COVID-19: REVENUE PROCEDURE 2021-53

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As the economy continues to grapple with the continuing effects of the coronavirus (COVID-19) pandemic, companies are increasingly facing liquidity issues. Among those affected are real estate investment trusts (REITs) and regulated investment companies (RICs), which maintain their tax-advantaged status only if they are able to satisfy certain distribution requirements. Acknowledging the continuing need for enhanced liquidity in the current economic climate, the Internal Revenue Service (IRS) released Revenue Procedure 2021-53, which echoes Revenue Procedure 2020-19 in providing temporary guidance regarding the treatment of certain stock distributions by publicly offered REITs and publicly offered RICs under the Internal Revenue Code of 1986, as amended (Code).

If a corporation or other entity qualifies as a REIT or RIC as defined in the Code, it will generally not be subject to U.S. federal income tax on the taxable income distributed to stockholders, provided such distributions qualify for the deduction for dividends paid. The benefit of that tax treatment is that it avoids the “double taxation,” or taxation at both the corporate and stockholder levels, that generally results from owning stock in a corporation. To qualify as a RIC or REIT, an entity must, among other things, distribute annually at least 90 percent of its taxable income (adjusted without a deduction for dividends received and with special treatment for capital gains among certain other modifications). Failure to meet the annual distribution requirements jeopardizes the tax-advantaged status of such vehicles and implicates substantial taxes upon the entity.

Revenue Procedure 2017-45 provides a safe harbor that allows publicly offered REITs and publicly offered RICs to satisfy their distribution requirements through distributions of a combination of cash and stock provided that certain requirements are met. One of the conditions requires that the amount of cash offered to all stockholders must make up at least 20 percent of the total distribution (the Cash Limitation Percentage). Where each condition set forth in Revenue Procedure 2017-45 is met, the IRS will treat the stock distribution as a distribution of property under Code Section 301 by reason of Code Section 305(b), and the value of the stock received by any shareholder in lieu of cash will be considered to be equal to the amount of cash that could have been received instead.

Revenue Procedure 2021-53 modifies the safe harbor set forth in Revenue Procedure 2017-45 by again announcing a temporarily reduction of the Cash Limitation Percentage to 10 percent, thus allowing such REITs and RICs to further limit the amount of cash required to be distributed to shareholders. This temporary reduction applies to distributions declared on or after 1 November 2021, and on or before 30 June 2022. Revenue Procedure 2020-19 applied the same lower limit to distributions declared on or after 1 April 2020 and on or before 31 December, 2020. Both Revenue Procedures are intended to enable publicly offered REITs and publicly offered RICs to conserve capital and thereby enhance their liquidity.

The safe harbor only applies to REITs and RICs that are “publicly offered.” A REIT is considered “publicly offered” if it is required to file annual and periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934. A RIC is considered “publicly offered” if its shares are (i) continuously offered pursuant to a public offering, (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.

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