REIT Taxation and Data Centers: Basics, Developments, Structures & Predictions

May 14, 2018

Ameek Ashok Ponda
aponda@sullivanlaw.com
617 338 2443

Sullivan

SULLIVAN & WORCESTER

REITs

- Sullivan's REIT Practice
- Predictions
- What is a REIT?
- REIT Tax Structure
- Why are REITs Utilized?
- ORIAD Requirements
  - **O**rganization & Capital Structure
  - **R**evenue from Real Property
  - **I**ncome from Other Sources
  - **A**ssets
  - **D**istributions of Income
- Global REIT Considerations
- Developments
  - Tax Cuts and Jobs Act
  - Treasury Priority Guidance Plan
  - PATH Act
  - Alternative Tax Reform Proposals
- REITs as JV Vehicles and M&A Targets
  - Structures for JV Between Public REIT and Third-Party Investor
  - Tax-Related Deal Issues for JV REITs
  - Business Issues for a JV
  - Exit Issues for JV REITs
- Predictions Revisited

Sullivan’s REIT Practice

Sullivan & Worcester Client	Ticker	NAREIT Property Sector	1/31/18 Equity Market Capitalization ($M)
American Tower Corporation	AMT	Infrastructure	$62,773.9
Equinix, Inc.	EQIX	Data Centers	$35,464.7
Iron Mountain, Inc.	IRM	Specialty	$9,759.9
Hospitality Properties Trust	HPT	Lodging/Resorts	$4,666.9
Senior Housing Properties Trust	SNH	Health Care	$4,116.6
Select Income REIT	SIR	Office	$1,999.6
Government Properties Income Trust	GOV	Office	$1,650.4
Industrial Logistics Properties Trust	ILPT	Industrial	$1,469.0
Tremont Mortgage Trust	TRMT	Mortgage	$46.7
			$121,947.7
All Constituent Companies in the FTSE NAREIT All REITs Index			**$1,102,123.0**
Sullivan & Worcester Clients as Percentage of Total			**11.06%**

Predictions

- More data center targets will be REITs or “REIT ready”
- More foreign subsidiaries will be QRSs (rather than TRSs)
- Virtually all domestic JVs will involve a REIT
- The future of fiber and connectivity, as rent versus services, is the next big thing
- More countries will adopt a REIT structure
- Index fund ownership of REITs will persist and grow
- Global REITs will slowly deleverage and adopt multicurrency borrowings
- Normalization of new REITs will continue
- State tax authorities will take more notice of REITs

What is a REIT?

- A company that owns or finances investment real estate and that qualifies for and makes a special tax election
- Unlike a regular C corporation, a REIT is permitted to deduct dividends paid to its shareholders from its corporate taxable income
  - Most REITs distribute 100% of taxable income and therefore owe no income tax
  - Owners are subject to federal income tax on the dividends received
  - Most states in the U.S. conform to this U.S. federal treatment
  - Non-U.S. jurisdictions do not follow this U.S. federal treatment
- Note difference between qualification as a “REIT” for U.S. federal income tax purposes and organization as a real estate investment trust as a business form
- Designed like a mutual fund: provides a vehicle for passive investors to acquire a portfolio of real estate

REIT Tax Structure

Traditional C Corporation

Corporation Earns Return on Investment

↓

Tax on Income of the C Corporation

↓

Corporation Pays Dividend to Shareholders

↓

Tax on Dividend to Shareholders

Tax-Advantaged REIT

REIT Earns Return on Investment

↓

No Tax on Income of REIT*

↓

REIT Pays Dividend to Shareholders

↓

Tax on Dividend to Shareholders

*Assuming that all REIT taxable income is paid out as a dividend to REIT shareholders

Why are Public and Private REITs Utilized?

- REITs generally pay no income tax at the entity level
  - Income earned by a REIT is generally subject to only a single layer of tax at the shareholder level if the REIT distributes 100% of its REIT taxable income as a dividend to its shareholders
- REITs issue IRS Forms 1099 and 1042-S to shareholders instead of Forms K-1
  - Generally results in no state income tax and no state filing requirement for a shareholder
  - If there are any state income tax or state filing requirements, they are only in the shareholder's state of residence – i.e., there is no source-based state income taxation
- Investing in a REIT can be attractive to tax-exempt investors as dividends from a REIT typically are not treated as unrelated business taxable income (UBTI)
- REITs are attractive vehicles through which non-U.S. persons (particularly sovereign investors and non-U.S. pension funds) can invest in U.S. real estate

Why are Private REITs Utilized?

Non-U.S. persons are subject to tax on Effectively Connected Income (ECI)

REITs serve as blockers such that non-U.S. persons generally will not earn ECI by virtue of their investment in the REIT

FIRPTA can cause some REIT distributions and gain from the sale of REIT shares to be treated as if it was ECI

Exceptions from FIRPTA exist for certain REITs

Non-U.S. persons are still generally subject to tax and withholding on distributions from a REIT, even if FIRPTA does not apply

Certain classes of foreign investors can avoid even this withholding

Why are Private REITs Utilized?

- **General rules of taxation for non-U.S. persons**
  - Non-U.S. persons are taxed on ECI from a U.S. trade or business, regardless of source
    - ECI generally triggers a tax return filing requirement in the U.S.
    - ECI is typically taxed at high rates, including potential branch profits tax and U.S. state income taxation
  - Non-U.S. investors are taxed on U.S. source passive income (non-ECI), such as dividends and interest paid by a U.S. corporation, subject to reduction or elimination by treaty or by U.S. statute
    - The tax is generally collected via withholding at the source of payment to the foreign person
    - Treaties and U.S. statute can often reduce the tax rate to 15% or even 0%

Why are Private REITs Utilized?

- **As a regarded taxable entity, a REIT serves as a blocker for non-U.S. persons**
  - A non-U.S. shareholder will generally not be treated as engaged in a U.S. trade or business solely as a result of its investment in a REIT
  - U.S. tax return filing requirements are generally minimized for non-U.S. persons
  - Dividends paid by REITs are generally subject to the U.S. withholding rules applicable to dividends paid by any U.S. corporation
  - Rate of withholding on dividends is generally 30%, but often reduced by treaty or by U.S. statute to as little as 15% or even 0%
- But, FIRPTA is an exception to the above favorable rules

Why are Private REITs Utilized?

- **FIRPTA and REITs – General Concepts**
  - REIT distributions attributable to the disposition of underlying U.S. real estate may be subject to tax under the Foreign Investment in Real Property Tax Act (FIRPTA) regime and obligate non-U.S. persons to file U.S. income tax returns
    - FIRPTA considerations often lead to careful tax structuring of U.S. real estate transactions, including possible activity restrictions on the monetization and disposition of the investment
  - FIRPTA treats the gain or loss realized by a non-U.S. investor from the disposition of a U.S. real property interest as ECI
    - FIRPTA generally applies to any dividend by a REIT attributable to the REIT's gain from the disposition of a U.S. real property interest
    - If a non-U.S. person disposes of a U.S. real property interest, a portion of the sale proceeds generally is subject to a U.S. withholding tax
  - U.S. real property interests include land, improvements, leasehold interests, and certain personal property associated with real property
  - As important, U.S. real property interests include equity interests in U.S. corporations that are considered to be a "U.S. real property holding corporation"

Sullivan
SULLIVAN & WORCESTER

Why are Private REITs Utilized?

- **Exceptions to application of FIRPTA to REIT shareholders**
  - Stock in a "domestically controlled" REIT
  - Publicly traded stock in a REIT held by a 10% or less shareholder
  - Certain publicly traded entities, pensions and similar investment funds may own and dispose of any amount of stock in a REIT without the REIT stock being treated as a U.S. real property interest except to the extent an investor in the shareholder holds more than 10% of that class of REIT stock

Why are Private REITs Utilized?

- **FIRPTA and Non-U.S. Governmental Entities (i.e., sovereign investors)**
  - Generally, non-U.S. governmental entities are not subject to U.S. federal income taxation on dividends, interest and capital gains
  - To qualify for this exemption, it is important that the investment not be made by or through a "controlled commercial entity" (generally defined as an entity that is controlled by a non-U.S. government and is engaged in commercial activity)
  - REITs are used to avoid the recognition of income from commercial activities, but they must be structured to avoid classification as a controlled commercial entity of the foreign government
    - To cede "control", sovereign investor may opt for fewer veto/control rights
    - REIT shares can be held indirectly through a partnership
    - Exit events must generally be structured as a sale of shares in the REIT rather than a sale of fee title in real estate held by the REIT
  - An eligible investor may utilize this status to eliminate U.S. tax on regular REIT dividends and also on sales of REIT shares (even if not "domestically controlled"), but the exemption does not extend to REIT dividends attributable to FIRPTA dispositions

