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Oct. 1, 2018

Via www.regulations.gov (REG-107892-18)

The Honorable Steven Mnuchin
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution, Avenue, N.W.
Washington, D.C. 20224

Re: Proposed Section 199A Regulations (the Proposed Section 199A Regulations)
CC:PA:LPD:PR (REG-107892-18)

Dear Secretary Mnuchin and Commissioner Rettig:

Nareit appreciates the opportunity to offer comments regarding the Proposed Section 199A Regulations.[1] Nareit is the worldwide representative voice for real estate investment trusts (REITs) [2] and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community.

Executive Summary

Confirm that Both Direct Holders of REIT Stock and Indirect Shareholders of REITs through Mutual Funds Receive Section 199A's 20% Deduction for Qualified REIT Dividends

With the enactment of last year's tax reform legislation,[3] section 199A[4] was added to the Internal Revenue Code. Section 199A generally entitles individual taxpayers to a deduction equal to 20% of, among other things, their "qualified REIT dividends." Congress intended that all individuals receiving REIT dividends should be permitted to claim the 20% deduction under section 199A. This intent is clear

[1] Qualified Business Income Deduction, 83 Fed. Reg. 40884 (Aug. 16, 2018).
[2] REITs are real estate working for you. Through the properties they own, finance and operate, REITs help provide the essential real estate we need to live, work and play. All U.S. REITs own approximately $3 trillion in gross assets, public U.S. REITs account for $2 trillion in gross assets, and stock-exchange listed REITs have an equity market capitalization of over $1 trillion. In addition, more than 80 million Americans invest in REIT stocks through their 401(k) and other investment funds.
[3] Pub. L. No. 115-97 (also known as the Tax Cuts and Jobs Act, or TCJA). The Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, further refined section 199A. These refinements are not relevant to or addressed by this comment letter.
[4] Unless otherwise noted, references to "section" in this letter refer to sections of the Internal Revenue Code of 1986, as amended (the Code).

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by the text of section 199A, which states that REIT dividends eligible for the deduction include "any" dividends that non-corporate taxpayers receive "from" REITs (without limiting the provision to those received "directly"); by the structure of the section that provides a deduction for qualified REIT dividends without regard to whether a taxpayer also earns "qualified business income" and without regard to the restrictions and limitations applicable to a deduction for qualified business income;[5] by the broad grant of regulatory authority to the Treasury Department to issue guidance to carry out the intent of Congress; and, by the more specific grant of authority to issue guidance in the case of "tiered entities."[6]

Nareit commends the IRS and Treasury Department for addressing many interpretive issues in the Proposed Section 199A Regulations.[7] However, the Proposed Section 199A Regulations do not address the recommendation raised by Nareit in its June 14, 2018 letter requesting that the IRS and Treasury Department exercise their expressly provided regulatory authority to confirm Congressional intent that the section 199A deduction for qualified REIT dividends is available to both direct REIT shareholders and shareholders of REITs through regulated investment companies (RICs or "mutual funds").[8]

Congress has clearly demonstrated its intent to treat both REITs and RICs as conduit entities so that shareholders of both entities attain the same tax consequences as if the shareholders directly own the assets of the REITs and RICs. As further described below, the Treasury Department has effectuated this intent more than once with respect to similar issues through administrative guidance promulgated pursuant to the grant of regulatory authority and has appropriately carried out this conduit approach for RICs that own REIT stock.[9] Congress is presumably aware of and has reaffirmed this guidance through subsequent legislation.[10] Any departure from this conduit approach would negatively impact the over 15 million shareholders owning mutual funds in taxable accounts that own REITs and would produce an aberrational result that could not be what Congress intended.

Accordingly, Nareit respectfully requests that the IRS and Treasury Department promptly issue guidance confirming that the section 199A deduction for qualified REIT dividends applies both to REIT dividends to direct REIT shareholders as well as to indirect REIT dividends when the REIT distributes a dividend to a RIC, and the RIC passes through the dividend to its shareholders. Nareit requests the opportunity to speak on this specific topic at the Oct. 16, 2018 hearing regarding the Proposed Section 199A Regulations.

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[5] Section 199A(e)(3).
[6] Section 199A(f)(4)(B).
[7] Nareit supports the comments made by The Real Estate Roundtable regarding these regulations.
[8] The issue has also been raised in comments submitted by the U.S. Chamber of Commerce, the Investment Company Institute, The Real Estate Roundtable, the National Multifamily Housing Council, and the International Council of Shopping Centers.
[9] See *infra,* notes 35 to 42 and accompany text.
[10] *Id.*

Eliminate the 45-Day Holding Period as a Definitional Requirement for Qualified REIT Dividends

Additionally, the Proposed Regulations' requirement that a taxpayer must hold REIT stock for 45 days to be eligible for the section 199A 20% deduction should be eliminated. This requirement inappropriately makes it harder for taxpayers who purchase stock (either in a separate transaction such as a dollar cost averaging plan recommended by financial planners or through a dividend reinvestment plan) at the end of a calendar year to claim the section 199A deduction. Further, the 45-day requirement was not authorized in statutory language or legislative history.

