NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

May 1, 2012

VIA E-MAIL [Notice.Comments@irscounsel.treas.gov]

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2012-25)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Notice 2012-25: 2012-2013 Guidance Priority List Recommendations

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity, pursuant to Notice 2012-25, 2012-15 I.R.B. 789, to offer our suggestions regarding regulatory guidance to be placed on the 2012-13 Guidance Priority List. NAREIT® is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses.

We request that the Department of the Treasury and the Internal Revenue Service (IRS) include in their 2012-13 Guidance Priority List the following five issues, listed in order of priority, with the first two items having the greatest priority:

1) reversing Notice 2007-55 regarding liquidating REIT distributions to non-U.S. investors;

2) clarifying that a REIT's investment in the shares of a money market fund constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A), [1] consistent with an item in the 2009-10, 2010-1011, and 2011-12 Priority Guidance Plans and in accordance with the recommendations in an April 22, 2009, letter from the American Bar Association Section of Taxation (Tax Section);

[1] For purposes of this letter, "section" refers to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

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3) clarifying certain regulatory provisions regarding the consequences to REITs of certain "distressed" debt, as discussed more fully in a letter dated May 26, 2011, from NAREIT to the IRS;

4) finalizing the recently-issued proposed regulations under section 337(d); and,

5) liberalizing the election procedures with respect to which a REIT and its subsidiary make and revoke taxable REIT subsidiary (TRS) elections in line with existing rules for other elections, in order to provide flexibility for REITs and their affiliates in connection with inadvertent errors and to reduce the need to allocate IRS resources to issue private letter rulings granting relief under section 9100.

The reasons for the priority given to the above issues are as follows.

First, Notice 2007-55 should be reversed because its application discourages the investment of foreign equity in the U.S. at a time when such capital is needed to assist in the economic recovery, it contravenes Congressional intent and provides inconsistent results for foreign shareholders and domestic shareholders engaging in similar transactions.

Second, clarifying that money market funds are indeed, as they are perceived and used in the business world, a "cash item" would eliminate a trap for the unwary that could threaten REIT status.

Third, because of the current economic climate, guidance regarding the consequences of distressed debt would help ensure that REITs can participate in the market for distressed mortgage loans without jeopardizing their REIT status for federal income tax purposes, particularly in situations when they had acquired secured debt and the underlying real property has increased in value.

The other issues would permit REITs to carry on their activities with more certainty and would allow the IRS to deploy its limited resources elsewhere.

GUIDANCE PRIORITY LIST RECOMMENDATIONS

A. Reverse Notice 2007-55 to Treat REIT Liquidations and Redemptions as Sales/Exchanges of Stock

Although not clear, for many years tax practitioners concluded that payments from a REIT made as part of its liquidation or redemption should be considered a sale of its stock (to which FIRPTA does not apply under several circumstances) rather than as a capital gain distribution (to which FIRPTA does apply in several circumstances). The IRS issued a private letter ruling in 1990 concluding that liquidating distributions should be treated as a sale of stock, but that ruling was revoked in 2004. In 2007, the IRS issued Notice 2007-55 in which it concluded that liquidating distributions and redemptions should be treated as capital gain liquidations that are subject to

FIRPTA if paid to foreign shareholders. An item relating to Notice 2007-55 was contained on the 2008-09 Priority Guidance Plan, although the exact parameters of that item were unclear.

As more fully presented in another comment letter by the Tax Section dated June 10, 2008, NAREIT believes that Notice 2007-55 should be reversed, except when "the existing provisions create a clear loophole, namely, a foreign controlled REIT that undergoes a liquidation, with the REIT deducting liquidating distributions under section 562(b) and the REIT's foreign shareholders relying on the 'cleansing exception' of section 897(c)(1)(B) [in order] to avoid FIRPTA tax." As a result, if a third party stock sale would be exempt under current law (for example, as in the case of sales of shares of a "domestically controlled REIT," which are not United States Real Property Interests, or USRPIs), then the tax treatment of a non-dividend distribution that gives rise to a constructive sale or exchange ought to be taxed the same way. NAREIT agrees with this specific recommendation of the Tax Section, as well as the other recommendations contained in the June 10, 2008 comment letter.

