Internal Revenue Service

Department of the Treasury

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Date:
December 21, 2001

Legend:

Trust =

Corporation A =

State A =

Date 1 =

x =

Corporation B =

Business A =

Month 1 =

Dear :

This in in reply to a letter dated September 24, 2001, requesting rulings on behalf of Trust. The requested rulings are that:

1) A distribution of Corporation A stock that is declared and payable to shareholders of record on a date in December 2001 and paid in January 2002, will be treated for purposes of §§ 301, 311(b), 312, 316, 561, 562(e), 856, 857(b), 1001, 4981, and 6042 of the Internal Revenue Code as distributed on December 31, 2001, as provided under § 857(b)(9);

2) Payment of cash in lieu of fractional shares of Corporation A stock will not result in a preferential dividend under § 562(c); and

3) Trust will be entitled to a deduction for dividends paid in Corporation A stock and cash in lieu thereof under §§ 561, 562(a), and 857(b)(2)(B) based on the December 31, 2001 price of the Corporation A stock.

Facts:

Trust is a State A corporation that elected to be taxed as a real estate investment trust (REIT) beginning with its tax year ended Date 1. Trust owns buildings used in Business A that are leased to third-party operators. Trust has outstanding one class of common stock, which is traded on a national stock exchange.

Trust owns x percent of the outstanding common stock of Corporation A, which was formerly known as Corporation B. Trust acquired the Corporation A stock in Month 1 as rent for leasing certain real properties to Corporation A. Corporation A stock has appreciated since Month 1. Although the stock of Corporation A has not yet been registered with the Securities and Exchange Commission (SEC) or listed for trading on a stock exchange, Trust expects that Corporation A stock will be registered and listed on a national stock exchange by December 31, 2001.

Consistent with its normal dividend policy, Trust plans to declare a dividend in December, 2001, payable to its shareholders of record as of a December 2001 record date. The dividend will be paid in January 2002 at least in part with Corporation A stock held by Trust so that Trust may allocate its cash to debt service payments. The dividend payable in Corporation A stock is predicated on Corporation A registering its stock that is held by Trust with the SEC.

Trust will distribute Corporation A stock pro rata to all Trust shareholders as of the December 2001 record date, except that Trust will pay cash (using the same December 31, 2001 price) in lieu of fractional Corporation A shares to avoid the cost and administrative and shareholder inconvenience associated with fractional shares. The balance of the December 2001 dividend not satisfied with Corporation A stock will be paid with cash. Pursuant to § 857(b)(9), Trust intends to treat the dividend as distributed on December 31, 2001.

Law:

Section 857(a)(1) requires, in part, that a REIT's deduction for dividends paid for a tax year (as defined in § 561, but determined without regard to capital gains dividends) equal or exceed 90 percent of the REIT taxable income for the tax year (determined without regard to the deduction for dividends paid and by excluding any net capital gain).

Under § 4981, a REIT must distribute 85 percent of the REIT's ordinary income for the calendar year and 95 percent of its capital gain net income for such year to avoid imposition of a 4 percent excise tax.

Section 857(b)(9) provides that, for purposes of this title, any dividend declared by a REIT in October, November, or December of any calendar year and payable to shareholders of record on a specified date in such a month shall be deemed to have been received by each shareholder on December 31 of the calendar year and paid by the REIT on December 31 of the calendar year (or, if earlier, as provided in § 858) if the dividend is actually paid by the REIT during January of the following tax year.

Section 561(a) generally provides that the deduction for dividends paid shall be the sum of the dividends paid during the tax year and the consent dividends for the tax year. Under § 562(c), the amount of any distribution shall not be considered as a dividend for purposes of computing the dividends paid deduction unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference. Section 1.561-2 of the Income Tax Regulations provides that a dividend will be considered as paid when it is received by the shareholder. A deduction for dividends paid during the taxable year will not be permitted unless the shareholder receives the dividend during the taxable year for which the deduction is claimed. However, § 1.563-3 provides that a distribution made after the close of the taxable year that is considered as paid during the taxable year will be treated as distributed on the last day of the taxable year for purposes of applying § 562(a).

Section 1.562-2(a) provides that before a corporation may be entitled to a dividends paid deduction with respect to a distribution regardless of the medium in which the distribution is made, every shareholder of the class of stock with respect to which the distribution is made must be treated the same as every other shareholder of that class, and no class of stock may be treated otherwise than in accordance with its dividend rights as a class.

Section 301 generally provides for the treatment of distributions of property made by a corporation to its shareholders with respect to its stock. The amount of the distribution is the amount of money received by the shareholder plus the fair market value of any property received. Section 301(b)(1). The fair market value of the property is determined on the date of the distribution. Section 301(b)(3).

Generally, no gain or loss is recognized by a corporation when it distributes (with respect to its stock) either its own stock or property (as defined in § 317). Section 311. Section 311(b) provides that if a corporation distributes appreciated property to its shareholder with respect to its stock, the distributing corporation will be taxed as if it sold the appreciated property to the shareholder at fair market value.

A dividend is a distribution of property (qualifying under § 301) made by a corporation to its shareholders out of earnings and profits. Section 316. The date of distribution for distributions taxable as dividends (as defined in § 316) is the date of payment for purposes of determining the effect of the dividend on earnings and profits[1] and for purposes of claiming a dividend paid deduction.[2]

Analysis:

Trust is concerned about and seeks clarification regarding the time that property is considered distributed by a REIT under § 857(b)(9) and the other sections cited above, including §§ 301 and 311. Under the latter sections, the time of distribution of a dividend is generally the time when the distribution is actually made by a corporation. On the other hand, § 857(b)(9) permits a REIT to declare a distribution in October, November, or December and actually make the distribution in January of the following year while deeming that distribution as having been made on the last day of the prior year.

The prefatory language to the deemed distribution rule in § 857(b)(9) states that the rule applies for purposes of this title. Thus, it applies for all purposes of the Code and supersedes the general distribution rules of the Code.

Section 562 and the regulations thereunder do not directly address the effect of payment in cash in lieu of fractional shares of stock. However, if all shareholders are treated alike with respect to such distributions, the payment of cash in lieu of fractional shares will not result in any Trust shareholder being treated in a manner that is preferential to any other Trust shareholder. Consequently, this manner of making distributions of fractional shares will not violate the requirements of § 1.562-2(a).

In conclusion, we rule as follows:

1) In accordance with § 857(b)(9), the distribution of Corporation A stock declared in December 2001, and payable in January 2002 by Trust to shareholders of record on a date in December 2001, will be treated for all purposes of the Code as distributed on December 31, 2001.

2) The payment of cash in lieu of fractional shares of Corporation A stock will not result in a preferential dividend under § 562(c).

3) Trust will be entitled to a deduction for dividends paid in Corporation A stock and cash (in lieu of fractional shares of stock) under §§ 561, 562(a), and 857(b)(2)(B) based on the fair market value of the Corporation A stock on December 31, 2001.

Except as specifically set forth above, no opinion is expressed regarding the federal tax consequences of the transaction described above under any other provision

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[1] Rev. Rul. 62-131, 1962-2 C.B. 94; see also Rev. Rul. 65-23, 1965-1 C.B. 520.

[2] § 1.561-2(a)(1).

of the Code. Specifically, no opinion is expressed concerning whether Trust otherwise qualifies as a REIT under subchapter M, part II of the Code. Furthermore, no opinion is expressed concerning whether the Corporation A stock acquired by Trust in lieu of rental payments qualifies as “rents from real property” for purposes of § 856(c).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
Patrick E. White
Assistant to the Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosure:
Copy of this letter
Copy for 6110 purposes

cc: