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U.S.-Japan Tax Treaty Is Ratified; Lower Withholding Rates Apply to REIT Ordinary Dividends Paid After July 1, 2004

Last year, the United States and Japan signed a new tax treaty and protocol that will reduce the withholding rate applicable to REIT dividends to as low as 10% for non-pension fund investors and 0% for pension fund investors if certain conditions are satisfied. For the text of the treaty, Click HERE, and for the text of the protocol, Click HERE. For a detailed description of the U.S.-Japan tax treaty, see the U.S. Treasury Department's explanation of the treaty Click HERE, the Joint Committee on Taxation's explanation of the treaty Click HERE. The treaty was officially ratified on March 30, 2004, and the reduced withholding rates apply to ordinary dividends paid after July 1, 2004.

Background

Under the Internal Revenue Code, a U.S. corporation must withhold and remit to the IRS 30% of its ordinary dividends paid to non-U.S. shareholders. Since World War II, the United States has entered into many bilateral treaties that reciprocally lower withholding taxes to encourage cross-border investments.

In 1996 and 1997, NAREIT conducted a dialogue with Congress and the Treasury Department regarding the U.S. tax treaty negotiating position for REIT dividends. The pre-1997 position had been to seek a 15% rate on dividends to foreign individuals owning less than 10% of a REIT, with 30% withholding imposed on other distributions. In 1997, the Treasury Department agreed to amend its negotiating position to obtain in tax treaties a 15% withholding rate on REIT ordinary dividends to non-U.S. institutions so long as the institution owns less than (1) 5% of a publicly traded REIT; or (2) 10% of any REIT, the properties of which are sufficiently diversified.

New U.S.-Japan Treaty

Under the U.S.-Japan Treaty, a 10% withholding rate applies to REIT ordinary dividends if: (a) the investor is an individual who owns not more than 10% of the REIT; (b) the investor owns either (i) not more than 10% of the REIT and the REIT is "diversified" (no own property comprises more than 10% of the REIT's total properties) or (ii) not more than 5% of the REIT and the REIT is publicly traded.

Importantly, the treaty provides a 0% withholding rate for ordinary dividends paid to Japanese pension funds, which applies so long as the pension fund meets the conditions of paragraph (b) above. The exemption of ordinary dividends to pension plans follows similar provisions in the U.S. tax treaties with Canada, the Netherlands,

national policy
bulletin
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Switzerland, Venezuelas, and, more recently, the U.K. and Mexico. Although both the Treasury Department and Joint Committee's explanation do not state that a 0% withholding rate applies to REIT ordinary dividends to Japanese pension funds, the text of the treaty is clear on this point.

After the U.S. Senate and the Japanese Diet approved the treaty, the treaty was formally ratified in Tokoyo on March 30, 2004. Accordingly, the lower withholding rates on U.S. REIT ordinary dividends takes effect with respect to REIT distributions made on or after July 1, 2004.

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