B. Clarify That Money Market Funds Are "Cash Items" Under Section 856(c)(4)(A)

Section 856(c)(4)(A) requires that at the close of each calendar quarter of the taxable year at least 75% of the value of a REIT's "total assets" consist of real estate assets, government securities and cash and cash items (the 75% asset test). On April 22, 2009, the Tax Section submitted comments to the IRS requesting that the Treasury Department and the IRS promptly issue guidance clarifying that a REIT's investment in the shares of a money market mutual fund (money market fund) constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A).

As the Tax Section noted:

> [Money market funds] play a pivotal role in the day-to-day operations of many companies, including [REITs], when cash must be readily available to meet the needs of their business. Money market funds are an attractive alternative to interest-bearing checking accounts due to the convenience they provide, their competitive returns, and their regulatory safeguards that are intended to provide liquidity and minimal risk to principal. In light of these features common to money market funds, industry practice for financial personnel and the accounting rules such personnel rely upon generally treat money market funds as "cash items."

NAREIT agrees with the Tax Section's recommendation, especially since money market funds are considered cash items for SEC reporting purposes and in light of the Administration's steps taken to assure the stability of such funds. An item relating to this issue was included most recently in the 2011-12 Priority Guidance Plan.

C. Modify Revenue Procedure 2011-16 to Encourage Workouts of Distressed Debt

NAREIT appreciates the issuance of Revenue Procedure 2011-16 (the Revenue Procedure) concerning modifications and acquisitions of distressed debt, and, in particular, the valuable guidance with respect to distressed mortgage loans that REITs modify in order to avoid foreclosure. With that said, and as discussed more fully in a February 3, 2011, NAREIT letter to the IRS and Treasury Department, NAREIT requests that the Revenue Procedure concerning modifications and acquisitions of distressed debt be clarified and revised as follows:[2]

> 1) the Revenue Procedure should be clarified so that a REIT will not be penalized if the value of the real property that secures a distressed mortgage loan later increases. This clarification would prevent a disproportionate amount of a distressed mortgage loan from being treated as a nonqualifying asset if the value of the real property securing the loan increases;[3]
>
> 2) consistent with NAREIT's previous submissions on this issue, the Revenue Procedure should be revised or supplemented to provide a safe harbor under which, when a REIT acquires a mortgage loan with market discount, the REIT may use as the "amount of the loan," for purposes of applying the applicable apportionment regulations, the REIT's highest adjusted tax basis in the mortgage loan during the taxable year. If the IRS

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[2] We note that on Feb. 13, 2012, the Unified Agenda of Federal Regulatory and Deregulatory Actions (Unified Agenda) http://www.gpo.gov/fdsys/pkg/FR-2012-02-13/pdf/2012-1620.pdf was published in the *Federal Register*, and an excerpt of the Unified Agenda stated as follows:

> A number of tax issues relating to the amount, character, and timing of income, expense, gain, or loss on distressed debt remain unresolved. In addition, the tax treatment of distressed debt, including distressed debt that has been modified, may affect the qualification of certain entities for tax purposes or result in additional taxes on the investors in such entities, such as regulated investment companies, real estate investment trusts (REITs), and real estate mortgage investment conduits. During fiscal year 2011, Treasury and the IRS have addressed some of these issues through published guidance, including (1) a revenue procedure providing relief for certain modifications of distressed mortgage loans held by a REIT, and (2) final regulations clarifying that the deterioration in the financial condition of the issuer of a modified debt instrument is not taken into account to determine whether the instrument is debt or equity. **Treasury and the IRS plan to address more of these issues in published guidance**.

(Emphasis added).

We hope that the Treasury Department and IRS will provide guidance on this issue as suggested by the Unified Agenda.

[3] We understand that there may be some concern that, if the value of distressed debt increases due to greater solvency of a guarantor (or borrower if the loan is recourse), the solution we proposed in our Feb. 3, 2011, letter (generally speaking, that the proportion of the debt secured by real property on acquisition or origination would remain consistent; thus, if the value of the real estate, and, therefore, the value of the secured loan, were to increase, then that increase in value would be considered a real estate asset in that same proportion), that increase in value could be viewed as a real estate asset notwithstanding that it may not represent an increase in the value of the underlying real estate security. If so, we would not oppose a rule applying our proposed solution to situations only involving non-recourse debt. Further, we are open to dialogue with the IRS and Treasury Department regarding other potential solutions as well.

believes that a regulatory change is needed to make this change, then NAREIT strongly urges that such a project immediately be initiated and then completed swiftly; and,

3) the Revenue Procedure should be modified or supplemented to provide a safe harbor pursuant to which the value of, and the interest income from, a mortgage loan would not be bifurcated into qualifying and nonqualifying portions for purposes of the 75% gross income test or the 75% asset test if substantially all of the property securing the loan constitutes real property, based on fair market values determined as of the date the REIT committed to originate or acquire the loan. Such a safe harbor would mitigate many of the REIT qualification issues faced by REITs investing in distressed mortgage loans, as a REIT would not have to bifurcate a distressed mortgage loan when the value of the non-real property securing the loan is insubstantial.

