AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

# BDO KNOWS: FEDERAL TAX

## SUBJECT

## GUIDANCE ISSUED REGARDING CERTAIN STOCK DISTRIBUTIONS BY REITS AND RICS

## SUMMARY

On August 11, 2017, the Internal Revenue Service ("IRS") issued Revenue Procedure ("Rev. Proc.") 2017-45. The Rev. Proc. provides guidance regarding certain stock distributions by real estate investment trusts ("REITs") and regulated investment companies ("RICs"). In particular, if a Publicly Offered REIT or Publicly Offered RIC (as defined by the Rev. Proc.) distributes stock in a transaction meeting the requirements of the Rev. Proc., the IRS will treat the distribution of stock as a distribution of property to which Section 301 of the Internal Revenue Code ("Code") applies by reason of Section 305(b). Therefore, the distribution will be treated as a dividend to the extent of the REIT's earnings and profits and be eligible for the dividends paid deduction ("DPD"). The Rev. Proc. requires that shareholders must be able to elect to receive cash or stock and provides that the amount of cash to be distributed cannot be less than 20 percent of the aggregate declared distribution. The Rev. Proc. is very detailed and contains many definitions and requirements that must be met in order to comply with the guidance.

Rev. Proc. 2017-45's guidance is similar to the temporary guidance issued in previous Rev Procs., and in numerous private letter rulings.[1] Unlike the guidance in these previous Rev. Procs., the guidance in Rev. Proc. 2017-45 does not have an expiration date. The guidance in the Rev. Proc. is effective for distributions declared on or after August 11, 2017.

## CONTACT

**JULIE ROBINS**
National Tax Office
Managing Director
512-391-3534 / jrobins@bdo.com

**JEFFREY N. BILSKY**
National Tax Office Partner &
Partnerships Technical
Practice Leader
404-979-7193 / jbilsky@bdo.com

1 Rev. Proc. 2008-68 was issued as a result of the economic downturn during that period and was amplified and superseded by Rev. Proc. 2009-15, which was later extended three years by Rev. Proc. 2010-12. These earlier Rev. Procs. required only at least 10 percent of the distribution to be in cash. After the expiration of Rev. Proc. 2010-12 on December 31, 2011, REITs and RICs that wanted certainty as to the tax treatment of a distribution containing a cash or stock election would have had to file for a private letter ruling.

# DETAILS

## Law

Generally, gross income does not include the amount of any distribution of the stock of a corporation made by such corporation to its shareholders with respect to its stock.[2] However, the general rule does not apply to a distribution by a corporation of its stock if the distribution is at the election of any of the shareholders and payable either in its stock or in property.[3] The general rule also does not apply to a distribution by a corporation of its stock if the distribution has the result of the receipt of property by some shareholders and an increase in the proportionate interests of other shareholders in the assets or earnings and profits of the corporation.[4] In such cases, the distribution is treated as a distribution of property to which Section 301 applies and will be included in gross income and treated as a dividend to the extent of the corporation's earnings and profits.

If any shareholder has the right to an election or option with respect to whether a distribution is to be made either in cash or any other property, or in stock or rights to acquire stock of the distributing corporation, then, with respect to all shareholders, the distribution of stock is treated as a distribution of property to which Section 301 applies regardless of (1) whether the distribution is actually made in whole or in part in stock or in stock rights, (2) whether the election or option is exercised or exercisable before or after the declaration of the distribution, (3) whether the declaration of the distribution provides that the distribution will be made in one medium unless the shareholder specifically requests payment in the other, (4) whether the election governing the nature of the distribution is provided in the declaration of the distribution or in the corporate charter or arises from the circumstances of the distribution, or (5) whether all or part of the shareholders have the election.[5]

Treasury Regulation Section 1.305-1 (b)(2) provides that, if a corporation that regularly distributes its earnings and profits, such as a RIC, declares a dividend pursuant to which the shareholders may elect to receive either cash or stock of the distributing corporation of equivalent value, the amount of the distribution of the stock received by any shareholder electing to receive stock will be considered to equal the amount of the cash which could have been received instead. The regulation does not specifically mention REITs.

2 Section 305(a).

3 Section 305(b)(1).

4 Section 305(b)(2).

5 Regulation Section 1.305-2(a).

## Rev. Proc. 2017-45

If a Publicly Offered REIT or a Publicly Offered RIC makes a distribution of stock in a transaction that complies with the Rev. Proc., then the IRS will treat the distribution of stock as a distribution of property to which Section 301 applies by reason of Section 305(b). The value of the stock received by any shareholder in lieu of cash will be considered to be equal to the amount of cash for which the stock is substituted.

The Rev. Proc. also states that if a shareholder participates in a dividend reinvestment plan ("DRIP"), the stock received by that shareholder pursuant to the DRIP is treated as received in exchange for cash received in the distribution.

A Publicly Offered REIT is defined as a real estate investment trust that is required to file annual and periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934.[6] A Publicly Offered RIC is defined as a regulated investment company the shares of which are (i) continuously offered pursuant to a public offering (within the meaning of section 4 of the Securities Act of 1933, as amended, (ii) regularly traded on an established securities market, or (iii) held by or for no fewer than 500 persons at all times during the taxable year.[7]

The Publicly Offered REIT or Publicly Offered RIC must make a distribution to its shareholders with respect to its stock and each shareholder must have a cash-or-stock election (as defined by the Rev. Proc.) with respect to all or part of the distribution. The existence of a cash-or-stock election does not affect the federal income tax treatment of the portion, if any, of the declared dividend that is not subject to the election. The percentage of total cash distributed cannot be less than 20 percent of the total distribution.

Every shareholder that does not elect to receive more than the cash limitation percentage must receive cash equal to the shareholder's elected cash amount. If the aggregate of all shareholders' elected cash amounts does not exceed the cash limitation amount, then each shareholder who elected to receive cash greater than the cash limitation percentage receives cash equal to that shareholder's elected cash amount.

If the aggregate of all shareholders' elected cash amounts exceeds the cash limitation amount, then each shareholder who elected to receive cash greater than the cash limitation percentage receives a pro rata amount of cash that corresponds to the shareholders total entitlement under a formula described in the Rev. Proc.

6 Section 562(c)(2).

7 Section 67(c)(2)(B).

The calculation of the number of shares to be received by a shareholder must be based upon a formula that utilizes the market price of the shares, is designed so that the value of the number of shares to be received corresponds as closely as practicable to the amount of cash to be received under the declaration with respect to that share, and uses data from a period of no more than two weeks ending as close as practicable to the payment date.

The entire amount of the distribution that is treated as a dividend pursuant to Section 301 is taxable to the shareholders regardless of whether the distribution is made in all stock, all cash or a combination of both. As such, both the cash and stock portions of the distribution qualify toward the distribution requirements of the REIT or RIC. The distribution also constitutes a DPD to the extent of the earnings and profits of the corporation.

## EFFECTIVE DATE

The revenue procedure is effective with respect to distributions declared on or after August 11, 2017.

## BDO INSIGHTS

- Publicly Offered REITs and RICs that want to issue distributions containing a cash-or-stock election to purge C corporation earnings and profits or to retain cash no longer need to file for a private letter ruling to receive certainty of tax treatment of the distribution as long as the guidance in the Rev. Proc. is followed. A distribution containing a cash-or-stock election could also be used to fulfill a deficiency dividend requirement.
- The Rev. Proc. is not effective for private REITs. Therefore, a private REIT that does not want to utilize a consent dividend must continue to file for a private letter ruling to the extent that it wants certainty as to the tax treatment of distribution containing a cash-or-stock election.