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IRS Provides Temporary Guidance on the Treatment of Certain Stock Distributions by Publicly Offered REITs and RICs

On May 4, 2020, the Internal Revenue Service (the “IRS”) released temporary guidance (Revenue Procedure 2020-19, or “the Revenue Procedure”) on the treatment of certain stock distributions by publicly offered real estate investment trusts (“REITs”) and publicly offered regulated investment companies (“RICs”). The Revenue Procedure modifies the safe harbor provided in 2017 guidance (Rev. Proc. 2017-45) to address the need for enhanced liquidity during the economic downturn. Under the Revenue Procedure, in order for a distribution of stock to be treated as a distribution of property under section 301 of the Internal Revenue Code (the “Code”), which permits a REIT or RIC to satisfy its distribution requirement, the minimum required percentage of cash that shareholders must receive is temporarily reduced to 10 percent of the total distribution.

Rev. Proc. 2017-45 provided that where a public REIT or RIC makes a distribution pursuant to which shareholders may elect to receive cash or stock, so long as the aggregate amount of cash distributed is no less than 20 percent of the total amount of distributions (in both cash and stock), all of such distributions will be treated as distributions of property under section 301 of the Code, by reason of section 305 of the Code. In calculating the total distribution, the amount of the distributed stock will be treated as equal to the amount of cash that a distributee shareholder could have received had he/she not made the election to receive stock. This modification applies to any qualified distribution declared by a publicly offered REIT or RIC between April 1, 2020 and December 31, 2020, affording the flexibility to preserve cash while maintaining compliance with the REIT or RIC distribution requirements.

The Revenue Procedure is an important response to the current economic downturn and the deteriorating cash liquidity positions of many REITs, especially in the retail and hospitality sectors. A similar measure was



temporarily enacted during the previous financial crisis through Rev. Proc. 2008-68. While the distribution of stock in lieu of cash may enhance a REIT's liquidity and cash position, it is by no means a panacea. A significant stock dividend in an environment of depressed stock prices creates costly dilution for a REIT. We believe that the IRS and Treasury may want to consider more serious measures for REITs, including a rule that would deem certain distribution shortfalls to be due to reasonable cause. Regardless of whether future guidance arises, REITs face a tough road ahead until the rental real estate market recovers in a meaningful way.

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