If the Revenue Procedure is not clarified and revised as discussed herein, REITs will be significantly limited in their ability to invest in distressed mortgage loans and mortgage-backed securities. As a result, there will be less liquidity in the market for those assets, and retail investors will have limited ability to participate in that market. NAREIT believes that a failure by the IRS to clarify and revise the Revenue Procedure would undermine the government's efforts to address the continuing effects of the credit crisis on the mortgage market.

NAREIT has requested this guidance in order to clarify the treatment of distressed loans and to eliminate uncertainties that are particularly problematic for publicly traded REITs. Given that there still is fragility in the economy, while, at the same time, real estate securing debt acquired at or near the nadir of the economic crisis may have increased in value, issuance of this guidance would be particularly timely.

D. Finalize Recently-Issued Proposed Regulations under Section 337(d) Relating to Certain Conversion Transactions

NAREIT appreciates that the IRS and Treasury Department recently-issued proposed regulations under section 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or regulated investment companies (RICs), in accordance with the May 1, 2008, submission by the Tax Section. We currently are analyzing these proposed regulations and will submit comments under separate cover. We urge the IRS and Treasury Department to include on the Priority Guidance Plan an item relating to finalizing these proposed regulations.

E. Provide Flexibility for TRS Election and Revocation Procedures

1. *Background*

The REIT Modernization Act (RMA), enacted in 1999 as part of the Ticket to Work and Work Incentives Improvement Act of 1999, modified the REIT provisions of the Code to allow REITs to form RSs. The RMA also modified section 856(c)(4)(B) to prevent a REIT not only from owning more than 10% of the voting power of a non-REIT corporation, but also from owning

more than 10% of the value of such corporation (10% Value Test). Under section 856(c)(4)(B)(iii), ownership in a TRS is exempt from this rule.

Section 856(l) provides that a REIT and a corporation (other than a REIT) may elect jointly to treat such corporation as a TRS. To be eligible for treatment as a TRS, section 856(l)(1) provides that the REIT must directly or indirectly own stock in the corporation, and the REIT and the corporation must jointly elect such treatment. The election is irrevocable once made, unless both the REIT and the subsidiary consent to its revocation. In addition, the election and the revocation may be made without the consent of the Secretary. Failure to make a valid and timely TRS election could cause the REIT to fail the 10% Value Test.

In Announcement 2001-17, 2001-1 C.B. 716, the IRS announced the availability of Form 8875 (the Form) for making the TRS election. According to the Announcement, the Form is to be used for tax years beginning after 2000 for eligible entities to elect treatment as a TRS. The instructions to Form 8875 provide that the TRS and the REIT can make the election at any time during the tax year. The instructions further provide that the effective date of the election cannot be more than 2 months and 15 days prior to the date of filing the election, or more than 12 months after the date of filing the election. If no date is specified on the Form, the election is effective on the date the Form is filed with the IRS. Officers of both the REIT and the TRS must sign the Form, which is filed with the IRS Service Center in Ogden, Utah. The deadline and election process has never been exposed to the regulatory process and the opportunity for public comment.

2. *TRS Elections: Inadvertent Errors May Require Private Letter Rulings*

Since 2001, more than 50 private letter rulings have been issued permitting REITs and affiliated corporations an extension of time to correct an invalid or late TRS election pursuant to Treas. Reg. § 301.9100-1(c), which provides that the IRS has discretion to grant a reasonable extension of time to make a regulatory election (defined in § 301.9100-1(b) as an election whose due date is prescribed by regulations or by a revenue ruling, a revenue procedure, a notice, or an announcement published in the Internal Revenue Bulletin) or a statutory election. In virtually all cases, the TRS election was late or improper due to an inadvertent error. *See, e.g.*, PLRs 200152010 (REIT and TRS employee incorrectly calculated insufficient postage); 200304011 (CFO inadvertently failed to sign Form 8875 in a timely manner prior to leaving for a conference); 200419010 (despite intended TRS election, Form 8875 not filed because officer of REIT believed election was due at time of filing of Form 1120-REIT); 200539018 (due to clerical error, incorrect companies listed on Form 8875); 200615013 (relevant officer inadvertently failed to sign Form 8875; effective date mistakenly left blank); 200805002 (due to a mix-up in communication between REIT and its outside tax advisor, REIT and affiliate inadvertently failed to make the necessary election on a timely basis).