Discussion

I. Confirm that under Section 199A, a "Taxpayer" Includes Both Direct Holders of REIT stock and Indirect Shareholders of REITs through Mutual Funds

Background: Regulated investment companies

RICs provide the opportunity for ordinary investors to access the capital markets and professional portfolio management. An entity must satisfy certain asset and income tests to qualify as a RIC; if so, provided the RIC distributes all its income to its shareholders every year (and satisfies other operational and compliance requirements), the RIC will not incur tax at the RIC level. Instead, the income is taxable to the RIC shareholders. The policy rationale for this treatment is in large part based on Congress' view of RICs as an aggregation of individual shareholders that had pooled their funds into the RIC for the purposes of collectively investing in the stocks and securities of the operating companies.[11] Tax thus should be imposed at the individual shareholder level. In granting RICs tax treatment akin to flow through status, Congress sought to allow the shareholders of a RIC to achieve "essentially the same tax treatment" as if they had invested directly in the operating companies.[12] All rate reductions, expenses, or tax credits in the Code that would be available to a direct individual investor are permitted in some fashion to the benefit of the RIC shareholder at either the RIC level or RIC shareholder level. Congress has used a variety of methods, not exclusively through Subchapter M of the Code, to provide for specific

[11] *See, e.g.*, Overton Durrett, *The Real Estate Investment Trust: A New Medium for Investors*, 3 WM. & MARY L. REV. 140, 140 (1961); *see also, e.g.*, *Grew v. Comm'r*, 7 T.C.M. (CCH) 538, 545 (1948).*; see also* H.R. REP. NO. 2020, 86th Cong., 2d Sess. 3 (1960), *as reprinted in* 1960-2 C.B. 819, 820 [hereinafter HOUSE REPORT].
[12] HOUSE REPORT AT 820; *see also* Statement of Senator Charles Percy (R-Ill.) explaining the "concept of a mutual fund under which the shareholders of the fund are considered, for tax purposes, as the actual owners of the fund's holdings." 122 Cong. Rec. 26111 (1976).

tax treatment at the RIC shareholder level including direct statutory references in the Code and granting authority to the Treasury Department to work out the specifics.[13]

REITs-authorized in 1960, modeled after mutual funds

Congress granted REITs their particular tax status in 1960.[14] Prior to the enactment of sections 856 through 858 of the Code,[15] real estate trusts (or equivalent entities) were taxed as corporations.[16] In enacting the REIT rules, Congress recognized the fact that the only real distinction between a RIC and a REIT was the type of investment they made (*i.e.*, stocks and securities in the case of RICs and real estate equities and mortgages in the case of REITs).[17] Congress enacted the REIT provisions in order to provide REITs "substantially the same tax treatment…as present law provides for regulated investment companies,"[18] and crafted sections 856 through 858 such that "to the full extent feasible . . ., [those] requirements and conditions now applicable to regulated investment trusts [sic] [would be made] applicable to the real estate investment trusts."[19]

Congress' intent in enacting the REIT provisions was that REIT investors should be able to receive "the same type of tax treatment they would receive if they held the real estate equities and mortgages directly and therefore, [the REIT legislation] equates their treatment with that accorded investors in regulated investment companies."[20] Congress believed "that the equality of tax treatment between the beneficiaries of real estate investment trusts and the shareholders of regulated investment companies is desirable since in both cases the methods of investment constitute pooling arrangements whereby small investors can secure advantages normally available only to those with larger resources."[21] In addition, Congress also believed comparable treatment for RICs and REITs was appropriate because "it is also desirable to remove taxation to the extent possible as a factor in determining the relative size of investments in stocks and securities on one hand, and real estate equities and mortgages on the other."[22]

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[13] *See infra,* notes 35 to 42 and accompanying text.
[14] Pub. L. No. 86-779 sec. 10(a), 74 Stat. 998, 1003 (1960).
[15] In addition to sections 856 through 858, Part II of Subchapter M of Chapter 1 of Subtitle A of the Code also contains section 859, dealing with a REIT's adoption of an accounting period, which was enacted in 1976. Part III of Subchapter M contains section 860, which deals with a deduction for deficiency dividends and is applicable to both REITs and RICs. Section 860 was enacted in 1978.
[16] *See, e.g.*, Overton Durrett, *The Real Estate Investment Trust: A New Medium for Investors*, 3 WM. & MARY L. REV. 140, 140 (1961); *see also, e.g.*, *Grew v. Comm'r*, 7 T.C.M. (CCH) 538, 545 (1948).
[17] HOUSE REPORT, *supra* note 11 at 820; *see also* Durrett, *supra* note 16, at 140.
[18] HOUSE REPORT, *supra* note 11 at 820.
[19] *Id.*, at 821.
[20] *Id.*, at 820.
[21] *Id.*
[22] *Id.*, at 821.

