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IRS Completes Review of REIT Ruling Standards and Resumes Issuing Rulings

On November 14, the IRS contacted many firms to let them know that the so-called REIT working group has completed its task. The IRS's temporary hold on issuing rulings on what constitutes real property for REIT purposes is over.

At least three public companies have issued press releases about their conversations with the IRS on this topic. Iron Mountain Incorporated, Equinix, Inc. and Lamar Advertising Company have each stated that it received word from the IRS that the IRS has resumed working on each company's respective ruling. The IRS itself has not made any formal announcements or issued any public guidance about the working group or its conclusions.

As we noted in our publication discussing Iron Mountain, we expect the IRS will continue its traditional approach of analyzing each particular private letter ruling request it receives based on the specific facts presented. It will continue to carefully make judgments consistent with the Internal Revenue Code, the Treasury Regulations and existing IRS published guidance. As in the past, the IRS will not grant every private letter ruling requested.

Recent REIT conversions that have garnered significant press attention are not a result of a change in the definition of real estate or the way in which the IRS interprets that definition. To be a REIT, a company must own real property. All of the companies that have recently converted to REIT status own significant assets that have always qualified as real estate. Contrary to recent press reports, the IRS has not expanded the definition of "real estate" to make the REIT structure more widely available than Congress intended. Rather, the IRS has interpreted the definition of real estate with remarkable consistency and integrity, applying the law strictly as Congress intended it. Each ruling issued by the IRS with respect to a REIT conversion has simply confirmed that the taxpayer's assets are real estate, as that term has always been understood.

Some have suggested that the IRS is expanding the REIT rules to allow companies outside the intended parameters of REIT status to become REITs and that this expansion is harmful to the economy and the Treasury. This is inaccurate. Companies have become REITs over the years in response to economic incentives, including, in recent cases, the demand for yield-producing investments at a time when alternative investment returns are at record lows. Such investments are in short supply because of the Federal Reserve's policy of quantitative easing.

REITs have always presented a unique investment opportunity across a wide range of sectors. Restaurants, retailers and casinos have always been able to transfer any real estate that they own to a REIT if they separate their active business operations into a taxable entity. REITs have been investing in shopping malls and other properties that rent to retailers and restaurants for decades. Jobs at these active businesses aggregated with jobs at REITs themselves number almost one million for publicly traded REITs alone. Any increase in companies electing to become REITs is attributable to the current economic climate making REIT stock particularly attractive to investors and therefore more valuable.

The definition and interpretation of what constitutes real estate remains unchanged and true to the legislative intent behind the REIT rules. We expect that, consistent with its prior practice, the IRS will continue to thoughtfully and thoroughly analyze the issues when it is asked to rule on what constitutes real property for REIT purposes.