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IRS Issues Temporary Guidance on REIT Taxable Stock Dividends

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On December 10, 2008, the Internal Revenue Service (***"IRS"***) issued Revenue Procedure 2008-68 (the ***"Procedure"***), providing temporary guidance regarding certain stock distributions by publicly traded real estate investment trusts (***"REITs"***). Effective January 1, 2008 and for taxable years ending on or before December 31, 2009, IRS will treat a distribution of stock by a publicly traded REIT pursuant to certain elections to receive stock or cash as a taxable distribution of property. The amount of such stock distribution will be treated as equal to the amount of cash that could have been received instead. Under the Procedure, REITs can limit the aggregate amount of cash available to shareholders pursuant to the election to 10 percent of the aggregate distribution of cash and stock taken together.

Under the Internal Revenue Code (the***"Code"***), REITs must distribute to their shareholders each year their taxable income to minimize the imposition of taxes. Only taxable distributions of property satisfy this distribution requirement. Although a REIT might normally distribute cash to its shareholders, given current market conditions and liquidity constraints, REITs can conserve capital through taxable distributions of stock. While *pro rata* distributions of stock to shareholders often are nontaxable, under Section 305(b)(1) of the Code such distributions become taxable when shareholders have the option to elect between receiving stock or cash. Prior to the Procedure, REITs have in fact used this Code provision to issue taxable stock distributions. Generally, REITs have limited the aggregate amount of cash available pursuant to the election to 20 percent of the aggregate distribution of cash and stock taken together.

Among other things, limiting the amount of cash available pursuant to a cash-or-stock election casts some doubt on the application of Section 305(b)(1), particularly when the limit is low. IRS has issued a number of favorable private letter rulings addressing 20 percent cash limitations. Members of the publicly traded REIT community have argued the need to request letter rulings and a 20 percent limitation impede the ability of REITs to conserve capital and meet their distribution requirements in the current economic climate. Provided the distribution falls within its strictures, the Procedure temporarily obviates the need to seek such rulings and allows a 10 percent cash limitation.

In pertinent part, the Procedure provides a distribution of stock by a publicly traded REIT to its shareholders will be considered a taxable distribution of property in an amount equal to the amount of cash that could have been received instead if:

- Each shareholder may elect to receive its distribution in cash or stock of equivalent value subject to a limitation on the aggregate amount of cash to be distributed to all shareholders (the ***"Cash Limitation"***), provided (a) such Cash Limitation is not less than 10 percent of the aggregate declared distribution and (b) if too many shareholders elect to receive cash, each shareholder electing to receive cash will receive a *pro rata* amount of cash corresponding to its respective entitlement under the declaration, but in no event will any shareholder electing to receive cash receive less than 10 percent of its entire entitlement in cash.

- The calculation of the number of shares to be received by any shareholder will be determined, as close as practicable to the payment date, based upon a formula utilizing market prices designed to equate in value the number of shares to be received with the amount of cash that could be received instead.

Special rules apply to dividend reinvestment plans.

REITs should note the Procedure does not address the “preferential dividend” rules of the Code, which must be considered prior to relying on taxable stock distributions to meet their distribution requirements.