**BRIAN E. HAMMELL** and **AMEEK ASHOK PONDA** are Partners at Sullivan & Worcester LLP, in Boston.

# *Tax Tip*

## *What a Relief: Avoiding "REIT M&A Drama"* via *the Temporary Investment of New Capital Rules*

By Brian E. Hammell and Ameek Ashok Ponda

The real estate investment trust ("REIT") stands as a successful and shining innovation of modern tax policy. Although slow to gain traction following their 1960 creation, REITs experienced tremendous growth in the decades that followed, in step with Congress liberalizing overly-technical qualification requirements and investors becoming more comfortable with the vehicle.[1] Today, public REITs have an aggregate market capitalization in excess of $1.2 trillion and own more than $3 trillion of gross real estate assets, which represents a significant fraction of U.S. commercial real estate.[2] In tandem with this rapid expansion of the sector, REITs have also become global in their reach and focus, and increasingly turn to international markets for both investors and investment opportunities.[3]

While REITs are active players in mergers and acquisitions ("M&A") transactions, they face obstacles that other acquirors do not. In particular, due to the complex requirements under the Code relating to a REIT's organizational form, asset composition, income sources, and distribution levels,[4] an acquisitive REIT must carefully diligence the tax characteristics of any target portfolio or target company for REIT compliance issues. Absent available coping strategies between signing and closing—or even post-closing—an acquiring REIT would need to negotiate with the seller pre-signing to restructure the target real estate and operations in order to ensure REIT compliance upon acquisition. Any pre-closing restructuring likely would be both expensive and time-consuming, impacting the cost, timing, and certainty of closing, and creating the opportunity for competing non-REIT acquirors to outbid the REIT not only on net sales price but also on deal simplicity and certainty. In some cases, owing to applicable antitrust and competition law considerations, it may not even be possible for the bidding REIT and its intended target to cooperate and coordinate on these REIT-compliance matters pre-closing. In other words, a REIT acquiror may introduce drama into the M&A process that a non-REIT would not, potentially putting REIT acquirors at a competitive disadvantage.

So how can an acquisitive REIT compete with other buyers that have no need to navigate the numerous REIT qualification requirements? That is, how can a buyer REIT insulate its potential sellers from "REIT M&A drama"?[5] An effective but underappreciated means of eliminating this "REIT M&A drama" is to utilize a Code Sec. 856(l) taxable REIT subsidiary ("TRS") in tandem with the relief afforded by the "temporary investment of new capital" rules (the "TINC Rules").[6] Together, the TRS and the TINC Rules provide a mechanism for a REIT to comply at closing with all the complex REIT requirements, while giving the REIT time to structure an acquired target portfolio or target company in a REIT-compliant manner.[7]

To fully appreciate the scope and utility of the TINC Rules outlined below, one must remember that they are designed as relief provisions, *viz.*, a (temporary) reprieve from the otherwise exacting standards of the REIT organization, asset, income, and distribution requirements.[8] Like all relief provisions, the TINC Rules are to be interpreted generously and broadly so as to further their relief-providing purpose.[9]

## REIT Asset Test Requirements

As discussed, an entity must satisfy a number of statutory requirements in order to qualify for taxation as a REIT under the Code. Of particular note when buying a target company (or a target portfolio through a blocker company), a REIT must satisfy specified asset tests at the close of each quarter of its taxable year (the "REIT Asset Tests").[10] Specifically, the REIT Asset Tests include a requirement that at least 75% of the value of a REIT's total assets be represented by real estate assets, cash and cash items (including receivables), and Government securities (the "75% REIT Asset Test").[11] The REIT Asset Tests also generally direct that no more than 25% of the value of a REIT's total assets may be represented by securities (other than those includible in the 75% REIT Asset Test).[12] Further, no more than 20% of the value of a REIT's total assets may be represented by securities of TRSs (the "20% TRS Limit").[13]

A TRS is treated as a separate, stand-alone corporation from its REIT parent. TRSs are very useful to REITs because they generally can provide services or conduct business activities that a related REIT cannot provide or conduct directly without jeopardizing its compliance with the REIT gross income tests of Code Sec. 856(c)(2) and 856(c)(3). Importantly, in the context of a REIT undertaking an acquisition, acquiring the target company as a TRS (or acquiring the target portfolio through a TRS) can serve to insulate the REIT from gross income that might not satisfy the REIT requirements if the REIT earned those revenues for its own account.[14] While this (temporary) TRS interposition is advantageous from a REIT gross income testing perspective, if the specific transaction were sufficiently large, then a REIT might violate the 20% TRS Limit unless the shares in the TRS were excluded from the definition of securities for purposes of the REIT Asset Tests, including the 20% TRS Limit. This is precisely where the TINC Rules make a contribution, for the TINC Rules provide a tool to carve outstanding TRS stock and debt, temporarily, out of the 20% TRS Limit and shift them into the 75% REIT Asset Test. As illustrated below, if a REIT issues new shares or public debt in order to directly acquire the target shares (or to raise cash, which in turn is used to acquire the target shares), then the acquired target company shares as a TRS investment can constitute "real estate assets" for purposes of the applicable REIT Asset Tests for the duration of a temporary one-year period. During this temporary one-year period and while the REIT is the owner of the acquired target/target assets, the REIT can restructure and rationalize the acquired operations not only as a business matter but also with respect to REIT compliance.

