NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

May 29, 2008

VIA E-MAIL

Internal Revenue Service
Attn: CC:PA:LPD:RR (Notice 2008-47)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2008-47: 2008-2009 Guidance Priority List

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity, pursuant to Notice 2008-47, 2008-18 I.R.B. 869, to offer our suggestions regarding regulatory guidance to be placed on the 2008-2009 Guidance Priority List. 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 businesses that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service these businesses.

We request that the Department of the Treasury and the Internal Revenue Service include in their 2008-2009 Guidance Priority List the following four issues:

(1) allowing a safe harbor under which non-substantial mistakes and inadvertent errors in computing and making distributions, including potential rounding errors, are disregarded so that those distributions from a REIT are not considered as preferential dividends, consistent with an item on the 2007-2008 Guidance Priority List “addressing the correction of minor errors by RICs and REITs;”

(2) updating the language in Treas. Reg. § 1.856-2(d)(3) to require a REIT to determine its total assets based on tax, rather generally accepted accounting (GAAP), principles;

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1875 I Street, NW, Suite 600, Washington, D.C. 20006-5413
Phone 202-739-9400 Fax 202-739-9401 www.nareit.com

(3) revising the regulations under § 337(d) of the Internal Revenue Code of 1986, as amended[1] concerning "built in gains" so that these regulations do not apply to exchanges of property from a C corporation to a REIT under § 1031 nor to transfers of property to a REIT from a corporation exempt from tax under § 501(a); and

(4) finalizing regulations allowing the creation of a class of REIT stock (described as a "non-economic residual interests by REIT taxable mortgage pools" or "TMPs") and related issues described in NAREIT's submissions dated January 29, 2007 and May 17, 2007.

Preferential Dividends

There are situations in which a REIT inadvertently, through a "foot fault" such as a rounding error or similar situation, arguably could be viewed as having distributed a non-deductible, preferential dividend. Because these errors truly have no substantive meaning, we respectfully recommend that the IRS issue guidance providing safe harbors as to these types of situations that will not be treated as preferential dividends, consistent with an item on the 2007-2008 Guidance Priority List "addressing the correction of minor errors by RICs and REITs."

Updating Regulations Concerning Determination of a REIT's "Total Assets"

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). Treas. Reg. § 1.856-2(d)(3) provides that "[t]he term total assets means the gross assets of the [REIT] determined in accordance with generally accepted accounting principles." When this regulation was first issued decades ago, the distinctions between tax and GAAP principles may not have been significant. However, in recent years, there have been many changes to GAAP that make application of this regulation difficult.

Such difficulty was illustrated by the taxpayer's situation in PLR 200813009, in which the taxpayer requested that the IRS rule that certain real estate intangibles, a distinct and separate asset under GAAP, were "real estate assets" for purposes of the 75% asset test. In fact, the IRS did rule that "notwithstanding its treatment as a separate asset for GAAP purposes … to the extent that the value of the real estate intangibles is inextricably linked to the [REIT's] underlying real estate, the real estate intangibles will be treated as 'real estate assets' … for purposes of § 856(c)(4)(A)." There are many other examples of the difficulty of reconciling tax and GAAP principles for purposes of a REIT's 75% asset test. For this reason, we recommend that Treas. Reg. § 1.856-2(d)(3) be modernized so that a REIT determine its "total assets" in accordance with its tax financial statements, rather than GAAP financial statements.

Revising Final Regulations Under § 337(d) Relating to Conversion Transactions

On May 1, 2008, the American Bar Association Tax Section (the Tax Section) submitted comments recommending certain changes to the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or RICs.

[1] the Code, and, unless otherwise provided herein, "section" or "§" shall be to a section thereof.

The regulations under § 337(d) implement Congress' directive as part of the repeal of the *General Utilities* doctrine in the Tax Reform Act of 1986 (the 1986 Act) to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments effected by the 1986 Act, including:

> …regulations to ensure that such purposes may not be circumvented through the use of … a regulated investment company, real estate investment trust, or tax exempt entity…

Section 337(d).

Prior to its repeal, the *General Utilities* doctrine allowed certain transfers of appreciated property to avoid corporate level tax. The 1986 Act eliminated those rules, effectively preventing the avoidance of corporate-level tax on the disposition of appreciated property.

We support the suggestions made in those comments, and respectfully request that the IRS and Treasury Department revise the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or RICs, in accordance with those comments.

The Tax Section comments address two specific issues:

First, the Tax Section points out that the § 337(d) regulations technically apply to transfers from a C corporation to a REIT or RIC in an "exchanged basis" transaction and indicates that this treatment is inappropriate. "Exchanged basis" transactions include § 1031 like-kind exchange transactions. C corporations often transfer real property in like-kind exchange transactions when a REIT is the acquirer. These transactions are commonplace, non-abusive, and do not implicate any of the concerns that are properly addressed by the regulations.

Second, the Tax Section states that the § 337(d) regulations improperly treat tax-exempt corporations as "C corporations" for purposes of the regulations. It follows from this treatment that a transfer of assets from a tax-exempt corporation to a REIT or RIC can result in the imposition of a C corporation level tax with respect to the property (under § 1374 principles if the property is sold by the REIT or RIC within ten years). As the Tax Section points out, this treatment also applies in connection with a transfer of assets from a real estate partnership to a REIT when the partnership has partners that are tax-exempt corporations. Such transfers are undertaken all the time, and for the reasons given by the Tax Section, NAREIT believes that the regulations should not be applied in these situations.