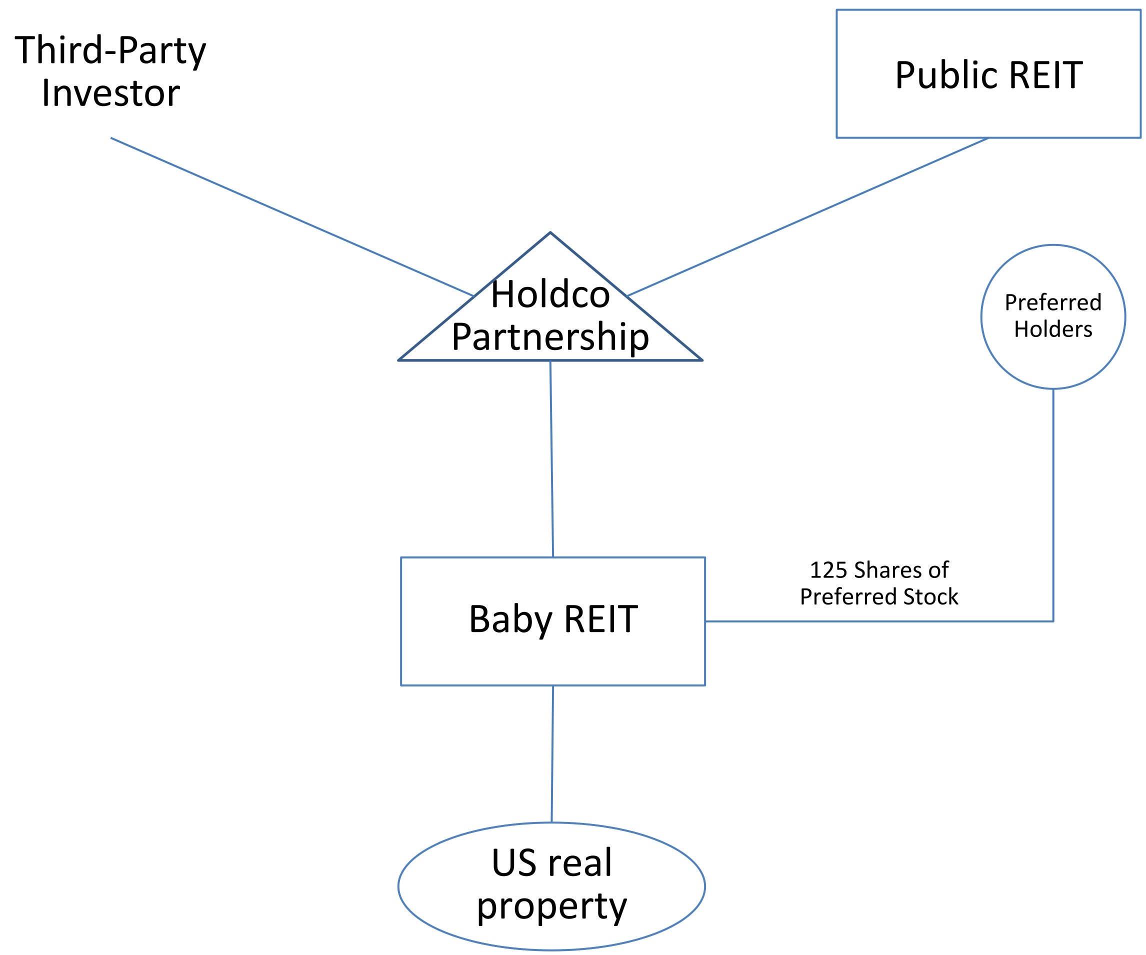
Sullivan
SULLIVAN & WORCESTER

Why are Private REITs Utilized?

- **FIRPTA and "Qualified foreign pension funds"**
  - Qualified foreign pension funds (including wholly-owned subsidiaries of such funds) are entirely exempt from FIRPTA
  - In order to qualify as a qualified foreign pension fund, certain U.S. requirements must be satisfied, including requirements relating to:
    - the taxation of the fund and its beneficiaries under the laws of the country in which it was formed
    - the composition of its beneficiaries
  - Although exempt from FIRPTA, qualifying foreign pension funds may still be subject to U.S. federal income tax under the general rules applicable to all non-U.S. persons, such as U.S. federal withholding tax on dividends from a REIT
    - However, income tax treaties often eliminate or reduce the U.S. federal withholding tax for pension funds
  - Practical Consideration: When the FIRPTA exemption for qualified foreign pension funds is combined with the elimination of dividend withholding, a foreign pension fund can effectively invest in U.S. real estate through a REIT without any U.S. federal or state income tax

Why are Private REITs Utilized?

Baby REIT Model



ORIAD Requirements

- To maintain REIT status, various requirements must be met:
  - **O**rganization & Capital Structure
  - **R**evenue from Real Property
  - **I**ncome from Other Sources
  - **A**ssets
  - **D**istributions of Income
- Relief Provisions

Organization & Capital Structure

- Shares must be held by at least 100 shareholders (aggregating common and preferred shareholders)
- No more than 50% of the value of a REIT's outstanding stock may be owned, directly or indirectly, by 5 or fewer individuals
- Organizational Documents
  - Typically contain restrictions on stock ownership/transfer to avoid becoming closely held or having affiliated tenants
  - Typically contain provisions relating to shareholder demand letters so that ownership can be ascertained
  - REIT must be "managed by one or more trustees or directors"

Organization & Capital Structure

- Annual Reporting
  - IRS Form 1099-type reporting to shareholders
  - IRS Form 8937 reporting with respect to distributions treated as a return of capital
- Various recordkeeping is required for asset tests, shareholder demand letters, related tenants, and independent contractors

Organization & Capital Structure

- Taxable REIT Subsidiary (TRS)
  - TRSs are subject to federal corporate income tax on their taxable income
  - TRSs are treated as separate corporations and are not consolidated with the REIT for income and asset testing, and are generally outside the activity restrictions and distribution requirements and considerations
  - "Bad" assets and businesses should be assigned to TRSs
- Qualified REIT Subsidiary (QRS)
  - QRSs are corporations that are wholly-owned by the REIT and for which a TRS election is not made
  - QRSs are transparent for income and asset testing purposes and thus are consolidated with the REIT for income and asset testing, and also for activity restrictions
  - Among REIT practitioners, QRSs colloquially include disregarded entities under the Section 7701 regulations
- Partnerships and Disregarded Entities
  - Partnerships and disregarded entities are transparent for income and asset testing purposes
  - Proportionate share rolls up for income and asset tests
  - Partnerships should be operated to fit within ORIAD

Organization & Capital Structure

Practical Considerations for Private REITs:

- Class A Preferred Shares are often issued in a private placement in order to satisfy the 100 shareholder requirement
- Investors in common stock will often indirectly own REIT shares through an entity taxed as a partnership for U.S. federal income tax purposes
- The limited partnership agreement of the holding partnership contains provisions designed to maintain the REIT's organizational requirements
  - "Qualified Assignee" concept prevents transfers that would cause REIT failure or cause qualifying REIT income to cease to so qualify
  - Investors are required to respond to shareholder demand letters
- No changes should be made to the Organization or Capitalization of the REIT structure (whether by waiver, amendment or otherwise) without legal documentation being reviewed by (internal or external) REIT specialists

Organization & Capital Structure

Practical Considerations for Private REITs:

- A partnership holding structure is safer with regard to a number of existential REIT requirements, as well as with respect to cross-border withholding mechanics and exposure
  - Governance provisions are documented in the upper-tier partnership agreement, reducing pressure on the “managed by [a board of] directors” requirement
  - REIT common dividends are paid to a single shareholder, narrowing the opportunities for the REIT to make problematic “preferential dividends”
  - Interposing a partnership on top of the REIT simplifies withholding mechanics under the Internal Revenue Code, and also makes consent dividends easier
  - It also simplifies a future sale of REIT shares, in that a future buyer can transact with the selling partnership and its general partner (to buy 100% of the target REIT)
    - FIRPTA compliance is also simplified as the buyer can accept a FIRPTA affidavit from the selling U.S. partnership as a U.S. person, and not have to investigate the status of the non-U.S. investors

Revenue from Real Property

- At least 75% of the REIT's gross income for each taxable year must consist of:
  - *Rents from Real Property*;*
  - Interest on obligations secured by Real Property (such as Mortgage Loans);
  - Dividends received on shares of other REITs;
  - Gain from the sale of shares of other REITs;
  - Dividends and interest from temporary investments of new capital (TINC) raised by the REIT;
  - Gain from the sale of Real Property that is not Dealer Property (gains on Dealer Property are subject to a 100% tax);
  - Abatements and refunds of real estate taxes; and
  - Income and gain from Foreclosure Property

* Terms in italics are defined in the Code or Regulations

Revenue from Real Property

- *Rents from Real Property* **include**:
  - Payments for use or occupancy of real property or interests in real property (§ 1.856-4(a))
  - Income received or accrued for certain services furnished to tenants, including:
    - Charges for services customarily furnished or rendered in connection with the rental of real property, whether or not separately stated
      - Services that are (a) furnished or rendered to the tenants of the REIT or, primarily for the convenience or benefit of the tenant, to the guests, customers, or subtenants of the tenant, and (b) are customarily provided to tenants in buildings which are of a similar class and in the same geographic market in which the building is located (§ 1.856-4(b)(1))
      - Services that either are not provided primarily for the tenant's convenience or are usually or customarily rendered in connection with the rental of rooms or other space for occupancy only (§ 1.512(b)-1(c)(5))
    - Amounts received for services performed by TRSs
      - For a discussion on the treatment of bundled versus separately stated charges for services performed by TRSs, see Decker, Kaplan, and Ponda, "Non-Customary Services Furnished By Taxable REIT Subsidiaries", 148 Tax Notes 413 (July 27, 2015)
  - Rent attributable to personal property leased under or in connection with a lease of real property (only if such rent does not exceed 15% of the total rent for the lease of both real and personal property) (§ 1.856-4(b)(2))

