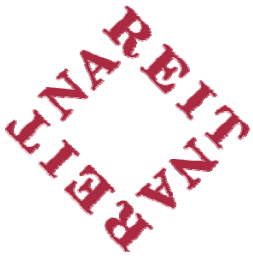

NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

August 13, 2008

Eric Solomon, Esq.
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Room 3120
Washington, D.C. 20220

Re: Post-Housing Bill REIT Guidance

Dear Mr. Solomon:

The Housing and Economic Recovery Act of 2008 (the Act) contains several provisions the genesis of which was H.R. 1147 and S. 2002, the REIT Investment Diversification and Empowerment Act of 2007 (RIDEA). The purpose of this letter is to bring to your attention several issues on which we believe the Treasury Department should issue guidance in the coming months.

The National Association of Real Estate Investment Trusts® (NAREIT) is the worldwide representative voice for United States real estate investment trusts (REITs) and publicly traded real estate companies. Members are 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 these businesses.

To summarize, we recommend that the government: 1) issue guidance advising REITs how to calculate the new 10% fair market value measurement test under the dealer safe harbor for transactions occurring after the Act's July 30, 2008 enactment date; 2) amend the instructions for Form 1120-REIT or otherwise provide guidance clarifying that a REIT's election of tax basis or fair market value under the dealer safe harbor test is made when it files its annual tax return; 3) issue guidance confirming that dividend-like income such as Subpart F income either qualifies as "good income" under the REIT gross income tests or is excluded from the computation of such tests; and, 4) issue guidance delineating how the modified REIT hedging rule in newly-amended section 856(c)(5)(G)(ii) can apply to foreign currency risk management transactions that are not covered by the definition of a "hedging transaction" under section 1221(b)(2)(A).[1]

♦ ♦ ♦

1875 I Street, NW, Suite 600, Washington, D.C. 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

1. Measurement of 10% Test Under the Dealer Safe Harbor.

As you know, to provide REITs with certainty, for decades Congress has provided a safe harbor under which sales are not considered dealer sales and therefore not subject to a 100% excise tax. The safe harbor has several intricate requirements, including that in any year a REIT can either have no more than seven taxable sales or can not make taxable sales exceeding 10% of its property portfolio. Before the Act, a REIT measured the 10% threshold by testing the tax basis of the sold assets against its aggregate tax basis. Effective for sales made after July 30, 2008, the RIDEA provisions in the Act enable a REIT to choose between tax basis or instead to use fair market vale to measure the 10% threshold. The clear Congressional intent for this choice was to make it easier for REITs to buy and sell properties, especially in light of the state of the current capital markets.

The most immediate regulatory issue facing REITs today is how they should utilize the new fair market option for sales occurring after July 30. NAREIT suggests that the government issue guidance stating that, so long as a REIT satisfies the 10% test as measured by tax basis for transactions occurring before July 30, then a REIT can then test its total 2008 transactions by using either tax basis or fair market value. We believe that this straightforward test would implement Congress' intent to immediately allow REITs to better manage their property portfolios.

2. Timing of Fair Market Value or Tax Basis Election.

Senator Orrin Hatch was RIDEA's lead sponsor in the Senate. In his introductory remarks, Senator Hatch stated:

> Current law measures the 10 percent level by reference to the REIT's tax basis in its assets. H.R. 1147 instead would measure the 10 percent level by using fair market value. To allow a REIT to maximize its sales under the safe harbor (and thereby generating more economic activity), RIDEA would allow a REIT to choose either method for any given year. Presumably, the IRS would develop instructions on Form 1120–REIT allowing a REIT to declare which method it selected when it files its tax return for the year in which the sales occur.

153 Cong. Rec. S10932 (Daily Digest, Aug. 3, 2007).

To allow REITs to expeditiously plan sales and purchases, NAREIT requests that the government clarify the process under which a REIT can choose the tax basis or fair market value method of measuring the 10% test. To provide REITs with the flexibility to maximize sales under the safe harbor, we support Senator Hatch's suggestion that the election between methods be made after the taxable year in which the sales occur. We suggest the government consider having a REIT simply checking the appropriate box to make this election, with the election contained either in Form 1120-REIT or a separate form.

3. Dividend-like Income.

The Act clarifies that the Secretary has the authority to classify any income item as either satisfying the REIT gross income tests or as being included from its computations. In describing this clarification of regulatory, Representative Joseph Crowley (the lead RIDEA sponsor in the House of Representatives) stated:

> Under current law, even if a REIT were to earn a substantial amount of certain types of income that are not specified in the gross income baskets, the REIT could jeopardize its REIT status—even though these types of income may be directly attributable to the REIT's business of owning and operating commercial real estate. Examples include amounts attributable to recoveries in settlement of litigation and ''break up fees'' attributable to a failure to consummate a merger. The IRS has issued private letter rulings to taxpayers holding that the particular type of income should be considered either qualifying income or should be ignored for purposes of the REIT rules.
>
> Under this provision, I would expect that the IRS would conclude, for example, that dividend-like items of income such as Subpart F income and income produced by holding stock of a passive foreign investment company either are considered qualified income for purposes of the REIT income tests [or] are not taken into account for purposes of these tests.

