NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

May 22, 2008

VIA OVERNIGHT DELIVERY

Mr. Robert E. Young
Assistant Director
Department of Assessments and Taxation
301 West Preston Street, 8th Floor
Baltimore, Maryland 21201

Re: Proposed Regulations under COMAR 18.13.02

Dear Mr. Young:

Thank you for the opportunity for the National Association of Real Estate Investment Trusts® (NAREIT) to submit this letter to comment on regulations on Transfers of Controlling Interests, which were published in the Maryland Register on April 25, 2008 (the Proposed Regulations).

NAREIT is the representative voice for U.S. real estate investment trusts (REITs) and publicly traded real estate companies worldwide. Members are REITs and other public businesses that own, operate and finance income producing real estate, as well as those firms and individuals who advise, study and service these businesses. A REIT is a company dedicated to owning, and in most cases operating, income-producing real estate, such as apartments, shopping centers, offices and warehouses, as well as the financing of real estate.

As further described below, because the 2007 legislation expanding the Maryland transfer and recordation tax to transfers of controlling interests in real estate entities incorporated by reference all exemptions to the imposition of tax on the direct transfers of Maryland real property, the Proposed Regulations should be amended to clarify that transfers of controlling interests pursuant to one or more of these exemptions will not be subject to transfer and recordation taxes.

Our primary request is for the Proposed Regulations to be amended to clarify that, just as transfers of Maryland real property pursuant to mergers under section 368 of the Internal Revenue Code of 1986, as amended (the Code), are exempt from Maryland's transfer and recordation taxes, so should transfers of controlling interests in real property entities pursuant to such mergers similarly be exempt. NAREIT further recommends that the Proposed Regulations delete the requirement that a publicly traded entity be required to demonstrate that a series of sales of shares of publicly traded stock within a twelve month period in a publicly traded entity be pursuant to "entirely separate, distinct, and unrelated contracts or agreements."

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NAREIT represents over 132 publicly traded REITs and real estate companies, with an equity capitalization of approximately US $315 billion. Our current data indicates that over 65 REITs have invested almost $9.5 billion in Maryland apartments, office buildings, hotels, storage facilities, and other properties. Over 122 NAREIT REIT members have formed as REITs in Maryland because they view Maryland as a good place to conduct business.

Last year, Maryland enacted, and NAREIT supported, legislation that eliminates the use of so-called "captive REIT" structures that are formed for the sole purpose of avoiding Maryland taxes. While this legislation was being considered, State Comptroller Peter Franchot issued a press release dated March 6, 2007 [http://www.comp.state.md.us/publications/nr/2007/pr09.asp], in which he stated:

> Maryland has long been a leading center for REITS. In 2006, 326 REITS paid the state's $300 Annual Report fee for total General Fund Revenue of $97,800. This makes Maryland home to well over 50 percent of the nation's REITS according to the National Association of Real Estate Investment Trusts. The genesis of this can be traced back to 1963 when Maryland became the first state to pass a REIT statute called the Maryland REIT Law. In addition several factors have contributed to keeping Maryland a REIT magnet. . . It is important to note that the typical investment REIT, corporate REIT and trust REIT will not be affected by today's action. The accounting practices targeted by the Comptroller are used solely by the captive REITS and are solely for the purpose of tax avoidance.

DISCUSSION

I. BACKGROUND

A. REITs

Congress authorized the creation of REITs in 1960 to enable investors from all walks of life to own professionally managed, income-producing real estate through companies modeled after mutual funds. REITs combine the capital of many shareholders to invest in a diversified portfolio of income-producing real estate, such as apartments, hotels, shopping centers, offices, timberlands, and warehouses.

Federal law requires shares in a REIT to be freely transferable, and REIT shares regularly are traded on a major stock exchange. As of April 30, 2008, there were approximately 149 publicly traded REITs in the United States with an equity market capitalization of approximately $326 billion. In 2007, publicly traded REITs distributed over $19 billion in dividends to their shareholders.

Federal law also requires that REITs not be "closely held" and have at least 100 shareholders. For this reason, many REIT that are not publicly traded are required under U.S. securities laws to register their securities with the Securities and Exchange Commission (SEC) because of the size of their investor and asset base. Additionally, many more REITs that are neither listed nor SEC-registered have shareholders that number in the thousands.