Approximately 80 million Americans own REITs through their retirement savings and other investment funds, and approximately 40% of REIT shares are held by RICs.[23] Nareit estimates that over 15 million of those shareholders invest through taxable accounts in RICs that hold REITs. The impact of this issue extends far beyond shareholders of the approximately 150 REIT-dedicated mutual funds because REITs are included in virtually all of the thousands of mutual funds benchmarked to broad stock indexes.[24]

Section 199A

The 20% deduction

Section 199A provides a "taxpayer other than a corporation" with a yearly deduction for the lesser of the taxpayer's "combined qualified business income amount" (QBIA) or 20% of the taxpayer's taxable income net of the taxpayer's net capital gain.[25] A taxpayer's combined QBIA equals the sum of: i) 20% of the taxpayer's qualified business income for each qualified trade or business; plus, ii) 20% of the taxpayer's "qualified REIT dividends and qualified publicly traded partnership income."[26]

A taxpayer's qualified business income includes certain real estate income.[27] The statute contemplates that taxpayers may earn such real estate income through various pass-through structures. For example, when the real estate income is earned by a partnership, the partner is the taxpayer, and the partner claims the 20% deduction. When the real estate income is earned by an S corporation, the S corporation shareholder is the taxpayer and the shareholder claims the 20% deduction. When the real estate income is earned by a trust, the trust beneficiary is the taxpayer and claims the 20% deduction. In each case, the property is owned in a separate legal entity, and the income flows through to the owner who, under section 199A, is permitted to claim the deduction.

Qualified REIT dividends

A "qualified REIT dividend" is "**any** dividend **from a real estate investment trust** received during the taxable year which [is an ordinary dividend]."[28] (Emphasis added). In the case of a REIT, the "taxpayer"

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[23] Nareit, available at https://www.reit.com/data-research/research/nareit-research/80-million-americans-own-reit-stocks (last accessed Sept. 28, 2018).
[24] For example, as of Sept. 25, 2018, over $1 trillion was invested in mutual funds benchmarked to the Russell 1000 and 2000 Indexes and variants. For example, REITs account for about 6.98% of the Russell 2000 index market cap. However, because of REITs' higher dividends, more than 30% of that ETF's dividends were attributable to REITs. Similarly, $4.4 trillion was invested in mutual funds benchmarked to the S&P 500 Index. As of June 30, 2018, more than 1,000 funds were benchmarked to this index, with 5.2% of the funds' dividends being attributable to REITs.
[25] Section 199A(a).
[26] Section 199A(b)(1).
[27] Section 199A(c).
[28] Section 199A(e)(3).

can be the direct shareholder of the REIT; or a partner, if REIT stock is owned by a partnership; or an S corporation shareholder, if the REIT stock is owned by an S corporation; or a trust beneficiary, if the REIT stock is owned by a trust; or, a RIC shareholder, if the REIT stock is held by a RIC. Again, while the REIT shares may be owned by a separate conduit entity, the REIT dividends flow through and are received by the owners of those conduit entities.

Section 199A's grant of regulatory authority

The Code provides the Treasury Secretary ultimate authority to administer and enforce the provisions of the Code.[29] The Code also specifically provides the Treasury Secretary authority to "prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."[30] In addition to this grant of "general" authority, particular Code sections also provide "specific" grants of authority with respect to various aspects of the Code.