Revenue from Real Property

- *Rents from Real Property* **<u>exclude</u>**:
  - Rents determined in whole or in part on the income or profit of any person (though rent based on a fixed percentage or percentages of receipts or gross sales is acceptable) (§ 1.856-4(b)(3))
  - Any amount received from:
    - a corporation, of which the REIT owns (actually or constructively) 10% or more of the stock by vote or value, and
    - any other entity, of which the REIT owns an interest (actually or constructively) of 10% or more of the assets or profits (§ 1.856-4(b)(4))
  - Impermissible tenant service income
    - Favorable exception for service that either satisfies the standard of
    - § 1.512(b)-1(c)(5) or is provided through a TRS
    - When in doubt, use a TRS to provide services
  - **Practical Consideration:** With a baseline rental relationship in place, a TRS can be used to accommodate any related services that the tenant requires

REIT Services Timeline

- 1909: First corporate income tax
- 1911: *Eliot v. Freeman*, 220 U.S. 178 (real estate trusts exempt from corporate tax)
- 1935: *Morrissey v. Comm'r,* 296 U.S. 344 (real estate trusts subject to corporate tax)
- 1956-58: Early REIT legislation is vetoed and struggles
- 1960: Section 856 (REITs are born)
- 1962: § 1.856-4(b)(3)
- 1976: Section 856(d)(1)(B) and §§ 1.856-4(b)(1) and 1.856-4(b)(5)
- 1986: Section 512(b)(3) – UBTI Exception
  See also Rev. Rul. 2004-24, 2004-1 C.B. 550 (parking revenue)
- 2001: Section 856(l) – Taxable REIT Subsidiary
- 2002: Rev. Rul. 2002-38, 2002-2 C.B. 4*

*For a detailed exposition, *see* Decker, Kaplan, and Ponda, "Non-Customary Service Furnished By Taxable REIT Subsidiaries", 148 Tax Notes 413 (July 27, 2015)

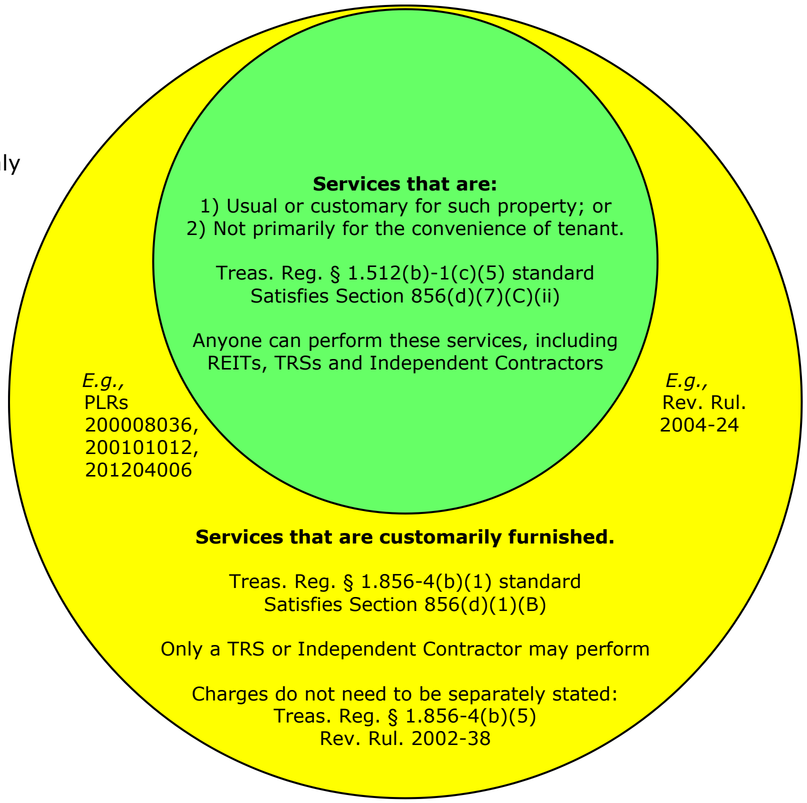
Services at REIT-Owned Properties

Independent Contractors

Treas. Reg. §1.856-4(b)(5)

Independent Contractor may perform only if:

- The cost of the services are borne by the independent contractor;
- A separate charge is made for the services;
- The amount of the separate charge is received and retained by the independent contractor; and
- The independent contractor is adequately compensated for the services.



Taxable REIT Subsidiaries

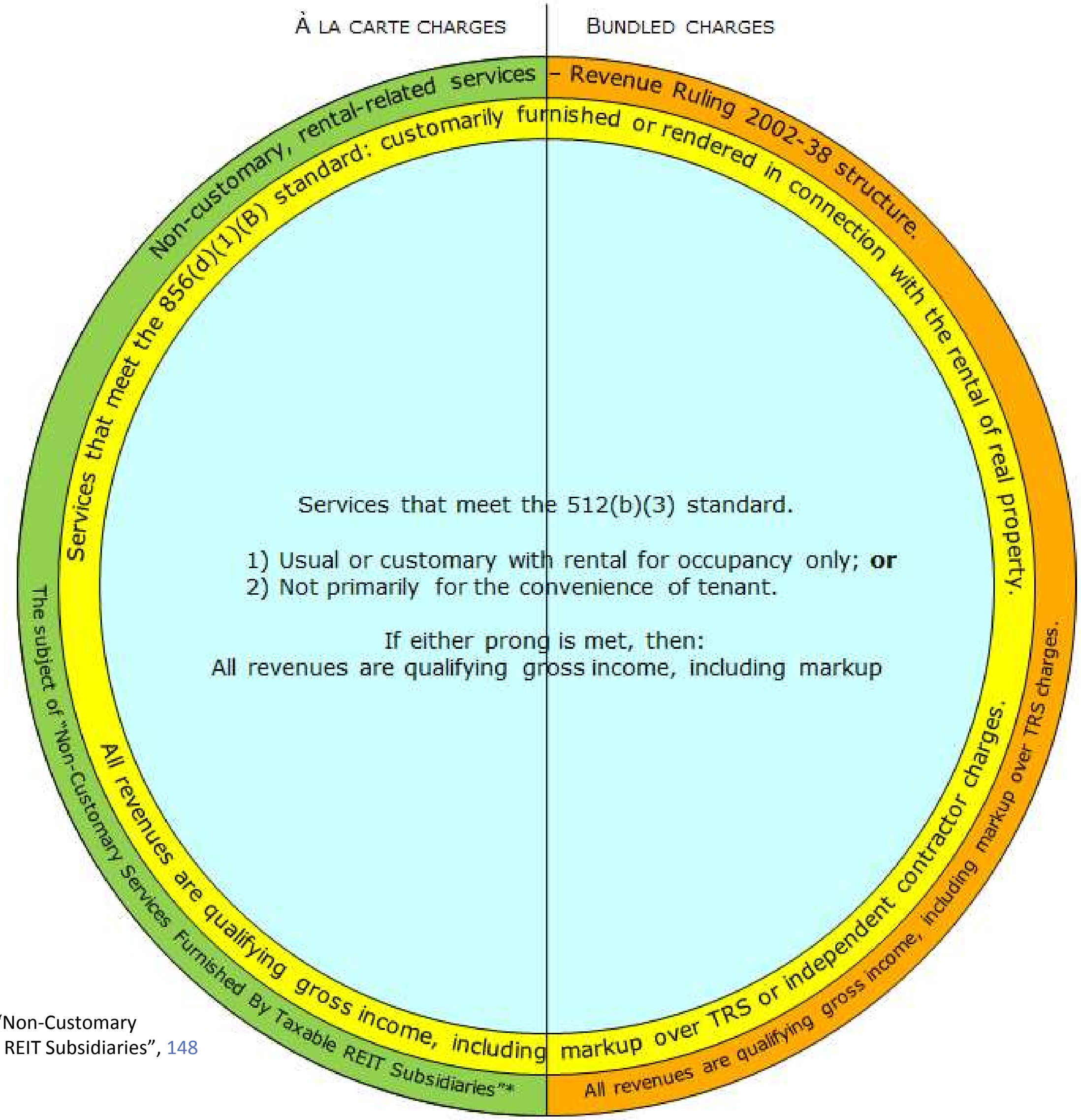
Section 857(b)(7)

Rev. Rul. 2002-38

Not a REIT qualification issue, but 100% tax unless:

- The REIT pays the TRS an arm's-length charge for the services or pays a 50% markup on the TRS's costs;
- The TRS provides a significant amount of similar services to unrelated parties for substantially comparable fees within the meaning of Section 857(b)(7)(B)(iii); or
- The charges are separately stated and rent paid by the tenant is comparable to rent paid by tenants not receiving the service, all within the meaning of Section 857(b)(7)(B)(iv).

Services at REIT-Owned Properties



*Decker, Kaplan, and Ponda, "Non-Customary Services Furnished By Taxable REIT Subsidiaries", 148 Tax Notes 413 (July 27, 2015).

Data Center REIT Alternatives

- Two models that might be deployed so that interconnection solutions fit within the REIT framework:
  - Super Rental Model, with a QRS handling all interconnection business
  - Pure Services Model, with a TRS occupying less than 10% of the leased property and operating the high-end of the interconnection business as a subcontractor for the QRS
- Each alternative draws a different line between rental and services
- The choice between the alternatives may depend upon technical information, industry developments, IRS feedback, contractual wording, etc.

