Understanding and applying the REIT structure

March 26, 2013
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Presenters

- Ed Liva  State of the REIT Market
- David Brandon  REIT Conversions/Opco/Propco Transactions
- David Lee  Nontraditional REITs
- Steven Moore  Value-enhancing Transactions
- Angela Yu  Foreign Investors, REITs and Exit Strategies
State of the REIT market

Ed Liva
Overview of the public REIT world

- Real Estate Investment Trusts (REITs) created by Congress in 1960
  - To provide average investors the ability to invest in investment-grade commercial real estate
  - Patterned after Mutual Fund/RIC regime
  - REIT Modernization Act (1999) provides for Taxable REIT Subsidiaries (TRS)

- Current size of Public REIT Market
  - 172 publicly traded REITs
  - Market cap of approximately $603B (2012YE)

- Current Segment Breakdown
  - 30 Industrial/Office Building
  - 31 Retail
  - 18 Multifamily
  - 16 Diversified
  - 11 Healthcare
  - 14 Lodging/Resorts
  - 5 Timber and Infrastructure
  - 33 Mortgage
  - 14 Other
New trend – Expansion of REITs into nontraditional sectors of real estate

- Timber
- Prisons
- Casinos
- Billboards
- Document Storage Business
- Data Centers
- Cell Towers
- Railroads
- Energy Transmission Lines
- Infrastructure Assets

Note – contrary to some recent public comments, the IRS has not expanded the definition of "real estate" for the purpose of creating a REIT. These asset categories have always been "real estate" for REIT purposes.
What’s needed to qualify as a REIT?

- REIT-able assets
- Real estate rental income
- Limitation on related party rent
- Five or fewer investors cannot own more than 50 percent
- Must have 100 or more shareholders
- Many other REIT qualification requirements
REIT conversion/restructuring alternatives

- "Opco/Proco" – Carve out and spin off real estate assets into REIT
  - Spin-off can be taxable or tax-free
  - Section 355 IRS ruling needed if tax free
  - Purge all accumulated earnings and profits
  - State transfer taxes
- Contribute real estate to Umbrella Partnership REIT (UPREIT) and raise capital via Initial Public Offering (IPO)
- Convert existing entity into a REIT
  - Must meet all REIT requirements
    - Can be as simple as electing REIT status
  - "Built-in Gain" taint
  - Must purge all accumulated earnings and profits (E&P)
Benefits of a REIT conversion

- Unlocks the value of real estate embedded in an integrated operating company
  - Sum of the parts are greater than the whole
- Allows REIT assets to trade at market value
- Provides efficient tax structure
  - Prior to REIT Conversion
    - 35% tax at Corporate level
    - 20% (plus 3.8%) tax on dividends at shareholder level
  - Post REIT Conversion
    - No tax at REIT level (provided dividends equal or exceed taxable income)
    - 39.6% (plus 3.8%) tax on dividends at shareholder level
- Benefits must be considered together with business objectives and consequences
  - Lower cost of capital, which can fuel internal and external growth
  - May open new markets, expand acquisition opportunities
  - Optimum vehicle for converting from high-growth phase to dividend-paying company
  - Will the business tolerate the REIT structure?
    - Income distribution requirement
    - Loss of control of key real estate assets
REIT Conversions
Opco/Propco Transactions

David Brandon
Opco/Propco

- Opco/Propco
  - Real estate assets of C corporation spun off into a REIT, which leases assets back to parent entity that operates them. This structure required when assets do not ordinarily produce rental income.
- Opco/Propco structures can be difficult from tax and business standpoint
  - Penn National Gaming announced November 16, 2012, will divide into an Opco/Propco structure via tax-free spin
    - Propco will elect REIT status and master-lease gaming assets to Opco
    - Opco as lessee, retains gaming licenses and will operate casinos
    - Single, master lease of all casinos (15-20 years, three 5-year options to renew)
    - Effectively cross-collateralized
    - Base rent plus share net gaming revenue (about 50-50)
    - Total net income split about 50-50
- Typical Opco/Propco assets
  - Lodging (prior to Tax Relief Extension Act 1999)
  - Healthcare (prior to Housing Assistance Tax Act 2008)
  - Infrastructure, Pipeline, Electric Transmission, Ski Resorts
Opco/Propco Diagram