Section 199A(f)(4) provides the Secretary with such a specific grant of authority to "prescribe such regulations as are necessary to carry out the purposes of this section, including [but not limited to] regulations…(B) for the application of this section in the case of tiered entities [bracketed language added for emphasis]." The term "tiered entities" is used in three Code sections but is not defined in any of them.[31] Treasury Regulations, however, define the term to include RICs and REITs.[32]

The Proposed Section 199A Regulations & congressional intent

The Treasury Department considered congressional intent in a variety of contexts to provide clarity and certainty to taxpayers in the Proposed Section 199A Regulations. For example, the Treasury

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[29] Section 7801(a).
[30] Section 7805(a).
[31] *See* sections 168(h)(5)(B) ("tiered partnerships and other entities"), (h)(6)(E) ("tiered partnerships and other entities"); 199A(f)(4)(B) ("tiered entities"); and 514(c)(9)(D) ("tiered partnerships and other entities"). Congress has employed the word "tiered" in other sections of the Code, limiting the term to specific types of entities as appropriate given the context. *Cf.* sections 245A(e)(2) ("[h]ybrid dividends of tiered corporations"); 444(d)(3)(A)((i) ("no election may be under subsection (a) with respect to any [partnership, S corporation, or personal service corporation] which is part of a tiered structure"); 856(c)(5)(E) ("if such REMIC's [*sic*] are part of a tiered structure"); 960(a)(2)("[t]iered controlled foreign corporations"); and 6225(c)(2)(F)("[a]pplication to partnerships and S corporations in tiered structures").
[32] *See, e.g.*, Treas. Reg. § 1.362-3(d)(5) (subsection (iii) provides a look through rule for "tiered entities . . . described in (d)(5)(i)(A)" and subsection (d)(5)(i)(A) includes "a domestic entity that is a trust . . . , estate, regulated investment company (as defined in section 851(a)), a real estate investment trust (as defined in section 856(a)), or a cooperative . . ."); Treas. Reg. § 1.7704-1(a)(2)(iii) ("Exception for tiered entities. For purposes of section 7704(b) and this section, an interest in a partnership or corporation, (including a regulated investment company as defined in section 851 or a real estate investment trust as defined in section 856) that holds an interest in a partnership is [eligible for the exception]").

Department's guidance on the definition of a specified service trade or business (SSTB) is "based on the plain meaning of the statute, past interpretations of substantially similar language in other Code provisions, and other indicia of legislative intent."[33] In providing a reasonable compensation rule, the Treasury Department took into consideration that the rule "was intended" to apply to S corporations and for arrangements involving multiple trusts, the Treasury Department noted that the proposed rule "generally reflects the intent of Congress."[34]

Statutory and regulatory framework for RICs owning REITs

Congressional text

The statutory definition of a "qualified REIT dividend" under section 199A is very broad: the test defines it as "any" dividend "from" a REIT that is an ordinary dividend. Congress could have inserted "directly" before "from" but chose not to do so. REIT dividends received by a RIC are in turn distributed to its shareholders as Congress intended. The mere fact that a RIC aggregates and then distributes dividends from securities cannot somehow deny the RIC shareholder from receiving the 20% deduction that Congress intended to apply to "all" REIT dividends. Blocking the deduction at the RIC level would be an aberrant result that would not be a reasonable construction of the statute or Congressional intent.

Parallel interpretation

The Treasury Department should interpret section 199A not in isolation but in the context of the Congress' intent in enacting it and the entire statutory and regulatory framework[35] applicable to the taxation and reporting of REIT and non-REIT dividends and other tax-related items through RICs. One example of this framework is contained in section 1(h). Prior to its amendment by the Taxpayer Relief Act of 1997 (TRA 97),[36] section 1(h) provided a maximum capital gains rate.[37] The TRA 97 amended section 1(h) to provide lower maximum tax rates for capital gains, depending on the length of time the underlying asset was held and whether the gain was attributable to "unrecaptured section 1250 gain." As relevant to gains from dispositions of real estate, the relevant rates were: 20% for assets held for more than 18

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[33] 83 Fed. Reg. at 40897; 83 Fed. Reg. at 40896 ("Most importantly, section 199A is a new Code provision <u>intended</u> to benefit a wide range of businesses") (emphasis added).
[34] 83 Fed. Reg. at 40893; 83 Fed. Reg. at 40902. *See also* Prop. Reg. § 1.199A-6(d) (applying special rules regarding the section 199A deduction for trusts and estates not specifically mentioned in the statutory text).
[35] *Cf. United Savings Ass'n v. Timbers of Inwood Forest Associates, 484 U.S. 365, 371* (1988).
[36] Taxpayer Relief Act of 1997 (TRA 97), Pub. L. No. 105-34, as modified by the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No.105-206.
[37] Section 1 generally describes the relevant tax rates applicable to the taxable income and/or net capital gain of individuals, estates, and trusts. Section 1(h) begins "If a taxpayer has a net capital gain for a taxable year, the tax imposed by this section for such taxable year shall not exceed . . ."

months, 25% for unrecaptured section 1250 gain (essentially gain attributable to depreciation deductions claimed), and 28% for assets held for more than one year.

