NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

March 28, 2002

VIA HAND DELIVERY AND E-MAIL

The Honorable Charles O. Rossotti
Commissioner of the Internal Revenue
CC:ITA:RU (REG-142299-01)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20044

RE: Certain Transfers of Property to Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs)

Dear Commissioner Rossotti:

On behalf of the National Association of Real Estate Investment Trusts® ("NAREIT"), we wish to thank you for providing this opportunity to comment on Proposed Treasury Regulation sections 1.337(d)-6 and 1.337(d)-7, relating to certain transfers of property, issued on January 2, 2002 (the "2002 Proposed Regulations").

The 2002 Proposed Regulations replaced proposed regulations issued on February 7, 2000 (the "2000 Proposed Regulations"). As you may recall, NAREIT and the Real Estate Roundtable ("RER") made a written submission and testified before the Internal Revenue Service (the "Service") and Treasury Department on the 2000 Proposed Regulations. This letter gratefully acknowledges the efforts of the Treasury and the Service in resolving most of the concerns that NAREIT raised. This letter offers three suggestions for amendments to the 2002 Regulations before they are finalized.

NAREIT is the national trade association for real estate investment trusts ("REITs") and publicly traded real estate companies. Members of NAREIT are REITs and publicly traded businesses that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses. REITs are companies the income and assets of which are mainly connected to income-producing real estate. NAREIT's membership includes over 200 REITs and publicly traded real estate companies that own over $250 billion of real estate assets, as well as over 2,000 industry professionals who provide a range of legal, investment, financial and accounting-related services to these companies.

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I. EXECUTIVE SUMMARY

To begin with, NAREIT would like to thank the Treasury Department and the Service for incorporating most of NAREIT and RER's comments in the 2002 Proposed Regulations. While NAREIT is pleased with the 2002 Proposed Regulations, NAREIT respectfully asks the Service and Treasury to consider incorporating the following three suggestions in the final regulations.

First, we are concerned that the –6T provisions of the 2002 Proposed Regulations could cause a REIT to lose REIT status inadvertently and inappropriately if it were to engage in a transaction that it incorrectly, but reasonably, believed was not a conversion transaction. This situation could occur if a REIT were to acquire a second REIT that it later discovered was not a REIT. In such a case, the acquired "REIT" would have been a C corporation, possibly with accumulated C corporation's earning and profits, but the acquiring REIT very well could have failed to distribute the C corporation earnings and profits (not having been aware of its existence) within the relevant time period, thereby risking its REIT status. Loss of REIT status could be avoided if the final regulations were to permit either a late section 1374 of the Code[1] election or a "protective" section 1374 election with respect to this type of transaction.

Second, we request that a C corporation that elects "deemed sale" treatment under the –7T provisions of the 2002 Proposed Regulations be permitted to attach such election to an amended return.

Third, we believe that the final regulations should clarify that the "wash sale" rules of section 1091 do not apply to a "deemed sale" under the regulations.

Last, we request that the final regulations allow net operating loss carry forwards to be applied to REIT taxable income.

II. NAREIT COMMENTS ON THE 2002 PROPOSED REGULATIONS

A. The Final Section 337(d) Regulations Should Allow Late Deemed Sale Elections or Protective Deemed Sale Elections under § 1.337(d)-6T for "Inadvertent" Conversion Transactions

As you know, there are number of requirements under Subchapter M of the Code that, if not satisfied, could cause a company to lose its REIT status and be unable to re-elect such REIT status for five years. Because there is no "reasonable cause" exception for some of these requirements, REITs must be very careful to prevent "foot faults" that could result in loss of REIT status. One such requirement is contained in section 857(a)(2)(B), which requires that, by the end of each taxable year, a REIT have no earnings and profits accumulated by a C

[1] All references to the "Code" are to the Internal Revenue Code of 1986 (as amended) and, unless otherwise stated, all references to sections are references to sections of the Code.

corporation. Thus, if a REIT inherits a C corporation's earnings and profits in a merger transaction, or a transaction under the 2002 Proposed Regulations known as a "conversion transaction," it must distribute the C corporation's earnings and profits by the end of the first year after such transaction.

