

Internal Revenue Service

Department of the Treasury

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Washington, D.C. 20224

Person to Contact:

Telephone Number:

Refer Reply to:

CC:FIP:3/PLR-114860-00

Date:

December 5, 2000

LEGEND:

Trust =
Company A =
Company B =
Year 1 =
a =
b =
c =
d =
e =
f =

Dear _____ :

This ruling responds to a letter dated July 31, 2000, as well as subsequent correspondence, submitted on behalf of Trust, requesting several rulings under §§ 301, 305, 561, 562, and 857 of the Internal Revenue Code.

FACTS

Trust is a domestic corporation that has elected to be taxed as a real estate investment trust (REIT). Trust regularly distributes its earnings and profits as required under § 857(a)(1) of the Code. Trust stock has been publicly traded since Year 1. Trust owns a percent of the nonvoting and b percent of the voting stock of two corporations, Company A and Company B. Trust, Company A, and Company B are all involved in the acquisition, financing, development, management, and leasing of real estate properties.

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Trust intends to make a special dividend (Special Dividend). Its shareholders may elect to receive it in cash, stock, or a combination of cash and stock. Specifically, a shareholder may elect one of the following three options:

- A) c percent cash
- B) c percent Trust common stock, or
- C) d percent cash ("the cash percentage") and e percent Trust common stock.

Trust may elect to use a different cash percentage but anticipates that the range will be f to d percent. If a shareholder does not make an election, Trust has the right to make the distribution to the shareholder under option C (the "default election"). Trust may change the default election to option A or option B. Shareholders who elect to receive stock will be allocated a number of shares with a value equal to the amount of cash the shareholder would have received if the shareholder had elected an all-cash distribution (the "cash allocation amount"). This allocation will occur on the "valuation date," which is a few days prior to the distribution date. Because the value of a share of Trust stock may change between the valuation date and the distribution date, the value of the stock actually distributed to the Trust shareholders may not equal the cash allocation amount.

Furthermore, Trust will limit the total amount of cash it will distribute to the shareholders to the cash percentage multiplied by the total value of the cash and Trust common stock to be distributed as a Special Dividend ("maximum cash distribution"). Given this limitation, an adjustment may be made to the amount of cash distributed to shareholders who elect option A. If an adjustment is made, then the class of shareholders who elect option A will receive cash equal to the maximum cash distribution less the amount of cash distributed to shareholders electing option C ("the option A cash"). In this case, the option A cash will be distributed pro rata to the shareholders electing option A, with these shareholders receiving the balance of their dividend in Trust common stock.

LAW AND ANALYSIS

Section 857(a)(1) of the Code provides, in part, that the provisions of part II of Subchapter M of Chapter 1 (except §§ 856(g) and 857(d)) shall not apply to a REIT for a tax year unless the deduction for dividends paid during the year (as defined in § 561, but determined without regard to capital

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gains dividends) equals or exceeds 95 percent of its real estate investment trust taxable income.

Section 857(b)(2)(B) of the Code provides that in determining real estate investment trust taxable income, the taxable income of the REIT will be adjusted by, among other things, the deduction for dividends paid (as defined in § 561) computed without regard to that portion of such deduction that is attributable to the net income from foreclosure property.

Section 561(a) of the Code provides, in part, that the deduction for dividends paid shall be the sum of (1) the dividends paid during the taxable year, and (2) the consent dividends for the taxable year (determined under § 565).

Section 1.561-2(a)(1) of the Income Tax Regulations provides that a dividend will be considered paid when it is received by the shareholder.

Section 562(a) of the Code provides that the term dividend shall, except as otherwise provided in that section, include only dividends described in § 316 (relating to the definition of dividends for purposes of corporate distributions).

Section 562(c) of the Code provides that 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 to another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

Section 1.562-2(a) of the regulations provides, in part, that a corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class. Nor will a corporation be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled

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compared with any other class of stock. A preference exists if any rights to preference inherent in any class of stock are violated. The disallowance, where any preference in fact exists, extends to the entire amount of the distribution and not merely to a part of such distribution.