Even before the amendment to section 1(h) by TRA 97, sections 1(a)(1), (a)(2), (b), (c), (d), (e), and (f) all began with the statement that "[t]here is hereby imposed on the taxable income of every" and added various types of individuals, estates or trusts (*e.g.*, married individual, surviving spouse, individual (other than surviving spouse or head of household), estate, or trust, respectively) that were subject to a tax at a particular rate (or rates).

Congress delegated regulatory authority to the Treasury Department in connection with TRA 97's lower capital gains rates. As enacted by TRA 97, section 1(h)(11) (now section 1(h)(9)) provided:

> The Secretary may prescribe such regulations as are appropriate (including regulations requiring reporting) to apply this subsection in the case of sales and exchanges by pass-thru entities (as defined in 10(C)), and of interests in such entities.

Under section 1(h)(10)(C) (now section 1(h)(11), RICs and REITs are included in the definition of "pass-thru entities."

Notably, the statutory language in section 1(h) did not explicitly include indirect REIT shareholders owning their REIT interests through RICs as the "taxpayer" for purposes of the new lower tax rates. Pre-existing statutory provisions[38] addressed the distribution of capital gains by both REITs and RICs. These provisions allowed both REITs and RICs to designate capital gain dividends to shareholders based on their net capital gain for the taxable year. REIT and RIC shareholders were permitted to treat such capital gain dividends as gain from the sale or exchange of a capital asset held for more than one year.

Absent regulatory guidance, after TRA 97, it would have appeared that, at best, a shareholder's receipt of a REIT or RIC capital gain dividend would have been subject to a maximum tax rate of 28%, the rate attributable to the disposition of a capital asset held for more than one year. This result would have been contrary to Congress' intent to apply a lower 20% rate to gain from the disposition of assets held for more than 18 months, and a lower 25% rate applying to unrecaptured section 1250 gain. Note that unrecaptured section 1250 gain represents gain attributable to real estate depreciation. It is not a type of gain that a RIC would realize absent the receipt of a REIT capital gain dividend representing such gain.

However, exercising its rulemaking authority in the same year as the TRA 97 was enacted, the Treasury Department issued Notice 97-64,[39] which provided, among other things, that RICs and REITs could essentially pass through to their shareholders REIT capital gain dividends divided among the three new applicable capital gains rates.

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[38] Sections 857 and 852(b)(3), respectively.
[39] Notice 97-64, 1997-2 C.B. 323.

Specifically, Notice 97-64 describes "temporary regulations that will be issued under [section] 1(h). . ., effective for taxable years ending on or after May 7, 1997, and provides guidance that [RICs, REITs,] and their shareholders must use in applying [section] 1(h) until further guidance is issued." Notice 97-64 provides that, subject to certain limitations contained in the Notice, if a RIC or REIT designates a dividend as a capital gain dividend, it may also designate that dividend as a 20% rate gain distribution, an unrecaptured section 1250 gain distribution taxable at a 25% rate, or a 28% rate gain distribution. If no designation is made, the default designation is 28% rate gain.

Notice 97-64 also addressed shareholder treatment with respect to capital gain dividends received from a REIT or a RIC. Specifically, the treatment is as follows: 1) a 20% rate gain distribution is an amount of long-term capital gain in the 20% group; 2) an unrecaptured section 1250 gain distribution is an amount of long-term capital gain in the 25% group; and, 3) a 28% rate gain distribution is an amount of long-term capital gain in the 28-percent group. A REIT or RIC determines the maximum amount that can be designated in each rate group by performing the section 1(h) calculation as though it were an individual and subject to a limitation of the entity's total capital gains.

In other words, the Treasury Department essentially interpreted the term "taxpayer" in the context of applying section 1(h) to REITs by adopting a conduit approach, including both direct shareholders in REITs and shareholders in REITs through RICs in the definition of "taxpayer" under sections 1(a)(1), (a)(2), (b), (c), (d), (e), and (f) for purposes of applying the lower capital gains rates of section 1(h), an approach consistent with Congressional intent.[40]

Although they have not issued temporary regulations under section 1(h), the IRS and the Treasury Department reaffirmed Notice 97-64 in 2004[41] and 2015[42] after updating various provisions to reflect subsequent legislative changes.

