NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

October 31, 2008

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

Re: Cash/Stock Proposed Ruling Request

Dear Mr. Solomon:

The National Association of Real Estate Investment Trusts® (NAREIT) requests the issuance of a revenue ruling (or other published guidance that can be cited as precedent) as soon as possible to formalize the conclusions reflected in several private letter rulings concerning elective dividends by REITs when shareholders have the ability to elect to receive either cash or stock subject to a cap on the aggregate amount of cash that the REIT will distribute. In addition, NAREIT requests the issuance of temporary guidance that would be effective for distributions through the end of 2010 that would permit REITs to pay cash-stock elective dividends when the cash cap is as low as 5%.

Specifically, this guidance would provide that, among other things, a distribution from a real estate investment trust (REIT) that allows shareholders to elect to receive stock or cash qualifies for the dividends paid deduction (DPD) so long as a requisite amount of cash is distributed. We view this issue as very important guidance that would assist in the conservation of funds in what has become a capital-constrained environment. In addition, these rules are consistent with the purpose of the REIT rules and distribution requirements and would not result in any revenue cost because REIT shareholders would continue to recognize 100% of the REIT taxable income on a current basis.

NAREIT is the worldwide representative voice for United States 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.

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I. Flexibility in a Credit-Constrained Environment

In order for a company to maintain its qualification as a REIT, among other requirements, it must distribute at least 90% of its taxable income annually (the 90% Test).[1] To the extent that a REIT distributes its income, it may claim a DPD for the dividend distributed.[2] This rule requires a distribution of a significant amount of a REIT's cash flow in order to avoid adverse tax consequences.

In addition, if a REIT has capital gain income (*e.g.*, from asset sales), it may deduct that amount from its taxable income under REIT tax rules so long as it pays a capital gains dividend. Alternatively, the REIT can retain the capital gain income and pay corporate level tax, in which the REIT shareholders receive a corresponding tax credit. In the case of a sale of a low basis asset that has substantial mortgage debt, the cash proceeds received by the REIT may be less than the resulting distribution requirement or corporate-level tax.

In the midst of the severe credit crisis underway and the clearly slowing economy, distribution of taxable income solely in cash may be a burden at odds with long-term shareholder interests for some companies. Notably, there is no minimum distribution test applicable to non-REIT C corporations (other than mutual funds) to avoid adverse tax consequences should they wish to retain additional capital for corporate purposes such as paying down debt obligations.

Most SEC-registered REITs are conservatively leveraged, and their borrowings are repayable over a seven to ten year "laddered" basis. However, the current freeze in the credit markets has made it difficult to refinance real estate debt even with respect to properties that are performing well. To illustrate the dearth of financing for commercial real estate, note that in 2007 there were $230.2 billion of commercial mortgage-backed securities (CMBS) issued. In contrast, through the third quarter of this year, only $12.1 billion of CMBS were issued, with no issuance at all during the third quarter. As a result, with approximately $38 billion in loan maturities coming due for publicly traded REITs by the end of 2009,[3] REITs and their shareholders require maximum flexibility to conserve capital to meet the significant challenges posed by the current credit crisis.

II. Elective Stock Dividends: Existing Private Rulings Allow Entire Distribution to Be Treated as Dividend

During this decade, a number of REITs have paid dividends by giving their shareholders the ability to choose to receive either cash or stock of the REIT with equivalent value. This type of distribution has been used both by existing REITs and by REITs that are newly converted from C corporations (*i.e.*, to purge their C-corporation earnings and profits).[4] The IRS has issued several private letter rulings concluding that, so long as the cash cap is at least 20% of the aggregate distribution, the

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[1] Section 857(a)(1) of the Internal Revenue Code of 1986, as amended (the Code). Unless otherwise provided all references herein to a "section" shall be to a section of the Code.
[2] To the extent a REIT retains taxable income above the 90% distribution requirement, it is subject to the usual corporate-level tax.
[3] There is another $78 billion in debt maturing in 2010.
[4] A REIT must eliminate non-REIT earnings and profits by the end of the first taxable year as a REIT.

entire distribution is treated as a dividend.[5] Except with respect to elective distributions representing a purge of non-REIT earnings and profits, the IRS also held that such distributions qualified for the DPD.

A. Typical Structure of Elective Stock Distributions

A publicly traded REIT (Taxpayer) with one class of stock outstanding (Common Stock) regularly distributes its earnings and profits as required under section 857(a)(1). Taxpayer intends to make a distribution to its shareholders that is payable at the election of shareholders, as described below, in the form of cash or shares of Common Stock (the Distribution). The aggregate amount of the Distribution will be $X. Taxpayer has sufficient earnings and profits for tax purposes such that the entire amount of the Distribution will be taxed to shareholders as a dividend if the Distribution is taxable under section 301.

Taxpayer will declare the Distribution on [Date 1], payable to shareholders of record as of [Date 2]. Each record shareholder will be permitted to designate, by [Date 3], whether it desires to receive its distribution in the form of cash (the Cash Option) or shares of Common Stock (the Stock Option). If any shareholder does not make a timely election by [Date 3], Taxpayer has the right to make the election on behalf of the shareholder, but intends to pay the Distribution to such shareholder pursuant to the Stock Option (the Default Election). Cash will be distributed in lieu of fractional shares of Common Stock.