Public Shareholders

Related Shareholders < 10%

C corporation
Lessee/operator

Step 1

REIT
(before spin)

Step 3

REIT
(after spin)

Step 2

Master Lease of
Assets to
Lessee/Operator
Opco/Propco – Major Structuring Considerations

- Spin requirements
  - Business purpose
  - Not a device to distribute E&P
  - Active trade or businesses

- Related-Tenant rule
  - REIT may not derive qualified rents from a tenant in which it owns, directly or indirectly, 10 percent or more of voting power or value of all classes of stock (or 10 percent or more of assets or net profits)
  - May require redemptions, or disproportionate split-up distribution to avoid related-tenant restriction

- Earnings & profits purge
  - End of first REIT year
  - Use of stock dividends (qualified dividend rate) with 20-30% cash

- Built-in gains
Opco/Propco – REIT Qualification Issues

- Must hold at least 75 percent real estate assets
  - Other securities held must be diversified
  - Classification of intangibles may be problematic
- Classification of real estate
  - Appearance and function tests – looks and acts like a building
  - Inherently permanent tests – intent to leave in place; difficult and costly to move
  - Part of integrated system that is inherently permanent, e.g., railroad tracks, gas transmission pipes and pressure stations
- Bad assets, active business operations may be housed in taxable REIT subsidiary (cannot be valued at more than 25 percent total assets)
Opco/Propco – REIT Qualification Issues (continued)

- Must derive at least 95 percent passive income (rents, dividends, interest) and at least 75 percent from rental income
  - True leases; cannot be in substance a partnership, management arrangement or financing*
  - Not based in whole or in part on income or profit derived from property
  - Not from related tenant
- Other REIT Requirements
  - Must distribute 90 percent of ordinary income as dividend
  - Must be widely held, with at least 100 shareholders
  - Must be classified as domestic corporation with board of directors or trustees
  - Must elect REIT status by filing Form 1120-REIT, instead of Form 1120 (retroactive to first day of taxable year for which filed)
  - Must make any required TRS elections (Form 8875); retroactive only 75 days (elections may need to be filed before REIT election)

*May work if treated as a mortgage
Alternative Opco/Propco – UPREIT Structure
(Umbrella Partnership REIT)

- Umbrella Partnership REIT (UPREIT) structure
  - Sponsor C corporation contributes assets to operating partnership
  - Newly formed REIT conducts IPO; contributes cash to operating partnership
- REIT leases assets back to Sponsor C corporation
  - Cash-out or distribution to shareholders may be taxable
  - E&P purge may be avoided
  - Related-tenant restrictions more easily avoided

Structure may be ideal if:
- C corp desires to cash out RE with REIT IPO, with proportionate amount of gain potentially taxed
- Deleverage RE with REIT IPO
- Excessive E&P
Alternative Opco/Propco – UPREIT Structure

Public Shareholders

C corporation
Lessee/operator

Step 1

OP RE Assets

Master Lease of Assets to Lessee/Operator

Step 3

Related Shareholders < 10%

Step 2

Public Shareholders (IPO)

REIT

C corp may retain interest in assets, or cash out (taxable)

C corp continues as operator
Opco/Propco Business Considerations

- Historically, some Opco/Propco structures poorly received in REIT market
  - Single tenant REIT viewed as high risk
  - Tendency to ‘over-strip’ operating income as rents
  - Limited ability to predict future performance when setting lease rates
  - Nature of the asset (owner-occupied vs. traditional rental) may limit meaningful comparables for setting rents
  - Opco loses long-term control of core asset
  - Paper-clipped arrangements make each company dependent on the fortunes of the other

- May overcome objections
  - Opco is well capitalized and rent coverage is high (ratio of EBITDA: Rent is 1.4:1 or higher)
  - Credible plan for future independent growth for both companies
Straight C Corporation Conversions