Nareit believes that as with section 1(h) and Notice 97-64, section 199A should be read to include not only direct shareholders of REITs but also REIT shareholders through mutual funds. In particular, the structure of both TRA 97 provisions - sections 1(h) (that relates to reducing capital gains rates for net capital gains of a "taxpayer") and section 1(h)(9) (that authorizes the Treasury Department to prescribe regulations relating to the application of the provision to sales or exchanges by or in "pass-thru entities") is analogous to that of section 199A(a) (providing that in the case of a "taxpayer other than a

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[40] In addition, Notice 97-64 also contained information regarding the "use of substitute Forms 1099-DIV for 1997." Presumably, because Notice 97-64 was issued in November 1997, the IRS did not have sufficient time to update Forms 1099-DIV and 1040 to reflect the provisions of the TRA 97 in time for accurate reporting. Instead, Notice 97-64 both authorized and required reporting of capital gain dividends in a manner separate from what otherwise would have been required on the already released Form 1099-DIV and Form 1040 through the use of a substitute Form 1099-DIV.

[41] Notice 2004-39, 2004-22 I.R.B. 982.

[42] Notice 2015-41, 2015-24 I.R.B. 1058.

corporation," there is a deduction for "any" REIT dividend) and section 199A(f)(4) (providing that the Treasury Department has authority to prescribe such regulations as are necessary to carry out the purposes of the provision, including for the application of the section to "tiered entities").

Conclusion

The Treasury Department should exercise its authority to confirm that section 199A(a) applies both to direct REIT Shareholders and REIT shareholders through mutual funds

The shareholder of a RIC invested in a REIT is the "taxpayer" under section 199A(a)

Under a plain reading of the text, section 199A(a) provides a deduction to a taxpayer other than a corporation. Nothing in the definition of qualified REIT dividend specifies that the eligible taxpayer must be a direct shareholder of the REIT. The statute merely states that a qualified REIT dividend is any [ordinary] dividend from a REIT received in the taxable year.[43] Moreover, the definition of combined qualified business income amount under section 199A(b)(2) provides that the deduction amount includes "20 percent of the aggregate amount of the qualified REIT dividends . . . of the taxpayer for the taxable year." Whether received directly or indirectly, the REIT dividends are part of the taxable income of the taxpayer for the taxable year, which, in the context of a RIC, is the RIC's shareholder. Thus, the statutory text clearly indicates that Congress intended the section 199A deduction to the REIT income in the hands of the taxpayer.

Nareit requests that the Treasury Department confirm this plain-reading of the text that the non-corporate shareholders of RICs that invest in REITs are the relevant, eligible taxpayers for purposes of the application of section 199A with respect to qualified REIT dividends distributed by REITs to RICs. If the Treasury Department believes the statute on its face is ambiguous, as discussed below, there is ample regulatory authority with which it may reach this outcome for these taxpayers.

Section 199A provides the deduction for qualified REIT dividends without the restrictions applicable to the deduction for qualified business income

As acknowledged by the IRS and Treasury Department in the Preamble to the Proposed Section 199A Regulations,[44] Congress enacted section 199A to provide a deduction to trades and businesses that did not benefit from the tax rate reduction commensurately enacted for C corporations. This deduction was

[43] Section 199A(e)(3).
[44] *See* 83 Fed. Reg. at 40,899.

provided in part by a 20% deduction for a taxpayer's "qualified business income." Such deduction is subject to several robust restrictions[45] and limitations.[46]

The deduction for qualified REIT dividends, however, is not subject to such restrictions or limitations. Further, the deduction for qualified REIT dividends is available to any shareholder of a REIT, regardless of whether she or he has any qualified business income for the particular taxable year. This general statutory structure amplifies and bolsters the conclusion derived from examining the structure of the deduction for qualified REIT dividends and plain language of the relevant statutory text. Specifically, these facts reinforce Congress's clearly demonstrated intent that all shareholders of a REIT should be able to claim a deduction for qualified REIT dividends.

Section 199A includes broad discretion for the Treasury Department to issue guidance on RICs owning REITs

Section 199A(f)(4) states that the "Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section … ." In relevant part, Congress' intent with respect to this provision is clear from the text of the statute cited above: "any" dividend an individual receives "from" a REIT should qualify for the 20% deduction. The Treasury Department would be satisfying Congressional intent by confirming that an individual owner of REIT stock through a mutual fund qualifies for the 20% deduction. Any other outcome would lead to illogical results. If REIT dividends to a RIC did not qualify for the 20% deduction when distributed to the RIC shareholders, shareholders of mutual funds owning REIT shares would be incentivized to sell their mutual fund investment and buy those same REIT shares directly to obtain their 20% deduction.[47] This rational economic behavior would serve no good tax policy purpose and lead to economic inefficiency.

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[45] *See, e.g.*, section 199A(d)(1)(A) (excluding income from a "specified services trade or business" from constituting qualified business income where the taxpayer's taxable income exceeds a phaseout cap).

