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REITS:
BUILDING
DIVIDENDS
AND
DIVERSIFICATION

REITs and the 2003 Tax Law
(The Jobs and Growth Tax Relief Reconciliation Act)

Questions and Answers

Q: HOW DOES THE "JOBS AND GROWTH" TAX PACKAGE AFFECT REIT SHAREHOLDERS?

A: The "Jobs and Growth" package signed into law in May of 2003 lowered income tax rates on most dividends and capital gains received by individuals to a 15 percent maximum. In the Tax Increase and Prevention Reconciliation Act of 2005, Congress extended the current tax rates through 2010. Because REITs generally do not pay corporate taxes, the majority of REIT dividends will continue to be taxed as ordinary income at a maximum new rate of 35 percent (down from 38.6 percent).

However, REIT dividends will qualify for a lower rate in these instances:

1) when the individual taxpayer is subject to a lower scheduled income tax rate;
2) when a REIT makes a capital gains distribution (15 percent maximum tax rate) that is not allocable to recaptured depreciation;
3) when a REIT distributes dividends received from a taxable REIT subsidiary or other corporation (15 percent maximum tax rate); and,
4) when, as permitted, a REIT pays corporate taxes and distributes earnings that were subject to tax (15 percent maximum tax rate).

Also, the maximum 15 percent capital gains rate applies generally to the sale of REIT stock.

Q: WHAT PORTION OF REIT DIVIDENDS QUALIFY FOR THE NEW MAXIMUM 15 PERCENT RATE?

A: Available data indicate that approximately 45 percent of REIT dividends qualified for the lower tax treatment in 2006. Thirty-eight percent of REIT dividends qualified for the 15 percent capital gains rate in 2006. Of this amount, approximately 63% represented long-term capital gain distributions; approximately 37% represented return of capital, which is taxed at a capital gain rate when the stock is sold. In addition, approximately 7 percent of REIT dividends was taxed at the 25 percent rate attributable to recaptured depreciation from capital gains distributions.

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Q: HOW DOES INVESTING IN REITS CONTINUE TO BENEFIT INVESTORS?

A: Investing in REITs continues to make good sense because they provide investors with dividends and portfolio diversification.

As of December 31, 2006, REITs yielded 4.1 percent, which is over two times higher than the average yield of 1.8 percent for stocks in the S&P 500.

On an after-tax basis at the new maximum tax rates, REIT dividends are approximately two times that of non-REIT dividends. That is still a very significant difference.

In addition, analysis by Ibbotson Associates – a leading authority on asset allocation – factoring in performance data through the end of 2006, makes a compelling case for the use of REITs to boost returns and reduce risks in a variety of investment portfolios, especially 401(k)s. Lower-rate taxpayers, or those planning for retirement in qualifying accounts, are ideal candidates for REIT investing, and can especially benefit from the dividends and portfolio diversification provided by real estate stocks.

Q: HOW HAVE REITS PERFORMED?

A: As of December 31, 2006, REITs outperformed the Dow Jones Industrial Average, the S&P 500 and the Nasdaq, in the previous 1, 3, 5, 10, 15 and 30 years.

Their high income and low correlation to the returns of other stocks and bonds underscores the value of including real estate stocks in a diversified portfolio.

Q: ARE DIVIDENDS FROM PREFERRED STOCKS TREATED THE SAME AS COMMON STOCK UNDER THE NEW TAX LAW?

A: Generally yes, for REITs as well as other corporations.

Q: DO THE NEW RATES APPLY TO DIVIDENDS OR CAPITAL GAINS RECEIVED BY CORPORATIONS?

A: No.

Q: DOES THE 2003 TAX LAW CHANGE THE RATES AFFECTING TAX-EXEMPT INVESTORS, SUCH AS 401(K) PLANS?

A: No.