3/23/07 DRAFT

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1. Purpose

This revenue procedure sets forth a safe harbor under which dividends from a real estate investment trust ("REIT") will not be construed as preferential dividends under § 562(c) of the Internal Revenue Code and will be deemed dividends for purposes of computing the dividends paid deduction.

2. Background

.01. Under § 857(a)(1), the REIT's deduction for dividends paid generally must equal or exceed: (A) the sum of (i) 90 percent of the REIT taxable income for the taxable year (determined without regard to the deduction for dividends paid (as defined in § 561) and by excluding net capital gain); and (ii) 90 percent of the excess of the net income from foreclosure property over the tax imposed on such income; minus (B) any excess noncash income.

.02. A distribution by a REIT is not considered as a "dividend" for purposes of computing the dividends paid deduction if it is treated as a "preferential dividend" under § 562(c). The failure of a REIT distribution to be considered as a "dividend" for purposes of computing the dividends paid deduction could cause the REIT to lose its status as such.

.03. Under § 562(c), a REIT dividend distribution is treated as a preferential distribution unless:

(1) the distribution is pro rata,

(2) the distribution is made with no preference to any share of stock as compared with other shares of the same class, and

(3) the distribution is made with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

.04. The legislative history of the preferential dividend rule indicates that such rule was meant to prevent income shifting among shareholders of a personal holding company (as defined in § 542), which, by definition under § 542(a)(2), is closely held. *See* H.R. Rep. No. 1860, 75th Cong., 3d Sess. 23 (1938) ("No dividends-paid credit should be allowed in the case of a distribution not in conformity with the rights of shareholders generally inherent in their stockholdings, whether the preferential distribution reflects an act of injustice to shareholders or a device acquiesced in by shareholders, rigged with a view to tax avoidance. . . .The committee believes that no distribution which treats shareholders with substantial impartiality and in a manner consistent with their rights under their stock-holding interests, should be regarded as preferential by reason of minor difference in valuations of property distributed.") In contrast, a REIT, by definition under §§ 856(a)(6) and (h), cannot be closely held.

.05. Under § 1.562-2(a) of the Income Tax Regulations, specific illustrations of preferential dividends are set forth as follows:

(1) A corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class.

(2) A corporation will not be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock.

.06. As a general matter, § 1.562-2(a) of the Income Tax Regulations provides that a preference exists if any rights to preference inherent in any class of stock are violated. The three Examples set forth in § 1.562-2(b) of the Income Tax Regulations reflect the focus of the preferential dividend concept on discrepancies in the treatment of different holders of the same class or financially advantaging holders of one class of stock to the detriment of holders of another class of stock. Thus, de minimis and inadvertent errors should not constitute preferential dividends. *See* Hanco Distributing, Inc. v. Commissioner, 32 AFTR 2d 73-5485 (D. Utah 1973).

.07. When a preferential dividend is found to exist, the entire amount of the REIT's dividend distribution that includes the preferential dividend is not entitled to the dividends paid deduction.

3. Scope

This revenue procedure applies to the situations listed below that are recognized as not constituting tax avoidance or other circumstances that the Congress intended to be considered as preferential dividends.

The following examples are illustrative of situations that the Service will not treat as involving preferential dividends as to REITs. The Service will supplement this list as it becomes aware of similar circumstances through private ruling letter requests, fact patterns that are the subject of closing agreements and other sources of information. The Service recognizes that the examples provided in this revenue procedure are not exhaustive. No inference is intended that REIT dividends that are not specifically described in this revenue procedure constitute preferential dividends.

.01. The REIT's charter requires that dividends on preferred stock be declared or declared and paid before any dividends are paid on common stock. However, the board of directors of the REIT declares and pays dividends on the preferred and common stock simultaneously. Alternatively, the REIT's charter provides that dividends with respect to a certain class of shares be paid on a specific date, and either: a) the dividend checks with respect to that class of shares are not all mailed on the correct day, but within several days of one another; or, b) the dividend checks with respect to that class of shares are not all mailed on the correct day, but as soon as the REIT realizes the error, the relevant dividend checks are mailed

(1) In this both situations, no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, the full amount of dividends distributable on the preferred shares, as well as on the common shares, has been distributed, although not in accord with the charter provisions.

(2) In both situations, the only question is timing, and the value of any timing differential is considered to be de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to this dividend.