Like other publicly traded companies, the shares of publicly traded REITs change hands every day among thousands, if not millions, of individual owners. Because most shareholders hold their shares in "street name," these REITs have no practical way of discovering the identities of these shareholders. Absent large transactions involving either an acquisition of the REIT's stock by a more than 5% shareholder, or the sale of most or all of the REIT's assets or stock, the existence of which would be required to be disclosed to the SEC, a publicly traded REIT is likely to have no knowledge of the reasons behind any sales of its shares in the public markets.

Furthermore, like other publicly traded companies, REITs from time to time engage in mergers and acquisitions, which may be structured as taxable or tax-deferred transactions pursuant to § 368(a) of the Internal Revenue Code. It goes without saying that these mergers are effected consistent with the respective REIT's overall business plans of owning and operating professionally-managed, income-producing property in the most valuable way for their shareholders, rather than as a means to avoid Maryland's, or any other state's transfer and recording taxes.

B. Controlling Interest Legislation

1. Generally

Last year, the Maryland legislature enacted, and Governor O'Malley signed, S.B. 2 (the Legislation), which adds new sections 12-117 and 13-103 to the Annotated Code of Maryland.[1] These new sections impose Maryland's transfer and recordation tax on certain transfers of "controlling interests" in "real property entities."

In general, a "real property entity" is a corporation, partnership or other business entity that "directly or beneficially" owns Maryland real property worth more than $1 million and that constitutes more than 80% of its assets.

2. Reasons for Legislation: "Shell" Limited Liability Companies

A number of policymakers have indicated the reason for the legislation was to address the scenario in which:

> property owners are setting up shell corporations to avoid [transfer and recordation] taxes. Under this scenario, the property owner sets up a limited liability company (LLC) which exists solely for the purpose of owning real estate. Instead of selling the real estate, the owner sells controlling interest (or ownership) of the corporation—effectively selling real estate without conducting a taxable real estate transaction.

Delegate Maggie McIntosh's (D) Newsletter (May 15, 2008) [http://www.delmaggie.org/newsletter.php?id=8].

[1] Unless otherwise provided herein, all references to "Section" are to a section of the Annotated Code of Maryland.

3. Exemptions to Recordation/Transfer Tax

Section 12-117(c) provides for a number of situations which might otherwise involve the application of the Maryland transfer and recordation tax, but which are explicitly exempt from the scope of these taxes (and section 13-103(b) incorporates these exemption by reference).

a. Reorganizations Under § 368(a) of the Internal Revenue Code

Specifically, and as relevant here, § 12-117(c)(1) provides that:

> the transfer of a controlling interest in a real estate entity is not subject to recordation tax if the transfer of the real property by a an instrument of writing between the same parties and under the same circumstances would have been exempt under § 12-108 of this title.

Section 12-108(p) provides for a number of situations in which "[a]n instrument of writing is not subject to recordation tax." One such situation is "if the instrument of writing is made pursuant to reorganizations described in § 368(a) of the Internal Revenue Code." § 12-108(p)(2) (Section 368 Transaction Exemption). As you know, Section 368 transactions are tax-deferred reorganizations that meet specific requirements under the Internal Revenue Code designed to ensure continuity of business interest and business enterprise.

Although the prefatory language of § 12-108(p) refers to "transfers of corporate property between related corporations," nowhere in the actual text of § 12-108(p)(2) is there a reference to "related corporations." Thus, under well-established principles of statutory construction, this prefatory language should have no effect on the plain meaning of § 12-108(p)(2), which applies equally to related and unrelated corporations.

b. Other Exemptions: More Than 12 Months **OR** Not in Accordance with Plan of Transfer

Section 12-117(c)(2) of the statute further provides:

> The recordation tax is not imposed on the transfer of a controlling interest in a real property entity effected in more than one transaction if:
>
> (i) the transfer is completed over a period of more than 12 months; **or**
>
> (ii) the transfer is not made in accordance with a plan of transfer.

(Emphasis added). Thus, § 12-117(c)(2) clearly provides for two distinct, alternative exclusions from the recordation tax.

First, any transfers of a controlling interest in a real property entity effected in more than one transaction over 12 months are exempt from recordation and transfer tax.

Second, transfers of a controlling interest in a real estate entity that occur within a 12-month period **and** not pursuant to a "plan of transfer" similarly are exempt from transfer and recordation tax.

