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NATIONAL ASSOCIATION OF
 REAL ESTATE INVESTMENT TRUSTS®

April 30, 2004

VIA HAND DELIVERY AND E-MAIL

Courier's Desk
 Internal Revenue Service
 Attn: CC: PA:LPD:PR (Notice 2004-26)
 1111 Constitution Avenue, N.W.
 Washington, D.C. 20224

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

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (“NAREIT”) 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 Guidance Priority List that would carry out Congressional intent while saving both taxpayers and the Administration time and resources in complying with the very technical REIT tax tests. NAREIT is the national trade association for U.S. real estate investment trusts (“REITs”) and other publicly traded real estate companies. Members include 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 those businesses.

We request that the Department of the Treasury and the Internal Revenue Service include in their 2004-05 Guidance Priority List the following issues:

- (1) Guidance under § 856 regarding (a) the treatment of foreign currency gain under §§ 987 and 988 and (b) the valuation of assets denominated in a foreign currency.
- (2) Guidance under § 856 concerning the implementation of a “protective trust” used in order to maintain compliance with the REIT asset tests.

The first two subissues arise in the application of the statutory qualification tests of a REIT with direct or indirect real estate investments outside the United States.



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To briefly summarize, in order to maintain status as a REIT, the entity must satisfy a number of statutory requirements. Two of the requirements relate to the type of income the entity can derive (the “income test”) and the type of assets it can hold (the “asset test”). Thirty years ago, the IRS confirmed (in Revenue Ruling 74-191, 1974-1 C.B. 170) that qualifying REIT assets can include investments in, and mortgages secured by, real estate located outside the United States. However, little guidance exists regarding how the REIT statutory requirements apply in connection with such investments and security interests.

Of particular concern is the application of the income test and the asset test to what are fundamental REIT transactions. For example, if a REIT (through a qualified business unit) manages rental property overseas, there is no guidance on how a REIT should apply the income test to rental income that is denominated in a foreign currency or when it receives payments of principal and interest on a mortgage note secured by overseas real estate assets when the payment is denominated in a non-functional currency. Similarly, there is no guidance on how a REIT determines its compliance with the asset test with respect to assets that are denominated in a foreign currency.

Revenue Ruling 74-191 properly cited Congressional intent justifying its conclusions that REIT investors should obtain the benefits of a REIT operating globally. We believe that our requested guidance would further carry out this Congressional intent by not penalizing a REIT from engaging in activities fundamentally consistent with being a real estate company.

Second, it would be useful if public guidance could be issued along the lines of a private letter ruling in which a trust was used to maintain compliance with the REIT asset tests.¹ Disqualification of REIT status is a disproportionate penalty for inadvertently failing the asset tests, and the solution in the private letter ruling of imposing corporate tax instead of losing REIT status is much more logical.

To assist you in the drafting guidance in both areas, we plan to submit draft revenue procedures in the near future.

We view both the foreign currency issues and the protective trust issue as having equal importance. Nevertheless, to the extent that the Treasury Department and the IRS do not have sufficient resources to address both sets of issues, we suggest that the focus be on providing guidance that would address the implications of foreign currency transactions on the REIT income and asset tests. The consequences of failing to satisfy the REIT statutory requirements are significant – disqualification of REIT status, which carries with it significant adverse tax consequences for the REIT and its shareholders. Guidance on these issues also may have the salutary effect of accelerating the repatriation of overseas earnings back to the United States.

¹ See PLR 200234054; cf. PLR 200132008.



If the Treasury Department and the IRS choose not to issue public guidance concerning “protective trusts” for purposes of the REIT asset tests, NAREIT respectfully requests that the IRS resume issuing private letter rulings that permit such trusts under certain circumstances. These rulings would provide assurance to the many REITs that have adopted the protective asset trust structure described in the 2002 private ruling.

We look forward to working with the Treasury Department and IRS in developing the requested guidance that comports with the goals and objectives set forth in Notice 2004-26: (1) consistent with the Code and Congressional intent, (2) in a manner that promotes sound tax administration, (3) easy to understand and apply, (4) uniformly administrable by the IRS, and (5) in a manner that lessens controversy.

Respectfully submitted,



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