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NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

May 28, 2009

VIA E-MAIL and USPS

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2009-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2009-43: 2009-2010 Guidance Priority List Recommendations

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity, pursuant to Notice 2009-43, 2009-21 I.R.B. 1037, to offer our suggestions regarding regulatory guidance to be placed on the 2009-2010 Guidance Priority List. NAREIT is the representative voice for U.S. real estate investment trusts (REITs) and publicly traded real estate companies worldwide. 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.

We request that the Department of the Treasury and the Internal Revenue Service include in their 2009-2010 Guidance Priority List the following nine issues, listed in order of priority:

1) allowing a safe harbor under which non-substantial mistakes and inadvertent errors in computing and making distributions, including potential rounding errors, are disregarded so that those distributions from a REIT are not considered as preferential dividends, consistent with an item on the 2007-2008 and 2008-2009 Guidance Priority Lists “addressing the correction of minor errors by RICs [regulated investment companies] and REITs;”



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- 2) treating REIT “earnings and profits” (E&P) as increased when deferred cancellation of debt income (CODI) under new section 108(i)¹ (which was added by the American Recovery and Reinvestment Tax Act of 2009, or the Act) is recognized, not when it is realized, and other guidance under section 108(i) allowing REITs and other taxpayers considering debt repurchases and other transactions that could result in CODI to utilize fully the tools that Congress has provided so that they may conserve capital, reduce debt, and provide stimulus to the economy during the current crisis;
- 3) clarifying that Section 1603 of the Act, which provides for a grant for a portion of the expense of placing in service “specified energy property” (Energy Grants) in lieu of a tax credit for such property is available without a limitation based on the amount of taxable income retained by a REIT;
- 4) interpreting and clarifying provisions of the REIT Investment Diversification and Empowerment Act of 2007 (RIDEA), which was included in the Housing Assistance Tax Act of 2008 (2008 Act), consistent with an item included in the 2008-2009 Guidance Priority List;
- 5) clarifying that a REIT’s investment in the shares of a money market fund constitutes an investment in a “cash item” for purposes of section 856(c)(4)(A);
- 6) revising the regulations under section 337(d) concerning “built in gains” so that these regulations do not apply to exchanges of property from a C corporation to a REIT under section 1031 nor to transfers of property to a REIT from a corporation exempt from tax under section 501(a), consistent with an item in the 2008-2009 Guidance Priority List;
- 7) repealing Notice 2007-55, 2007-27 I.R.B. 13 so as to treat REIT liquidating distributions and redemptions as sales of stock rather than capital gains distributions under the Foreign Investment in Real Property Tax Act (FIRPTA);
- 8) in response to IRS Announcement 2008-115, 2008-48 I.R.B. 1228, clarifying the treatment under FIRPTA of governmental permits to operate infrastructure assets in a manner that encourages investment in infrastructure, and confirming that, in any event, such assets are “real estate assets” under section 856(c)(5)(B) for REIT asset test purposes; and,
- 9) also in response to I.R.S. Announcement 2008-115, so long as the government is addressing what constitutes real estate (at least with respect to infrastructure), amending the withholding regulations under section 1445 that implement the FIRPTA taxation regime of section 897 to clarify that they require FIRPTA withholding only with respect to distributions to non-U.S. shareholders of gains attributable to a REIT’s dispositions of “U.S. real property interests” (USRPIs).

¹ For purposes of this letter, “section” refers to the Internal Revenue Code of 1986, as amended (the Code) unless otherwise provided herein.

The reasons for the priority given to the first three issues listed above are as follows. First, the issue regarding inadvertent errors in computing required REIT distributions has been on the Guidance Priority List for a number of years and continues to be important to the REIT industry, particularly during the current economic crisis. Second, again because of the difficult economic climate, guidance under section 108(i) to the COD provisions of section 108, to encourage companies, including REITs, to deleverage by providing for a deferral of COD income realized in 2009 and 2010 is very important due to the short-term nature of the provision. Similarly, Section 1603 of the Act (the recently enacted 2009 stimulus legislation), provides for outright cash grants in lieu of tax credits for certain investments in renewable energy projects again only in 2009 and 2010 is of significant interest to REITs considering investments in 2009-2010 that might benefit from such grants.