[46] *See, e.g.*, section 199A(b)(2)(B) (generally limiting the deduction for qualified business income to the greater of 50% of the taxpayer's allocable share of the trade or business's "W-2 wages" or the sum of 25% of the taxpayer's allocable share of the trade or business's "W-2 wages" plus 2.5% of such taxpayer's allocable share of the unadjusted basis immediately after acquisition of "qualified property").

[47] *See* Baldwin, William. "Sell Your Reit Fund. Buy The Stocks." *Forbes* Feb. 20, 2018 https://www.forbes.com/sites/baldwin/2018/02/20/sell-your-reit-fund-buy-the-stocks/#2cac3c2b3d5c. Last accessed Sept. 28, 2018. *See also* Notice 2018-70; 2018-38 IRB 1, recently issued by the IRS with respect to the TCJA, "clarifying the definition of "qualifying relative" in [section] 152(d) for purposes of various provisions of the [Code], including the new $500 credit for other dependents under [section] 24(h)(4) and head of household filing status under [section] 2(b), for taxable years in which the [section] 151(d) exemption amount is zero." In its explanation in Notice 2018-70 regarding Congressional intent, the IRS construed section 152 "in light of the structure of the statute" and noted that "[a] zero exemption amount would thus effectively render section 152(d)(1)(B) inoperable and eliminate an entire category of dependents." Notice 2018-70 provides that the exemption amount referenced in section 152 must be $4,150 (adjusted for inflation), rather than zero, for purposes of determining who is a qualifying relative."

Section 199A also includes a specific grant of authority

Section 199A grants the Treasury Department specific authority to regulatorily address "the application of [section 199A] to tiered entities."[48] Treasury Regulations predating section 199A clearly define the term "tiered entities" to include RICs.[49] A specific legislative delegation of regulatory authority means there is no need to inquire regarding whether a statutory ambiguity gives the agency authority to promulgate guidance.[50] Thus, the Treasury Department and IRS could rely on this expressly-delegated authority to promulgate guidance on this issue.

The Treasury Department has authority to address ambiguity in the statute

To the extent that the Treasury Department believes it is not clear that "tiered entities" refers to RICs that hold REITs, the issue (*i.e.*, whether a RIC was a tiered entity in this context) would itself be ripe for regulatory determination. A determination by the Treasury Department that the term "tiered entities" in this context included REITs and RICs would be a reasonable construction of the statute and consistent with congressional understanding of the term generally and congressional intent that it apply in this case specifically.

The Treasury Department has exercised authority on similar provisions in recent guidance

Section 199A's 20% deduction is applicable to trusts and estates generally.[51] However, section 199A does not provide specific rules regarding its application to qualified REIT dividends received by nongrantor trusts and estates. Section 199A(f)(1)(C) provides that rules similar to the rules under former section 199(d)(1)(B)(i) should apply to the apportionment of wages and unadjusted basis with respect to trusts and estates.

Nareit commends the Treasury Department for providing specific rules in the Proposed Section 199A Regulations that essentially apply a look-through treatment to qualified REIT dividends received by nongrantor trusts and estates with the dividends reportable by their beneficiaries, notwithstanding the absence of a specific provision relating to these entities in section 199A.[52] That the Treasury Department

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[48] Section 199A(f)(4)(B).
[49] *See supra* note 32 and accompanying text.
[50] 467 U.S. 843-844 ("If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.").
[51] *See* section 199A(a) (flush language) (allowing for the deduction for a "taxpayer other than a corporation"); *see also* H.R. Rep. No. 115-466, at 224 (2017) (Conf. Rep.) (noting that the "conference agreement provides that trusts and estates are eligible for the 20-percent deduction under the provision"); *c.f. also* section 199A(f)(1)(B) (discussing rules for apportioning W-2 wages and unadjusted tax basis immediately after the acquisition of qualified property in the context of trusts and estates).
[52] *See, e.g.*, Prop. Treas. Reg. §1.199A-6(d)).

has already determined it is appropriate to flesh out the rules relating to this deduction in the context of trusts and estates strongly suggests that the Department should conclude likewise in the context of qualified REIT dividends received and distributed by RICs.

Accordingly, Nareit urges the Treasury Department and IRS to issue guidance under section 199A reflecting this approach and treating REIT shareholders through RICs as eligible for the 20% deduction under Section 199A for qualified REIT dividends.

II. Do not Condition Definition of "Qualified REIT Dividend" on a 45-Day Hold Requirement

Proposed Section 1.199A-3(c)(2)(ii) imports a new requirement into the statutory definition of "qualified REIT dividend." Specifically, this provision states as follows: "A REIT dividend is not a qualified REIT dividend if the stock with respect to which it is received is held for fewer than 45 days, taking into account the principles of section 246(c)(3) and (4)." This requirement is not included in the statutory text. Sections 246(c)(3) and (4) indicate when the holding period begins and when it is suspended.