- **Straight REIT conversion**
  - Traditional revenue stream should be classifiable as rents for use or occupancy of space only
  - Non-qualifying assets/income may be housed in taxable REIT subsidiary
  - Otherwise meets organizational, operational, share ownership, asset, income tests – valuations likely needed
  - Election made by filing Form 1120-REIT by return due date (election retroactive); TRS election(s) made by filing Form 8875, only retroactive up to 75 days (may be required before REIT election filed)
  - May be used with UPREIT structure

- **Lamar Advertising Company recently announced intention to convert to REIT status**
  - Assets are 100,000+ billboards, interstate logo signs, digital billboards, bus stop shelters
  - Revenue is from the use of billboard space
  - Significant intangibles, resulting from acquisitions
  - Limited design and production services
Straight C Corporation Conversion – Business Considerations

- **REIT distribution requirements**
  - Is E&P purge manageable (assuming minimum 20-25 percent cash)?
  - Can the business meet the income distribution requirement on an ongoing basis?
  - Is there available tax basis for depreciation at REIT level to help reduce required annual distribution?

- **Assets and revenues**
  - What portion of business(es) will need to be housed in TRS?
  - What is nature of intangibles on the books?
  - Can revenue sources be classified as rents, without renegotiating customer contracts?

- **Organizational, other**
  - Is company closely held, or concentrated pension fund ownership?
  - Will private letter ruling be required?
  - Will debt need to be restructured or reduced?
### Straight C Corporation Conversion

**Shareholders**  
(Widely Held, at least 100)

**Company**  
(New REIT)

- REIT election filed on tax return due date
- Holds qualifying real estate
- Receives qualifying rental income
- Purges E&P before end of first REIT year

**Taxable REIT Subsidiary**

- Non-qualifying assets or income sources, other active businesses contributed to TRS
- Not consolidated with REIT for tax
- Election retroactive only 75 days (i.e., file before REIT election)
- TRS securities not exceed 25% REIT gross assets
Nontraditional REITs
David Lee
Rev. Rul. 73-425 – total energy system
Rev. Rul. 69-94 – railroad properties
Rev. Rul. 71-220 – mobile home units
Rev. Rul. 75-424 – microwave transmission system
PLR 200725015 – electricity transmission system
PLR 199904019 – cold storage warehouse
PLR 200041024 – rooftop site & platform
PLRs 200752012, 200921019, 201034010, 201037005 – data center
PLR 200937006 – natural gas pipeline system
PLR 201005018 – terminaling & storage facility
PLR 201250003 – offshore platform
PLR 201204006 – outdoor signs and sign superstructures
201129007 – wireless and broadcast communications sites

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## Nontraditional REITs – Current landscape

<table>
<thead>
<tr>
<th>Type</th>
<th>Completed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data center</td>
<td>CoreSite, CyrusOne, Digital Realty, Dupont Fabros Technology</td>
</tr>
<tr>
<td>Correctional and detention facilities</td>
<td>Corrections Corporation of America, Geo Group</td>
</tr>
<tr>
<td>Excess MSRs*</td>
<td>Newcastle Investment**</td>
</tr>
<tr>
<td>Single family home rental</td>
<td>Silver Bay Realty</td>
</tr>
<tr>
<td>Wireless infrastructure</td>
<td>American Tower</td>
</tr>
<tr>
<td>Energy infrastructure</td>
<td>CorEnergy Infrastructure Trust</td>
</tr>
<tr>
<td>Railroad</td>
<td>Power REIT (formerly Pittsburgh &amp; West Virginia Railroad)</td>
</tr>
<tr>
<td>Ski, golf, attractions, marinas</td>
<td>CNL Lifestyle Properties</td>
</tr>
</tbody>
</table>

* Mortgage Servicing Rights  
** Pending spinoff as New Residential Investment
Nontraditional REITs – Current landscape (continued)

