

NAREIT IRS REIT Guidance



National Association of Real Estate Investment Trusts®
REITs: Building Dividends and Diversification®

BACKGROUND

Since 2001, the IRS has issued a number of private letter rulings regarding the tax treatment of a distribution that allows shareholders to elect to receive cash or stock. See PLRs [200832009](#), [200817031](#), [200618009](#), [200615024](#), [200406031](#), [200348020](#), and [200122001](#). In these rulings, the IRS has held that any and all of the cash and stock distributed would be treated as a dividend. Furthermore, the IRS concluded that the amount of the distribution of the stock received by any shareholder electing to receive stock would be considered to equal the amount of money that could have been received instead. Thus, the full amount of the declared dividend would be available to satisfy the REIT's 90% distribution requirement. Other than where redacted, all of these rulings contained a minimum threshold on the amount of cash that would be distributed equal to 20% of the total distribution. Only PLR 200122001 held that the dividend would not be considered preferential.

Because these private rulings cannot be relied upon by taxpayers other than those to which they were issued, and given the current difficulties in preserving liquidity, on Oct. 31, 2008, NAREIT submitted a [request](#) to the Treasury Department and the IRS to issue precedential guidance both codifying the principles in the above-mentioned private rulings and temporarily reducing the minimum cash threshold to 5% of the total value of the distribution.

As more fully described below, [Rev. Proc. 2008-68](#) treats a publicly traded REIT's entire

Compendium Memorandum 2008-33

[Rev. Proc. 2008-68](#)

Compendium Reference:

- 6.01 Distributions - Generally

distribution to shareholders pursuant to which shareholders can elect either cash or stock (an elective stock distribution) as a dividend equal to the amount of cash that could have been received, provided that at least 10% of the distribution is in cash, and the dividend is declared on or after Jan. 1, 2008 with respect to taxable years ending on or before Dec. 31, 2009. Unfortunately, the revenue procedure did not address the circumstances under which the elective stock dividend would or would not be considered a preferential (and therefore, non-deductible) dividend although requested to do so by NAREIT. However, the absence of precedential guidance on this issue was not a surprise since only one of the seven private rulings had addressed the issue.

HOLDING

Under Rev. Proc. 2008-68, effective for all distributions declared on or after Jan. 1, 2008, the IRS will treat a distribution of stock by a REIT as a distribution of property to which section 301 applies by reason of section 305(b), and the amount of such distribution of stock will be considered to equal the amount

of the money which could have been received instead, if:

- 1) The distribution is made by the corporation to its shareholders with respect to its stock;
- 2) Stock of the corporation is publicly traded on an established securities market in the United States;
- 3) The distribution is declared with respect to a taxable year ending on or before Dec. 31, 2009 (and thus the distribution includes “spillover dividends” declared with respect to the 2008 and 2009 tax years that are not paid until 2009 or 2010, respectively, or deficiency dividends declared with respect to 2008 or 2009 and not paid until a later year);
- 4) Pursuant to such declaration, each shareholder may elect to receive its entire entitlement in either money or stock of the distributing corporation of equivalent value subject to a limitation on the amount of money to be distributed in the aggregate to all shareholders (the Cash Limitation), provided that: a) the Cash Limitation is a minimum of 10% of the aggregate declared distribution; and, b) if too many shareholders elect to receive money, each shareholder electing to receive money will receive a *pro rata* amount of money corresponding to their respective entitlement under the declaration not less than 10% of their entire entitlement under the declaration in money;
- 5) The calculation of the number and value of shares to be received by any shareholder will be determined, as close as practicable to the payment date, based upon a formula utilizing market prices that is designed to equate in value the number of shares to be received with the amount of money that could be received instead; and,

- 6) With respect to any shareholder participating in a dividend reinvestment plan (DRIP), the DRIP applies only to the extent that, in the absence of the DRIP, the shareholder would have received the distribution in money under the above subsection 4.

ANALYSIS

NAREIT is pleased that the IRS and Treasury acted expeditiously in response to NAREIT’s request to codify the principles of the relevant private rulings and to reduce the minimum cash distribution to 10% of the total amount distributed. (The amount of the cash distributed nevertheless can exceed 10% of the total distribution if the REIT so chooses.) Although NAREIT noted in its Oct. 31 submission that it believes that the principles of the relevant private rulings should apply equally to publicly traded and non-listed REITs, Rev. Proc 2008-68 applies only to publicly traded REITs.

We understand the language in Section 5 of the revenue procedure concerning the calculation of the number of shares to be received by any shareholder under the REIT’s distribution was carefully chosen. Clearly, the guidance does not endorse any specific calculation other than to say it must be determined “as close as practicable to the payment date,” and it must be based upon “a formula utilizing market prices that is designed to equate in value the number of shares to be received with the amount of money that could be received instead.”

Finally, the sixth requirement in Section 3 of the procedure essentially provides that to the extent a shareholder is also a DRIP participant, any so-called “discount” under the DRIP to the trading price of the REIT stock on the distribution date will apply only to the amount of cash the shareholder elects to receive in connection with

the elective stock distribution, not to the entire amount of the distribution. Thus, the calculation of the number of shares to which a shareholder/DRIP participant who elects 100% stock will be entitled will be based on the formula stated in connection with the elective stock distribution, not the DRIP plan's calculation formula. To achieve the maximum benefit of any so-called "discount" under the DRIP, any shareholder/DRIP participant should elect 100% cash with respect to the elective stock distribution.

If you have any questions regarding this revenue procedure, please contact Dara Bernstein at dbernstein@nareit.com



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