Accordingly, the Proposed Section 199A Regulations appear to say that the REIT stock has to have been held for at least 45 days prior to the dividend, not taking into account the day of the acquisition and not counting any period during which the taxpayer has engaged in certain transactions that reduce its risk of loss on the stock. Pursuant to the Preamble, "the proposed anti-abuse rule incorporates the principles of section 246." The actual wording of the proposed regulation is, however, a considerable departure from section 246(c)(1)(A), on which the proposed regulation is supposedly modeled, in that section 246(c)(1)(A) requires a holding period of 45 days within the 91-day period beginning 4 days before and ending 45 days after the dividend. In other words, the Proposed Section 199A Regulations place no relevance on how long the stock is held after the dividend payment.

The Preamble notes that this additional requirement is based on the authority in section 199A(f)(4) (the same authority by which the IRS and Treasury could describe the pass-through of REIT dividends to RIC shareholders). Additionally, the Preamble states that "Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity)." However, an analysis of the costs and benefits of this requirement is not addressed in the Preamble.

There are a number of issues with conditioning the definition of "qualified REIT dividend" on a specific holding period. Among the situations impacted by the proposed regulation may occur in the context of a shareholder's acquisition of stock in lieu of a cash dividend (*i.e.*, through a dividend reinvestment plan or "DRIP") when a dividend is paid on the new stock within 45 days of acquisition. Many REITs have

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DRIPs, and some of them pay dividends monthly; thus, a small portion of each monthly dividend would relate to stock issued fewer than 45 days before the dividend.

First, it is not clear whether the reporting entity with respect to Forms 1099-DIV will be aware whether the requisite holding period will be met and thus whether a particular dividend is in fact a "qualified REIT dividend" for purposes of Box 5 of Form 1099-DIV. Failure to properly report could subject a REIT or broker to information reporting penalties.

Second, the proposed requirement is not part of the statutory text. Third, to the extent that the holding period requirement might be attempting to avoid a potentially abusive situation (for example, offsetting short-term capital gains with a short-term capital loss from the REIT stock)[53], the proposed test would impose significant administrative burdens especially in the case of REITs with DRIPs and monthly dividend payments and the loss of the deduction even when there is no abuse. One such example would be when a shareholder fails the new regulatory 45-day test but has no short-term gain to offset with any associated short-term loss from the sale of the REIT stock. Another such situation would exist even when the shareholder continues to hold the stock indefinitely, which is in no way abusive.

Because of the issues discussed above, Nareit suggests that the 45-day requirement be eliminated in the final section 199A regulations. To the extent that the IRS and the Treasury Department believe that there is a potential for abuse, another approach could be to disallow the section 199A deduction to the extent it offsets short-term capital gains. Alternatively, the 45-day holding period requirement could be eliminated as part of the definition of "qualified REIT dividend." Instead, the IRS and Treasury could have authority to disallow the deduction in the event that the taxpayer held the stock for the period specified in section 246(c)(1)(A).

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We would be pleased to discuss these comments if you believe it would be helpful. Please feel free to contact me at (202) 739-9408, or tedwards@nareit.com; Cathy Barré, Nareit's Senior Vice President,

[53] As to the potential of abuse, offsetting short term gains with such a strategy would require a significant investment that would produce uncertain results. The average annual yield for REIT stocks in the Nareit All Equity REIT index is 3.95%. The average quarterly dividend yield is 0.9875%. Therefore, in order to offset $3,000 in short-term taxable gains using this strategy, an investor would need to purchase $303,000 dollars in REIT securities if there was a one-to-one relationship between dividend payments and stock price changes. However, stock prices do not generally fully reflect dividend payments; thus, the strategy would require even larger stock purchases. Further complicating matters is the fact that while REIT stocks fall on average on the Ex-Date (after the dividend is claimed), the change in stock price is by no means uniform or assured. For example, between 2014 and 2018Q2, a sample of the largest 5 REITs showed an average price decline of 0.50% on their Ex dates, but only showed declines on about two-thirds of the Ex-Dates. Without a predictable and stable relationship between share prices and the Ex-Date, this strategy is difficult and costly to implement effectively.

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Policy & Politics, at (202) 739-9422, or cbarre@nareit.com; or Dara Bernstein, Nareit's Senior Vice President and Tax Counsel, at (202) 739-9446 or dbernstein@nareit.com. We reiterate our request to speak regarding the application of section 199A to RIC shareholders who indirectly receive REIT dividends through RICs at the Oct. 16, 2018 hearing regarding the Proposed Section 199A Regulations.

Respectfully submitted,

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