<table>
<thead>
<tr>
<th>Type</th>
<th>Completed</th>
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</thead>
<tbody>
<tr>
<td>Gasoline station and convenience store</td>
<td>Getty Realty</td>
</tr>
<tr>
<td>Timber</td>
<td>Plum Creek, Potlatch, Rayonier, Weyerhaeuser</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Type</th>
<th>Pending</th>
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</thead>
<tbody>
<tr>
<td>Records storage</td>
<td>Iron Mountain</td>
</tr>
<tr>
<td>Outdoor advertising</td>
<td>CBS Outdoor, Lamar Advertising</td>
</tr>
<tr>
<td>Energy infrastructure</td>
<td>Hannon Armstrong Sustainable Infrastructure Capital</td>
</tr>
<tr>
<td>Casino</td>
<td>Penn National Gaming</td>
</tr>
</tbody>
</table>

- Completed carve-out transactions in the senior living sector
  - Ventas/Atria Senior Living
  - Health Care REIT/Sunrise Senior Living
Value-enhancing transactions

Steven Moore
REIT sector performance and key characteristics

**REIT Index RMS and S&P 500 Performance (2007-present)**

- MSCI U.S. REIT Index - Total Return Gross - USD (RMS) - Index Value
- S&P 500 Index (^SPX) - Index Value

**Major REIT Overview**

<table>
<thead>
<tr>
<th>Public REITs</th>
<th>172</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cumulative Market Cap (as of 2012)</td>
<td>$603 bn</td>
</tr>
<tr>
<td>12-month return</td>
<td>13.1%</td>
</tr>
</tbody>
</table>

**Breakdown by Type**

- Traditional
- Unconventional

**Correlation**

<table>
<thead>
<tr>
<th>Period</th>
<th>Value</th>
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</thead>
<tbody>
<tr>
<td>5-year</td>
<td>.96</td>
</tr>
<tr>
<td>1-year</td>
<td>.81</td>
</tr>
<tr>
<td>90 Days</td>
<td>.98</td>
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Source: CapitalIQ

MSCI U.S. REIT Index - Total Return Gross - USD (RMS) - Index Value

S&P 500 Index (^SPX) - Index Value

Source: REIT.com

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### REIT stock attributes

<table>
<thead>
<tr>
<th>Performance</th>
<th>Income</th>
<th>Inflation Protection</th>
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<tbody>
<tr>
<td>Outperforms S&amp;P 500 and Corporate Bonds</td>
<td>Dividend Stability</td>
<td>Returns Generally Outpace CPI</td>
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<tr>
<td>Growth &amp; Income Investment</td>
<td>Current Income Returns</td>
<td>High and Low Inflation Hedge</td>
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<table>
<thead>
<tr>
<th>Diversification</th>
<th>Liquidity</th>
<th>Transparency</th>
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</thead>
<tbody>
<tr>
<td>Low Correlation with Broader Market</td>
<td>Liquid Equity with Real Estate Exposure</td>
<td>Strong Corporate Governance</td>
</tr>
<tr>
<td>Complements Asset Allocation</td>
<td>Tactical Asset Allocation</td>
<td>Market and Tax Transparency</td>
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### Major REIT owners

#### Top 10 Holders
- BlackRock
- Vanguard
- Cohen & Steers
- State Street
- Fidelity
- ING
- Investco
- Daiwa A.M.
- ABP
- Capital Group Co.

#### Cumulative Ownership of the Top 10 Holders of Major U.S. REITs

<table>
<thead>
<tr>
<th>REIT</th>
<th>BlackRock</th>
<th>Vanguard</th>
<th>Cohen &amp; Steers</th>
<th>State Street</th>
<th>Fidelity</th>
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Source: CapitalIQ
### U.S. wireless tower industry

#### Assets
- Wireless Towers
- Underlying Land
- Other Technology Infrastructure

#### Tenants
- Wireless Carriers (Verizon, AT&T, T-Mobile, Sprint, etc.)
- Broadband Distributors
- Other (Broadcasters, WiFi, etc.)

