Real estate
working for you®

Dec. 2, 2019

VIA EMAIL

International Cooperation and Tax Administration Division
Centre for Tax Policy and Administration
Organisation for Economic Co-Operation and Development
taxpublicconsultation@oecd.org

Re: Comments on Public Consultation Document *Global Anti-Base Erosion Proposal (GloBE) – Pillar Two*

Ladies and Gentlemen:

Nareit[1] appreciates the opportunity to provide comments on the Public Consultation Document *Global Anti-Base Erosion Proposal (GloBE) – Pillar Two*, which was released by the OECD on Nov. 8, 2019. These comments focus on the risk that new minimum tax rules developed under the GloBE proposal could inappropriately capture real estate investment trusts (REITs) if the special circumstances of REITs are not taken into account in the design of such rules.

As discussed further below, we urge the OECD to incorporate specific rules for REITs in the design of the GloBE proposal. REITs do not raise the tax policy issues that are the target of the work under Pillar Two. Moreover, the potential application of new minimum tax rules to REITs would undermine the policies underlying the REIT regimes that are in place in the United States and many other countries around the world. Providing special rules for REITs that prevent the imposition of minimum taxes under the GloBE proposal would be consistent with the OECD's long history of recognizing the special circumstances of REITs through the inclusion in its guidance of specific rules ensuring the appropriate treatment of cross-border investment in and by REITs.

Background on U.S. REITs and their global activity

Both the magnitude and globalization of investments in and through REITs are significant and increasing. As of Oct. 31, 2019, the FTSE EPRA/Nareit Global Real Estate Index, the broadest index of global stock exchange-listed REITs and property companies in both developed and emerging countries, included 476

[1] Nareit is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community. U.S. REITs of all types collectively own more than $3 trillion in gross assets across the U.S., with stock-exchange listed REITs owning approximately $2 trillion in assets. U.S. listed REITs have an equity market capitalization of more than $1 trillion. In addition, more than 87 million Americans invest in U.S. REIT stocks through their 401(k) and other investment funds.

constituents with a combined float-adjusted equity market capitalization of $1.869 trillion.[2] REITs represented 75% of that market capitalization.[3] Nearly 40 countries have adopted the U.S.-based REIT approach to real estate investment, including all of the G-7 and more than half of the OECD.[4]

Additionally, as of Oct. 31, 2019, over 200 U.S. REITs had a market capitalization of over $1.3 trillion.[5] U.S. REITs are increasingly investing some of their capital outside the United States for a variety of business reasons. In particular, U.S. REITs have multinational businesses as customers and global investment by a REIT allows it to meet these customers' global real estate needs. By expanding outside the United States, a U.S. REIT can provide a multinational customer with a consistent real estate product across the customer's geographic footprint. Additionally, foreign markets offer significant opportunities for real estate development and therefore represent a growth opportunity. Investment in non-U.S. real estate also provides diversification benefits, allowing a U.S. REIT to expand its portfolio to include investments that differ from U.S. real estate investments in their response to economic cycles. For similar reasons, REITs based outside the United States also are increasing their investments outside their home countries.[6]

Focusing on U.S. REITs in particular, under U.S. tax law, a U.S. REIT is taxable as a U.S. corporation. U.S. REITs compute their taxable income like other U.S. corporations, but are required to distribute at least 90% of their taxable income. Further, they are entitled to a dividends paid deduction to the extent that they distribute their taxable income. They pay a corporate income tax on any income that they retain. Many U.S. REITs are registered with the U.S. Securities and Exchange Commission (SEC) and are publicly traded on a stock exchange (Listed REITs). In addition, there are U.S. REITs that are registered with the SEC but are not listed on a stock exchange (Public Non-listed REITs). As provided in the Technical Explanation to the 2006 U.S. Model Tax Treaty, U.S. REITs are considered to be residents of the United States for tax treaty purposes.[7]

