

Client Alert

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Private Letter Ruling Exempts Subsidiary REITs From Preferential Dividend Rule

In a recent private letter ruling, the Internal Revenue Service concluded that a subsidiary REIT of a “publicly offered REIT” is exempt from the preferential dividend rule.

The preferential dividend rule affects whether a dividend payment is eligible for the dividends paid deduction applicable to REITs. In general, the preferential dividend rule requires that each class of stock be paid in accordance with its terms and that each share in a class be paid pro rata with every other share in the same class. Under the rule, a minor or inadvertent deviation from this requirement could lead to a REIT qualification failure if a large dividend becomes ineligible for the dividends paid deduction.

Beginning with the 2016 taxable year, the preferential dividend rule no longer applies to “publicly offered REITs.” Publicly offered REITs are REITs that are required to file annual and periodic reports with the SEC under the Securities and Exchange Act of 1934.

In Private Letter Ruling 201924003, the Internal Revenue Service considered dividends paid by a subsidiary REIT of a publicly offered REIT (the Parent REIT). Under generally accepted accounting principles, the subsidiary REIT was consolidated with the Parent REIT for purposes of financial reporting. As a result, the subsidiary REIT’s assets, income, loss and other activities were reported to the SEC as part of the Parent REIT’s reporting. Based on these facts, the Internal Revenue Service ruled that the subsidiary REIT itself met the definition of publicly offered REIT and thus was not subject to the preferential dividend rule.

The Internal Revenue Service’s broad reading of the statutory exception is welcome news to subsidiary REITs of public REITs facing the potentially draconian consequences of violating the preferential dividend rule.

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