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NATIONAL ASSOCIATION OF  
REAL ESTATE INVESTMENT TRUSTS®

May 24, 2004

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Washington, D.C. 20224

Re: Notice 2004-26: Recommendations for Inclusion in the 2004-05 Priority Guidance Plan

Dear Eric and Lon:

The National Association of Real Estate Investment Trusts® (“NAREIT”) once again greatly appreciates the opportunity pursuant to Notice 2004-26, 2004-16 I.R.B. 782 to offer our suggestions regarding regulatory guidance to be placed on the 2004-05 Priority Guidance Plan that would carry out Congressional intent while saving both taxpayers and the Administration time and resources in complying with the REIT tax tests.

As we indicated in our letter dated April 30, 2004, NAREIT requests that the government issue guidance regarding: (1) REITs that engage in real estate activities outside the United States; and (2) protective asset trust arrangements. Enclosed for your consideration with regard to the second issue is a draft revenue procedure that sets forth our recommendations. We believe that public guidance along these lines would relieve the IRS of the administrative burden of processing a large number of private letter ruling requests and closing agreements arising from inadvertent reporting.

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Eric Solomon, Esq.  
Lon B. Smith, Esq.  
May 24, 2004  
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Thank you for your willingness to consider the industry's need for guidance, and we would be pleased to discuss these drafts with you in greater detail.

Respectfully submitted,



Tony M. Edwards  
Senior Vice President & General Counsel

Enclosures

cc: Gregory F. Jenner, Esq.  
Helen M. Hubbard, Esq.  
Deborah Harrington, Esq.  
Alice M. Bennett, Esq.  
William E. Coppersmith, Esq.  
Elizabeth Handler, Esq.  
Jonathan D. Silver, Esq.

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## **REVENUE PROCEDURE**

### **SECTION 1. PURPOSE**

This revenue procedure establishes a safe harbor under which a protective asset trust formed by a real estate investment trust (“REIT”) or an affiliated entity for the benefit of one or more taxable REIT subsidiaries of the REIT (“TRS”) and/or one or more entities that are unrelated to the REIT will prevent the REIT from failing the asset tests under Section 856(c)(4)(B)(iii) of the Internal Revenue Code (“Code”).

### **SECTION 2. BACKGROUND**

.01 Section 856(a)(7) provides that a REIT must meet the requirements set forth in Section 856(c) of the Code. Section 856(c)(4)(A) provides that at the close of each quarter of its taxable year, at least 75 percent of the value of the REIT’s total assets must be represented by real estate assets, cash, and cash items (including receivables), and government securities. Section 856(c)(4)(B)(i) provides that, at the close of each calendar quarter, no more than 25 percent of a REIT’s total assets can be represented by securities (other than those included in Section 856(c)(4)(A)).

.02 Section 856(c)(4)(B)(iii) prohibits a REIT from owning at the close of each quarter of its taxable year, certain securities in excess of specified amounts. Specifically, except with respect to securities of a TRS and securities includible under Section 856(c)(4)(A): (I) not more than 5 percent of the value of a REIT’s total assets can be represented by securities of any one issuer; (II) the REIT cannot hold securities possessing more than 10 percent of the total voting power of the outstanding securities of any one issuer; and (III) the REIT cannot hold securities having a value of more than 10 percent of the total value of the outstanding securities of any one issuer.

.03 These limitations do not apply to the securities of an issuer if the issuer is an entity that is a corporation for federal income tax purposes and that entity has elected together with the REIT to be treated as a taxable REIT subsidiary under Section 856(l). However, Section 856(c)(4)(B)(ii) prohibits a REIT from owning securities in one or more TRSs that, in the aggregate, represent in excess of 20% of the value of the REIT’s assets. A TRS is subject to federal corporate income tax and, for purposes of the REIT assets tests, a REIT is not treated as owning directly the assets owned by a TRS.

.04 Section 1.856-3(g) of the Treasury regulations provides that a REIT is treated as owning directly its proportionate share of the assets of a partnership in which it is a partner. For purposes of section 856, the interest of a REIT in the partnership’s assets shall be determined in accordance with its capital interest in the partnership.