---

[2] The FTSE EPRA Nareit Global Real Estate Index https://research.ftserussell.com/Analytics/FactSheets/temp/7d2ad26f-1090-42ac-b2b2-db1417c8162c.pdf
[3] Nareit analysis of FTSE EPRA Global Real Estate Index.
[4] Nareit analysis, https://www.reit.com/investing/global-real-estate-investment.
[5] REITWatch (October 2019) (Nareit), p. 1, https://www.reit.com/sites/default/files/reitwatch/RW1910.pdf
[6] See, e.g., https://www.theinvestor.jll/news/australia/office/singaporeans-boost-investment-in-australia/; https://www.theinvestor.jll/news/world/others/singapore-investors-remain-regions-top-cross-border-spenders-in-2019/; https://www.forbes.com/sites/bradthomas/2019/02/28/around-the-globe-unibail-rodamco-westfield/#a04bdab7499f; https://www.bizjournals.com/atlanta/news/2019/11/06/granite-reit-pays-47m-for-a-second-distribution.html; https://www.hotelmanagement.net/transactions/nexpoint-hospitality-trust-to-acquire-condor-hospitality-trust; https://realassets.ipe.com/news/apg-and-hammerson-now-hold-50-stake-each-in-16bn-premium-outlet-business/realassets.ipe.com/news/apg-and-hammerson-now-hold-50-stake-each-in-16bn-premium-outlet-business/10033069.fullarticle.
[7] *Model Technical Explanation Accompanying the United States Model Tax Treaty*, Nov. 15, 2006, Art. 4, para. 1.

Although U.S. REITs do not pay tax at the entity level like other corporate entities to the extent that they distribute 100% of their annual taxable income, the mandatory distribution rules mean that U.S. REITs have significant levels of income distribution as compared to other corporate entities. In 2018, SEC-registered U.S. REITs distributed approximately $62 billion to shareholders.[8] Thus, the amount of U.S. tax collected on a current basis with respect to dividends paid by U.S. REITs through tax on dividend distributions is high. This includes withholding tax on dividends paid to non-U.S. investors in such REITs.

OECD recognition of special circumstances of REITs

The increasing globalization of investments in and through REITs led to the OECD's work on tax treaty issues related to REITs, which resulted in the issuance of the OECD's 2007 report on REITs and the inclusion of REIT-related language in the 2008 update to the OECD Model Tax Convention. The main focus of this work was on the appropriate application of withholding tax reductions provided under a treaty for dividends paid by a REIT that is resident in one of the treaty partner countries to an investor that is resident in the other treaty partner country.

As was discussed in the 2007 OECD report, a REIT is a widely held company, trust or contractual or fiduciary arrangement that: 1) derives its income primarily from long-term investment in real estate; 2) distributes most of that income annually to its investors; and, 3) does not pay income tax on income related to real estate that is so distributed.[9] As the OECD report further noted, REITs typically are considered to be a resident for treaty purposes:

> Since the income of a REIT is typically distributed, the REIT is not, in a purely domestic context, taxed on that distributed income. As already mentioned, the tax mechanisms that ensure that result vary from country to country and can include, for example, rules that allow the deduction of REIT dividends or distributions, the tax exemption of all the REIT's income, the tax exemption of only part of the REIT's income that is distributed within a specified period of time or rules that allocate the income to the investors rather than to the REIT itself. It seems, however, that in most cases, the REIT would meet the condition of being liable to tax for purposes of the treaty definition of "resident of a Contracting State", subject to the particular problems arising from the application of tax treaties to trusts.[10]

The OECD reconfirmed the treatment of REITs as residents with access to treaty benefits in connection with its work with Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances).

---

[8] S&P Global Market Intelligence, https://www.reit.com/sites/default/files/reitwatch/RW1910.pdf.
[9] *Tax Treaty Issues Related to REITs, Public Discussion Draft*, Center for Tax Policy and Administration, OECD, Oct. 30, 2007, p. 3.
[10] *Id.*, p. 4.