I. Preferential Dividends

There are situations in which a REIT inadvertently, through a “foot fault” such as a rounding error or similar situation, arguably could be viewed as having distributed a non-deductible, preferential dividend. Because these errors truly have no substantive meaning, we respectfully reiterate our request that the IRS issue guidance providing safe harbors as to these types of situations that will not be treated as preferential dividends, consistent with an item on the 2007-2008 and 2008-2009 Guidance Priority Lists addressing the “correction of minor errors by RICs and REITs.”

The time spent by both the IRS and REITs on such non-substantive mistakes is unnecessary and non-productive. NAREIT has made several submissions in this regard over the last few years and has engaged in a constructive dialogue with the government on this issue. We hope that the government will be able to issue useful advice in this area in the very near future.

II. New Section 108(i) Concerning Deferral of CODI

One of the provisions included in the Act adds section 108(i). Section 108(i) allows certain taxpayers to elect to defer certain types of CODI in connection with “applicable debt instruments” realized in 2009 or 2010 until 2014, and the CODI is recognized ratably over the tax years 2014-2018. This provision was designed to “[p]rovide . . . assistance to companies looking to reduce their debt burdens by delaying the tax on businesses that have discharged indebtedness, which will help these companies strengthen their balance sheets and obtain resources to invest in job creation.”² There are a number of open issues under section 108(i) with respect to which regulatory guidance would be appreciated.

NAREIT reiterates its request for guidance under section 108(i), which was more fully articulated in a comment letter dated April 17, 2009. The specific issues with respect to which NAREIT seeks guidance are set forth below.

² Speaker of the House Nancy Pelosi (D-CA), quoted in <http://www.speaker.gov/newsroom/legislation?id=0273>.

First, to remain consistent with both Congressional policy to defer certain CODI realized in 2009 and 2010 and longstanding Congressional policy to provide for one level of REIT taxation on distributed earnings, NAREIT requests that the Treasury Department and IRS issue guidance that REIT E&P are increased when the deferred CODI under section 108(i) is recognized, not when it is realized.³ Otherwise REIT shareholders would face double taxation of the CODI under section 108(i), thereby making this new subsection less attractive to REITs.

Second, debt issued by a pass-through entity should be considered issued “in connection with the conduct of a trade or business” of such entity (and therefore eligible for exclusion under section 108(i)) so long as the partnership is eligible to claim deductions under section 162. This simple rule would provide clarity for pass-through entities considering the repurchase of outstanding debt or the workout of troubled debt.

Third, transfers of interests or assets that do not result in a “cashing out” of such interests should not be viewed as events causing acceleration of CODI deferred under section 108(i). Thus, tax-free reorganizations, like-kind exchanges, and similar transactions should not give rise to acceleration of deferred CODI.

Fourth, NAREIT recommends that this guidance also clarify that REITs are not considered “pass-through entities” for purposes of section 108(i)(5)(D)(ii) so that transfers of interests in REITs do not accelerate a REIT’s CODI deferred under section 108(i).

III. Energy Grants Under Section 1603 of the Act Should Be Available to REITs Regardless of Taxable Income Retained

As noted above, Section 1603 of the American Recovery and Reinvestment Tax Act of 2009 (the Act) includes a provision that provides for outright grants of cash for investment in certain energy projects. Although the tax law already includes energy tax incentives in the form of credits, these Energy Grants encourage taxpayers whose tax liability may not be sufficient to undertake projects that generate energy tax credits to undertake investment in renewable energy projects. In general, the Energy Grants are available only in 2009 and 2010.