153 Cong. Rec. E384 (Daily Digest, Feb. 16, 2007).

Similarly, Senator Hatch stated:

> In May, 2007, the IRS released Revenue Ruling 2007–33 and Notice 2007–42 to clarify that in the overwhelming majority of cases a REIT's foreign currency gains earned while operating its real estate business qualify as ''good income'' under the REIT rules. Title I essentially reaches the same result on a more direct basis and also provides some conforming changes in other parts of the REIT rules.
>
> Although the recent guidance was welcome, it took the IRS about four years to issue it because of questions about the extent of the government's regulatory authority in the area. To prevent similar delays in the future, Title I clearly provides the Secretary of the Treasury with the authority to determine what items of income can be treated either as ''good income'' or disregarded for purposes of the REIT income tests. Under this authority, it is expected that, for example, the IRS would conclude that dividend-like items such as Subpart F deemed dividends and PFIC income would be treated in the same manner as dividends for purposes of the 95 percent gross income test. Further, the IRS could convert many of its rulings it issued to individual taxpayers into public guidance, which could be a more efficient use of its resources.

153 Cong. Rec. S10931 (Daily Digest, Aug. 3, 2007).

NAREIT requests that the government immediately place on its priority list of regulatory business plan items a project under which it will issue guidance that subpart F income or income from a PFIC is either qualified income under the 95% gross income test or is excluded from computing that test. Further, it would be very useful if the private letter rulings[2] describing various items of income under the REIT tests could be used as the basis for issuing public guidance.

4. REIT Hedging Rule

Section 3031(b) of the Act modifies the REIT hedging rule under section 856(c)(5)(G) so that income from a clearly identified hedging transaction (as defined in section 1221(b)(2)(A)(ii) or (iii)) generally is excluded from the computation of both the 95% income test (as under prior law) and the 75% income test (section 856(c)(5)(G)(i)). The Act also modifies the REIT hedging rule to generally exclude from the computation of both tests income from a transaction entered into primarily to manage the risk of currency fluctuations with respect to any item of income or gain that would be qualified income under the 75% or 95% income tests (or any property which generates such income or gain), provided the transaction is clearly identified as such before the close of the day on which the transaction was acquired, originated, or entered into (or such other time as the Secretary may prescribe) (Section 856(c)(5)(G)(ii)).[3]

The modified REIT hedging rule can apply to foreign currency risk management transactions that are not covered by the definition of a "hedging transaction" under section 1221(b)(2)(A). Whereas section 1221(b)(2)(A) is limited to transactions that manage risks with respect to ordinary property held or to be held by the taxpayer, borrowings made or to be made by the taxpayer, or ordinary obligations incurred or to be incurred by the taxpayer, section 856(c)(5)(G)(ii) covers foreign currency risk management transactions with respect to items of income or gain and capital assets that generate such items of income or gain.

The hedging regulations under section 1221 (Treas. Reg. § 1.1221-2) contain a procedure for “clearly identifying” hedging transactions under section 1221(b)(2)(A), as well as curative provisions when there is a failure to identify such transactions due to inadvertent error. However, these regulations do not appear to apply to transactions encompassed by section 856(c)(5)(G)(ii). NAREIT requests that guidance under section 856(c)(5)(G)(ii) be issued, for example, to comply with the requirement in section 856(c)(5)(G)(ii) that a transaction described therein be clearly identified in a timely manner and to determine the consequences of an inadvertent failure to properly identify a transaction. Because the statutory language in section 856(c)(5)(G)(ii) closely resembles that in section 1221(a)(7) in large measure, it appears that the rules contained in the section 1221 hedging regulations would be suitable for application to foreign currency risk management transactions that are covered by section 856(c)(5)(G)(ii) but that are not considered "hedging transactions" under section 1221(b)(2)(A). In any event, interim guidance will be necessary while permanent guidance is being developed so that REITs can comply with the requirements of section 856(c)(5)(G)(ii). Such interim guidance generally should permit REITs to apply the provisions of the hedging regulations under section 1221 in complying with these requirements.

Unlike section 856(c)(5)(G)(ii), the portion of the modified hedging rule contained in section 856(c)(5)(G)(i) is limited to hedging transactions as defined in section 1221(b)(2)(A)(ii) or (iii),

and specifically requires that such transactions be clearly identified pursuant to section 1221(a)(7). The hedging regulations under section 1221 contain a curative provision in cases when there is a failure to identify a hedging transaction due to inadvertent error (Treas. Reg. § 1.1221-2(g)(2)(ii)). However, this provision technically does not treat an inadvertent failure to identify as a clear identification under section 1221(a)(7)—rather, it simply provides for the same tax consequences as a clearly identified hedging transaction (*i.e.*, treatment of gain or loss from a transaction as ordinary income or loss).

Accordingly, there is some concern that the clear identification requirement in section 856(c)(5)(G)(i) could be interpreted as not encompassing the curative provisions under the section 1221 regulations. NAREIT requests that guidance be issued to clarify that section 856(c)(5)(G)(i) applies to hedging transactions to which the curative provisions of the section 1221 hedging regulations apply.

Respectfully submitted,

Tony M. Edwards
Executive Vice President & General Counsel

Cc: Eric A. San Juan, Esq,
Michael S. Novey, Esq.
Mark S. Smith, Esq.
Stephen R. Larson, Esq.
David Silber, Esq.
Alice M. Bennett, Esq.
Jonathan D. Silver, Esq.

[1] For purposes of this letter, "section" refers to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.
[2] *See* PLRs 200821020, 200726002, 200550025, 200550017, 200550010, 200519007, 200532015, 200531013, and 200548004.
[3] In the case of foreign currency risk management transactions, the exclusion of such income from the 95% and 75% income tests generally seems to correspond to the treatment of real estate foreign exchange gains and passive foreign exchange gains for purposes of these tests, so the significance of applying the modified REIT hedging rule to income from foreign currency risk management transactions may be limited.