

IRS Relaxes Stock Dividend Safe Harbor for Publicly Offered REITs and RICs in 2020

Recent IRS guidance reduces the minimum aggregate amount of cash required for certain distributions of stock and cash to qualify for the dividends paid deduction.

In order to enhance liquidity of publicly offered real estate investment trusts (REITs) and regulated investment companies (RICs), the Internal Revenue Service (IRS) has published Revenue Procedure 2020-19, which temporarily reduces to 10% the minimum aggregate amount of cash required to be offered to shareholders for distributions of stock and cash to be treated as dividends. This modifies the safe harbor in Revenue Procedure 2017-45, which requires a minimum of 20% cash in the aggregate to be offered to shareholders. The modified rules apply to distributions declared on or after April 1, 2020, and on or before December 31, 2020.

Background

To qualify as a REIT or RIC for US federal income tax purposes, a company must meet a number of requirements, including a requirement that its “dividends paid deduction” (*i.e.*, generally, the dividends it pays or is deemed to pay) must equal or exceed 90% of its taxable income for the taxable year, subject to certain adjustments. Section 305(b) of the Internal Revenue Code (Code) provides that distributions payable in either stock or cash at the election of shareholders may qualify as dividends under Section 301 of the Code.

Revenue Procedure 2017-45 sets forth safe harbor rules for ensuring that distributions of stock and cash by publicly offered REITs and RICs qualify as dividends under Section 301 of the Code. Among those rules is a requirement that shareholders are offered a minimum of 20% cash in the aggregate in such distributions. Revenue Procedure 2020-19 temporarily reduces such minimum required cash percentage from 20% to 10% for distributions declared on or after April 1, 2020, and on or before December 31, 2020; otherwise, the safe harbor rules of Revenue Procedure 2017-45 continue to apply.

Impact

REITs and RICs that are financially impacted by the COVID-19 pandemic may choose to make any distributions required to maintain REIT or RIC status partially in the form of stock, in order to preserve their liquidity. Revenue Procedure 2020-19 enhances the ability of REITs and RICs to pursue such cash preservation strategy.

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