The difficulty arises when the REIT acquires another company in what otherwise would be a conversion transaction if the acquired company were a C corporation, but the REIT reasonably believes the acquired company to be a REIT. If the acquiring REIT ultimately was incorrect, and the acquired company in fact was a C corporation, under the -6T provisions of the 2002 Proposed Regulations, the acquiring REIT would be viewed as having acquired a C corporation and having failed to make a section 1374 election. In such case, the acquired company would have been viewed as having sold its assets, recognizing gain that would have increased its C corporation earnings and profits. If the acquiring REIT did not distribute the C corporation's earnings and profits, it would face loss of REIT status. Note that, if the –7T provisions of the 2002 Proposed Regulations applied to this transaction (they apply to transactions and REIT qualifications occurring on or after January 2, 2002), this situation could not arise because the default rule under the –7T provisions is to apply section 1374, rather than deemed sale treatment, to the transaction.

To prevent the inappropriate loss of REIT status when a REIT reasonably, but incorrectly, believes that a transaction was not a conversion transaction subject to the –6T provisions of the 2002 Proposed Regulations, we recommend that the final regulations allow a REIT to make either a "protective" section 1374 election or a late section 1374 election within a reasonable time period after the promulgation of the final regulations in the event a transaction reasonably believed not to have been a conversion transaction at the time entered ultimately is determined to have been a conversion transaction.

B. The Final Section 337(d) Regulations Should Permit a C Corporation to Attach a "Deemed Sale" Election to an Amended Return

As you know, under the 2000 Proposed Regulations, a C corporation that elected REIT status would be viewed as recognizing gain as if it had sold its assets at fair market value and immediately liquidated unless it elected to be subject to the rules of section 1374. Thus, a C corporation that elected REIT status for Year 1 would file its REIT election in Year 2, but it would have been treated as having liquidated as of the end of Year 0.

Under the –7T provisions of the 2002 Proposed Regulations, a C corporation that elects REIT status for Year 1 again would file its REIT election in Year 2. However, if this C corporation desired "deemed sale" treatment, the 2002 Proposed Regulations require that it file a "deemed sale" election with the "federal income tax return of the C corporation for the taxable year in which the deemed sale occurs." Treas. Reg. § 1.337(d)-7T(c)(5). Because the deemed sale occurs, under Treas. Reg. § 1.337(d)-7T(c)(3), on "the end of the last day of the C corporation's last taxable year before the first taxable year in which it qualifies to be taxed as a . . . REIT," or Year 0, the C corporation would be required to file its deemed sale election with its Year 0 return, and its Year 0 return would be filed in Year 1, a full year

earlier than under the 2000 Proposed Regulations. If the C corporation waited until Year 2, when its REIT election was due for Year 1, it would be too late to elect deemed sale treatment for Year 0.

We note that, under the –6T provisions of the 2002 Proposed Regulations, the C corporation effectively would have until Year 2 to elect deemed sale treatment. Although deemed sale treatment is the default rule under the –6T provisions, Treas. Reg. § 1.337(d)-6T(b), the C corporation would not be subject to this rule until it makes its REIT election. Thus, a C corporation that elected REIT status for Year 1 would file this election in Year 2, but would be subject to deemed sale treatment for Year 0. We believe that a similar time frame should apply under the –7T provisions of the final regulations. Accordingly, we recommend that the final regulations permit a C corporation to file a deemed sale election with an amended return.

C. The Final Section 337(d) Regulations Should Clarify That Section 1091 Does Not Apply to Deemed Sales Under the Regulations

It would be helpful to clarify that the wash sale rules of section 1091 do not apply to a C corporation that makes a deemed sale election under the regulations.

Absent a section 1374 election, § 1.337(d)–6T(b) of the 2002 Proposed Regulations treats a C corporation that elects REIT status as recognizing gain or loss as though it sold the property transferred to the REIT on the "deemed sale date." While this provision does not apply if it would lead to recognition of a net loss, it is not clear that it would not trigger application of the wash sale rules of section 1091. In the case of a C corporation that holds depreciated securities, essentially what has occurred is that the C corporation is viewed as having sold and reacquired these securities almost immediately, thus potentially implicating the loss disallowance rules of section 1091. Similarly, a deemed sale election may be made under Treas. Reg. § 1.337(d)-7T(c), although the provision would not apply if its application would lead to a net loss. As the regulations are currently drafted, it is not clear whether a deemed sale election under the –7T provisions would trigger the application of section 1091.