Pursuant to the terms of the Distribution, the total amount of cash distributed, excluding cash paid in lieu of fractional shares, will be limited to no less than 20% of the aggregate amount of the Distribution. Because of this limitation, depending upon the number of shareholders who elect the Cash Option, Taxpayer may need to reduce the amount of cash distributed to such electing shareholders (but in no event will any shareholder electing the Cash Option receive less than 20% of its share of the Distribution in cash). In the case of such reduction, the amount of cash distributed, excluding cash in lieu of fractional shares, will be prorated among those shareholders that elect the Cash Option. The remainder of the Distribution that is not paid in cash will be paid in shares of Common Stock.

If a sufficient number of shareholders elect to receive Common Stock pursuant to the Stock Option, or are deemed to elect the Stock Option pursuant to the Default Election, Taxpayer will fully fund the cash component of the Distribution, and the shareholders that elect the Cash Option will receive 100% cash. The total number of shares of Common Stock to be issued in the Distribution will be determined by dividing (i) the excess of (A) the total amount of the Distribution over (B) the total amount of cash to be paid as part of the Distribution (excluding cash in lieu of fractional shares) by (ii) the value per share of the Common Stock. For these purposes the Common Stock will be valued using an average of the trading price of the Common Stock over a specified valuation period that will not exceed five business days and will commence on or shortly after [Date 3]. The Distribution will be paid on [Date 4], which will be as close as administratively practicable to the last day of the valuation period, and in no case more than 10 business days thereafter.

[5] *See* PLRs 200832009, 200817031, 200618009, 200615024, 200406031, 200348020, and 200122001.

B. Elective Distribution Results in Treatment of Entire Distribution as Non-Preferential Dividend Qualifying for the DPD

In connection with facts similar to those described above, the IRS has generally held in several private letter rulings that: 1) the distribution of cash and stock will be treated as a distribution of stock and property to which section 301 applies by reason of section 305(b); 2) the amount of taxable income under section 301 that is attributable to the Common Stock received by any shareholder in the distribution will be equal to the amount of the cash that the shareholder could have received instead; and, 3) the distribution will not be a preferential dividend and will qualify for the DPD.

Although not all of the existing private rulings contain extensive analysis, those that do have focused on the treatment under section 305(b)(1) of a stock distribution as a dividend if the distribution is at the election of any shareholder payable either in cash or stock. In addition, the rulings concluded that under section 305(b)(2) a stock distribution is treated as a dividend if it results in the receipt of property by some shareholders and an increase in the proportionate interests of other shareholders in the assets or earnings and profits of the corporation. In the case described above, the distribution would be disproportionate to shareholders if at least one shareholder received all stock and the other shareholders received cash.

III. Request for Precedential Guidance Codifying Existing Private Rulings

A. Generally

As noted above, the current freeze in the credit markets has made it extremely challenging for REITs as well as other real estate owners to refinance debt, thereby increasing the importance of conserving cash from both operations and asset sales to repay debt. Accordingly, many REITs would prefer to use an elective cash-stock dividend structure such as that described above as a means to satisfy the 90% Test and to distribute capital gain income, thereby permitting them to husband cash for use in managing their balance sheets in the midst of the pervasive credit crisis.

While the IRS has historically issued private rulings in this context, these private rulings are not precedential. Additionally, the private ruling process is time consuming and injects uncertainty. Given the current credit difficulties and the fact that the taxable year has just over two months remaining, published guidance would provide immediate clarity of the IRS' position. Note that we believe that the principles underlying the prior private letter rulings apply with equal force to REITs that are not publicly traded.

B. Temporary Reduction in Minimum Cash Distributed to 5% of Total

We understand that the IRS ruling policy has generally required at least 20% of the aggregate amount of the dividend to be paid in cash (assuming cash elections are made for at least 20% of shares), and this 20% cash requirement may be appropriate in a "normal" credit environment. However, this 20% cash requirement obligates REITs to distribute a significant amount of cash that could otherwise be used to meet upcoming debt maturities or otherwise enhance liquidity. Thus, NAREIT recommends reducing the cash cap on a temporary basis to as low as 5% for distributions through the end of 2010 (including dividends declared in the fourth quarter of 2010 that are paid in January 2011 pursuant to section 857(b)(9)). Additionally, NAREIT recommends that this guidance should apply to distributions of both ordinary income and capital gain income given that many REITs facing liquidity issues are pursing asset sales to meet upcoming obligations.

IV. Additional Points

In connection with NAREIT's request for this guidance, it is important to note the following:

1) This guidance would result in no revenue loss to the fisc. One hundred percent of the taxable income of the REIT still would be recognized on a current basis by and taxable to the REIT shareholders (or to the REIT if it retains income in excess of the 90% distribution requirement).

2) This guidance would put publicly traded REITs on a level playing field with privately held REITs. Privately held REITs can use a consent dividend procedure in section 561 to comply with the 90% Test and to ensure reinvestment of an otherwise cash distribution. The consent dividend process is not a practical option for listed REITs.

3) This guidance would reduce the administrative burdens on the Internal Revenue Service from having to issue private letter rulings in this area as it has frequently done in the past.

4) Given current market conditions, it is important to issue this guidance as soon as possible to allow REITs to plan for the rest of 2008 and 2009.

Respectfully submitted,

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