## Real-World M&A Example

Suppose a publicly-traded REIT ("Parent REIT") acquires a target company ("Target") using newly-issued Parent REIT shares ("New Parent Shares") as consideration. Immediately after the acquisition, Parent REIT, together with Target and its regarded subsidiaries, elects to treat Target and those subsidiaries as TRSs.[15] Following the acquisition and as soon as practicable, Parent REIT will restructure the operations of Target's principal subsidiaries (the "Restructuring") in such a manner that (i) the revenues received by the restructured entities generally will qualify as "rents from real property" within the meaning of Code Secs. 856(c)(2)(C), 856(c)(3)(A), and 856(d) if received by a REIT, and (ii) the assets of the restructured entities generally will qualify as "real estate assets" within the meaning of Code Secs. 856(c)(4) and 856(c)(5)(B) if owned by a REIT.[16] After the Restructuring and pursuant to a revocation of the Target's TRS status (whereby the Target and its subsidiaries are deemed liquidated for federal income tax purposes into Parent REIT pursuant to Code Secs. 332, 337, and 381),[17] the assets and operations of Target and its subsidiaries (other than the assets retained by or transferred to extant TRSs) will be treated as assets and operations of Parent REIT for purposes of the REIT gross income tests and the REIT Asset Tests.[18]

In the example above and while the Target is a TRS, the 20% TRS Limit could put pressure on Parent REIT's intended REIT compliance strategy. As explained below, one coping strategy available to acquisitive REITs like Parent REIT exists at the intersection of the TINC Rules and the rules governing TRSs. A REIT that issues shares or certain types of debt, either directly as consideration to a seller or indirectly to generate capital for such consideration, can utilize a TRS structure in concert with the TINC Rules to insulate itself from adverse REIT compliance consequences, all while avoiding a violation of the 20% TRS Limit. That is, through application of these TINC Rules, REITs are able to take any necessary steps to make a target company and its operations REIT-compliant post-closing, without risking REIT status in the interim,[19] thereby putting REIT acquirors on more equal footing with their non-REIT competitors in M&A bidding.[20]

## TINC Rules

For purposes of the REIT Asset Tests, "real estate assets" are defined to include, among other items, "any property (not otherwise a real estate asset) attributable to the temporary investment of new capital, but only if such property is stock or a debt instrument, and only for the one-year period beginning on the date the [REIT] receives such capital."[21] "New capital" is defined to include any amount received by a REIT in exchange for stock or specified public debt in such REIT.[22] Confirming the idea that the TINC Rules are a relief provision and therefore are to be given a broad, taxpayer-friendly scope, the IRS on several occasions has liberally interpreted and broadly applied the TINC Rules.[23]

Applying the TINC Rules' foundational definitions above, shares of Target are appropriately treated as "real estate assets" for purposes of the REIT Asset Tests for the one-year period following the acquisition by Parent REIT, if and only if these three requirements are satisfied:

(i) The shares of Target that were acquired by Parent REIT in exchange for New Parent Shares represent both the "amount received" by Parent REIT and the "new capital,"
(ii) Ownership of shares of Target represents an "investment" by Parent REIT, and
(iii) Ownership of shares of Target represents a "temporary" investment by Parent REIT.

Each of these three requisite components is analyzed below.

## "Any Amount Received" in Respect of New Parent Shares

Per Code Sec. 856(c)(5)(D)(ii), "new capital" includes "any amount received" by the REIT in exchange either for its stock or for specified public debt. However, that definition does not specify how to determine the "amount received" in the exchange. In determining the proper scope of the TINC Rules, it is useful to inquire whether the term "any amount received" in Code Sec. 856(c)(5)(D)(ii) is somehow limited to cash received.[24] There is no statutory definition of "any amount received" in Code Sec. 856 (or anywhere else in Subchapter M of the Code); there are no relevant Treasury regulations; the term is not defined in the Investment Company Act of 1940, as amended (the "1940 Act")[25]; and the legislative history does not require or suggest a narrow meaning.[26] In fact, the term "amounts received" is used in numerous other sections of the Code, and it is clear that, in those sections, the term encompasses the receipt of both cash and property other than cash.[27] In addition, there appear to be no provisions in the Code where an "amount received" is inherently limited to cash. In fact, prior to its repeal in 2017, Code Sec. 71 specifically limited the definition of alimony to cash payments precisely because "amounts received" would not otherwise have been so limited.[28] Thus, because there does not appear to be any inherent limitation in the term "any amount received," receipt of property other than cash also gives rise to "any amount received."[29]

Further, both clauses (I) and (II) in Code Sec. 856(c)(5)(D)(ii) contemplate that the TINC Rules encompass more than just money. Clause (I) includes any amount received by the REIT in "exchange" for stock of the REIT. This reference to "exchange" signals that a property exchange has been contemplated because, as used throughout the Code, "exchange" means an exchange for either property or money; if only money is intended, the transaction is called a "sale."[30] Meanwhile, clause (II) includes any amount received by the REIT in a public offering of long-term debt obligations of the REIT. Although clause (II) requires a public offering, it does not limit the amount received to only money. More telling, the Code's original issue discount rules contemplate two kinds of public offerings of debt obligations—either for money or for property[31]—and the TINC Rules explicitly reference particular Code Sec. 1275 definitions for original issue discount.[32]

Finally, "amount received" cannot and does not mean the "property received" or the "items received," but rather the "amount [of value] received." To begin, as a principle of statutory construction, the plain meaning in everyday usage is instructive.[33] There seems to be little question regarding the meaning of "any" or "received," so the analysis should properly focus on "amount," which refers to a numerical value.[34] Also, "amount" is used repeatedly throughout the Code when the statute contemplates the receipt of both money and property other than money. In total, the term "amount received" (or a variation thereof) appears over 100 times in the Code. Each and every instance of "amount received" (or a variation thereof) in the Code is consistent with, or compels the conclusion that, "amount received" means the amount of money received plus the amount of value of the property received.[35]

Accordingly, the amount of value received by Parent REIT in the form of Target shares, to the extent received in exchange for New Parent Shares, should qualify as "any amount received" for such New Parent Shares within the meaning of Code Sec. 856(c)(5)(D)(ii). Because the "amount received" by Parent REIT in exchange for New Parent Shares is defined as "new capital" within the meaning of Code Sec. 856(c)(5)(D)(ii), the amount of value received by Parent REIT in the form of Target shares, to the extent received in exchange for New Parent Shares, should also qualify as Parent REIT's "new capital."