Section 12-117 also defines "plan of transfer." Specifically, § 12-117(a)(4)(I) provides that a "plan of transfer means an intentional plan or program to transfer the controlling interest in a real property entity." With that said, § 12-117(a)(4)(II) then provides that "a plan of transfer does not include a series of sales of shares of a publicly traded entity." Thus, it appears that, under § 12-117 as enacted, a transfer of a controlling interest in a publicly traded entity (that also meets the definition of real estate entity) effected in more than one transaction within a twelve month period is exempt from Maryland's transfer and recordation tax apparently irrespective of whether the transactions are pursuant to an intentional plan or program to transfer the controlling interest in a real property entity." It would be helpful if the Proposed Regulations could affirm this interpretation.

4. Regulatory Authority

Section 12-117(g) (and section 13-103(g) by reference) authorizes the Maryland State Department of Assessments and Taxation (SDAT) to adopt regulations to "administer [these] section[s]." Section 12-117(g)(2)(II) states that "the regulations shall include any additional standards and exemptions to assure that exemptions provided by law when real property is transferred by an instrument of writing are applicable."

C. Regulations

On April 25, 2008, the SDAT issued the Proposed Regulations.

II. COMMENTS

A. The Regulations Should Refer Specifically to the Section 368 Transaction Exemption

As the legislative grant of regulatory authority requires, the regulations should include those exemptions to the Maryland recordation and transfer tax applicable to a transfer of real property by an instrument of writing. One such exemption is a Section 368 Transaction. The Proposed Regulations should be modified to clarify that such transaction are exempt from Maryland's recordation and transfer tax.

From a policy standpoint, clearly referencing this exemption is important to the publicly traded and widely held REIT industry so that it is clear that Section 368 Transactions will not be impeded due to uncertainty from the applicability of the Maryland recordation and transfer tax. Furthermore, such transactions are effected for valid business reasons consistent with a REIT's business of owning and operating real property. They are not the type of transactions in which single member LLC interests are transferred in order to avoid Maryland transfer and recordation tax.

B. The Regulations Should Be Consistent with the Legislation in Deeming a Series of Sales of Shares in a Publicly Traded Entity Within a 12-Month Period Not a "Plan of Transfer"

As noted above, § 12-117(a)(4)(II) clearly provides that "a plan of transfer does not include a series of sales of shares of a publicly traded entity." NAREIT views this provision as essential for the publicly traded REIT industry, in which thousands of shares change hands daily, often without the knowledge of the REIT, and perhaps involving the transfer of more than 80% of a particular publicly traded REIT's value. Absent this exemption, theoretically, many of these small, unrelated transfers could cause the REIT to become subject to transfer and recordation tax. This tax would affect negatively the interest of potential shareholders in REITs with Maryland properties from owning shares of such REITs.

Contrary to the Legislation, Section .02(7)(a) of the Proposed Regulations would provide that a "plan of transfer" includes:

> [t]ransfers of interests in a real property entity to multiple grantees under one or more agreements if the totality of the transfers to the separate grantees meets the controlling interest percentage standard in any 12-month period, **unless the real property entity can establish** to the Department's satisfaction that the transfers were part of **entirely separate, distinct, and unrelated contracts or agreements**.

(Emphasis added).

As the Legislation specifically provides that a series of sales of stock in a publicly traded entity **is not** a "plan of transfer," the provision quoted above is contrary to the Legislation. Furthermore, it would impose an impractical if not impossible burden on publicly traded REITs, first, to monitor each and every transfer of their stock in the public markets to determine whether a sufficient percentage of their stock changed hands within any given 12-month period, and second, to determine whether, and substantiate that, such transfers were not part of separate and unrelated contracts or agreements.

Again, because most publicly traded REIT stock is held in "street name," REITs are not generally aware of the acquisition of their stock below a 5% threshold (transactions involving over 5% of the REIT's stock must be disclosed to the SEC). As a result, the burden that would be imposed by this provision in the Proposed Regulations could affect the appeal of REITs with Maryland properties to potential shareholders. As a result, we respectfully request that the final regulations eliminate this provision.

At the very least, Section .02(7)(a) of the Proposed Regulations should be amended, in accordance with the enacting legislation, to include something along the lines of the following:

"Notwithstanding anything herein the contrary, a plan of transfer does not include a series of sales of shares of a publicly traded entity."

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Thank you for the opportunity to submit these comments. NAREIT also is aware of the comments submitted by letter dated May 15, 2008, by the Maryland Chamber of Commerce, and we agree with those comments. We also request a formal hearing to discuss our comments in more detail. Please feel free to contact either Dara Bernstein or Tony Edwards of NAREIT at (202) 739-9400 to discuss this submission in further detail.

Respectfully submitted,

Tony M. Edwards
Executive Vice President and General Counsel
NAREIT

cc: Dara F. Bernstein