of the Domestic C Corporation "Look-Through" Rule

The new proposed regulations modify Treasury's guidance regarding how it applies the domestic control test in respect of certain REIT shareholders. Specifically, the new proposed regulations would limit the impact of the 2024 regulations by repealing the rule requiring REITs to "look-through" certain domestic C corporations with foreign ownership for purposes of applying the domestic control test. For a more detailed discussion of this "look-through" rule, see our previous *Alert*.

The new proposed regulations instead treat all domestic C corporations as non-look-through persons. For example, under the new proposed regulations, a REIT would be domestically controlled where it is owned by a domestic C corporation holding 51% of its stock (by value) and by foreign persons holding the remaining 49% of its stock, regardless of the domestic C corporation's underlying ownership. For this purpose, "domestic C corporations" do *not* include REITs or regulated investment companies (RICs). Public RICs and REITs remain non-look-through persons and are treated as domestic for purposes of the domestic control test only if they are domestically controlled, while private RICs and REITs remain look-through persons under the new proposed regulations.

Effective Date

The new proposed regulations apply to transactions occurring on or after the date they are finalized, although taxpayers may choose to rely on the new proposed regulations for transactions occurring before that date. Once they are issued in final form — which may differ in some respects from their proposed form — taxpayers will be permitted to apply the finalized regulations retroactively to transactions occurring on or after the effective date for the 2024 regulations (generally, April 25, 2024).

For questions regarding application of the new proposed regulations, please reach out to any member of the Kirkland tax team, including the authors below.

Sarah Gough also contributed to this Kirkland Alert.

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1. Section references are to the Internal Revenue Code of 1986, as amended. ↩

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