Energy Grants in Lieu of Tax Credits
The American Recovery and Reinvestment Act should be Amended to Enable Full Participation by REITs

Background

Congress created REITs in 1960 to enable investors from all walks of life to own professionally managed, income-producing real estate. REITs combine the capital of many investors to benefit from a diversified portfolio of income-producing real estate, such as apartments, storage facilities, hotels, shopping centers, offices, and warehouses. REITs are required to distribute at least 90% of their taxable income to their shareholders. In exchange for doing so, federal law grants a deduction for the dividends they pay – the dividends paid deduction (DPD), which in 2008 totaled about $17.8 billion for listed REITs. REITs often distribute at least 100% of their taxable income, thereby shifting their entire tax liability to their shareholders.

REITs own approximately 6 billion square feet of commercial real estate, amounting to about 10% of all U.S. commercial real estate. Since buildings represent about 40% of all U.S. energy use and approximately 70% of all electricity consumption, providing incentives for REITs to engage in energy efficiency projects could significantly contribute to achieving the energy reduction goals outlined by Congress and the Obama Administration.

Energy Grants in Lieu of Tax Credits

Current law limits use of energy tax credits by REITs based on amount of retained income. Energy tax credits (Energy Credits) have been the primary incentive for private investment in qualifying energy projects by providing a credit against federal income tax liability. Qualifying projects include investments in solar, fuel cell, small wind, combined heat and power system, and geothermal technology. REITs generally do not benefit from these credits because they typically have no tax liability and they are not entitled to pass-through these credits to shareholders. To the extent a REIT is eligible for Energy Credits, the credit is further limited based on the amount of taxable income retained by the REIT. For example, a REIT that distributes 90% and retains 10% of taxable income may be eligible for an Energy Credit, but the credit will be limited to 10% of its value.

Energy grants authorized in the American Recovery and Reinvestment Act (Recovery Act) have been similarly limited for REITs – reducing the effectiveness of the program. On February 17, 2009, President Obama signed the Recovery Act into law. Section 1603 of the Recovery Act provides for energy grants in lieu of tax credits (Energy Grants) for companies that invest in the same classes of energy projects that qualify for under the Energy Credits. These grants are intended to encourage qualifying investments by taxpayers whose tax liability may not be sufficient to benefit from Energy Credits. In fact, the Recovery Act Energy Grants were designed as a substitute for Energy Credits during the current economic downturn since many taxpayers have inadequate taxable income or tax liability for the Energy Credits to provide a sufficient incentive. Despite being designed for this purpose, the Energy Grants provision in the

Recovery Act have been interpreted to benefit a REIT only to the extent it retains taxable income.

Action Requested

Amend the Recovery Act to Allow REITs to Participate Fully Without Income Limitation. As the Senate continues to draft energy and climate change legislation, it should amend the Recovery Act to allow REITs to participate fully in the energy grants in lieu of tax credits program without a limitation based on their statutorily mandated payment of taxable income as dividends to shareholders.

Supporting Organizations

In this request, NAREIT is joined by the Solar Energy Industry Alliance, The Real Estate Roundtable, the National Multi Housing Council, the National Apartment Association and the Building Owners and Managers Association International.