

U.S. releases final regulations on domestically controlled REITs

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The United States Treasury Department and Internal Revenue Service issued final regulations that clarify how a U.S. REIT determines whether it is “domestically controlled” for purposes of applying the exemption from the FIRPTA capital gains tax that otherwise applies when a non-U.S. investor sells shares of a U.S. REIT. Under the final regulations, a “look-through” rule applies to certain taxable U.S. corporations that own an interest in a U.S. REIT, which requires looking to the U.S. or foreign status of the corporate investor’s own shareholders to determine the REIT’s status as “domestically controlled”.

The final regulations also retain various other rules contained in proposed regulations that were issued in 2022, which we discussed in [our previous bulletin](#).

What you need to know

- **QFPFs not “domestic” for purposes of determining domestically controlled REIT status.** The rules provide that Qualified Foreign Pension Funds (QFPFs) will be considered “foreign persons” for purposes of determining whether a REIT is domestically controlled. Thus, a REIT that is majority-owned by QFPFs and/or other foreign investors will not be considered to be a domestically controlled REIT.
- **Look-through of foreign-owned U.S. corporations for purposes of determining domestically controlled REIT status.** The rules provide for a look-through of a “foreign-controlled” privately traded U.S. domestic corporation for purposes of determining whether a REIT is domestically controlled. If a foreign investor or group of foreign investors form and own the majority of a taxable U.S. corporate blocker, and that blocker invests in a REIT, the blocker will be treated as foreign to the extent of its foreign ownership to determine whether the REIT is domestically controlled—notwithstanding the blocker’s general status as a taxable U.S. corporation. Unlike the proposed regulations, the final regulations adopted a more than 50% ownership threshold to determine whether a corporation is foreign-controlled and therefore subject to the look-through rule.
- **Withholding exemption.** A domestically controlled REIT can certify that interests in the REIT are not interests in a United States real property holding corporation for the purpose of avoiding FIRPTA withholding tax that would otherwise apply upon a disposition of interests in the REIT.
- **REIT shareholders that are publicly traded entities.** U.S. publicly traded corporations and U.S. publicly traded partnerships that are shareholders of a REIT are generally treated as domestic for purposes of determining whether the REIT is domestic unless the REIT has reason to know that the publicly traded corporation or partnership is itself foreign controlled.

- **2022 proposed rules applicable to Section 892 investors.** Certain rules relevant only to Section 892 investors who own interests in REITs that were proposed in 2022 were not addressed in the final regulations and will be finalized in an upcoming separate regulatory project.
- **Transition rule.** REITs in existence can delay application of the look-through rule for ten years, providing they do not materially change their ownership or mix of assets.

To discuss these issues, please contact the author(s).

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