## "Investment" of New Capital

To satisfy the TINC Rules' second requirement, the Target shares that Parent REIT acquires in exchange for New Parent Shares must represent an "investment" of Parent REIT's "new capital." The proper view here is that the Target shares received in Parent REIT's capital raise qualify as an "investment of new capital" under Code Sec. 856(c)(5)(B), and Parent REIT need not undertake a separate "purchase" transaction in order to receive "investment" treatment under the TINC Rules. This is because "investment" under the TINC Rules does not require a discrete "spending" of the "new capital" that Parent REIT receives in its capital raise; rather, the TINC Rules merely require that such "new capital" be held in the form of stock or a debt instrument. As discussed above, "amount received" and "new capital" cannot and do not mean "property received" or "items received," but rather "amount [of value] received"; thus, if that "new capital" amount of value is represented by stock or debt instruments received, then the new capital has been "invested," and the received stock or debt instruments represent the investment.

Code Sec. 856(c)(5)(B) specifies that "any property (not otherwise a real estate asset) attributable to the temporary investment of new capital" is a real estate asset, but only if "such property is stock or a debt instrument." There is no statutory definition of "investment" in Code Sec. 856 (or anywhere else in Subchapter M of the Code), and there are no relevant Treasury regulations. However, the term is defined in the 1940 Act and its interpretations by the Securities and Exchange Commission ("SEC"). Accordingly, the meaning assigned to what constitutes an "investment" under the 1940 Act should be dispositive or, at least, highly probative regarding what "investment" means in Code Sec. 856 on account of Code Sec. 856(c)(5)(F). Under the 1940 Act and as explained below, "investment" is a broad concept that would cover not only items purchased with money, but also items received in a capital raise.

First, for purposes of the 1940 Act, "security" is very broadly defined to include "any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement …."[36] In implementing this definition, case law and the SEC draw a distinction between "investment" transactions versus "commercial" transactions.[37] Whether a transaction is for "investment" or "commercial" purposes depends on the nature of the transaction and each party's intent in entering into the transaction; there is absolutely no distinction under the 1940 Act between an "investment" purchased for money versus an "investment" received by an entity in return for issuing its equity or debt.[38] In fact, very much to the contrary, specific sections of the 1940 Act make clear that "investments" can be received pursuant to an entity's capital raising efforts.[39] The securities acquired by the investing entity pursuant to such provisions, even though not purchased with money and instead acquired as part of an equity capital raise, are nonetheless and without doubt considered to be the acquiring entity's investment securities under the 1940 Act.[40] Moreover, it is not uncommon for 1940 Act companies to acquire portfolio securities directly in exchange for issuance of their own equity capital; this does not diminish the status of the acquired portfolio securities as "investments."

Second, the SEC has adopted Rule 2a51-1(b), which broadly defines the term "investments" to include securities and other items.[41] As with the case law and the 1940 Act statutory provisions discussed above, the consideration paid for such assets (*i.e.*, money versus issued equity or debt capital) does not in any way impact whether items are "investments" under the SEC rule. Thus, on account of Code Sec. 856(c)(5)(F), the amount of value represented by the "amount received," and thus the "new capital," may come in the form of the very investment that qualifies as the "temporary investment of new capital," as these terms are defined and used in the TINC Rules.[42]

In addition to the above textual analysis, to require a REIT to structure a transaction under the TINC Rules so that the "investment" is different from the property received in the capital raise, even when the items or property received are themselves qualifying investments, would elevate form over substance and thus be incompatible with sound tax administration. Also, imposing an independent re-"investment" requirement is to insist upon meaningless, inconsequential steps as a pre-condition to the TINC

Rules' application, and would be at odds with the intended scope and application of a relief provision.[43]

Accordingly, the property that Parent REIT receives (*i.e.*, the shares of Target, to the extent received in exchange for New Parent Shares as part of the acquisition) should qualify as an "investment" attributable to the "new capital" that Parent REIT receives in its capital raise, all within the meaning of Code Sec. 856(c)(5)(B).

## "Temporary" Investment of New Capital

The TINC Rules' third and final requirement is that the Target shares that Parent REIT acquires in exchange for New Parent Shares represent a "temporary" investment of Parent REIT's "new capital." Because Parent REIT may maintain ownership of Target for an extended period of time, perhaps well beyond one year, it is necessary to evaluate whether such investment qualifies as a "temporary" investment. At a minimum, if there is an anticipated Code Secs. 332, 337, and 381 liquidation of Target into Parent REIT, whereupon Target ceases its existence as a separate taxpayer, that alone should be enough to establish that Parent REIT's investment in Target is but "temporary."[44]

As with the term "any amount received," neither Code Sec. 856 nor any other provision of Subchapter M of the Code defines a "temporary" investment, there are no relevant Treasury regulations, and the term is not defined in the 1940 Act. Though the legislative history provides no explicit guidance, it implies that "temporary" is merely a reference to the applicable one-year relief period and nothing more.[45] In everyday usage,[46] "temporary" means "lasting for a limited time."[47]

LTR 9342021[48] supports the legislative history's implication that the term "temporary" corresponds to the applicable one-year relief period and nothing more. In that ruling, a taxpayer REIT raised "new capital" through a private placement of its shares.[49] It used the "new capital" to acquire stock in a target corporation that owned real estate. The business plan of the taxpayer REIT was to purchase both interests in private REITs that it expected to become public REITs and controlling interests in public REITs to refocus their strategic plans. Of particular significance, the taxpayer REIT represented that it contemplated holding shares of the target corporation for long-term appreciation; presumably then, the taxpayer REIT planned to hold its shares in the target corporation indefinitely or permanently. Nevertheless, the ruling held that for the one-year period beginning on the date on which the taxpayer REIT received its "new capital," the investment of that capital in shares of the target corporation would be treated as "real estate assets" by virtue of the TINC Rules. Thus, in step with available legislative history, LTR 9342021 properly defines "temporary" investment not by the length of time that the investment will be held (which would be long-term in the situation presented therein) but by the one-year limit on the relief period during which the investment would be considered a "real estate asset." Accordingly, any stock or debt instrument attributable to the "new capital" that is held during the one-year relief period beginning on the date on which the REIT receives its "new capital" will qualify as a "temporary" investment for such duration.