#### Key Demand Drivers
- Mobile Device Penetration
- Voice and Data Utilization
- Technology Changes (2G, 3G, 4G)
Tower company business model overview

- Owned by Tower Company (AMT)
  - Tower structure – generally with the capacity for ~ 4-5 tenants
  - Land parcel owned or operated pursuant to a long-term lease
- Owned by Tenant (TEN)
  - Antenna equipment, including microwave equipment
  - Tenant shelters containing base-station equipment and HVAC
  - Coaxial cable

Source: AMT Investor Presentations

- Tower site footprint follows population patterns
  - Major cities
  - Outlying areas
  - Transportation Corridors

Source: AMT Investor Presentations
Tower company business model overview (continued)

<table>
<thead>
<tr>
<th>Key Business Model Elements</th>
<th>REIT-like</th>
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<tbody>
<tr>
<td>Long-Term tenant leases</td>
<td>✔️</td>
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<tr>
<td>High lease renewal rates</td>
<td>✔️</td>
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<tr>
<td>High operating leverage</td>
<td>✔️</td>
</tr>
<tr>
<td>Low maintenance capital expenditures</td>
<td>✔️</td>
</tr>
<tr>
<td>Growth opportunities</td>
<td>✔️</td>
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</tbody>
</table>

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  - Tower site footprint follows population patterns
    - Major cities
    - Outlying areas
    - Transportation Corridors
- Owned by Tenant (TEN)
  - Antenna equipment including microwave equipment
  - Tenant shelters containing base-station equipment and HVAC
  - Coaxial cable

Source: AMT Investor Presentations
American Tower Corporation – Overview

AMT Key Highlights

- Largest U.S. wireless tower owner
- 47,000 tower sites
  - 21,600 cities in the United States
  - 25,000 international sites
- Lease to wireless service providers
- 98% total revenue is generated from leasing

Valuation Overview – 2013E

<table>
<thead>
<tr>
<th></th>
<th>EV</th>
<th>EV/EBITDA</th>
<th>Net Debt</th>
<th>Price/FFO</th>
<th>Price/AFFO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$36.1 bn</td>
<td>17.0 x</td>
<td>$8.3 bn</td>
<td>23.1 x</td>
<td>24.5 x</td>
</tr>
</tbody>
</table>

Source: CapitalIQ and AMT Investor Presentations
American Tower Corporation – REIT conversion timeline

Indexed Performance – 5/19/2010 to Present

1. Announced plan to convert to REIT Status
2. Began disclosing REIT statistics
3. Conversion complete
4. First Dividend Distribution

Source: CapitalIQ
Did it work?

Share Price Return %

EV/EBITDA

Source: CapitalIQ
Did it work? (continued)

<table>
<thead>
<tr>
<th>Equity Ownership</th>
<th>Equity Research Chart</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holdings of the Top 15 U.S. REITs</td>
<td><strong>Green Street Advisors</strong></td>
</tr>
<tr>
<td>Holdings of AMT ($ and % CSO)</td>
<td><strong>UBS</strong></td>
</tr>
<tr>
<td>BlackRock, Inc. (NYSE: BLK)</td>
<td><strong>Goldman Sachs</strong></td>
</tr>
<tr>
<td>8.0%</td>
<td><strong>Piper Jaffray</strong></td>
</tr>
<tr>
<td>The Vanguard Group, Inc.</td>
<td><strong>Citigroup</strong></td>
</tr>
<tr>
<td>6.3%</td>
<td><strong>Cowen and Company</strong></td>
</tr>
<tr>
<td>Cohen &amp; Stein Capital Management, Inc.</td>
<td><strong>Deutsche Bank</strong></td>
</tr>
<tr>
<td>4.9%</td>
<td><strong>RBC</strong></td>
</tr>
<tr>
<td>State Street Global Advisors, Inc.</td>
<td><strong>Credit Suisse</strong></td>
</tr>
<tr>
<td>4.8%</td>
<td><strong>Raymond James</strong></td>
</tr>
<tr>
<td>Fidelity Investments</td>
<td><strong>Merrill Lynch</strong></td>
</tr>
<tr>
<td>3.9%</td>
<td><strong>Oppenheimer Funds</strong></td>
</tr>
<tr>
<td>ING Investment Management LLC</td>
<td><strong>JP Morgan</strong></td>
</tr>
<tr>
<td>3.8%</td>
<td><strong>MacQuarie</strong></td>
</tr>
<tr>
<td>Invesco Ltd. (NYSE: IVZ)</td>
<td><strong>Morgan Stanley</strong></td>
</tr>
<tr>
<td>3.9%</td>
<td><strong>Wedbush</strong></td>
</tr>
<tr>
<td>Daiwa Asset Management Co. Ltd.</td>
<td><strong>Barclays</strong></td>
</tr>
<tr>
<td>2.9%</td>
<td></td>
</tr>
<tr>
<td>Stichting Pensioenfonds ABP</td>
<td></td>
</tr>
<tr>
<td>2.2%</td>
<td></td>
</tr>
<tr>
<td>Capital Research and Management Company</td>
<td></td>
</tr>
<tr>
<td>1.4%</td>
<td></td>
</tr>
<tr>
<td>42.1%</td>
<td>$8,883.1</td>
</tr>
<tr>
<td>Source: CapitalIQ</td>
<td>28.8%</td>
</tr>
</tbody>
</table>