Super Rental Model

- The interconnection operates as a single integrated system with all components in a QRS
- Customer "leases" access to interconnection infrastructure from a QRS
  - All revenues received by a QRS for rental access are treated as rent and thus qualifying REIT gross income
  - Very little tax leakage because there is little-to-no TRS involvement
- Routing the signal through the interconnection infrastructure is not viewed as a service, but instead is part of the access rights
  - All routing functions are performed automatically by components "leased"to customers
  - Thus, with the exception of elements such as humans performing "remote hands" and/or use of third-party services, no outside intervention or services are needed
- This is the model used for distributed antenna systems (DAS), digital billboards, and master antennas, and might be used for complex interconnections

Pure Services Model

- Interconnection components are owned and operated by a TRS
- Customers purchase services from a QRS which in turn subcontracts to a TRS, which runs the high-end interconnection business
  - QRS leases to a TRS necessary floor space which represents less than 10% of total occupied floor space
    - Under REIT rules, as long as the percentage leased by the TRS is less than 10% of the total "leased space" (usually a square footage concept), the TRS rent payments to the QRS can count as qualifying rent
    - Transfer pricing may be an issue, leading to both high tax leakage and TRS valuations that push up against the 20% TRS asset test limit
    - Perhaps transfer pricing can take into account "exclusive" permitted use
- This is effectively an internal PropCo-OpCo model
- This is the model used by REITs for staffed office suites, internal cafeterias, childcare centers, etc., and (for the time being) complex interconnections

Interconnection and Lit Fiber – Like the Coffee Mug and the Doughnut

Income from Other Sources

- At least 75% of a REIT's gross income must be derived from real property
  - Such as rents from real property, gain from the sale of real property, qualified rents, mortgage interest, dividends on or gains from the sale of REIT stock, or refunds of real property taxes
- At least 95% of a REIT's gross income must generally be passive in nature
  - Income from real property that satisfies the 75% requirement above
  - Other interest, dividends, or gains from the sale of non-REIT stock or other securities
- Thus, only 5% of gross income may come from "bad" sources
  - Bad rents from improperly structured leases
  - Impermissible services
  - Businesses other than rental real estate
  - **Practical Consideration:** REIT income tests basically come down to managing the 5% bad basket
- Income earned in TRSs is not consolidated with the REIT for gross income testing
- 100% tax on net income from sales or other dispositions of "dealer property"

Sullivan
SULLIVAN & WORCESTER

Assets

- No more than 25% of a REIT's assets may be represented by assets that do not count favorably toward the 75% asset test
- **Practical Consideration**: "Bad" assets may be segregated into taxable REIT subsidiaries
  - Stock in TRSs are "bad" assets, but are valued on a net equity basis
  - Assets held in TRSs are not consolidated with the REIT for asset testing
- No more than 20% of a REIT's assets may be represented by stock or other securities of TRSs
- Except for TRSs, the value of the securities of any one issuer owned by the REIT may not exceed 5% of the aggregate value of the REIT's assets
- Except for TRSs, a REIT may not own securities having a value of more than 10% of the total value or voting power of the outstanding securities of any one issuer
  - **Practical Consideration:** There is no *de minimis* test for the 10% vote or value tests—thus, a small security held by a REIT can cause a failure

Basic Framework of Finalized REIT Real Property Regulations

- Property must be broken down into “distinct assets”
- Distinct assets must be evaluated individually
- Assets that fall into one of three categories are considered real property for REIT purposes:
  - Land
  - Improvements to Land
    - Inherently Permanent Structures
    - Structural Components
  - Certain Intangible Assets
- Examples
- Effective Date and Transition Issues
- These new rules are for REIT purposes only, not depreciation, FIRPTA, etc.
  - *See* public comments of Ameek Ashok Ponda to Proposed Treasury Regulations § 1.856-10, available at 2014 TNT 177-22 (Aug. 11, 2014)

Sullivan
SULLIVAN & WORCESTER

Distinct Assets – § 1.856-10(e)

- Each “distinct asset” is evaluated separately from any other asset to which the distinct asset might relate, in order to determine if it is real property
- Whether or not a separately identifiable item is distinct is based on all facts and circumstances
- In particular, four factors must be taken into account:
  - Whether the item is customarily sold or acquired as a single unit rather than as a component part of a larger asset;
  - Whether the item can be separated from a larger asset, and if so, the cost of separating the item from the larger asset;
  - Whether the item is commonly viewed as serving a useful function independent of a larger asset of which it is a part; and
  - Whether separating the item from a larger asset of which it is a part impairs the functionality of the larger asset

Land – § 1.856-10(c)

- Includes water and air space superjacent to land
- Natural products and deposits that are unsevered from the land (such as timber, crops, ores and minerals) are real property
  - Once natural products are severed, extracted, or removed from the land, they no longer constitute real property
  - Natural products severed, extracted, or removed from the land do not become real property by the fact that they are stored in or upon real property

Improvements to Land – § 1.856-10(d)

- Inherently Permanent Structures
  - Includes buildings and other structures that are permanently affixed to either land or other inherently permanent structures
  - Affixation is considered permanent if it is reasonably expected to last indefinitely based on all of the facts and circumstances
  - Any distinct asset that serves an active function is not an inherently permanent structure
- Structural Components of Inherently Permanent Structures

Sullivan
SULLIVAN & WORCESTER

Inherently Permanent Structures – § 1.856-10(d)(2)

- A building is defined as a structure that encloses a space within its walls and is covered by a roof
  - Safe harbor - If permanently affixed, the following constitute buildings: houses, apartments, hotels, motels, enclosed stadiums and arenas, enclosed shopping malls, factory and office buildings, warehouses, barns, enclosed garages, enclosed transportation stations and terminals, and stores
- Other inherently permanent structures are structures that serve passive functions, such as to contain, support, shelter, cover, protect, or provide a conduit or a route – they do not serve any active function such as to manufacture, create, produce, convert, or transport
  - Safe harbor - If permanently affixed, the following constitute other inherently permanent structures: microwave transmission, cell broadcast and electrical transmission towers; telephone poles; parking facilities; bridges; tunnels; roadbeds; railroad tracks; transmission lines; pipelines; fences; in-ground swimming pools; offshore drilling platforms; storage structures; and stationary wharves and docks

Inherently Permanent Structures

- For distinct assets that fall outside the safe harbors, a facts and circumstances approach is used to determine if they are inherently permanent structures. In particular, five factors must be taken into account:
  - The manner in which the distinct asset is affixed to real property;
  - Whether the distinct asset is designed to be removed or to remain in place indefinitely;
  - The damage that would be caused to the item or to the real property to which it is affixed if the item were to be removed;
  - Circumstances that that might suggest that the affixation is not indefinite (such as lease terms); and
  - The time and expense required to move the distinct asset

Structural Components – § 1.856-10(d)(3)

- A structural component is any distinct asset that:
  - is a constituent part of and integrated into an inherently permanent structure,
  - serves the inherently permanent structure in its passive function, and
  - does not produce or contribute to the production of income other than consideration for the use or occupancy of space (even if it is capable of producing such income)
- Interconnected assets that work together to serve an inherently permanent structure with a utility-like function (such as electric, water, or heat systems) are analyzed as a single distinct asset

Structural Components

- A structural component may only qualify as real property if the REIT holds an interest in the structural component together with a real property interest in the space in the inherently permanent structure served by the structural component
  - The REIT need not hold equivalent interests in both the structural component and the inherently permanent structure that it serves
  - An affirmation and update of Rev. Rul. 73-425, 1973-2 C.B. 222, and a rejection of *Samis v. Comm'r*, 76 T.C. 609 (1981), in the REIT arena
  - For example, a REIT may lease a building shell or floor from a superior landlord, do a tenant-owned build-out of the interior, and the build-out can constitute the REIT's real property structural components within its leased (but not owned) space
- Safe harbor – The following distinct assets and systems are structural components if integrated into the inherently permanent structure and held together with a real property interest in the space in the inherently permanent structure served by the distinct asset or system:
  - Wiring; plumbing systems; central heating and air-conditioning systems; elevators or escalators; walls; floors; ceilings; permanent coverings of walls, floors and ceilings; windows; doors; insulation; chimneys; fire suppression systems, such as sprinkler systems and fire alarms; fire escapes; central refrigeration systems; security systems; and humidity control systems

Structural Components

- For distinct assets that fall outside the safe harbor, a facts and circumstances approach is used to determine if they are structural components. In particular, eight factors must be taken into account:
  - The manner, time, and expense of installing and removing the distinct asset;
  - Whether the distinct asset is designed to be moved;
  - The damage that removal of the distinct asset would cause to the item itself or to the inherently permanent structure to which it is affixed;
  - Whether the distinct asset serves a utility-like function with respect to the inherently permanent structure;
  - Whether the distinct asset serves the inherently permanent structure in its passive function;
  - Whether the distinct asset produces income from consideration for the use or occupancy of space in or upon the inherently permanent structure;
  - Whether the distinct asset is installed during construction of the inherently permanent structure; and
  - Whether the distinct asset will remain if the tenant vacates the premises
- Customized structural components are acceptable, and thus *Hospital Corp. of Am. v. Comm'r*, 109 T.C. 21 (1997), *nonacq.*, is rejected in the REIT arena