The situation of Parent REIT is similar to the situation presented in LTR 9342021. The Parent REIT's "new capital" is automatically and contemporaneously "invested" in shares of Target, and Parent REIT intends to hold those shares for the long-term, or at least until such time as the Target ceases to be a separate taxpayer and is absorbed into Parent REIT under Code Secs. 332, 337, and 381. As in the private letter ruling, Parent REIT's intention to hold its economic interest in Target and its principal subsidiaries for longer-term appreciation is nevertheless consistent with treatment of the Target shares that Parent REIT acquires as a "temporary" investment of new capital for up to one year from the date of the New Parent Shares' issuance.[50]

In sum, Parent REIT's investment in Target shares, to the extent received in exchange for New Parent Shares, qualifies as a "temporary" investment within the meaning of Code Sec. 856(c)(5)(B).

## Securities of a TRS that Qualify as Real Estate Assets

Once shares or other securities of a TRS qualify as "temporary investments of new capital" (and are thus "temporarily" within the 75% REIT Asset Test), the next inquiry is whether such shares or other securities should be taken into account for purposes of the 20% TRS Limit in Code Sec. 856(c)(4)(B)(ii). Unfortunately, the text of Code Sec. 856(c)(4)(B)(ii), in contrast to the text of Code Sec. 856(c)(4)(B)(i), does not contain an explicit parenthetical stating that, if the securities are includable under the 75% REIT Asset Test, then such securities are automatically not counted toward the test's percentage limitation on securities.

Nevertheless, Reg. §1.856-3(e) provides that the term "securities" does not include "interests in real property" or "real estate assets." Although Code Sec. 856(c)(4)(B)(ii) does not contain an explicit parenthetical exclusion for items included in the 75% REIT Asset Test, there is nothing in the statute or the legislative history of Code Sec. 856

  

to indicate that Congress intended that the exclusion of "real estate assets" from the definition of securities in Reg. §1.856-3(e) should not apply for purposes of the 20% TRS Limit.[51] Accordingly, taxpayers may rely on the IRS's definition of "securities" as expressed in Reg. §1.856-3(e) in applying Code Sec. 856(c)(4)(B)(ii). Thus, "interests in real property" or "real estate assets" as defined in Code Sec. 856(c)(5) are not treated, per Reg. §1.856-3(e), as "securities" for purposes of Code Sec. 856(c)(4)(B)(ii). The IRS has issued multiple private letter rulings to this effect in respect of debt securities issued by TRSs,[52] and the logic and analysis of those rulings would apply equally in the context of equity securities issued by a TRS.

Accordingly, the Target shares that Parent REIT holds, to the extent and for the duration such shares are treated as a "temporary investment of new capital" and thus as "real estate assets" within the meaning of Code Sec. 856(c)(5), are not "securities" within the meaning of Code Sec. 856(c)(4)(B)(i)–(ii).[53]

## Conclusion

The IRS has issued three private letter rulings under the TINC Rules, all of which are consistent with the liberal construction and interpretation required of a relief provision. Any attempt to construe a relief provision such as the TINC Rules narrowly or hypertechnically would be at odds with general rules of statutory construction and thus must be rejected as inappropriate and incompatible with legislative intent.

From the legislative history, it is clear that Congress intended the TINC Rules to alleviate REIT testing pressure whenever a REIT's balance sheet has grown significantly and the REIT needs time to absorb its new assets and income streams in a REIT-compliant manner. Because TRSs are now an integral part of the modern REIT landscape (just as Congress intended), a REIT's election of TRS status for a target and its regarded subsidiaries, together with a REIT's treatment of the same as a "temporary investment of new capital" pursuant to the TINC Rules, is consistent with the policy underlying the TINC Rules as well as that underlying TRSs. In sum, the constraints on TRS ownership pursuant to the 20% TRS Limit create a source of REIT asset testing pressure, and the TINC Rules are designed to temporarily relieve that REIT asset testing pressure during the one-year post-acquisition period, obviating any pre-signing or pre-closing "REIT M&A drama."



### ENDNOTES

1 *See REIT Industry Timeline*, NAREIT, *www.reit.com/investing/reit-basics/reit-industry-timeline* (last visited Aug. 2, 2019); Sarah Borchersen-Keto, *Infrastructure REITs Playing Growing Role in Digital Economy*, NAREIT (July 26, 2019), *www.reit.com/news/podcasts/infrastructure-reits-playing-growing-role-digital-economy*; Paul W. Decker, David H. Kaplan, & Ameek Ashok Ponda, *Non-Customary Services Furnished by Taxable REIT Subsidiaries*, 148 TAX NOTES 413 (July 27, 2015).

2 *See* Alexandra Thompson, *Total Size of U.S. Commercial Real Estate Estimated Between $14 and $17 Trillion*, NAREIT (July 9, 2019), *www.reit.com/news/blog/market-commentary/total-size-us-commercial-real-estate-estimated-between-14-and-17?utm_source=smartbrief.com&utm_medium=email&utm_campaign=resource&utm_content=UScommercialsize* (REITs are estimated to own about 10% of the total available U.S. commercial real estate, and about 20% of the U.S. institutional grade real estate).

3 *See, e.g.*, Ameek Ashok Ponda, *REITs Abroad*, Practicing Law Institute's Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2006 (September 2006); Ameek Ashok Ponda, *Foreign Pension Plan Investments in U.S. REITs*, 74 TAX NOTES 1593 (Mar. 24, 1997).

4 *See* Code Secs. 856–860. *See also* Decker, Kaplan, & Ponda, *supra* note 1, at 413 (explaining the key statutory requirements a REIT must satisfy under the Code).

