

September 3, 2024

The Honorable Daniel Werfel
Commissioner
Internal Revenue Service
1111 Constitution Ave. NW
Washington, D.C. 20224

Dear Commissioner Werfel:

I write to encourage you to increase scrutiny of potential violations of tax law by Real Estate Investment Trusts (REITs), which experts warn include “financial actors that aggressively buy up property assets and manage them to extract wealth at taxpayers’ expense,” including in the health care and hotel industries.¹ Your leadership, and the increased funding for the Internal Revenue Service (IRS) included in the *Inflation Reduction Act*, are helping to ensure that the wealthy and large businesses pay the taxes they owe.² As part of those ongoing enforcement efforts, I appreciate the IRS’s recent warning that REITs must follow tax rules that bar them from managing lodging facilities,³ and I urge you to increase IRS scrutiny of potential abuse of REIT tax breaks by private companies.

Under the tax code, REITs can take advantage of lucrative tax breaks – including avoiding the 21 percent corporate income tax and qualifying for the 20 percent pass-through deduction for investors.⁴ REITs are supposed to be passive investment opportunities for smaller-scale investors and are subject to certain asset and income tests meant to reflect that passivity, including a prohibition on owning securities that represent more than 10 percent of the total voting power or value of a tenant, a ban on directly or indirectly operating or managing a lodging facility, and a ban on owning more than a 35 percent stake in an operator.⁵

¹ Institute for New Economic Thinking, “How Public Real Estate Investment Trusts Extract Wealth from Nursing Homes and Hospitals,” Rosemary Batt and Eileen Appelbaum, August 1, 2022, <https://www.ineteconomics.org/perspectives/blog/the-role-of-public-reits-in-financialization-and-industry-restructuring>.

² IRS, “Inflation Reduction Act 2-year report card: IRS continues to improve service, modernize online tools, pursue complex taxpayer arrangements used to evade taxes,” press release, August 23, 2024, <https://www.irs.gov/newsroom/inflation-reduction-act-2-year-report-card-irs-continues-to-improve-service-modernize-online-tools-pursue-complex-taxpayer-arrangements-used-to-evade-taxes>.

³ Bloomberg Tax, “IRS Warns of Hotel, Medical REITs Pushing Tax Status Boundaries,” Erin Slowey, September 3, 2024, <https://news.bloombergtax.com/daily-tax-report/irs-warns-of-hotel-medical-reits-pushing-tax-status-boundaries>.

⁴ Hunton and Williams, “REITs and the Effect of the Tax Cuts and Jobs Act,” December 2017, https://www.huntonak.com/media/legal/34828_reits_tax_cuts_and_jobs_act.pdf.

⁵ Congressional Research Service, “Real Estate Investment Trusts (REITs) and the Foreign Investment in Real Property Tax Act (FIRPTA): Overview and Recent Tax Revisions,” July 14, 2016, pp. 1-2, <https://crsreports.congress.gov/product/pdf/R/R44421>; RSM, “Taxable REIT subsidiaries: Q&A primer,” May 5,

REITs in the health care and hotel industries may be violating these tax rules. In Massachusetts, Medical Properties Trust (MPT) – a REIT that bought hospital properties from Steward Health Care (Steward) in 2016, saddling the hospitals with expensive lease agreements that ultimately drove Steward into bankruptcy – has a complex investment history with Steward that raises questions about whether it has met IRS requirements regarding the limitations on a REIT’s ownership of a tenant or an operator.⁶ Meanwhile, taxable REIT subsidiaries (TRSs) have negotiated agreements with hotel operators that give the TRS the right to exert significant control over labor terms, including vetoing collective bargaining agreements negotiated with hotel workers and participating in negotiations with hotel employee labor unions.⁷

In an August 26, 2024 letter to Senate Finance Committee Chair Ron Wyden, IRS Chief Counsel Marjorie Rollinson recently warned against such behavior. Rollinson clarified the law and IRS’s interpretation of it, warning that some REITs were at risk of losing their special tax status:

The law is clear that a TRS may not directly or indirectly operate or manage a lodging facility. If it does, it will lose its special tax status with potentially severe adverse tax consequences for its REIT owner. If a REIT and TRS avail themselves of the exception to the related party rent rule discussed above, operation and management of the qualified lodging facility must be performed by the eligible independent contractor.⁸

Rollinson continued:

Unfortunately, we have become aware that some in the industry have advocated the view that an appropriate structure is for the TRS to lease the qualified lodging facility from the REIT and indirectly operate the qualified lodging facility. Any TRS that implements such an approach will lose its tax status. That may cause its REIT owner to fail one or more of its qualification requirements. That in turn would cause the REIT to lose its tax status for five years, including the ability to deduct dividends paid to shareholders, and become fully subject to the corporate tax.⁹

2021, <https://rsmus.com/insights/industries/real-estate/taxable-reit-subsiidiaries.html>; RSM, “Navigating REIT income tests,” November 13, 2017, <https://rsmus.com/insights/industries/real-estate/navigating-reit-income-tests.html>.

⁶ Letter from Cerberus Capital Management to Senator Elizabeth Warren, February 26, 2024, <https://www.warren.senate.gov/imo/media/doc/Steward%20Response%20to%20Mass%20Congressional%20Members%20Letter.pdf>; Wall Street Journal, “The Private-Equity Deal That Flattened a Hospital Chain and Its Landlord,” Jonathan Weil, May 7, 2024, <https://www.wsj.com/finance/the-private-equity-deal-that-flattened-a-hospital-chain-and-its-landlord-3096747d>; Medical Properties Trust, “Steward Update,” October 2023, p. 3, <https://medicalproptiestrust.gcs-web.com/static-files/9f32b6d4-5210-424c-b110-4f40a787a93d>.


⁷ Hotel Management Agreement between TRS AUS LOUIS, LLC and VISTA HOST INC., March 24, 2017, <https://www.sec.gov/Archives/edgar/data/929545/000119312517104078/d368765dex105.htm>; Hotel Management Agreement between TRS SAN SPRING, LLC and PEACHTREE HOSPITALITY MANAGEMENT, LLC, October 1, 2015, https://www.sec.gov/Archives/edgar/data/929545/000090044015000109/condor_8kex10-4oct7.htm.

⁸ Letter from IRS Chief Counsel Marjorie Rollinson to Senator Ron Wyden, August 26, 2024, <https://aboutblaw.com/bfud>.

⁹ *Id.*

I appreciate this clarification of REIT rules, and that “the IRS takes seriously the proper enforcement of the tax rules, including those governing REITs.”¹⁰ As the IRS continues to identify massive corporations and businesses that may be violating tax law, I urge you to increase enforcement scrutiny of REITs, especially large health and hospitality REITs that may be illegally claiming significant tax breaks while meddling in the operations of their tenants. Decades-long underfunding of the IRS may have let bad actors feel safe to claim large REIT tax breaks while violating REIT rules, but such tax cheating should not be allowed to continue

Sincerely,



Elizabeth Warren
United States Senator

¹⁰ *Id.*