Intangible Assets – § 1.856-10(f)

- An intangible asset may be real property to the extent it meets three conditions:
  - It derives its value from real property or an interest in real property;
  - It is inseparable from that real property or interest in real property; and
  - It does not produce or contribute to the production of income other than consideration for the use or occupancy of space
- Licenses and Permits
  - A license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold or easement generally is an interest in real property
  - A license or permit to engage in or operate a business is not real property or an interest in real property if it produces or contributes to the production of income other than consideration for the use or occupancy of space

Examples – § 1.856-10(g)

- Thirteen examples
- An exposition of new real estate verticals – towers, pipelines, solar energy sites, data centers, cold storage warehouses
  - Outdoor real estate
  - Specialty buildings
- An applied demonstration of the various, multi-pronged facts-and-circumstances analyses
- A unified framework for real property intangibles, particularly the concept of capitalized value of Section 856(d)(1) "rents from real property" in § 1.856-10(g)(Example 11, Above-market lease)

Sullivan
SULLIVAN & WORCESTER

Effective Date and Transition Issues – § 1.856-10(h)

- Taxable years beginning after August 31, 2016 – *i.e.,* calendar 2017 is the start date in most cases
- Special transition for asset test grandfathering in Section 856(c)(4) flush language
- Taxpayers may choose to apply the new rules to earlier periods
- The new rules clearly impact REIT quarterly asset testing, but can also be impactful to REIT annual gross income testing, *i.e.,* "real property" underlies "rents from real property"
- The new rules are meant as a "restatement" of prior law that is built upon a coherent foundational framework
- Special rules for "green" infrastructure in the Treasury Decision preamble

What Impact on Prior Private Letter Rulings?

- New Regulations' impact on prior private letter rulings
  - Rev. Proc. 2017-1, 2017-1 I.R.B. 1, § 11.04(4)
  - "Nobody has a private letter ruling anymore"?
  - Prior rulings still valid to the extent "consistent" with new Regulations?
  - Prior rulings still valid to the extent "not inconsistent" with new Regulations?
  - Impact on public REIT markets
- Might older private letter rulings survive as "gloss" on the new Regulations? Yes, but caution is warranted in any such reliance:
  - New Regulations use a detailed framework for making "real property" determinations, whereas prior private rulings are not as clear on the applied criteria
  - PLR 200725015 (Mar. 13, 2007) (transmission and distribution system analyzed as an "integrated system" rather than new Regulations' framework of an inherently permanent structure and its constituent components)
- Caution is especially warranted when analyzing and concluding on intangible assets such as goodwill – new Regulations have a tighter definitional framework

Case Study – Chain-Link Fencing in a Data Center

- PLR 201314002 (Oct. 9, 2012) says that chain-link fencing within a data center is real property, presumably in partial reliance on the conclusion in Rev. Rul. 75-424 that outdoor fencing is real property
- But § 1.856-10(d)(3)(iii) and § 1.856-10(g)(*Example 7, Partitions*) now compel a much more nuanced and multi-factor analysis, and for this reason PLR 201537020 (May 22, 2015) is apparently more stingy on cage fencing

What Impact on Prior Private Letter Rulings?

- New Regulations "restate/codify" and solidify prior published rulings
- Except as specifically described in Treasury Decision 9784 and the prior Notice of Proposed Rule Making, the new Regulations were not intended to override or change prior published rulings
  - See public comments of Ameek Ashok Ponda to Proposed Treasury Regulations § 1.856-10, available at 2014 TNT 177-22 (Aug. 11, 2014)
  - See Ponda, "How Much Gain Would a REIT Defer if a REIT Could Defer Gain?", 135 Tax Notes 1249 (June 4, 2012)
- Do prior published rulings thus survive as a favorable "gloss" on the new Regulations – *i.e.,* different analysis but same bottom line conclusion? Yes, and Rev. Rul. 69-94, 1969-1 C.B. 189 (certain railroad assets are REIT real property) presumably fits this mold
- Might the new Regulations override or chip away at some conclusions from prior published rulings?

Case Study – Waveguides and Cabling at a Tower Site

- Rev. Rul. 75-424, 1975-2 C.B. 269, says that, although permanently encased and bolted to the steel tower, transmission lines and waveguides are not real property
- §§ 1.856-10(d)(2)(iii)(B) and 1.856-10(d)(3)(ii) now hold that such permanently installed wiring/transmission lines and conduits are per se real property, returning to the conclusion of GCM 36052 (Oct. 9, 1974)
- This has not been a material issue for tower REITs in that cabling is typically tenant-owned property
- But, the rule in § 1.856-10(d)(2)(iii)(B) (outdoor) and § 1.856-10(d)(3)(ii) (indoor) underlies and reinforces the distributed antenna system (DAS, aka “small cell networks”) conclusion in PLRs 201450017 (Aug. 29, 2014) and 201741002 (Jul. 12, 2017)

Case Study – Carbon Credits

- Outside of REIT arena, a carbon credit could arguably be any one of the following, depending on the design of the carbon credit program and on the interpretation and application of Rev. Rul. 92-16, 1992-1 C.B. 15:
  - A legal interest unsevered from the land (no realization event)
  - A legal interest severed from the land (realization event, but zero gross income inclusion)
  - An item of property received by the landowner *gratis* (realization event, but arguably zero gross income inclusion)
  - An item of property received by the landowner as *payment* for use of the land for a term of years, i.e., a temporary easement (realized rental income, with gross income inclusion equal to fair market value of received property)
  - *See, e.g.,* Feld, "Federal Taxation of State Tax Credits", 151 Tax Notes 1243 (May 30, 2016)
- Or is the starting point here whether carbon credits are a separate GAAP asset, per § 1.856-2(d)(3) (total assets are determined in accordance with GAAP), even though doing that might create a disconnect with Section 61 gross income measurement (and thus REIT gross income testing under § 1.856-2(c)(1))?

Case Study – Carbon Credits

- PLR 201123003 (Mar. 4, 2011) concluded that carbon credits are real estate assets
- PLR 201720008 (Feb. 15, 2017) concluded that income from the issuance of carbon credits is “good” REIT income
- In contrast, § 1.856-10(f) now suggests that, because they are separately tradable, carbon credits cannot be real property for REIT purposes
- PLR 201751011 (Sept. 14, 2017) prospectively modified and revoked PLR 201123003

Case Study – Data Centers

- Modular Containers
- Vapor Chamber

Distributions of Income

- Practical Considerations:
  - Most REITs distribute 100% of their taxable income to eliminate corporate income tax on retained income
  - Debt covenants must permit distributions
  - For private REITs, management fee waivers must be carefully reviewed to avoid preferential dividend issue
  - For private REITs, preferred dividend payments must be made on preferred stock in strict accordance with the terms of the charter