5 Mary J. Blige, *No More Drama*, No More Drama (MCA 2001):

> When you let go of all the drama in your life
>
> Now you're free from all the pain (free from all the pain)
>
> Free from all the game (free from all the game)
>
> Free from all the stress (free from all the stress)
>
> So find your happiness

6 Code Secs. 856(c)(3)(I), 856(c)(5)(B) and 856(c)(5)(D).

7 Anita Renfroe, ANITARENFROE.COM ("Difficulty is inevitable. Drama is a choice."); Seneca, INTERNATIONAL DICTIONARY OF THOUGHTS 626 (John P. Bradley, Leo F. Daniels and Thomas C. Jones eds., 1969) ("Every man has his chain and clog, only it is looser and lighter to one than to another, and he is more at ease who takes it up and carries it than he who drags it."); Gordana Biernat, TWITTER (May 30, 2016, 11:59 A.M.) ("Drama can not grow unless you feed it with your energy and presence. Turn around. Walk away. Let it go ….").

8 The legislative history consistently refers to the TINC Rules as a relief provision for taxpayers. *See, e.g.*, S. Rep. No. 313, 99th Cong., 2d Sess. 775, 1986-3 C.B. (Vol. 3) 1, 775 ("Senate Report"):

> The committee recognizes the impracticality of requiring REITs to identify their chosen real estate investments prior to raising any new equity capital, and believes that REITs should be afforded some relief from the 75 percent income test for one year after receiving the new equity capital. The committee believes, however, that consistent with the general passive nature of the REIT, that [*sic*] the relief should be available only to the extent that the income from the investment of new equity consists of income from either stock or debt instruments.

9 Under general rules of statutory construction, relief provisions intended for the benefit of taxpayers should be construed liberally in order to effectuate that purpose. *See, e.g.*, *Bonwit Teller & Co.*, SCt, 2 USTC ¶709, 283 US 258, 263, 51 SCt 395, 397 (1931) (holding that a relief provision is "to be construed liberally in favor of the taxpayers

to give the relief it was intended to provide" in evaluating Section 281(e) of the Revenue Act of 1924); *Loco Realty Co.*, CA-8, 62-2 USTC ¶9657, 306 F2d 207, 215 ("[T]his statute embraces relief provisions and is to be construed liberally in order to effectuate its purpose."); *Elkins*, CA-3, 37-2 USTC ¶9438, 91 F2d 534, 539 ("Next, the provision we are called upon to interpret is a relief provision intended for the benefit of the taxpayer and such construction should be given as will effectuate that purpose."); *Mutual of Omaha Ins. Co.*, 317 FSupp2d 1117, 1123 (D. Neb. 2004) ("Under the rules of statutory construction, federal tax legislation that is intended to provide relief is to be liberally construed in favor of the taxpayer," *citing Burnet v. Niagara Falls Brewing Co*., SCt, 2 USTC ¶674, 282 US 648, 654, 51 SCt 262, 264–265 (1931)); *Taft Broad. Co.*, DC-OH, 88-2 USTC ¶9401, 685 FSupp 1033, 1037, *rev'd and remanded on other issue*, CA-6, 91-1 USTC ¶50,189, 929 F2d 240, *reaff'd on remand*, DC-OH, 92-1 ustc ¶50,241 (noting that the sections at issue "are relief provisions and thus should be liberally construed."); LTR 201609003 (Nov. 24, 2015) (noting that "courts have long recognized" that "a relief provision ... should be liberally construed to effect its purpose.").

10 Code Sec. 856(c)(4) and Reg. §1.856-2(d).

11 Code Sec. 856(c)(4)(A) and Reg. §1.856-2(d)(1).

12 Code Sec. 856(c)(4)(B)(i) and Reg. §1.856-2(d)(2).

13 Code Sec. 856(c)(4)(B)(ii). Both securities of a TRS, as well as securities includible in the 75% REIT Asset Test, are then exempted from the remainder of the REIT Asset Tests in Code Sec. 856(c)(4)(B)(iv).

14 For example, in the typical M&A context, one of the most complex REIT issues to diligence (and then address through structuring) is "impermissible tenant services" to tenants at the property. *See* Code Sec. 856(d)(2)(C) and 856(d)(7); Rev. Rul. 2002-38, 2002-2 CB 4. Understanding what services are being provided to tenants (with or without explicit consideration), sorting through which such services are "impermissible," and then arranging for impermissible services to be provided by either a TRS or a Code Sec. 856(d)(3) independent contractor (in each case pursuant to prescribed and compliant formalities), all require thought, attention, and time. Again, for a variety of reasons (including possible violations of applicable antitrust and competition law), it may not be possible for the REIT and its target to coordinate on these issues prior to signing or prior to closing. In fact, sorting through impermissible tenant services can take months or years, particularly when dealing with assets outside the United States, where differences in language, time zones, and commercial environments may make it difficult or impossible to rapidly align ground realities with technical REIT-compliance rules.

15 Slight variations of this example include Parent REIT issuing New Parent Shares for cash, and then utilizing the cash to acquire Target, or even Parent REIT creating the Target as an interposed blocker between the REIT and the acquired asset portfolio. All these variations are well within the ambit of the TINC Rules.

16 Parent REIT presumably acquired Target for ultimate absorption into the REIT itself, as opposed to being permanently hived off into a TRS. Typically, REIT-destined assets bear a premium precisely because they are expected to be tax-advantaged after acquisition; for the anticipated return on investment to be realized, the target assets and revenue streams need to be placed in a REIT-compliant structure as soon as practicable following closing.

17 Code Secs. 856(i)(2)–(3) and 856(l)(1); Reg. §301.7701-3(g)(1)(iii) and §301.7701-3(g)(2)(ii). Revocation of Target's and its subsidiaries' TRS statuses may occur through one or more entity classification elections on IRS Form 8832 or revocations of TRS status on IRS Form 8875. *See* Ameek Ashok Ponda, *How Much Gain Would a REIT Defer if a REIT Could Defer Gain?*, 135 TAX NOTES 1249, 1251 (June 4, 2012) ("the members of the consolidated group are treated as liquidating or otherwise being absorbed into the REIT—the liquidations presumably beginning with the bottom tier of the consolidated group, proceeding upward tier by tier to the parent, and culminating in the parent's liquidation or reorganization into the REIT").