NAREIT respectfully reiterates its request for guidance contained in a May 13, 2009 comment letter signed by NAREIT along with a number of other national real estate organizations requesting guidance that interprets this legislation in the manner most likely to encourage REITs and other taxpayers to invest in renewable energy projects—without limitation based on their ultimate tax liability. Otherwise, the congressional incentives to stimulate the economy in a sustainable manner would not be available to a significant segment of available to a significant segment of the real estate industry well suited to deploy these new technologies.

³ This recommendation also was included in a report by the New York State Bar Association on section 108(i) dated April 27, 2009.

IV. Post-RIDEA Guidance

As noted above, the Housing Assistance Tax Act of 2008 (the 2008 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). NAREIT thanks the Treasury Department and IRS for the issuance of guidance thus far in response to both NAREIT's letter of August 13, 2008 requesting certain guidance under the 2008 Act and an item contained in the 2008-09 Guidance Priority List concerning guidance for REITs under the 2008 Act. NAREIT reiterates its request for guidance relating to the following issues as further described in the August 13, 2008, letter and the follow up letter of February 23, 2009:

- 1) in accordance with the introductory statements of RIDEA's principal sponsors, 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,
- 2) delineating how the modified REIT hedging rule in 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).

Furthermore, NAREIT requests that the Treasury Department and IRS issue guidance regarding the treatment of foreign currency gains for qualified business units (QBUs) of a REIT that: a) use a functional currency other than the U.S. dollar; b) may not meet the quarterly REIT asset tests or the 75% REIT gross income test for a taxable year; and, c) otherwise could apply the principles of the proposed regulations under section 987 issued September 7, 2006 to determine whether that section 987 gain is derived from income that is described in section 856(c)(2) or section 856(c)(3), pursuant to Notice 2007-42, 2007-21 I.R.B. 1288.

Such guidance would be consistent with the legislative history to the 2008 Act, in which the Joint Committee on Taxation noted that the 2008 Act's approach of excluding "qualified" foreign currency gains from the REIT gross income tests "supersede[s] Notice 2007-42 in the case of remittances from a QBU that uses a functional currency other than the dollar."⁴ So long as the QBU meets the quarterly assets tests and the 75% income test for a taxable year, the new provisions exclude from the REIT income tests section 987 gain on a remittance from the QBU to the REIT, and no tracing-type rules with respect to such section 987 gain are imposed, as would have been the case under Notice 2007-42. The Joint Tax Committee then noted that "[i]t is expected that the Treasury Department will use its regulatory authority⁵ to provide appropriate rules with respect to the treatment of section 987 currency gain for purposes of the REIT gross income tests if a QBU does not meet the requirements of the provision."⁶

⁴ *Id.*

⁵ Section 989(c) grants the IRS authority to issue regulations under the foreign currency provisions of §§985-989.

⁶ Joint Committee on Taxation, *Technical Explanation of Division C of H.R. 3221, the "Housing Assistance Tax Act of 2008,"* (JCX-63-08), July 23, 2008, at 45.

V. Money Market Funds as “Cash Items” Under Section 856(c)(4)(A)

Section 856(c)(4)(A) requires that at the close of each calendar quarter of the taxable year at least 75% of the value of a REIT’s “total assets” consist of real estate assets; government securities; and cash and cash items (the 75% asset test). On April 22, 2009, the American Bar Association Section of Taxation (Tax Section) submitted comments to the Internal Revenue Service requesting that the Treasury Department and the IRS promptly issue guidance clarifying that a REIT’s investment in the shares of a money market mutual fund (money market fund) constitutes an investment in a “cash item” for purposes of section 856(c)(4)(A).

As the Tax Section noted:

[Money market funds] play a pivotal role in the day-to-day operations of many companies, including [REITs], when cash must be readily available to meet the needs of their business. Money market funds are an attractive alternative to interest-bearing checking accounts due to the convenience they provide, their competitive returns, and their regulatory safeguards that are intended to provide liquidity and minimal risk to principal. In light of these features common to money market funds, industry practice for financial personnel and the accounting rules such personnel rely upon generally treat money market funds as “cash items.”