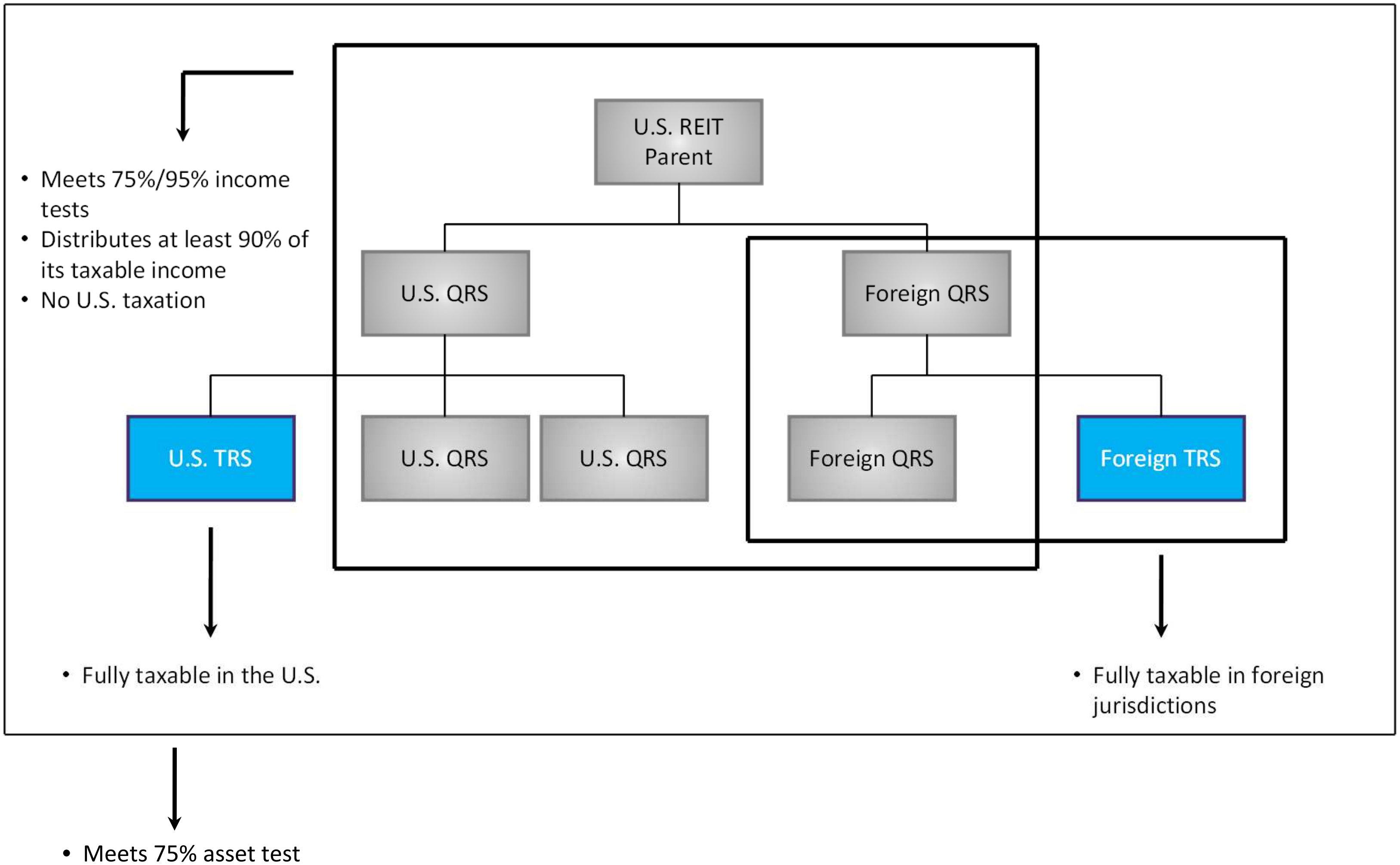
Relief Provisions

- Certain asset test violations may be cured by:
  - disclosing the violation (Section 856(c)(7)(A)(i)),
  - disposing of assets to the extent necessary to come into compliance with the asset test requirements (Sections 856(c)(4), 856(c)(7)(A)(iii) and 856(c)(7)(B)(ii)), and
  - if necessary, paying a penalty tax of the greater of $50,000 and the net income generated by violating assets (Section 856(c)(7)(C))
- Certain income test violations may be cured by a Section 856(c)(5)(J) PLR from the IRS, or by:
  - disclosing the violation (Section 856(c)(6)(A)), and
  - paying a penalty tax roughly equal to the amount by which the income test(s) was missed multiplied by a fraction intended to reflect the REIT's profitability (Section 857(b)(5))
- Distribution violations may be cured by:
  - making deficiency dividends or other distributions (Sections 852(e) and 860)
- Other violations may be cured by:
  - paying a penalty tax of $50,000 (Section 856(g)(5))

Global REITs – REIT Subsidiaries

- A TRS must be compensated at arm's-length pricing for services performed by it to the REIT's tenants/customers
  - The REIT must pay a 100% tax to the extent of any discount from arm's-length pricing provided by the TRS, but
  - The 100% tax will not apply (and general Section 482 sanctions apply) if the TRS is compensated at 150% of its costs for providing the service
- As a TRS accumulates income, it may distribute excess cash as a dividend
  - TRS dividends to the REIT are good income for the 95% gross income test, but not for the 75% gross income test
- A TRS may borrow from the REIT
  - Loans to a TRS count against the 20% asset test unless secured by real estate (e.g., foreign real estate in a foreign TRS)
  - Normal intercompany transfer pricing metrics are applicable; however, a 100% excise tax applies to interest that is excessive

Global REITs – REIT Subsidiaries*



* For a summary, *see* A. Ponda, "REITs Abroad," *Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2006*, Practising Law Institute (Sept. 2006-2008)

Global REITs

REIT	Ticker	Est. % Foreign	Regions/Countries
Equinix*	**EQIX**	**45%**	**China, Singapore, Japan, Australia, Netherlands, Canada, Brazil, UAE., UK, France, Germany, Ireland, Finland, Turkey, Italy, Sweden, Poland, Switzerland, and Bulgaria**
Prologis	PLD	44%	Canada, Mexico, Austria, Czech Republic, France, Germany, Hungary, Italy, Poland, Slovakia, Spain, Sweden, UK, China, Singapore, Netherlands, and Japan
American Tower*	**AMT**	**41%**	**Argentina, Brazil, Chile, Colombia, Costa Rica, France, Germany, Ghana, India, Mexico, Netherlands, Nigeria, Peru, Singapore, South Africa, Tanzania, and Uganda**
Iron Mountain*	**IRM**	**33%**	**Austria, Belgium, France, Germany, Ireland, Netherlands, Spain, Switzerland, UK, Sweden, Czech Republic, Denmark, Finland, Greece, Hungary, Norway, Poland, Romania, Serbia, Slovakia, Estonia, Latvia, and Lithuania, Turkey, Argentina, Brazil, Chile, Colombia, Mexico, Peru, Australia, New Zealand, China, India, Indonesia, Malaysia, Philippines, South Korea, Singapore, Thailand, South Africa, and UAE**
Digital Realty Trust	DLR	24%	UK, Netherlands, Ireland, Germany, France, Switzerland, Singapore, and Australia
Welltower, Inc.	HCN	19%	Canada, UK
SBA Communications	SBAC	17%	Canada, Central America, and South America
Public Storage	PSA	7%	UK and a 49% Investment in Shurgard (which operates in France, Sweden, UK, Netherlands, Belgium, Denmark and Germany)
Ventas, Inc.	VTR	6%	Canada, UK
Simon Property Group	SPG	4%	Austria, Italy, Germany, Japan, Malaysia, Mexico, Netherlands, South Korea, Canada, UK, with smaller equity stakes in ventures in several other countries
Host Hotels & Resorts	HST	3%	Asia Pacific, Canada, and Latin American

***Sullivan & Worcester LLP was counsel for REIT conversion (including IRS and SEC matters), and continues as counsel for REIT and tax matters.**

Challenges with a Foreign QRS

- Foreign cash favorably addressed by Section 856(c)(5)(K) and Rev. Rul. 2012-17
- Section 987 and Section 988 gains
  - REIT income testing favorably covered by Section 856(n); however, such gains can involve phantom income that impact REIT distribution requirements/planning
- Hedging gains under Sections 856(c)(5)(G) and 856(n)
  - Debt and currency hedges are covered; some asset hedging is achievable
  - With proper elections, qualified hedges are no longer a REIT income testing issue
- Foreign operations must be REIT-compliant in terms of asset and income testing
  - Commercial, language, and legal barriers
  - Issues with hiving off service employees in a separate TRS (e.g., payroll company)
  - Local group relief and local tax sharing agreements
  - VAT groupings and positions; statutory accounting and positions
- REIT distribution requirement imposed on QRS earnings
  - Repatriation of profits to the U.S. may encounter headwinds – capital controls, foreign withholding taxes, distributable reserves
  - Perhaps instead fund these distributions from depreciation-sheltered U.S. earnings, or from new capital raises

Sullivan
SULLIVAN & WORCESTER

Opportunities with a Foreign QRS

- Easier to satisfy 75%/20% REIT asset testing, which is the principal driver to the QRS answer, particularly if foreign assets are growing faster than U.S. assets
- Cross-border capital flows, guarantees, internal/external borrowings – all more transparent for REIT income and asset testing
- **Practical Consideration:** U.S. REIT parent is functionally tax-exempt in the United States, and planning possibilities often exist to limit foreign tax expense of non-U.S. subsidiaries

Challenges with a Foreign TRS

- Qualification issues
  - Satisfying 75%/20% REIT asset testing, which is the principal challenge
  - Intercompany loans adequately secured by real estate can help on 75%/20% REIT asset testing
  - "Classic" Subpart F income can qualify for the 95% income test – if based on TRS/CFC's FPHC income or in the case of certain Section 956 inclusions – but status of new Section 951A Global Intangible Low-Taxed Income ("GILTI") inclusions is unclear at best
  - PFIC income (including QEF inclusions) can qualify for the 95% test – if majority of TRS's income is FPHC-style passive income
  - Section 986(c) exchange gains can be excluded from REIT income testing
  - Commodities/foreign base company services income/insurance income
  - Guarantee fees for REIT parent guarantee of TRS's debt – Bank of America vs. Container Corp. (passive financial transaction vs. service)
  - Hedging gains
- Achieving conventional deferral
  - Subpart F's active rental exception, and Section 951A GILTI
  - Single vs. multi-tenanted properties

Opportunities with a Foreign TRS

- Deferral REIT-style is not about postponing U.S. taxes, but about postponing the distribution to REIT shareholders
- TRS activities do not need to be operated in REIT-compliant fashion
- Non-REIT activities may be hived off in a foreign (or domestic) TRS
- Foreign taxes of non-U.S. subsidiaries are managed with conventional structures
- Conversion from TRS to QRS can be achieved with check-the-box election and/or revocation of TRS election
  - Sections 481(a) and 964(a) depreciation recapture inside the TRS
  - Section 367(b) dividend income and impact on the 95% income test
  - Built-in gains tax on property disposed of during the five-year period following QRS conversion
- Conversion from foreign QRS to foreign TRS is much harder than domestically
  - Sections 351, 362(e)(2), 367(a)(3)(B)(v), 367(a)(3)(C), 367(d), 904(f), and 987; Treasury Regulation §§ 1.367(a)-2 and 1.367(a)-4(b), (c)
  - **Practical Consideration:** some or all gain triggered on outbound transfer

Foreign Tax Credit Planning

- As a practical matter, a REIT cannot use foreign tax credits – Rev. Ruls. 72-383 and 87-65; GCM 34871
  - No need for Sections 78 and 902
  - Section 338(g) elections are desirable, and Section 901(m) without practical impact
- Nor can the REIT pass through foreign tax credits to shareholders – no Section 853 analog for REITs
- Foreign taxes are deductible expenses – Sections 164(a)(3), 275(a)(4), and 901(a)
- **Practical Consideration:** foreign tax credit planning is thus about minimizing source country taxation
  - See OECD, "Tax Treaty Issues Related to REITs", ¶¶ 16 and 43 (Oct. 30, 2007)
  - See Ameek A. Ponda, "REITs Abroad," Practicing Law Institute's *Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2006* (September 2006).

