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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

May 12, 2004

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Washington, D.C. 20224

Re: Notice 2004-26: Recommendations for Inclusion in the 2004-05 Priority Guidance Plan

Dear Eric and Lon:

The National Association of Real Estate Investment Trusts® (“NAREIT”) greatly appreciates the opportunity pursuant to Notice 2004-26, 2004-16 I.R.B. 782 to offer our suggestions regarding regulatory guidance to be placed on the 2004-05 Priority Guidance Plan that would carry out Congressional intent while saving both taxpayers and the Administration time and resources in complying with the REIT tax tests.

As we indicated in our letter dated April 30, 2004, NAREIT requests that the government issue guidance regarding: (1) REITs that engage in real estate activities outside the United States; and (2) protective asset trust arrangements. Enclosed for your consideration with regard to the first issue are two draft revenue procedures discussing select REIT income and asset test foreign currency issues. It has recently come to our attention that similar income test issues arise with regard to the normal currency hedges companies undertake when they operate abroad, and in the near future we would like to discuss this issue as well.



Eric Solomon, Esq.
Lon B. Smith, Esq.
May 12, 2004
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We hope to submit a draft revenue procedure to you next week regarding the protective asset trust arrangement we have discussed. Thank you for your willingness to consider the industry's need for guidance, and we would be pleased to discuss these drafts with you in greater detail.

Respectfully submitted,



Tony M. Edwards
Senior Vice President & General Counsel

Enclosures

cc: Gregory F. Jenner, Esq.
Helen M. Hubbard, Esq.
Deborah Harrington, Esq.
Alice M. Bennett, Esq.
William E. Coppersmith, Esq.
Elizabeth Handler, Esq.
Andrew Froberg, Esq.
Jonathan D. Silver, Esq.



REVENUE PROCEDURE

SECTION 1. PURPOSE

This revenue procedure describes conditions under which gains recognized under § 987 and § 988 of the Internal Revenue Code attributable to activities conducted outside of the United States by a real estate investment trust (REIT) will be treated as qualifying income under § 856(c)(2) and (3).

SECTION 2. BACKGROUND

.01 To qualify as a REIT, an entity must derive (i) at least 95 percent of its gross income for the taxable year from sources listed in § 856(c)(2) and (ii) at least 75 percent of its gross income for the taxable year from sources listed in § 856(c)(3). In addition, to qualify as a REIT, (i) at least 75% of the value of an entity's total assets at the close of each quarter must be represented by real estate assets, cash and cash items (including receivables), and Government securities, and (ii) the entity's assets must meet the diversification tests under § 856(c)(4)(B) at the close of each quarter.

.02 A REIT may acquire real property located outside the United States or may acquire a debt instrument that is denominated in a foreign currency.

.03 In Rev. Rul. 74-191, the Internal Revenue Service concluded that the term "real estate assets" as defined by § 856(c)(5)(B) includes land and improvements thereon located outside the United States and security interests that, under the laws of the jurisdiction in which the property is located is the legal equivalent of a mortgage or deed of trust in the United States.

.04 Section 985(a) provides in general that all determinations for federal income tax purposes shall be made in the taxpayer's functional currency. Section 985(b)(1)(B) defines functional currency as the dollar except in the case of a qualified business unit (QBU), in which case the functional currency is "the currency of the economic environment in which a significant part of such unit's activities are conducted and which is used by such unit in keeping its books and records." Section 989(a) defines QBU as any separate and clearly identified unit of a trade or business of a taxpayer that maintains separate books and records. Section 1.985-1(b)(1)(iii) states that except as otherwise provided by ruling or administrative pronouncement, the dollar shall be the functional currency of a QBU that has the United States as its residence as defined in § 988(a)(3)(B).

.05 Section 988(a)(3)(B)(i)(II) states that the residence of a corporation or partnership which is a United States person as defined in § 7701(a)(30) shall be the United States. Section 988(a)(3)(B)(i)(III) states that generally the residence of a corporation or partnership that is not a United States person shall be a country other than the United States. Section 988(a)(3)(B)(ii) states an exception to the above rule, that in the case of a QBU of any taxpayer, the residence of such unit shall be the country in which the principal place of business of the QBU is located.

.06 A U.S. taxpayer becomes subject to § 987 when it invests in foreign property through a QBU that is considered a branch for federal tax purposes. For this purpose, an entity treated as a disregarded entity or partnership for federal tax purposes would be considered a branch. An exchange gain or loss under § 987 (Section 987 Gain or Loss) occurs when the QBU remits funds to a taxpayer that uses a functional currency other than the remitting QBU. Generally, the measure of the Section 987 Gain or Loss is the difference between the current value of the remitted funds and the value of the remitted funds at the time such funds were contributed to, or earned by, the QBU.

.07 A U.S. taxpayer becomes subject § 988 when it enters into a section 988 transaction as described in § 988(c)(1). For this purpose, the acquisition of a debt instrument is a section 988 transaction. Generally, the measure of the foreign currency gain or loss with respect to an investment in a debt instrument is the difference between the current value of the collections of principal and the value of the funds at the time such funds were lent to the borrower (or the debt instrument was acquired by the taxpayer).

SECTION 3. SCOPE

This revenue procedure applies to a REIT that acquires real property located outside of the United States or a debt instrument that is denominated in a foreign currency.

SECTION 4. PROCEDURE

.01 The Internal Revenue Service will ignore Section 987 Gains under § 856(c)(2) and (3) provided the QBU meets the asset test under § 856(c)(4)(A) for each quarter that the REIT owns the QBU.

.02 The Internal Revenue Service will treat gains recognized under § 988 attributable to the acquisition of a debt instrument that is secured by real property (under the laws of the jurisdiction in which the property is located is the legal equivalent of a mortgage or deed of trust in the United States) as qualifying income under § 856(c)(2)(D) and (3)(C).

.03 The Internal Revenue Service will treat gains recognized under § 988 attributable to the acquisition of a debt instrument that is not secured by real property as qualifying income under § 856(c)(2)(D) only.

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