Section 301(a) of the Code generally provides that a distribution of property made to a shareholder shall be treated in the manner provided in § 301(c). Section 301(c)(1) provides that in the case of a distribution to which § 301(a) applies, that portion of the distribution that is a dividend (as defined in § 316) shall be included in gross income.

The term dividend is defined in section 316(a) as any distribution of property made by a corporation to its shareholders out of current or accumulated earnings and profits. The term dividend used in §§ 561 and 562 refers generally to dividends described in § 316.

Rev. Rul. 64-292, 1964-2 C.B. 182, holds that a nontaxable stock dividend made by a REIT does not qualify for the dividends paid deduction under § 857(a)(1) because the dividend does not qualify as a distribution of property for purposes of § 316.

Rev. Rul. 78-375, 1978-2 C.B. 130, concerns the treatment of shareholders who participate in a dividend reinvestment plan (DRIP) that offers a dividend reinvestment component and an optional purchase component. The revenue ruling provides that under either component, a Participant is treated as having a distribution to which section 301 applies by reason of section 305(b).

Rev. Rul. 83-117, 1983-2 C.B. 98, concerns whether dividend distributions made by a REIT would qualify for the dividends paid deduction. Both situations considered by the revenue ruling involve REITs that established a DRIP, under which shareholders may elect to have cash dividends on their common stock that would otherwise be distributed to them reinvested in the REIT's common stock. Under the first plan (Situation 1), stock acquired by shareholders under the DRIP is priced at 95 percent of its fair market value on the distribution date. The 5 percent discount approximates the costs that the REIT would otherwise incur in issuing new shares. Under the second plan (Situation 2), the stock is acquired at a price less than 95 percent of its fair market value on the distribution date.

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In Situation 1, Rev. Rul. 83-117 holds that the REIT is entitled to a dividends paid deduction for the amount of any distribution made in either cash or discounted stock. The plan treats the shareholders impartially by giving them an equal opportunity to reinvest. Moreover, the plan's discount is relatively small, resulting in relatively minor differences in the amounts received by shareholders of the same class.

In Situation 2 of Rev. Rul. 83-117, the plan's discount is no longer relatively minor, causing more than relatively minor differences in the amounts received by shareholders of the same class. Accordingly, Rev. Rul. 83-117 holds that the dividend in Situation 2 is preferential and the REIT is not entitled to a dividends paid deduction.

In Trust's case, the Special Dividend is treated as a taxable stock dividend under § 305(b). Furthermore, the Special Dividend does not involve preferential treatment with respect to shareholders choosing a particular option. Instead, the number of shares distributed will have a value equal to the amount of cash that would otherwise be distributed and will be valued on a date as close to the distribution date as possible. Unlike the facts of Rev. Rul. 83-117, there is no discount offered to shareholders that choose to take all or part of the Special Dividend in stock. Thus, this reinvestment right is within the minimal discount exception portrayed in Situation 1 of Rev. Rul. 83-117. Accordingly, the Special Dividend will qualify for the dividends paid deduction under §§ 561, 562, and 857, provided Trust has sufficient earnings and profits.

HOLDING

Based upon the information submitted in the ruling request, we rule as follows:

A shareholder of Trust who receives all or part of the Special Dividend in stock will be treated as having received a distribution to which § 301 applies through the application of §§ 305(b)(1) and/or 305(b)(2) (§ 1.305-3; See Rev. Rul. 78-375, 1978-2 C.B. 130). For purposes of § 301, the amount of the distribution paid in stock will be equal to the value of the stock on the valuation date rather than on the date of distribution (§§ 1.305-1(b)(2) and 1.305-2(b), Example 2).

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We also rule that the Special Dividend will qualify for the dividends paid deduction under §§ 561, 562, and 857, provided Trust has sufficient earnings and profits.

Except as specifically ruled upon above, no opinion is expressed or implied regarding the consequences of this transaction under any other provision of the Code. In particular, no opinion is expressed whether Trust qualifies as a REIT under § 856 of the Code. Furthermore, no opinion is expressed whether Trust meets the 10 percent voting securities requirement of § 856(c)(4)(B) through its interests in Company A and Company B.

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

Sincerely yours,
Acting Associate Chief Counsel
(Financial Institutions and Products)

By: Alice M. Bennett
Chief, Branch 3

Enclosures:

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