

REIT Alert

An informational newsletter from Goodwin Procter's Real Estate & RE Capital Markets Group

IRS Issues Guidance on Taxable Stock Dividends

This update to our December 4, 2008 REIT Alert addresses capped cash option stock dividends, one of the [cash preservation strategies available to REITs](#). On December 10, 2008 the Internal Revenue Service (the "IRS") issued Revenue Procedure 2008-68 announcing that the IRS will treat a cash option stock dividend as satisfying a public REIT's distribution requirements for 2008 and 2009 so long as shareholders can elect to take at least 10% of the dividend in cash. Although the IRS declined to adopt NAREIT's suggested minimum cash cap of 5%, the 10% minimum cap is a favorable departure from prior private letter rulings, which had required 20% cash. The Revenue Procedure otherwise tracks the pattern of the existing private letter rulings. Public REITs can rely on the Revenue Procedure without any need to obtain their own private letter ruling.

The Revenue Procedure provides that the IRS will treat a capped cash option stock dividend by a REIT as a taxable dividend, and will consider the amount of stock distributed to be equal to the amount of cash which could have been received instead, if:

- the dividend is made by the REIT to its shareholders with respect to its stock;
- the terms of the dividend allow each shareholder the right to elect to receive its entire distribution in either cash or stock of the REIT of equivalent value, provided that the REIT may impose a limitation on the amount of cash to be distributed in the aggregate to all shareholders of not less than 10% of the aggregate distribution; and
- the number of shares to be distributed is determined as close as practicable to the payment date based upon a formula utilizing market prices.

The Revenue Procedure doesn't mandate any particular valuation formula, providing some flexibility to address concerns raised by the current market volatility. The formula employed, however, must be designed to equate in value the number of shares to be received by a shareholder with the amount of money that the shareholder could have elected to receive in lieu of the shares. Accordingly, if the REIT declares a cash option stock dividend of \$0.50 per share with a 10% cap, and each shareholder elects to receive all cash, the cash component of the dividend to

each shareholder would be \$0.05, and the per share stock component would be determined by dividing 0.45 by the price determined under the valuation formula.

The Revenue Procedure further provides that, to the extent the REIT maintains a dividend reinvestment plan, such plan would apply only to the cash portion of the dividend. It should be noted that this guidance applies only to REITs whose stock is publicly traded on an established securities market in the United States and to distributions with respect to taxable years ending on or before December 31, 2009.

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