

Taxpayer Favorable Proposed Regulations Would Repeal the “Domestic Corporation Look-Through Rule” for Domestically Controlled REITs

WRITTEN BY

Saba Ashraf | Aresh Homyoun | Thomas D. Phelan

On October 20, 2025, the Treasury Department issued proposed regulations (the “2025 Proposed Regulations”) that would remove a controversial rule for determining whether a REIT is “domestically controlled.” The 2025 Proposed Regulations are a welcome change and generally would allow taxpayers greater flexibility in planning for domestically controlled REITs.

By way of background, under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), gain on the disposition of a U.S. real property interest (USRPI) by a foreign person is subject to U.S. tax. USRPIs include shares in a U.S. real property holding corporation (USRPHC) – generally stock of a corporation holding significant USRPIs.^[1] However, a key exception exists for equity interests in a “domestically controlled REIT” under Section 897(h)(2) of the U.S. Internal Revenue Code of 1986, as amended (the “Code”). Such interests are not USRPIs and therefore the sale of such interests by a foreign person is not subject to U.S. income or withholding tax under FIRPTA. A REIT is considered domestically controlled if less than 50% of its stock is held “directly or indirectly” by foreign persons at all times during a certain testing period. This FIRPTA exclusion for domestically controlled REITs is one of the primary benefits of using REITs in real estate fund structures and joint ventures where there are foreign investors.

The historical context leading up to the 2025 Proposed Regulations involves the issuance of proposed regulations in 2022 (“2022 Proposed Regulations”), which were finalized in 2024.

- Prior to the issuance of the 2022 Proposed Regulations, tax regulations did not address whether to look through certain owners in determining whether a REIT was “directly or indirectly” held by foreign persons. Based on a private letter ruling and legislative history, it was not uncommon for taxpayers to plan based on the assumption that a U.S. C corporation shareholder of a REIT would not be looked-through to determine whether the REIT was domestically controlled.
- The 2022 Proposed Regulations would have required a REIT to look through any nonpublic domestic corporate shareholder to determine whether it is domestically controlled. Specifically, under the 2022 Proposed Regulations, a domestic C corporation shareholder would be looked-through if more than 25% of that shareholder’s stock (by value) was owned by foreign persons – the so-called “look-through rule.” Given that many real estate funds and JVs with private REITs, in reliance on the IRS’s prior long-standing position, used domestic corporate blockers for tax planning purposes, this change was surprising and concerning. Commentators heavily criticized these regulations as being unmanageable and inconsistent with the statute and legislative intent and urged the IRS to withdraw the rules. The IRS declined to do so at that time.

- The IRS issued final regulations in 2024 (“2024 Final Regulations”) that generally retain the rules of the 2022 Proposed Regulations, but increase the foreign ownership threshold from 25% to 50%. Thus, under the 2024 Final Regulations, a U.S. C corporation owner of a REIT would be looked-through for purposes of determining the domestically controlled status of the REIT if more than 50% of the value of the domestic C corporation is owned by foreign persons. As a practical matter, most taxpayers did not view the threshold increase from 25% to 50% as helpful, because many domestic corporations that met the 25% threshold under the 2022 Proposed Regulations also would meet the 50% threshold under the 2024 Final Regulations. Commentators also criticized the 2024 Final Regulations based on the practical difficulty of tracing ownership, the related administrative burdens and a possible chilling effect on investment in U.S. real estate.

The 2025 Proposed Regulations would remove the look-through rule for domestic C corporation shareholders of a REIT. Thus, under the 2025 Proposed Regulations, it will no longer be necessary to look through a domestic corporation to determine whether its owners are foreign for purposes of determining whether a REIT is domestically controlled. The 2025 Proposed Regulations would remove the look-through rule only for domestic C corporation shareholders of a REIT. Equity holders of REITs that are taxed as partnerships, REITs, or RICs would remain subject to the look-through rule.

The 2025 Proposed Regulations will be effective after being published in final form. Taxpayers may, however, rely on the 2025 Proposed Regulations before they are finalized. Once published in final form, taxpayers may choose to apply them to transactions occurring on or after April 25, 2024 (the date of the publication of the 2024 Final Regulations).

The 2025 Proposed Regulations are a welcome development. If finalized in their current form, they will provide taxpayers greater flexibility to plan for investment in domestically-controlled REITs.

[1] A corporation is a USRPHC if the fair market value of its USRPIs is at least 50% of the sum of the fair market values of (1) its total USRPIs, (2) its total interests in real property outside the U.S., and any other assets used in a trade or business.

RELATED INDUSTRIES + PRACTICES

- [Real Estate](#)
- [Real Estate Capital Markets \(REITs\)](#)
- [Tax](#)