.02. The REIT's charter provides that dividends on all classes of preferred stock shall be paid semi-annually and before any dividends are paid on the common stock. However, the board of directors adopts a practice of making distributions to the holders of all classes of preferred stock annually and to the holders of all common stock on a monthly basis.

(1) In this situation, no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, the full amount of dividends distributable on the preferred shares, as well as on the common shares, has been distributed, although not in strict accord with the charter provisions.

(2) In this situation, the only question is timing, and the value of any timing differential is considered to be de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to this dividend.

.03. The records of the REIT contain errors regarding share transfers or the identity of its shareholders, either because of internal record-keeping discrepancies or because the shareholders (or their agents or representatives) failed to furnish correct or updated information to the REIT on a timely basis. The REIT thus erroneously pays dividends to some persons who are not shareholders and fails to pay dividends to some other persons who are shareholders. As and when such errors are discovered, they are rectified to the extent practicable.

(1) In this situation, but for such errors no share of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class. Moreover, but for such errors no class of stock has received more or less than the amount to which it is entitled as compared with any other share in any other class of stock. Furthermore, but for such errors the full amount of dividends distributable on the shares has been distributed.

(2) In this situation, such errors are, as and when discovered, rectified to the extent practicable.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends or with respect to any payment made to rectify the errors.

.04. The records of the REIT contain errors regarding the number of shares of one or more classes of stock that are outstanding because of internal record-keeping discrepancies. For example, this situation could occur if REIT employees vest in restricted stock on a certain date, but the REIT's transfer agent is unable to update its records in time to make the correct dividend payment. The REIT thus erroneously fails to pay dividends to some persons who are shareholders. As and when such errors are discovered, they are rectified to the extent practicable.

(1) In this situation, but for such errors no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, but for such errors the full amount of dividends distributable on the shares has been distributed.

(2) In this situation, such errors are, as and when discovered, rectified to the extent practicable.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends or with respect to any payments made to rectify the errors.

.05. The REIT has made all distributions with respect to its classes of stock in accordance with the terms governing the same. When the distributions are made with respect to the shares of stock, rather than any dividend ending up with one or more shareholders receiving a fraction of a cent, there was rounding either up or down to a whole cent.

(1) In this situation, some holders of stock may receive a dividend differential, due to such rounding.

(2) The rounding of a dividend to a whole cent is de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends.

.06 The REIT's charter provides for classes A, B, and C of preferred stock, as well as for common stock. Dividends on the preferred stock are to be paid before dividends are paid on the common stock. The REIT erroneously fails to pay any dividends on class C preferred stock, although it pays dividends on the other classes of preferred and on the common. The total amount of dividends paid by the REIT is 95% or more of the amount which would have been paid had the REIT paid dividends on the common and on all classes of preferred. As soon as the error is discovered, the REIT pays the amounts that it should have paid on the class C preferred stock, plus an amount in the nature of interest to compensate the Class C preferred stockholders for the delay in paying their dividend.

(1) In this situation, the amount of the errors was de minimis, and the errors are, as and when discovered, rectified. Moreover, the additional amount in the nature of interest payable as compensation for delay in payment of the dividend is intended to treat all stockholders with substantial impartiality.

(2) Thus, there is no preferential dividend paid by the REIT with respect to the dividends which were paid on the class A and class B preferred stock and the common or with respect to the payments made to rectify the error with respect to the class C preferred stock.

.07. The REIT acquires shares of its stock by purchasing them on the established securities exchange on which its stock is listed. Depending on the circumstances of the sellers of these shares, the purchases by the REIT will be treated either as dividends under § 301 or as distributions in redemption under § 302. In both cases, under § 562(b) a portion of the amounts paid by the REIT for the shares would constitute dividends for purposes of computing the dividends paid deduction.

(1) In this situation, only the shareholders who sold their shares to the REIT will be considered to have received dividends from the REIT.

(2) All purchases by the REIT were made on the exchange on which the stock is listed at the market price at the moment acquired.

(3) All shareholders of the REIT had an equal opportunity to sell their shares to the REIT at fair market value. Accordingly, all shareholders were treated with substantial impartiality.

(4) Thus, none of such purchases is considered to result in any preferential dividend.