These issues are important to the REIT industry. We believe that the solutions proposed by the Tax Section are balanced and proper, and we hope that you will give serious consideration to adopting those solutions.

<u>Excess Inclusion Income/Taxable Mortgage Pool Regulations</u>

As you know, the 2006-2007 Guidance Priority List included an item concerning guidance under I.R.C. § 860E relating to excess inclusion income of a REIT that is a taxable mortgage pool or that has a qualified REIT subsidiary that is a taxable mortgage pool; both Rev. Rul. 2006-58, 2006-46 I.R.B. 876, and Notice 2006-97, 2006-46 I.R.B. 904, were published at the end of 2006. Notice 2006-07 specifically requested comments for the purpose of drafting regulations, and NAREIT's comments were included in the two submissions referenced above.

In particular, regulations allowing the creation of a separate class of stock representing non-economic residual interests by REIT taxable mortgage pools would help to assure that the holders of REIT TMP residual interests could not avoid paying federal income tax on the excess inclusion income generated by such interests. REITs would be able to dispose of the excess inclusion income "taint" by paying an inducement fee to the purchaser of the non-economic interest. This mechanism would provide flexibility to REITs which do not want the administrative burden of calculating excess inclusion income and allocating and reporting it to their shareholders. Assuming that appropriate guidance is issued, we expect that most mortgage REITs would adopt this mechanism for dealing with excess inclusion.

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All of the suggested projects above would fulfill the goals and objectives set forth in 2008-47, 2008-18 I.R.B. 869. First, resolution of these issues 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. Also, the excess inclusion project would resolve many issues facing mutual funds who invest in REITs as well as brokers who are now faced with the withholding and payment obligations of taxpayers holding REIT stock in street name.

Second, a number of interested parties already have submitted comments to the IRS formally and informally concerning the preferential dividend; built-in gain; and taxable mortgage pool issues listed above. Thus, these projects would not be appropriate for additional, enhanced public involvement through the process described in Notice 2007-17, 2007-12 I.R.B. 748. Further, the remaining issue, modernizing Treas. Reg. § 1.856-2(d)(3) so that "total assets" is determined in accordance with tax, rather than GAAP principles, is a relatively simple issue that could be easily corrected without devoting the resources required by a formal project contemplated in Notice 2007-17.

Third, these projects would promote sound tax administration. The preferential dividend project would allow REITs and their taxpayers certainty that minor differences in dividend payments will not result in disproportionate penalties, while simultaneously relieving the Government with having to devote unwarranted resources in negotiating closing agreements to resolve these types of issues. The modernization of Treas. Reg. § 1.856-2(d)(3) would provide certainty to REITs in connection with the determination of their "total assets" and would help avoid the need to seek private rulings when GAAP and tax principles may differ. Also, the modification of the § 337(d) regulations would conform the policy behind the issuance of these regulations with the application of these regulations. Finally, the excess inclusion project would greatly simplify the reporting responsibilities of REITs, mutual funds and brokers while assuring the IRS that Congressional intent is followed by effectively requiring that some taxpayer incurs a tax on excess inclusion income.

Fourth, these projects could clearly be drafted in a manner that would enable taxpayers to easily understand and apply the guidance. We have been working with, and would be pleased to continue to work with, with the IRS in discussing how the preferential dividend guidance could be drafted so as to apply to the most common types of non-consequential "foot faults." Similarly, the § 1.856-2(d)(3) regulation could be easily modernized by replacing the reference to GAAP to a reference to the taxpayer's tax financial statements. As noted above, the Tax Section already has submitted comments detailing how the § 337(d) regulations could be amended so taxpayers could easily understand and apply the guidance. Finally, our submissions on the excess inclusion income project provide detailed recommendations on how the guidance could be drafted, but basically NAREIT suggests that such guidance closely parallel the existing REMIC regulations on residual interests.

Fifth, we believe that guidance under these projects easily could be administered on a uniform basis. Published guidance on what constitutes preferential dividends is far superior to having to negotiate closing agreements on a case-by-case basis. Similarly, it would be preferable to determine "total assets" based on tax principles than have to resort to seeking a ruling from the IRS when GAAP principles arguably conflict. Additionally, modifying the § 337(d) in accordance with the Tax Section's comments would allow these regulations to be applied to transfers of appreciated property to RICs and REITs consistent with the policy behind the issuance of these regulations. Moreover, the reason NAREIT asked for guidance in the excess inclusion income area was because the lack of guidance since Congress in 1986 directed the government to prescribe regulations in this area has hindered REITs, mutual funds and brokers who have tried their best to comply with the statute in a consistent and administrable manner.

Finally, guidance in both requested projects would reduce controversy and lessen the burden on taxpayers or the Service for the reasons stated above. Feel free to contact me or Dara Bernstein, NAREIT's Senior Tax Counsel, if you would like to discuss this issues in greater detail.

Respectfully submitted,

Tony M. Edwards
Executive Vice President & General Counsel

cc: Eric Solomon, Esq.
Stephen R. Larsen, Esq.