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KPMG report: Regulations addressing treatment under section 199A, dividends paid by REITs

The U.S. Treasury Department and IRS on January 18, 2019, released versions of final regulations and proposed regulations under section 199A that relate to the treatment under section 199A of dividends paid by real estate investment trusts (REITs).

- The **final regulations** [PDF 1 MB] include holding period requirements that must be satisfied for REIT dividends to be eligible for the benefits of section 199A. In this report, these are referred to as the "Final Regulations."

- The new **proposed regulations** [PDF 124 KB] address the treatment of dividends paid by regulated investment companies (RICs) if the RIC has received REIT dividends. In this report, these are referred to as the "New Proposed Regulations."

These regulations were posted on the IRS website. Because of the partial shutdown of the federal government, it is uncertain when these regulations will be published in the Federal Register.

The following discussion provides initial impressions about these regulations.

20% deduction under section 199A

"Qualified REIT dividends" received by eligible taxpayers generally are eligible for a 20% deduction under section 199A. Under section 199A, qualified REIT dividends are dividends paid by a REIT that are neither qualified dividend income nor capital gain dividends (i.e., dividends already eligible, as a general matter, for taxation at rates applicable to long-term capital gain when received by eligible taxpayers).

Holding period requirement

An initial set of proposed regulations under section 199A was published in August 2018 (the "Initial Proposed Regulations"). The Initial Proposed Regulations included a holding period requirement under which the REIT shares must be held for a minimum of 45 days. Stakeholders had expressed concerns

that the holding period requirement was not provided by section 199A itself, and, moreover, would complicate the reporting of qualified REIT dividends by REITs on IRS Form 1099-DIV.

A holding period requirement has survived in the Final Regulations. Under the Final Regulations, in order for a dividend paid by a REIT to be eligible to be treated as a qualified REIT dividend, the shareholder must meet two holding period-related requirements.

- First, the shareholder must hold the REIT shares for a minimum of 46 days during the 91-day period that begins 45 days before the date on which the REIT share becomes ex-dividend with respect to the dividend. This holding period requirement is applied taking into account the principles of section 246(c)(3) and (c)(4).

- Second, the qualifying portion of the REIT dividend is reduced to the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property. These requirements mirror those set forth in section 246(c)(1).

In response to concerns expressed by stakeholders about the Initial Proposed Regulations, the preamble to the Final Regulations states that the Treasury Department and IRS intend to provide guidance to REITs and brokers about how to report qualified REIT dividends in circumstances in which it is impractical to determine whether the holding period requirements have been met. The preamble states that this guidance is expected to be similar to that applicable to qualified dividend income. The Treasury Department and IRS also intend to inform REIT shareholders that they may receive IRS Forms 1099-DIV that report qualified REIT dividends that are not in fact qualified REIT dividends (because the holding period requirement has not been met, but the REIT nonetheless has been permitted to report qualified REIT dividends).

Although the Final Regulations generally are effective for tax years ending after the date of their publication in the Federal Register, the holding period requirements described above are effective for tax years ending after December 22, 2017 (the date of enactment of Pub. L. No. 115-97).

REIT dividends received by RICs

The New Proposed Regulations address the application of the section 199A deduction to dividends paid by a RIC, when the RIC has itself received dividends from one or more REITs.

The RIC rules generally contemplate that a RIC's dividends take on the rate benefits of the RIC's underlying income (such as, for instance, tax-exempt interest and long-term capital gain). It had been unclear under the statutory language, however, whether any portion of a RIC's dividends would be eligible for the 20% deduction under section 199A as a result of the RIC having received dividends from a REIT. Addressing this issue has been a focus of stakeholders since the enactment of section 199A in December 2017 (Pub. L. No. 115-97).

The Initial Proposed Regulations did not resolve the issue. The New Proposed Regulations do.

Under the New Proposed Regulations, eligible taxpayers may receive dividends from a RIC (described by the New Proposed Regulations as "section 199A dividends") that the taxpayer can treat as if they were qualified REIT dividends. This is subject to several conditions.

- First, the taxpayer must satisfy the same holding period requirements (described above) for its holding of the shares of the dividend-paying RIC.

- Second, the RIC must report the dividends as section 199A dividends in written statements to its shareholders (presumably in Box 5 for "Section 199A dividends" on IRS Form 1099-DIV).

- Third, the aggregate amount of section 199A dividends reported by the RIC for the tax year cannot exceed the RIC's aggregate qualified REIT dividends less allocable expenses. The New Proposed Regulations specify that section 199A dividends "generally are also subject to the principles that apply to other RIC dividends."

This portion of the New Proposed Regulations may be relied upon until the date of the Treasury decision adopting these as final regulations is published in the Federal Register.

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