Developments

- REITs under the Tax Cuts and Jobs Act
- Treasury Priority Guidance Plan
- REITs under the PATH Act
- REITs under alternative tax reform proposals

Tax Cuts and Jobs Act (P.L. 115-97) – REIT Related Highlights

- Interest Expense Limitation – REITs that make an election to be a "Real Property Trade or Business" are expected to be able to continue to fully deduct their interest expense under Section 163(j)
- International Tax Changes:
  - Repatriation of foreign E&P will result in a one-time income inclusion (or spread of 8 years at the taxpayer's election) under Section 965(m)
  - Territoriality and participation deduction do not apply to REITs under Sections 245A and 857(b)(2)(A)
  - Section 59A BEAT regime does not apply to REITs
  - Section 951A GILTI provisions create some uncertainty regarding income generated by foreign TRSs
- Tax Rate on Shareholder Distributions – REITs maintain a preferential tax rate relative to regular C corporations due to shareholders' 20% deduction under Section 199A on "qualified REIT dividends" (an effective tax rate of 29.6% versus 36.8%)

Sullivan
SULLIVAN & WORCESTER

Regulatory Developments and Pending Guidance Projects

- Under its 2017-2018 Priority Guidance Plan, the IRS is prioritizing the following:
  - Computational, definitional, and other guidance regarding the new business interest deduction limitation
  - Computational, definitional, and anti-avoidance guidance under the QBI regime
  - Definitional and other guidance regarding income inclusions based on financial statements
  - Guidance on implementing repatriation regime and other international sections of the Tax Cuts and Jobs Act
  - Guidance clarifying the definition of income in Section 856(c)(3) for purposes of the REIT qualification tests, *i.e.*, the 75% gross income test
  - Guidance regarding whether Subpart F inclusions and PFIC inclusions are treated as qualifying income
  - Proposed modification to Temporary Regulation § 1.337(d)-7T
    - Covers the intersection of REIT M&A with Section 355 spin-offs
    - See Letter from Nareit to the IRS regarding Certain Transfers of Property to RICs and REITs, available at 2014 TNT 177-22 (July 19, 2016)

PATH Act (P.L. 114-113) – Highlights*

- Repeal of preferential dividend rule for 34 Act reporting REITs**
- Improved rules for REIT hedging
- Improved rules for de minimis personal property
- FIRPTA relaxation thresholds increased from 5% to 10%
- Administrable and more favorable determinations of "domestically controlled" status
- Qualified foreign pension fund exemption works best with a private REIT structure
- TRS securities cap reduced from 25% to 20%
- New proscriptions on spin-and-go-REIT transactions and REIT-to-C spin offs***

* For a discussion of these changes, *see* "Real Estate Investment Trusts (REITs) and the Foreign Investment in Real Property Tax Act (FIRPTA): Overview and Recent Tax Revisions," Congressional Research Service (July 14, 2016)

** With regard to relaxing the preferential dividend rule for private REITs, *see* Letter from Nareit to the Internal Revenue Service regarding Notice 2016-26: Request for Comments Regarding Recommendations for Items that Should be Included on the 2016-2017 Priority Guidance Plan, available at 2016 TNT 98-14 (May 16, 2016)

*** See Letter from Nareit to the Internal Revenue Service regarding Certain Transfers of Property to Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs); Final, Temporary and Proposed Regulations (REG-126452-15) (the 2016 Regulations), available at https://www.reit.com/sites/default/files/NAREIT-Submission-on-Proposed-337(d)-Regulations(7-19-16).pdf

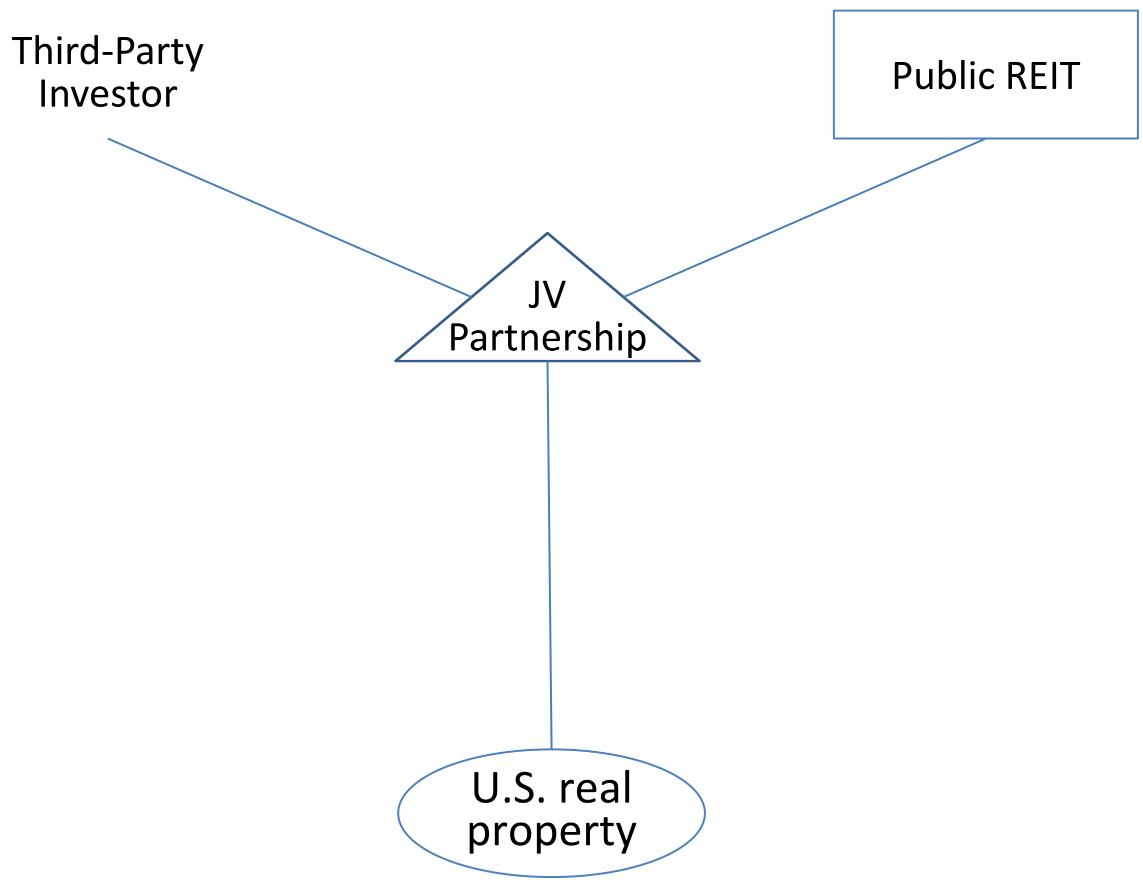
Taxation of REITs under a DBCFT*

- In moving from an income tax to a Destination Based Cash Flow Tax (DBCFT), no changes should be made to the various organizational, asset composition, and revenue composition tests for qualification for taxation as a REIT
- The immediate expensing of land should be allowed under a DBCFT for all taxpayers generally, and for REITs in particular
- It is crucial to maintain a single level of taxation for REITs under a DBCFT in order for REITs to fulfills their dual purpose of enabling small investors access to real estate markets and stabilizing the U.S. real estate markets
- In order for a single-level tax regime for REITs to function effectively, a REIT must be able to use its NOLs and distributions to offset up to 100% of its DBCFT base
- In order to fully and properly integrate a REIT's tax base with its shareholders' income tax base, Section 172(d)(6)(A) must be amended to include the dividends paid deduction in the NOL carryover computation to future REIT tax years
- Special issues exist for global REITs regarding territoriality, qualification and distribution requirements, active rental exception, and deferred foreign earnings on transition date**

* For a discussion of this topic by the author, *see* "Fundamental Thesis of REITs Should Continue Under Tax Reform, Sullivan & Worcester Partner Says," Nareit (April 19, 2017)
** A detailed memorandum describing the issues and recommendations for Global REITs is available from A. Ponda upon request