18 The completion of the Restructuring means that Parent REIT must distribute earnings and profits for federal income tax purposes ("E&P") inherited from Target, if any, before the end of Parent REIT's taxable year (typically December 31). *See* Code Secs. 316, 381, 857(a)(2), and 859. The amount of this inherited E&P depends significantly on whether or not a Code Sec. 338(g) election was made for the acquisition of Target, which is typically done in the case of an acquired foreign target but almost never done in the case of an acquired domestic target due to the attendant income tax gain that would be triggered; also, in the absence of a Code Sec. 338(g) election, and thus in a situation where the Target's pre-closing tax attributes survive and eventually carry over to Parent REIT at the time of the deemed liquidation per Code Secs. 332, 337 and 381, it is typical for Parent REIT and Target to cooperate pre-closing on measuring the Target's E&P, but not necessarily requiring as a closing condition that such E&P analysis be completed by a certain time or that the resulting computed E&P amount come below a prescribed threshold.

19 After all, the acquiring REIT simply wants to get the deal done but at the same time avoid Ella's fear in *Confessions of a Teenage Drama Queen*: "If we go, I just know something is gonna go wrong. I'm gonna die, and my parents are gonna find out." (Walt Disney Pictures 2004).

20 Thus, the TINC Rules permit REITs to be the best version of what tax policymakers intended, or as Ella ultimately recognizes in *Confessions of a Teenage Drama Queen*: "You gave me courage, Lola. Because of you, I'm brave enough to be different." *Id.*

21 Code Sec. 856(c)(5)(B).

22 Code Sec. 856(c)(5)(D)(ii).

23 *See* LTR 200740004 (July 3, 2007) (status of invested new capital under the TINC Rules was preserved despite the loan of the proceeds by the REIT to a limited partnership, which was a separate entity that then invested the capital in stock and debt instruments); LTR 200724031 (Feb. 27, 2007) (status of invested new capital under the TINC Rules was preserved despite the merger of the issuing REIT with and into another REIT, with the other REIT as the surviving entity); LTR 9342021 (July 22, 1993) ("temporary" is a reference and limitation on the duration of the relief period, not a separate and independent requirement on the nature and purpose of the investment). Although prior private letter rulings may not be relied upon as precedent per Code Sec. 6110(k)(3), they provide meaningful insight into the thinking of the IRS with respect to issues that are not otherwise the subject of published authority. *See* Internal Revenue Manual section 4.10.7.2.10(3-4) (2006) ("A private letter ruling to a taxpayer ... provide[s] insight with regard to the Service's position on the law and serve[s] as a guide. Existing private letter rulings and memorandums ... may be used as a guide with other research material in formulating an area office position on an issue."). *See also Hanover Bank*, SCt, 62-1 USTC ¶9487, 369 US 672, 686, 82 SCt 1080, 1088 (private letter rulings "reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws"); *Rowan Cos.*, SCt, 81-1 USTC ¶9479, 452 US 247, 261, 101 SCt 2288 n.17 (private letter rulings provide "evidence" about the application of the Code).

24 For instance, both the *General Explanation of the Tax Reform Act of 1986*, JCS-10-87, 390-95 (May 4, 1987) ("1986 Blue Book") and the Senate Report provide an example in which the "amount received" encompasses cash from a public offering of stock. However, no language in the legislative history states or implies that other, non-cash property could not be encompassed within "amount received," and Congress would have been capable of limiting this provision to "money received" or "cash received" instead of "amount received" had it actually intended to create such a limitation. There are numerous places in the Code where Congress did just that. *See, e.g.*, Code Secs. 301(b)(1), 351(b)(1)(A), 357(b)(1)–(2), 358(a)(1)(A)(ii), 358(d)(1), 361(b)(3), 737(a)(1), 853A(c), 1001(b), 1031(d), 1033(b)(1)(A), 3304(a)(3), 4372(c), 6167(a)(2), 6167(c)(3), 6343(b)(3), 7406, and 7809(c). In addition, in Code Sec. 856(c)(5)(D)(ii), Congress prefaced "amount received" with "any," suggesting a broad definition.

25 15 USC §§80a-1–80a-64. Code Sec. 856(c)(5)(F) provides that all terms not defined in Code Sec. 856 shall have the same meaning as when used in the 1940 Act.

26 To the contrary, as relief provisions the TINC Rules and component definitions such as "any amount received" should be broadly construed and generously applied.



  

[27] *See*, *e.g.*, Code Secs. 74 (amounts received as prizes and awards), 331 (amounts received in liquidation of a corporation), 1241 (amounts received by lessee on cancellation of lease), 1253 (amounts received for franchise rights), and 1271 (amounts received on retirement of debt instrument).

[28] Code Sec. 71 previously provided, *inter alia*, that "[g]ross income includes amounts received as alimony or separate maintenance payments. … For purposes of this section … [t]he term 'alimony or separate maintenance payment' means any payment in cash …." Consistent with the view that the meaning of "amount received" (and similar language) includes both amounts of money and amounts of value of property, payments of alimony and separate maintenance payments were payable in either cash or property until 1984 amendments to Code Sec. 71 added the "any payment in cash" limitation.

[29] In this sense, "amount received" appears congruous with "amount realized" under Code Sec. 1001, which clearly contemplates non-cash property. *See*, *e.g.*, Reg. §1.1001-1(a) (second sentence) (amount realized includes "the sum of any money received plus the fair market value of any property (other than money) received.").

[30] *See*, *e.g.*, Code Sec. 1001(c) ("Except as otherwise provided in this subtitle, the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized.") and Reg. §1.1001-1(a) (discussing "the exchange of property for other property differing materially in either kind or in extent …."). For the general differentiation between "sale" and "exchange" in the Code, *see Helvering v. W. Flaccus Oak Leather Co.*, SCt, 41-1 USTC ¶9427, 313 US 247, 249, 61 SCt 878, 880 ("Generally speaking, the language in the [Code], just as in any statute, is to be given its ordinary meaning, and the words 'sale' and 'exchange' are not to be read any differently. … '[E]xchange', as used in [the predecessor to Code Sec. 1211, discussing losses from the sale or exchange of capital assets], implies reciprocal transfers of capital assets ….").