As described in the October 2015 final report on Action 6 ("Further work to be done"),[11] the 2017 update to the OECD Model Tax Convention includes in the Commentary to Article 29 (Entitlement to Benefits) a reference to the treatment of REITs as residents as provided in the 2007 OECD report on REITs.[12]

The OECD also addressed REITs in its work in connection with BEPS Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements). The October 2015 final report on Action 2 provides a specific exclusion from the rules on hybrid financial instruments for dividend payments that are deductible because of the status of the payer:

> In order to preserve its tax neutrality, a jurisdiction may grant an investment vehicle, such as a mutual fund or a real estate investment trust (REIT), the right to deduct dividend payments. Although the payment of a deductible dividend is likely to give rise to a mismatch in tax outcomes, such a payment will not generally give rise to a hybrid mismatch under Recommendation 1 provided any resulting mismatch will be attributable to the payer's tax status rather than the ordinary tax treatment of dividends under the laws of that jurisdiction.[13]

This exclusion applies to dividends that are deductible in the United States (or another country) because the payor is a REIT. As a result, a U.S. REIT dividend eligible for the dividends paid deduction is not considered to give rise to a hybrid mismatch merely because of the dividends paid deduction.

Special rules for REITs under GloBE proposal

The GloBE proposal contemplates two sets of interlocking rules allowing for the imposition of additional tax when income is subject to tax in the residence country at an effective rate below an agreed minimum rate of tax. The first set of rules would allow the parent company's country of residence to impose tax on income earned by a controlled foreign subsidiary or foreign branch that is not subject to tax at or above the minimum rate. The second set of rules would allow the payor company's country of residence to impose tax when a payment made by that company is not subject to tax in the hands of the recipient at or above the minimum tax rate. It is intended that the priority of these two sets of rules will be specified so that both sets of rules cannot be applied to the same income.

We are concerned that, in the absence of specific rules providing for appropriate treatment for REITs, there is a risk that income of, or payments to, a REIT could be considered to trigger application of these minimum tax rules because of the operation of the REIT regime mechanisms that provide for no entity-

[11] *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: Final Report*, October 2015, para. 11.
[12] *2017 Model Tax Convention on Income and on Capital, Commentary to Article 29 (Entitlement to Benefits)*, Nov. 21, 2017, para. 55 and fn. 2.
[13] *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2015 Final Report*, October 2015, para. 101.

level tax on income that is distributed by the REIT to its shareholders under rules requiring current income distributions. The potential for inappropriate application of these minimum tax rules could arise when a REIT receives payments from a foreign subsidiary or when a REIT in one county holds a significant interest in a REIT organized in a different country. The imposition of tax under minimum tax rules in these circumstances would undermine the operation of REIT regimes, which provide for tax neutrality for the investment vehicle by conditioning the elimination of entity-level tax on the current distribution of income to the REIT shareholders. Moreover, any imposition of tax under these minimum tax rules would be in addition to residence-country tax that is imposed on distributed income at the REIT shareholder level as well as source-country withholding tax imposed on the income distribution by the REIT.

Providing an explicit special rule for REITs to prevent the imposition of minimum taxes under the GloBE proposal would ensure that the new minimum tax rules do not interfere with global investment through REITs. Such special rules would be consistent with the exclusion from the hybrid mismatch rules of BEPS Action 2 that is provided for REITs with respect to the dividend deduction rules that ensure tax neutrality for the REIT investment vehicle. Such special rules also would appropriately reflect the fact that REIT income is not the low or no-tax income that is the target of Pillar Two.

*****

We welcome the opportunity to provide comments on this important issue. We would be happy to discuss these comments or to respond to questions or provide additional information that would be useful. I can be reached at (202) 739-9408 or tedwards@nareit.com.

Respectfully submitted,

Tony M. Edwards
Senior Executive Vice President