Treas. Reg. § 301.9100-3(a) through (c)(1)(i) sets forth rules that the IRS generally will use to determine whether, under the particular facts and circumstances of each situation, the Commissioner will grant an extension of time for regulatory elections such as those described in Treas. Reg. § 301.9100-1. These rules generally require the taxpayer to have acted reasonably

and in good faith, and the grant of relief will not prejudice the interests of the Government. For these purposes, if the taxpayer applies for relief prior to the IRS's discovery of the failure to make the election, the taxpayer will be deemed to have acted reasonably and in good faith. Further, Treas. Reg. § 301.9100-3(c) provides that the interests of the Government are prejudiced if granting relief would result in the taxpayer having a lower tax liability in the aggregate for all years to which the regulatory election applies than the taxpayer would have had if the election had been timely made (taking into account the time value of money).

Based on the significant number of PLRs requesting relief for late or improper TRS elections, and the significant cost, resources and time expended by taxpayers and the IRS in connection with requests and review of relief requests under Treas. Reg. § 301.9100-1(c), we would welcome a modification of the deadline for filing TRS elections or remedying improper TRS elections. Therefore, we request that the TRS election be added to the list of elections in Treas. Reg. § 301.9100-2(a)(2) (including, among others, the election to use other than the required taxable year under section 444; the election to use the last-in, first-out (LIFO) inventory method under section 472; and the election to adjust basis on partnership transfers and distributions under section 754) with respect to which an automatic 12-month extension of time is granted so long as the taxpayer takes the appropriate corrective action (such as filing an original or an amended return for the year the regulatory or statutory election should have been made and attaching the appropriate form or statement for making the election).

In addition, or alternatively, we suggest following the currently-existing model for late "check-the-box" elections under Treas. Reg. § 301.7701-3(a) (relating to an entity classification election with Form 8832) as set forth in Rev. Proc. 2009-41, 2009-39 I.R.B. 439. If certain conditions are met, Rev. Proc. 2009-41 allows an entity to obtain automatic IRS approval of a late-filed election without the need to obtain a private letter ruling.

Specifically, under Rev. Proc. 2009-41, an eligible entity may request relief for a late classification election if: 1) the entity failed to obtain or change its requested entity classification solely due to failure to file a correct election on Form 8832; 2) the eligible entity (or in certain cases, its owners) has not filed a federal tax or information return for the first year in which the election was intended because the due date has not passed for that year's federal tax or information return; or has timely filed all required federal and information tax returns consistent with its requested classification for all of the years the entity classification is intended to apply; 3) the eligible entity has reasonable cause for its failure to timely make the entity classification election; and, 4) 3 years and 75 days from the requested effective date of the eligible entity's classification election have not passed.

A taxpayer requests relief under Rev. Proc. 2009-41 by filing a Form 8832 along with a statement that it is being filed pursuant to Rev. Proc. 2009-41. The statement should explain the reason for the failure to file a timely entity classification election (referred to as "the reasonable cause statement"). Entities that do not qualify for the relief under Rev. Proc. 2009-41 still may pursue relief through a private letter ruling request. Rev. Proc. 2009-41 also provides guidance for those eligible entities that do not qualify for relief under its provisions and that are required to request a letter ruling in order to request relief for a late entity classification election.

Upon receipt of a completed Form 8832 requesting relief under Rev. Proc. 2009-41, the IRS Service Center will determine whether the requirements for granting the late entity classification election have been satisfied and will notify the entity of the result of its determination. An entity receiving relief under the Rev. Proc. 2009-41 will be treated as having made a timely entity classification election as of the requested effective date of the election.