[31] *See* Code Sec. 1273(b) and Reg. §§1.1001-1(g) and 1.1275-1(h).

[32] *See* Code Sec. 856(c)(5)(D)(i)(I).

[33] Because the term "any amount received" is not specifically defined, its meaning in ordinary or natural usage would appear to be determinative of its meaning in the TINC Rules. *See The Limited, Inc.*, CA-6, 2002-1 USTC ¶50,353, 286 F3d 324, 333 ("When a word is not defined by statute, courts construe the undefined term in accord with its ordinary or natural meaning." (*citing Fed. Deposit Ins. Corp. v. Meyer*, SCt, 510 US 471, 476 (1994), *Smith*, SCt, 508 US 223, 228 (1993), and *Moses*, CA-6, 137 F3d 894, 899 (1998))).

[34] For example, Merriam-Webster's Collegiate Dictionary gives the principal definition of "amount" as a noun to mean: "*a*: the total number or quantity: AGGREGATE; *b*: the quantity at hand or under consideration." MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2007).

[35] Indeed, many of the Code sections use the plural term "amounts received" precisely because the term means "amount of money received" plus "amount of value of property received," and thus the plural "amounts received." Some Code sections include similar language that expressly references the "amount of money received and fair value of property received" instead of just stating "amount(s) received." *See*, *e.g.*, Code Secs. 301(b)(1) ("amount of money received, plus the fair market value of the other property received") and 897(g) ("amount of any money, and the fair market value of any property, received").

[36] 15 USC §80a-2(a)(36).

[37] *See*, *e.g.*, *Reves v. Ernst & Young*, SCt, 494 US 56, 61, 63 (1990) ("Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called. … A majority of the Courts of Appeals that have considered the issue have adopted, in varying forms, 'investment versus commercial' approaches that distinguish, on the basis of all of the circumstances surrounding the transactions, notes issued in an investment context (which are 'securities') from notes issued in a commercial or consumer context (which are not)."

[38] *See Reves*, 494 US at 62–63.

[39] For example, section 11(a) (permitting offers to exchange a fund's securities for securities of other funds) and section 23(a) (permitting the issuance of shares by a closed-end fund in exchange for cash or securities) of the 1940 Act expressly authorize an investing entity to issue its shares in exchange for other securities that will then constitute its "investments." *See* 15 USC §§80a-11(a) and 80a-23(a).

[40] 15 USC §80a-3(a)(2) ("As used in [15 U.S.C. § 80a-3], 'investment securities' includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which (i) are not investment companies, and (ii) are not relying on the exception from the definition of investment company in paragraph (1) or (7) of subsection (c).").

[41] *See* 17 CFR §270.2a51-1(b).

[42] *See, e.g.,* SEC Release No. 81207 (July 25, 2017) ("In determining whether an investment contract exists, the investment of 'money' need not take the form of cash," *citing Uselton v. Comm. Lovelace Motor Freight, Inc.*, CA-10, 940 F2d 564, 574 (1991) ("it is well established that cash is not the only form of contribution or investment that will create an investment contract.")).

[43] That is, it would be pointless to require a REIT to exchange its "amount received" of "new capital," when that amount is represented by stock or a debt instrument, into another form simply to qualify as an "investment of [that] new capital" under the TINC Rules. The statute simply does not require such reinvestment. First, given that "new capital" can and does encompass more than cash proceeds, it logically follows that an "investment of [that] new capital" can be identical to the items received, because under the statute "new capital" is not actually the items received but rather the "amount received" (*i.e.*, the amount of value received rather than the received property itself). *See* Code Sec. 856(c)(5)(D)(ii) ("The term 'new capital' means any amount received by the [REIT] …."). Second, requiring "new capital" that comes in the form of stock or debt instruments to somehow be exchanged into an "investment" in order to fit under the TINC Rules is tantamount to saying that "new capital" must be like "cash," for only "cash" is generally in need of some form of exchange (including *via* deposit into a bank account) in order to be invested, whereas non-cash "amounts" may come already invested in the required form. Having disproved the contention that "new capital" encompasses only cash, it would be incorrect to insist that "new capital" in the particular form raised must be exchanged into an "investment" before it may qualify under the TINC Rules. To elaborate, if a REIT receives money in a capital raise, then the REIT must spend the money to acquire the stock or debt instruments required by the TINC Rules, because money generally is in need of some form of exchange to become an investment. In that "plain vanilla" case arising from a "plain vanilla" fact pattern, a separate transaction is generally necessary to convert money into an investment. However, if a REIT receives property in the capital raise, and if that property consists of stock or debt instruments, then the property received by the REIT constitutes an "investment" in stock or debt instruments without any further action—because it is already in the form of stock or debt instruments. Adding a requirement to the TINC Rules under which investments in stock and debt instruments received by the REIT in a capital raise must be reinvested in new stock and debt instruments is nonsensical and inconsistent with those rules. Surely, the TINC Rules—a relief provision designed to give REITs a little bit of time to come into full and regular Code Sec. 856 compliance in situations where they have undertaken major transactions—were not meant to turn on such inconsequential steps.

[44] Even where Target is to become a part of Parent REIT by remaining in existence under state law but transforming into a disregarded entity for federal income tax purposes (*e.g.*, through an entity classification election on IRS Form 8832 or revocation of TRS status on IRS Form 8875), this transformation of Target is maximally disregarded such that Target no longer exists as an "investment" (and thus the investment has been disposed of by Parent REIT). *See, e.g.*, Brian E. Hammell, Caroline A. Kupiec, & Ameek Ashok Ponda, *'Cogito, Ergo Sum': Is that Disregarded Entity in Fact Regarded?*, J. PASSTHROUGH ENTITIES, July–Aug. 2019, at 53–63. But, as explained below, it is not necessary to parse through the subtle distinctions among Parent REIT's investment in Target shares, Target's underlying assets, Target's federal

income tax classification as an entity, or Target's other special tax statuses, for none of these appear to have any impact on the meaning of "temporary" under the TINC Rules.