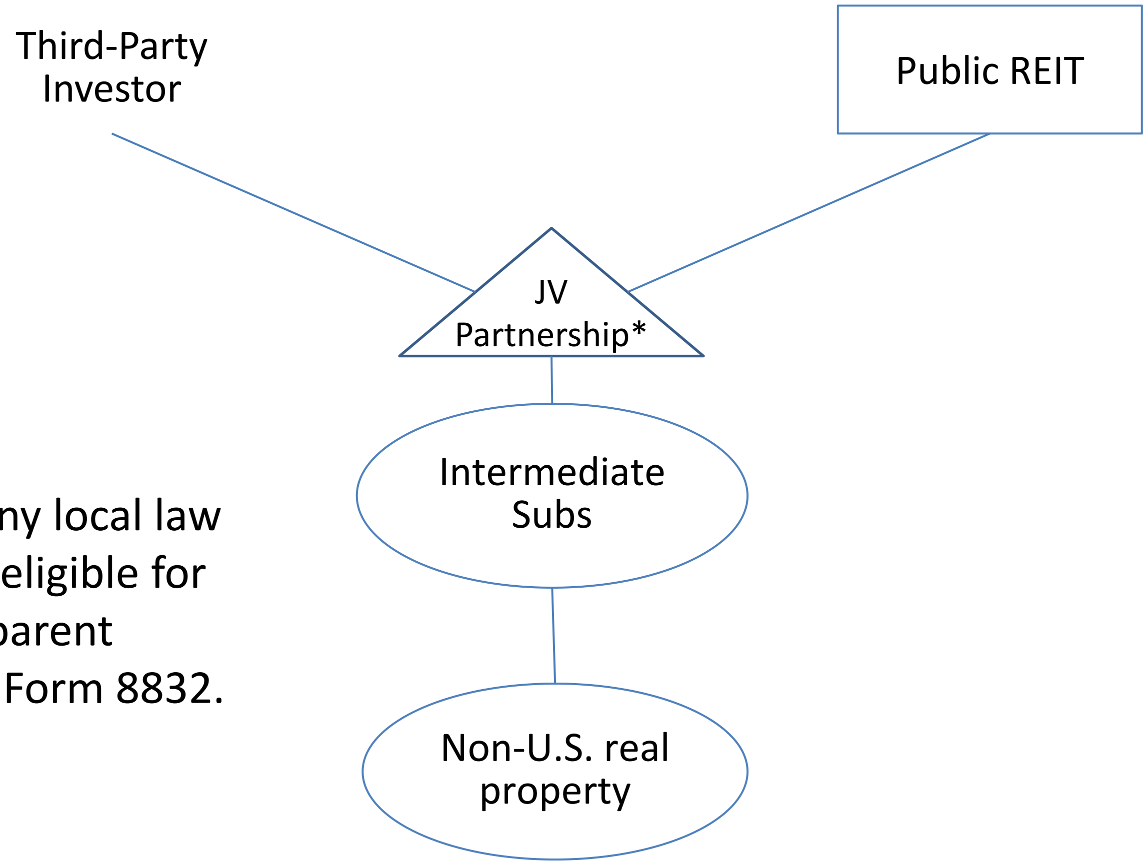
Structures for JV Between Public REIT and Third-Party Investor

- Domestic Partnership Model



Structures for JV Between Public REIT and Third-Party Investor

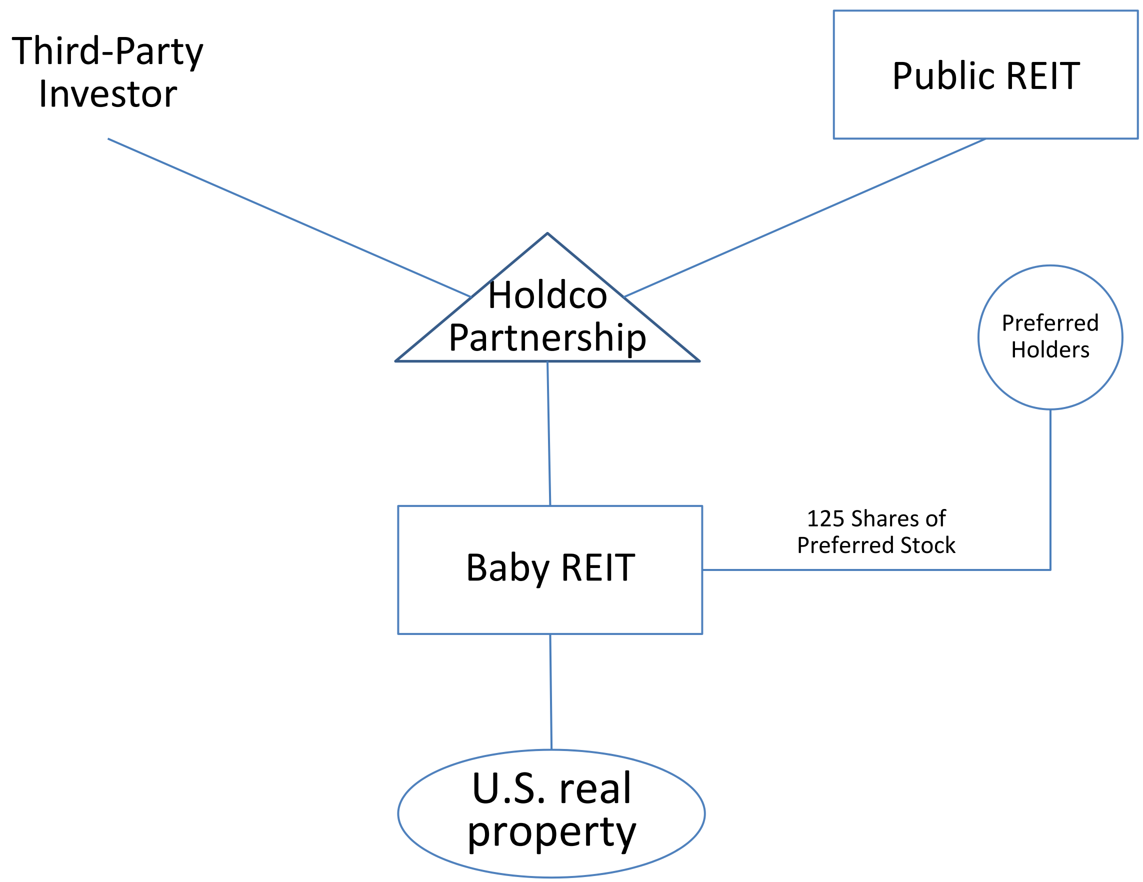
- Foreign Real Estate Model



* This can be any local law entity that is eligible for fiscally transparent status on IRS Form 8832.

Structures for JV Between Public REIT and Third-Party Investor

- Baby REIT Model



Structures for JV Between Public REIT and Third-Party Investor

- Structures require a weighing of the access to capital versus the additional operational complexity, tax costs/savings, and potential friction costs on exit
- Partnership agreement must clearly restrict partnership activities to REIT-compliant ones, even if that is contrary to the interests of non-REIT partners
- Subsidiary REITs, or “Baby REITs,” must separately meet the requirements imposed under the Code to qualify for taxation as a REIT
  - Some issues that are not of primary concern to public REITs will matter greatly for the Baby REIT (e.g., preferential dividend rule, 100 shareholder requirement)
  - Attribution issues stemming from third-party investors can negatively impact REIT qualification
  - REIT qualification deficiencies at the Baby REIT level can cascade up to the parent REIT, and so a “protective” TRS election is warranted

Tax-Related Deal Issues for JV REITs

- Public REITs are increasingly using Baby REITs as a means to attract tax-exempt and foreign co-investors
  - Baby REITs can serve as blockers for ECI and UBTI vis-à-vis the co-investor
- Organizational documents will generally include provisions to address U.S. tax concerns of third-party investor, including with respect to:
  - Requirements that exit events be structured as sales of REIT shares, and other limitations on the sale or disposition of real property interests
  - Maintenance of U.S. tax elections (including REIT elections)
  - Restrictions on transfers of interests and on admission of additional joint venturers, including affirmative obligations to maintain "domestically controlled" REIT status
  - Provisions governing treatment of distributions and intended withholding procedures

Business Issues for a JV

- Organizational documents will generally include non-tax related limitations on the ability of the parent REIT to manage the JV in an unfettered fashion, including limitations, prohibitions, or consent rights on:
  - Complying with CFIUS and similar processes
  - Creating and abiding by budgets, calling more capital, admitting new partners
  - Incurring debt, including refinancing of existing debt
  - Acquiring additional properties or improving existing ones
  - Entering or modifying leases, revenue contracts, other material agreements
  - Selling, destroying, or abandoning key assets
  - Modifying the insurance program, instituting major legal actions
  - Drag alongs, Tag alongs, Rights of first offer, Buy-sell
  - Filing for bankruptcy or making assignments for the benefit of creditors
  - Dissolving the JV

Exit Issues for JV REITs

- Exit events generally involve a sale of Baby REIT shares to avoid adverse FIRPTA consequences to non-U.S. investors
- Buyer will diligence REIT compliance matters since liabilities stemming from any failure will stay with the target and come over to the Buyer
  - Transaction documentation will include representations and warranties relating to REIT qualification, as well as a closing REIT tax opinion
  - Rep & warranty insurance may be obtained
- FIRPTA considerations must be examined, and appropriate certificates must be obtained from applicable sellers
- If acquisition is properly structured, Buyer should be able to use a captive partnership to acquire the target REIT and thereby obtain a step-up in tax basis through a Section 331, taxable (but tax-efficient) liquidation of the Baby REIT into the acquiring partnership following closing
  - Timing of liquidation can be impacted by integration concerns of the Buyer
  - Timing of liquidation is likely pushed to the following January if Sellers have taken out pre-closing dividends in the year of closing

Predictions Revisited

- More data center targets will be REITs or "REIT ready"
- More foreign subsidiaries will be QRSs (rather than TRSs)
- Virtually all domestic JVs will involve a REIT
- The future of fiber and connectivity, as rent versus services, is the next big thing
- More countries will adopt a REIT structure
- Index fund ownership of REITs will persist and grow
- Global REITs will slowly deleverage and adopt multicurrency borrowings
- Normalization of new REITs will continue
- State tax authorities will take more notice of REITs