.08. A REIT, the shares or beneficial interests of which are regularly traded on an established securities exchange ("Exchange"), creates a dividend reinvestment plan (DRIP) for its shareholders and a "cash option purchase plan" (COPP) for both shareholders and non-shareholders (together, the DRIP and the COPP constitute the "Plan"). Under the DRIP, which is available to all existing REIT shareholders of record, shareholders can elect to have the cash dividends that would otherwise be distributed to them automatically reinvested in shares of REIT common stock newly issued by the REIT. Both existing REIT shareholders of record and non-shareholders may participate in the COPP. The purchase date for shares acquired through the DRIP is the date the dividends are paid by REIT and the purchase date for the shares acquired through the COPP is the last business day of the month ("Purchase Date").

REIT regularly pays dividends quarterly. The purchase price of shares of REIT stock acquired under the Plan is determined by an objective multi-day pricing formula that applies equally to participants in both the DRIP and COPP. Under the formula, the purchase price is calculated by multiplying the average daily high and low trading prices (the "Average Price") of REIT's stock reported by the Exchange for a period from I to J business days preceding the applicable Purchase Date ("Pricing Period") less a discount of up to 5 percent that REIT's board of directors has determined to be reasonable. REIT's board of directors can adjust the discount applied to the Average Price in its sole discretion, provided that it cannot alter the discount for a particular Pricing Period after that period has begun. If a day's average high and low trading price of REIT's shares falls below a threshold price on any day of the Pricing Period, that day is ignored for purposes of the multi-day pricing formula. The multi-day pricing period is intended to minimize unwanted volatility in the purchase price of REIT's shares that might otherwise arise if a fixed-date pricing mechanism were used. Because the pricing formula is based primarily upon an average price that is determined over the multi-day Pricing Period, it is possible that on any given Purchase Date the purchase price of common shares under the Plan may be less than the average high and low trading prices of REIT's shares on such date by more than 5 percent. Conversely, on any given Purchase Date the purchase price of common shares under the Plan may exceed the average high and low trading prices of REIT's shares on such date.

DRIP participants do not have to participate in the COPP, and COPP participants do not have to participate in the DRIP. Participants in either or both portions of the Plan may terminate their participation at any time. Participants are aware of the fixed percentage discount determined by REIT before they agree to participate in the Plan. REIT pays all administrative costs of the Plan, including printing and distributing the Plan prospectus and reports, legal fees incurred in connection with the Plan's preparation, registration fees and transfer agency fees. Administrative costs do not include brokerage fees on common stock purchases because all purchases under the Plan are made directly from REIT. The Plan is designed to enable REIT to raise capital in a cost-efficient manner on a regular, recurrent basis directly from participants in the Plan. By issuing shares through the Plan, REIT is able to avoid investment banking, brokerage, distribution and other costs typically associated with a traditional underwritten equity offering. The Plan also diversifies REIT's shareholder base by enabling retail investors to invest directly alongside REIT's large, institutional investors on a cost-efficient basis. Further, REIT believes that raising capital through the Plan is advantageous as compared to a traditional underwritten equity offering because traditional underwritten equity offerings may be perceived by the market as an indication of REIT's belief that its shares are overvalued, whereas DRIPs and COPPs, because of their continuing, regular nature, minimize any such inference.

(1) In this situation, REIT is treating its shareholders with substantial impartiality, particularly in light of the fact that REIT is willing to sell its shares using the same formula price to non-shareholders under the COPP. In addition, because the pricing formula used to determine the purchase price of shares of REIT stock acquired through the Plan relies on a multi-day average, it is not possible to determine with certainty whether the purchase price will in fact be less than, equal to or greater than the price of the shares on the Exchange on the Purchase Date. If the pricing formula produces a discount of greater than 5 percent of the trading price of REIT's shares on the Purchase Date, such discount will result from market conditions beyond the control of REIT and the Plan participants, and will not be bargained for or intended by such parties. Any discount to participants in the Plan will not be treated as a preferential dividend, but will be a cost REIT would have incurred in issuing its stock under the Plan, and is intended to result in relatively minor differences in the amounts received by shareholders of the same class of REIT shares. The Plan treats all shareholders with impartiality by giving all shareholders an equal opportunity to participate, and any discount provided by the Plan is intended to result in relatively minor differences in the amounts received by shareholders of the same class of REIT shares.

(2) REIT's payment of the administrative costs of the Plan will not constitute a distribution of property to which section 301 applies. The amount of any discount shall not be considered an administrative cost or result in any preferential dividend.

4. Procedure

Dividend distributions made by a REIT that satisfy the safe harbor of Section 3 of this revenue procedure will not be treated as a preferential dividend for purposes of § 562(c).