Especially given the Administration’s focus of promoting the security and safety of investments in money market funds, NAREIT agrees with the Tax Section’s recommendation.

VI. Revising Final Regulations Under Section 337(d) Relating to Conversion Transactions Involving Tax-Exempt Entities

NAREIT reiterates its request for a revision to the regulations under section 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or regulated investment companies (RICs), in accordance with the May 1, 2008 submission by the Tax Section. An item concerning these issues is contained in the 2008-2009 Guidance Priority List

The regulations under section 337(d) implement Congress’ directive as part of the repeal of the *General Utilities* doctrine in the Tax Reform Act of 1986 (the 1986 Act) to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments effected by the 1986 Act, including:

...regulations to ensure that such purposes may not be circumvented through the use of ... a regulated investment company, real estate investment trust, or tax exempt entity...

Section 337(d).



Prior to its repeal, the *General Utilities* doctrine allowed certain transfers of appreciated property to avoid corporate level tax. The 1986 Act eliminated those rules, effectively preventing the avoidance of corporate-level tax on the disposition of appreciated property.

We support the suggestions made in those comments, and respectfully request that the IRS and Treasury Department revise the regulations under section 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or RICs, in accordance with those comments.

The Tax Section comments address two specific issues:

First, the Tax Section points out that the section 337(d) regulations technically apply to transfers from a C corporation to a REIT or RIC in an “exchanged basis” transaction and indicates that this treatment is inappropriate. “Exchanged basis” transactions include section 1031 like-kind exchange transactions. C corporations often transfer real property in like-kind exchange transactions when a REIT is the acquirer. These transactions are commonplace, non-abusive, and do not implicate any of the concerns that are properly addressed by the regulations.

Second, the Tax Section states that the section 337(d) regulations improperly treat tax-exempt corporations as “C corporations” for purposes of the regulations. It follows from this treatment that a transfer of assets from a tax-exempt corporation to a REIT or RIC can result in the imposition of a C corporation level tax with respect to the property (under section 1374 principles if the property is sold by the REIT or RIC within ten years). As the Tax Section points out, this treatment also applies in connection with a transfer of assets from a real estate partnership to a REIT when the partnership has partners that are tax-exempt corporations. Such transfers are commonplace, and for the reasons given by the Tax Section, NAREIT believes that the regulations should not be applied in these situations.

VII. Repeal Notice 2007-55 to Treat REIT Liquidations and Redemptions as Sales/Exchanges of Stock

Although not clear, for many years tax practitioners concluded that payments from a REIT made as part of its liquidation or redemption should be considered a sale of its stock (to which FIRPTA does not apply under several circumstances) rather than a capital gain distribution (to which FIRPTA does apply in several circumstances). The IRS issued a private letter ruling in 1990 concluding that liquidating distributions should be treated as a sale of stock, but that ruling was revoked in 2004. In 2007, the IRS issued Notice 2007-55 in which it concluded that liquidating distributions and redemptions should be treated as capital gain liquidations that are subject to FIRPTA if paid to foreign shareholders. An item relating to Notice 2007-55 is contained on the 2008-2009 Guidance Priority List, although the exact parameters of that item are unclear.

As more fully presented in another comment letter by the Tax Section dated June 10, 2008, NAREIT believes that Notice 2007-55 should be repealed except when “the existing provisions create a clear loophole, namely, a foreign controlled REIT that undergoes a liquidation, with the REIT deducting liquidating distributions under section 562(b) and the REIT’s foreign

shareholders relying on the ‘cleansing exception’ of section 897(c)(1)(B) to avoid FIRPTA tax.” As a result, if a third party stock sale would be exempt under current law (for example, as in the case of sales of shares of a “domestically controlled REIT,” which are not United States Real Property Interests, or USRPIs), then the tax treatment of a non-dividend distribution that gives rise to a constructive sale or exchange ought to be taxed the same way. NAREIT agrees with this specific recommendation of the Tax Section as well as the other recommendations contained in its June 10, 2008 comment letter.

