

Memorandum

IRS Releases Proposed Regulations Under Section 897 on Domestically Controlled REITs

October 21, 2025

On October 20, 2025, the Internal Revenue Service (“IRS”) released proposed Treasury Regulations that would revoke the look-through rule for domestic C corporations in determining whether qualified investment entities, such as real estate investment trusts (“REITs”), are domestically controlled under Section 897 of the Internal Revenue Code (the “Proposed Regulations”). By revoking this rule, the IRS would permit taxpayers to structure into, and have certainty as to, domestically controlled status of a REIT through the use of a domestic C corporation as a REIT shareholder.

Background: The Existing Rules

Section 897 of the Internal Revenue Code (“FIRPTA”) provides that foreign investors are generally subject to U.S. federal income tax as if they are engaged in a trade or business within the United States (i) on the disposition of a United States real property interest (“USRPI”) and (ii) on distributions from REITs to the extent attributable to gain from the sale of underlying USRPIs. However, an interest in a domestically controlled REIT is not treated as a USRPI and a sale of interests in, or other disposition of, such a REIT is not taxable for foreign investors pursuant to FIRPTA. This exception allows foreign investors in a REIT to sell shares of the REIT without any gain being subject to U.S. federal income tax, provided that more than 50% of the value of the REIT’s shares was held “directly or indirectly” by U.S. persons for at least 5 years prior to the date of disposition (or, if shorter, the period during which the REIT was in existence).

In determining whether more than 50% of the value of a REIT’s shares are held directly or indirectly by U.S. persons, regulations finalized in 2024 adopted a look-through rule for certain domestic C corporations, which required the REIT to look through to foreign investors among the upper-tier owners of the domestic C corporation. This look-through rule included so-called “foreign-controlled domestic corporations,” or non-publicly traded domestic C corporations 50% or more of the fair market value of which is owned, directly or indirectly, by foreign persons. This look-through rule applied to transactions occurring on or after April 25, 2024, with limited transition relief for existing REIT structures.

Given the practical difficulties in tracing upstream ownership, the look-through rule introduced significant uncertainty for REITs in determining domestically controlled status. As a result of transactions at the investor level (which may not be readily apparent to the REIT or fund sponsors), it may be impossible to determine with certainty at any particular time whether a REIT is domestically controlled in applying the look-through rule. For

example, a domestic corporation that is treated as a U.S. person at the time of the acquisition of REIT shares may subsequently become a subsidiary of a foreign corporation which may invoke the look-through rule discussed above.

The Proposed Regulations: Removal of the Domestic Corporation Look-Through Rule

The Proposed Regulations remove the domestic corporation look-through rule and treat all domestic C corporations as non-look-through persons in determining whether a qualified investment entity is domestically controlled. By revoking this rule, taxpayers would be permitted to structure into, and have certainty as to, domestically controlled status of a REIT through the use of a U.S. corporate REIT shareholder.

The Proposed Regulations are a taxpayer-favorable change in course from the IRS that will alleviate practical difficulties in determining ownership of a REIT while increasing taxpayers' certainty in determining whether a REIT is domestically controlled. Notably, the Proposed Regulations eliminate the risk that a domestic corporation, treated as a U.S. person at the time of the acquisition of REIT shares, has a subsequent shift in its ownership resulting in the application of the look-through rule discussed above.

The Proposed Regulations would retain the existing regulations' application of the look-through rule to REITs, RICs, S corporations, partnerships and trusts.

Applicability Date

The Proposed Regulations are retroactive, effectively eliminating the existing look-through rule for domestic C corporations. Once finalized, the Proposed Regulations would apply to transactions occurring on or after October 21, 2025. However, taxpayers would be able to elect to apply the final regulations retroactively to transactions occurring on or after April 25, 2024 (the effective date of the existing regulations), and to transactions that occurred before April 25, 2024, resulting from a "check-the-box" election that was effective on or before April 25, 2024, but was filed on or after April 25, 2024. Taxpayers may also rely on the Proposed Regulations for transactions occurring before the date the Proposed Regulations are finalized.

For further information regarding this memorandum, please speak to your regular contact in the [Simpson Thacher Tax Department](#).

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