Combining the current requirements for obtaining relief for a late TRS election and those for relief under Rev. Proc. 2009-41, we suggest that the IRS permit a REIT (REIT) and its affiliate with respect to which a TRS election was intended (Affiliate) to be eligible for automatic relief so long as:

1) REIT and Affiliate have not filed any tax returns inconsistent with the position that a timely made TRS election had been made for Affiliate by both REIT and Affiliate;

2) the failure to file a timely or valid TRS election was due to reasonable cause or inadvertent error;

3) REIT and Affiliate discovered the error with respect to the TRS election prior to its discovery by the IRS;

4) granting the relief will not result in REIT and/or Affiliate's having a lower tax liability in the aggregate for all years to which the regulatory election applies than if the election had been made on a timely basis; and,

5) the request for relief is filed within three years and 75 days from the requested effective date of the TRS election.

As in the case of entities that do not qualify for relief under Rev. Proc. 2009-41, upon receipt of a completed Form 8875 requesting relief under such guidance, the IRS Service Center will determine whether the requirements for granting the late election have been satisfied and will notify the REIT and its Affiliate of the result of its determination. We recommend that the IRS Service Center provide such notice within 90 days after receipt of the request for relief. Taxpayers receiving relief under the guidance should be treated as having made a timely TRS election as of the requested effective date of the election. Additionally, taxpayers should continue to be able to request relief via a private letter ruling.

3. *TRS Election Revocation: Allow Flexibility in Revocation Date to Provide Greater Certainty*

Along those same lines, we respectfully request that the IRS modify the revocation procedure for TRS elections. Under the current instructions to Form 8875, the revocation is effective on the date filed. This rule can be troublesome if there is a particular date for which the TRS election needs to be effective and either it cannot be mailed that day, or due to a clerical error, it does not get mailed at all. This result is very different from procedures for termination of similar elections with respect to which the revocation can be filed and made effective generally on a date specified that is up to 75 days before or after the date of filing. For example, an S corporation election can

be revoked prospectively if a date is specified in the revocation. Treas. Reg. § 1.1362-2(a)(2)(ii). An S corporation election also can be revoked retroactively, but only to the beginning of the taxable year and only if the revocation is made prior to March 16th of the relevant taxable year. Treas. Reg. § 1.1362-2(a)(2)(i). Furthermore, while not technically a revocation, an entity classification election can effectively be revoked by making a new entity classification election (provided no other election to change status was made in the prior 60 months). A new election can be made prospectively up to 12 months in advance and can be made retroactively to January 1 up to 75 days after the election is effective. Treas. Reg. § 301.7701-3(c)(1)(iii). In order to avoid the previously mentioned difficulties, NAREIT requests that the instructions to Form 8875 be amended so that the REIT and TRS may specify the date of revocation of a TRS election as a specified date up to 75 days before or after the date of filing.

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All of the suggested projects above would fulfill the goals and objectives set forth in Notice 2012-25. First, these recommendations would resolve significant issues relevant to the more than 1,000 entities that have elected REIT status and the tens of thousands of taxpayers who invest in REITs.

Second, these projects would promote sound tax administration. Specifically, in the context of how to manage distressed debt, the requested guidance could relieve uncertainties that are potentially paralyzing to those contemplating investing in such debt.

Third, these projects clearly could be drafted in a manner that would enable taxpayers to easily understand and apply the guidance. We have been working, and would be pleased to continue to work, with the IRS in discussing how the distressed debt guidance could be drafted.

Fourth, the recommended guidance involves regulations that are outmoded, ineffective, insufficient or excessively burdensome and that should be modified, streamlined, expanded or repealed. Specifically, the current asset test regulations are insufficient inasmuch as they do not include money market funds as a cash item. Similarly, although technically not a regulation, Notice 2007-55 should be repealed or withdrawn. Although NAREIT appreciates the issuance of Rev. Proc. 2011-16, it is insufficient with respect to acquired distressed debt whose secured real estate increases in value, and we recommend that it be clarified and expanded. Additionally, we also recommend that the proposed built-in gain regulations be finalized. Moreover, the current short time frame within which to make a TRS election can lead to the burdensome requirement of obtaining a private letter ruling in the event of inadvertent error. Lastly, allowing greater flexibility in choosing the date for revoking a TRS election would allow for greater certainty for taxpayers and the IRS. As a result, we recommend that the election and revocation procedure provide this additional flexibility.

Fifth, we believe that guidance under these projects easily could be administered on a uniform basis.

Finally, guidance on the requested projects would reduce controversy and lessen the burden on taxpayers or the IRS for the reasons stated above.

Feel free to contact me or Dara Bernstein, NAREIT's Senior Tax Counsel, if you would like to discuss these issues in greater detail.

Respectfully submitted,

Tony M. Edwards
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