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Key takeaways for AMT

**Tax Effects**
- Synthesized tax effectively previously enjoyed by NOL utilization

**Valuation**
- 52.6% implied value pickup since announcement

**Transparency**
- Enhanced disclosure and additional reporting

**Investor Base**
- Minimal dislocation of traditional telecom investors, limited REIT “mafia” acceptance

**Market Perception**
- Sell-side community perspectives largely unchanged
Key observations for broader REIT nontraditional applications

**Long Sale Cycle**
- KIMCO IPO was 1991 – Modern REIT Era
- October 2001 S&P Inclusion
- Multiyear Investor Conditioning Exercise

**Old Habits We Have to Break**
- Four Basic Food Groups + Hotels
- FFO, NOI, Cap Rate vs. ARPU, Data Utilization
- Understanding Externalities – Technology, Spectrum, Incarceration Rates

**Likely to Proliferate**
- Tax Efficiency
- Value Premium
- Regulatory Scrutiny
Foreign investors, REITs and exit strategies

Angela Yu
Foreign investors and REITs

- U.S. generally taxes all gains from a sale or disposition of U.S. real property interest.
- A foreign owner of REIT stock may be exempt from U.S. tax on the gain from exit under certain situations.
- Everything being equal, a foreign investor gets more residual cash flow investing in the stock of a REIT instead of a C corporation.
- In some instances, a foreign parent of a U.S. corporation may realize financial statement benefits when the U.S. subsidiary converts to a REIT.
- The REIT also operates as a blocker for foreign investors that do not wish to invest in U.S. partnerships directly.
- Each U.S. REIT determines its own earnings stripping limitation with respect to interest deductions.
Foreign investors and REITs

- Gain from a disposition of the stock of a USRPHC generally is treated as U.S.-sourced income taxable under FIRPTA.
- REITs generally qualify as U.S. real property holding companies (USRPHCs).
- FIRPTA does not apply to the gain from a disposition of:
  - The stock of a domestically controlled REIT
  - The stock of a publicly traded REIT by a shareholder that owns 5% or less of the REIT
  - The stock of USRPHC that has sold all its U.S. real property interest in a taxable transaction
Taxation of REIT distributions to foreign investors

- REITs may avoid U.S. corporate-level tax to the extent they distribute REIT taxable income dividends.
- Net cash flow to foreign investors is generally better under a REIT structure as compared to a C corporation structure.
- REIT ordinary dividends
  - If paid to taxable foreign investors, subject to U.S. withholding tax.
  - If paid to foreign governments and foreign pension plans, generally exempt from U.S. withholding tax.
- Capital gain dividends and similar distributions
  - If paid to taxable foreign investors, generally subject to FIRPTA* tax.
  - If paid to foreign governments by non-controlled REITs, generally exempt from FIRPTA tax.

* Foreign Investment in Real Property Tax Act
Application of FIRPTA on exit

- IRS Notice 2007-55 provides that regulations may treat liquidating distributions of REITs as subject to FIRPTA.
- Treasury Secretary Jacob Lew recently expressed concerns over the policy stated in Notice 2007-55.
- There are no monetary penalties for terminating REIT status.
- A corporation may not re-elect REIT status for five years after the termination.
- In some situations, there may be benefits to terminate a corporation’s REIT status before the assets have been sold.
Q&A
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