VIII. Governmental Permits to Operate Infrastructure Assets

NAREIT is pleased that, pursuant to IRS Announcement 2008-115, 2008-48 I.R.B. 1228, the Treasury Department and the IRS plan to address whether certain governmental permits required in the course of construction, operation and maintenance of certain infrastructure assets constitute USRPIs. NAREIT recognizes the government’s interest in increasing private investment in infrastructure and welcomes any regulatory guidance that encourages infrastructure investments, whether from domestic or non-U.S. sources.

Specifically, NAREIT reiterates its comments dated January 29, 2009, requesting that guidance be released treating governmental permits issued in connection with infrastructure assets in a manner that encourages investment in infrastructure, and confirming that such assets are “real estate assets” under section 856(c)(5)(B) for REIT asset test purposes. Accordingly, NAREIT recommends that, to the extent that any guidance under this regulatory project is issued that does not treat such governmental permits as USRPIs under section 897(c), the guidance nevertheless should treat such items as “real estate assets” under section 856(c)(5)(B) for REIT purposes in order to prevent hindrances to REIT investment in infrastructure. Further, to the extent that any guidance under this regulatory project is issued that does treat such governmental permits as USRPIs under section 897(c), the guidance also should treat such items as “real estate assets” under section 856(c)(5)(B) for REIT purposes.

IX. Clarifying That FIRPTA Withholding Regulations Apply Only to Dispositions of USRPIs

NAREIT also reiterates its request contained in its January 29, 2009 comment letter that the Treasury Department and IRS amend the withholding regulations under section 1445 that implement the FIRPTA taxation regime of section 897 to clarify that they require FIRPTA withholding only with respect to distributions to non-U.S. shareholders of gains attributable to a REIT’s dispositions of USRPIs. To the extent that the existing regulations could be read as applying FIRPTA withholding to distributions that are not attributable to gain from dispositions of USRPIs, they are beyond the scope of section 897.

All of the suggested projects above would fulfill the goals and objectives set forth in Notice 2009-43. First, resolution of these issues would resolve significant issues relevant to the more



than 1,000 entities that have elected REIT status and many thousands of taxpayers who invest in REITs.

Second, these projects would promote sound tax administration. Specifically, the preferential dividend project would allow REITs and their taxpayers certainty that minor differences in dividend payments will not result in disproportionate penalties, while simultaneously relieving the Government from having to devote unwarranted resources in negotiating closing agreements to resolve these types of issues. Furthermore, guidance relating to section 108(i) and Energy Grants would provide clarity to REITs regarding these two provisions that are only operative in the short term.

Third, these projects could clearly be drafted in a manner that would enable taxpayers to easily understand and apply the guidance. We have been working with, and would be pleased to continue to work with, the IRS in discussing how the preferential dividend guidance could be drafted so as to apply to the most common types of non-consequential "foot faults." Specifically, and as noted above, we previously have submitted comments relating to guidance under section 108(i) and Energy Grants, and we would be pleased to continue to work with the Treasury Department and IRS regarding implementation of these two provisions.

Fourth, we believe that guidance under these projects easily could be administered on a uniform basis. Published guidance on what constitutes preferential dividends is far superior to having to negotiate closing agreements on a case-by-case basis. A similar analysis applies in the case of published guidance under section 108(i) and the Energy Grants provision in the 2009 stimulus legislation.

Finally, guidance on the requested projects would reduce controversy and lessen the burden on taxpayers or the IRS for the reasons stated above.

Feel free to contact me or Dara Bernstein, NAREIT's Senior Tax Counsel, if you would like to discuss these issues in greater detail.

Respectfully submitted,



Tony M. Edwards
Executive Vice President & General Counsel

cc: Michael Mundaca, Esq.
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