If section 1091 were to apply to the deemed sale, the C corporation would be unable to offset any built-in gains with losses from depreciated securities, a result which seems to contradict the rule in the 2002 Proposed Regulations, allowing losses to offset gains as long as there is a net gain (or a complete offset). We note that in other "deemed sale" contexts, language has been added to the relevant legislative history or operative provisions to ensure against the inadvertent application of section 1091. See, e.g., H. R.Rep. 1033, 106th Cong., 2d Sess. 1026 (2000) (legislation permitting a reduced capital gains rate for property acquired after December 31, 2000, and allowing an election of a deemed sale for property held on that date for which gain or loss is recognized notwithstanding any other provision of the Code), which stated ". . . [I]t is clarified that the deemed sale and repurchase by reason of the election is not taken into account in applying the wash sale rules of section 1091." See also Treas. Reg. § 1.1502-13(g)(3)(ii)(B)(2) (preventing section 1091 from applying to the deemed

satisfaction and reissuance of a member obligation in a consolidated return). We hope that you will consider adding such language to the text of the final regulations, or, at the very least, to the preamble to the final regulations.

D. The Final Regulations Should Allow Net Operating Loss Carry Fowards To Be Applied Against REIT Taxable Income

Sections 1.337(d)-6T and 1.337(d)-7T of the 2002 Proposed Regulations take the position that net operating loss carry forwards ("NOLCs") applied against built-in gains do not simultaneously reduce REIT taxable income. Although this has been justified as the elimination of a "double benefit" from the same NOLCs, offsetting both built-in gains and REIT taxable income with the same NOLC is not a "double benefit" since only one economic gain is realized.

In section 857, Congress saw fit in the case of REITs (unlike that of S corporations) to allow C Corporation-year NOLCs to reduce real estate investment trust taxable income. However, the rule contained in the -6T and -7T regulations effectively eliminates a REIT's ability to use C Corporation-year NOLCs in a case where a REIT's capital gain is also a built-in gain.

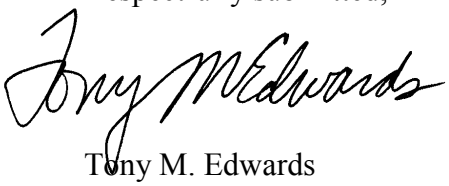
The regulatory mandate of section 337(d) is to prevent the avoidance of General Utilities repeal. Regulations under section 337(d) need not necessitate a distribution to shareholders to accomplish this goal; it is satisfied as long as a REIT does not avoid corporate tax on its recognized built-in gains in a manner not otherwise available to C Corporations. In fact the -6T and -7T regulations implicitly take this position in the case of a converting corporation that does not elect section 1374 treatment, by mandating a deemed sale of the corporation's assets, but not a distribution to its shareholders.

As a result of this position, converting corporations can be worse off with section 1374 treatment than with deemed sale treatment.

Example: C Corporation X and C Corporation Y each have $100 of built in gain, $100 of NOLCs and a $100 E&P deficit. Both X and Y elect REIT status for calendar year 2002. X elects section 1374 treatment, but sells all of its properties in 2002. Y does not elect section 1374 treatment and sells its properties in 2002. The results are as follows: X's NOLCs offset its recognized built-in gain, but it has $100 of REIT taxable income and, therefore, a distribution is necessary to avoid a corporate-level tax. As a result, its shareholders are taxed on $100 of income. Y's NOLCs offset its built-in gain upon the deemed sale of its properties on December 31, 2001, and Y obtains a step-up in basis for the properties. Since Y has no requirement to make a distribution, no shareholder-level tax applies to it; and since Y has a step-up in basis for the properties, no additional gain is recognized on its sale of the properties in 2002.

Thank you for your consideration, and again thank you for your revisions to the 2000 Proposed Regulations.

Respectfully submitted,



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