45 As a matter of statutory construction, courts generally give effect to each provision of a statute such that no part is deemed superfluous, but this statutory construction principle must yield in appropriate cases. *See Landgraf v. USI Film Prods.*, SCt, 511 US 244, 259 (1994) (acknowledging that petitioner's textual argument, based upon "the canon that a court should give effect to every provision of a statute," "has some force" but refusing to accept the averred meaning, because it was "unlikely that Congress intended the [disputed clause] to carry the critically important meaning petitioner assigns it"). In the case of the TINC Rules, the legislative history supports the argument that "temporary" merely refers to the one-year relief period and nothing more. *See* 1986 Blue Book, *supra* note 24 at 394–395, which explained the "temporary investment of new capital" provision as follows:

> Under the Act, if a REIT receives new equity capital, then income derived from stock or debt instruments (*i.e.*, interest, dividends, or gains from the sale of such stock or debt instruments) that is attributable to the temporary investment of the new equity capital is treated, for a one-year period beginning on the date that the REIT receives such capital, as qualifying income for purposes of the "75 percent income test." In addition, during such period, stock or debt instruments purchased with such capital are treated as "real estate assets" for purposes of the [75% REIT Asset Test]. Under the Act, new equity capital is any amount received by the REIT in exchange for stock of the REIT (other than pursuant to a dividend reinvestment plan).

Of particular significance, there is no separate definition or explication of "temporary" in this legislative history, only a "temporary" period of one year on the treatment of "investments" as "real estate assets."

46 *See The Limited, Inc.*, *supra* note 33.

47 *Temporary*, Merriam-Webster's Collegiate Dictionary (11th ed. 2007). Of course, there is a line of thinking that all things in the mortal realm are ephemeral and thus "temporary"; for example this concept is incorporated in one of the core beliefs of Buddhism ("*anicca*"). *See* Sayagyi Thray Sithu U Ba Khin, *The Essentials of Buddha Dhamma in Meditative Practice*, Collected Wheel Publications: Volume XVI, Numbers 231 to 247 (Buddhist Publication Society 2012). *See also* 2 *Corinthians* 4:18 (New International Version) ("So we fix our eyes not on what is seen, but on what is unseen, since what is seen is temporary, but what is unseen is eternal."); Mr. Spock, *Star Trek: The Original Series: Let That Be Your Last Battlefield* (NBC television broadcast, Jan. 10, 1969) ("Change is the essential process of all existence."); Percy Bysshe Shelley, *Ozymandias*, Miscellaneous and Posthumous Poems of Percy Bysshe Shelley (1826) (available at *https://en.wikipedia.org/wiki/Ozymandias* (last visited Aug. 28, 2019)):

> I met a traveller from an antique land
>
> Who said: Two vast and trunkless legs of stone
>
> Stand in the desert. Near them, on the sand,
>
> Half sunk, a shattered visage lies, whose frown,
>
> And wrinkled lip, and sneer of cold command,
>
> Tell that its sculptor well those passions read
>
> Which yet survive, stamped on these lifeless things,
>
> The hand that mocked them and the heart that fed:
>
> And on the pedestal these words appear:
>
> 'My name is Ozymandias, king of kings:
>
> Look on my works, ye Mighty, and despair!'
>
> Nothing beside remains. Round the decay
>
> Of that colossal wreck, boundless and bare
>
> The lone and level sands stretch far away.

Such a polar view of "temporary" might make particular sense for investments, where economic theory teaches that a "hold-versus-sell" decision is made every day, and also that the very point of making most investments would be to sell them one day. *See*, *e.g.*, Lawrence E. Lifson & Richard A. Geist, *The Psychology of Investing* 33 (1999) ("Investors who subscribe to a few advisory services and a telephone hotline and then watch CNBC or Bloomberg TV and visit a couple of investor Internet chatrooms can easily get multiple, somewhat differing opinions on one question: hold versus sell."). While all these are helpful and fascinating explorations of investing and impermanence, as explained below they should be unneeded to satisfy the TINC Rules' third and final requirement of "temporary."

48 *See supra* note 23.

49 The taxpayer REIT in LTR 9342021 also sold convertible debt in a private placement (not a public offering), and so the funds received in that sale were outside of Code Sec. 856(c)(5)(D)(ii)(II) and thus not included in "new capital."

50 The 1986 Blue Book and the Senate Report both state that a new or existing REIT that has "new capital" is entitled to relief under the TINC Rules. Nothing more is required. This is a broad mandate, consistent with the TINC Rules being a relief provision.

51 The exclusion in Code Sec. 856(c)(4)(B)(i) was added to the Code in 1960 as part of the original REIT legislation, and Reg. §1.856-3(e) was adopted in 1962 as part of the original REIT regulations, so these two similar (but not coterminous) provisions have co-existed since the origins of REITs without conflict. The clear interpretation of Reg. §1.856-3(e) is to count anything that qualifies as a real estate asset only as a real estate asset, and not also as a security; the difference is that, in addition to real estate assets covered by Reg. §1.856-3(e), the explicit parenthetical in Code Sec. 856(c)(4)(B)(i) also excludes securities that might be cash and cash items (including receivables) and Government securities.

52 *See*, *e.g.*, LTRs 201537020 (May 22, 2015); 201503010 (July 9, 2014); 201431020 (Apr. 16, 2014); 201315007 (Jan. 11, 2013); 201129007 (Apr. 6, 2011); 200705001 (Sept. 29, 2006); 200630010 (Feb. 28, 2006).

53 *See* Decker, Kaplan, & Ponda, *supra* note 1, at 422 n.62 (stating that "a REIT's investment in TRS equity or debt securities, to the extent and for the duration qualifying as a temporary investment of new capital, will qualify as a real estate asset that counts toward the 75 percent REIT asset test requirement and is therefore not a security subjected to the [then] 25 [and now 20] percent [TRS] limit [in Code Sec. 856(c)(4)(B)(ii)]."). As discussed, the shares of Target held by Parent REIT are not subject to the remainder of the REIT Asset Tests in Code Sec. 856(c)(4)(B)(iv) if they are counted within either the 75% REIT Asset Test or the 20% TRS Limit.