.05 Section 856(g) provides that an election to be taxed as a REIT under Section 856(c)(1) made by a corporation, trust, or association shall terminate if the corporation, trust, or association is not a real estate investment trust to which the provisions of this part apply for the taxable year with respect to which the election is made, or for any succeeding taxable year. Such termination shall be effective for the taxable year for which the corporation, trust, or association is not a real estate investment trust to which the provisions of this part apply, and for all succeeding taxable years.

### **SECTION 3. SCOPE**

This revenue procedure applies to a protective asset trust established by or on behalf of an entity that makes an election to be taxed as a REIT under Section 856(c) if the protective asset trust meets the requirements of this section.

.01 The REIT either directly, or indirectly through its operating partnership (“OP”), or another entity that is treated for federal income tax purposes either as a partnership or an entity that is disregarded for federal income tax purposes (an “affiliated look-through entity”) enters into certain arrangements intended to establish one or more trusts pursuant to a declaration of trust or trust agreement and other related documents (the “trust documents”) that provide that any and all assets included in the trust estate will be owned in trust for the benefit of the named beneficiary (or beneficiaries).

.02 The trust documents name the REIT, the OP, another affiliate of the REIT, an officer or employee of any such party, or a third party as the trustee of the trust.

.03 The trust documents name as the beneficiary (or beneficiaries) of the trust one or more taxable REIT subsidiaries and/or one or more entities that are unrelated to the REIT.

.04 The trust documents further provide the following:

- (1) The trust’s estate consists of specified assets (or categories of assets), which can include (but are not limited to) cash, any specified assets, or categories of assets that the REIT, the OP or an affiliated look-through entity could not own without causing the REIT to violate one or more of the asset limitations set forth in Section 856(c)(4)(B)(iii) (“Trust Assets”).
- (2) Any Trust Assets that otherwise would be considered to be owned by the REIT for purposes of the REIT asset tests of Section 856(c)(4) are deemed automatically transferred to the trust on a date specified in the trust documents.
- (3) Each beneficiary agrees to treat itself as the owner for federal income tax purposes of any Trust Assets that are determined to have been transferred to the trust commencing on the date of the deemed transfer to the trust and continuing thereafter.
- (4) The beneficiary (or beneficiaries) can demand distribution of the trust’s income and/or principal at any time.
- (5) None of the REIT, OP or any affiliated look-through entity retains any discretion as to the distribution of principal or income.
- (6) None of the REIT, OP or any affiliated look-through entity has administrative powers that are exercisable in a nonfiduciary capacity.
- (7) None of the REIT, OP or any affiliated look-through entity has a reversionary interest in any portion of the trust estate or the income from the trust estate.
- (8) The REIT will have no direct or indirect proprietary interest in the Trust Assets deemed held by the trust as of the date of the transfer to

the trust (other than indirectly as a shareholder of a beneficiary that is a TRS).

.05 The trust documents name the REIT, the OP, or an affiliated look-through entity as the transferor of the Trust Assets to the trust.

.06 The REIT has a reasonable belief that provisions of the trust documents are effective in accordance with their terms.

.07 The REIT, directly or through OP, reviews in good faith the composition of its assets not less frequently than on a quarterly basis for purposes of complying with the requirements of Section 856(c)(4)(B)(iii) and the REIT does not willfully disregard those requirements.

#### **SECTION 4. PROCEDURE**

.01 If a protective asset trust satisfies the requirements of Section 3 of this revenue procedure, for federal income tax purposes, any Trust Assets that otherwise would be treated as owned by the REIT in violation of Section 856(c)(4)(B)(iii) that are specified in the trust documents as being transferred to the trust will be treated as being held in trust for the benefit of the beneficiary and will not be treated as owned by any other entity for any purpose under the Code.

.02 The beneficiary will be required to include any income attributable to the Trust Assets (including income or gain upon a disposition of those assets) in its income for all periods during which the Trust Assets are treated under this revenue procedure as owned for federal income tax purposes by the beneficiary (whether by amended return or otherwise).

.03 The Service recognizes that “protective asset trust” arrangements may be accomplished outside of the procedures provided in this revenue procedure. Accordingly, no inference is intended with respect to the federal income tax treatment of “protective asset trust” arrangements entered into that do not satisfy the terms of this revenue procedure.

#### **DRAFTING INFORMATION**

The principal author of this revenue procedure is \_\_\_\_\_ of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact \_\_\_\_\_ at (202) \_\_\_\_-\_\_\_\_ (not a toll-free call).