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CC:FIP:B02
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Date:
November 26, 2013

Legend:

Taxpayer A =

Taxpayer B =

State =
Corporation A =
Corporation B =
Corporation C =
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Dear :

This is in reply to a letter dated May 17, 2013 and subsequent correspondence, requesting rulings on behalf of Taxpayer A and Taxpayer B (together, Taxpayers). Specifically, you have requested rulings that: 1) the issuance by Taxpayers of more than one class of common stock with fee structures suited to the distribution channel for each class of common stock will not cause dividends paid by Taxpayers with respect to its shares to be preferential dividends within the meaning of section 562(c) of the Internal Revenue Code; 2) that the issuance of more than one class of common shares with different fee structures will not cause either Taxpayer to fail to qualify as a real estate investment trust (REIT) under part II of subchapter M of the Code; and 3) that the issuance of shares pursuant to Taxpayers' dividend reinvestment plans (DRIPs) at a price net of the upfront fees will not cause the dividends paid by Taxpayers with respect to their shares to be preferential dividends under section 562(c).

Facts:

Taxpayers are corporations organized under State law. Taxpayers have filed initial registration statements with the Securities and Exchange Commission with the intent to offer shares of common stock to the public. The dealer manager of the Taxpayers' offerings will be Corporation A. Taxpayers' shares will not be listed on a securities exchange. Each Taxpayer intends to elect to be taxed as a REIT. Taxpayer A will be externally managed by Corporation B and Taxpayer B will be externally managed by Corporation C (hereafter, "Advisors"). The Advisors are affiliates of Corporation A. Taxpayers intend to primarily invest in commercial properties through operating partnerships.

In order to attract investors that invest through a variety of placement channels, Taxpayers each intend to issue up to eight classes of common stock. Each class of shares will have fee structures suited to a particular placement channel. The operation of Taxpayers' classes, including the fees and expenses that are allocated on a class-specific basis, is governed by Taxpayers' Articles of Incorporation (the charters), State General Corporation Law, multi-class plans adopted by Taxpayers, Taxpayers' prospectuses and the securities laws that govern their contents, and state laws that govern the operation of REITs whose securities are offered in their states.

The first class of stock, Class A-1 shares, would be issued to investors who purchase shares through registered representatives of participating broker-dealers who are compensated following the completion of the sale of the shares. These shares would be sold at $a per share plus a one-time, upfront selling commission of up to b percent of the offering price per share, and a one-time upfront dealer-manager fee of up to c percent of the offering price per share, for a total offering price to the investor of up $d per share. The upfront selling commission and dealer-manager fee would be paid to the dealer-manager, which would then reallow e percent of those fees to the participating broker-dealer. Thus, the net proceeds to Taxpayers would be $a per share.

Class A-2 shares would be designed for those investors who purchase their shares through a registered representative of a participating broker-dealer. These shares would be sold at $a per share, plus a one-time upfront selling commission of up to c percent of the offering price per share, and a one-time upfront dealer manager fee of up to i percent of the offering price per share, for a total offering price to the investor of up to $j per share. Taxpayers would pay the selling commission and dealer manager fee to the dealer manager, which would then reallow e percent of those fees to the participating broker-dealer. Thus, the net proceeds to Taxpayers per Class A-2 share would be $a. Taxpayers also expect that these shares would be subject to a trailing distribution fee of up to h percent of the net offering price of $a per share, which would be paid to the dealer manager, who would then reallow up to e percent of the distribution fee to the participating broker-dealer.

Class B-1 shares would be designed for those investors who purchase their shares through a registered representative of a participating broker-dealer and pay an upfront selling commission. These shares would be subject to a one-time upfront selling commission of up to i percent of the offering price per share, and a one-time upfront dealer manager fee of up to c percent of the total offering price per share, for a total offering price of $j per share. Thus, the net proceeds to Taxpayers per Class B-1 share would be $a. Taxpayers also expect that these shares would be subject to a trailing distribution fee of up to i percent of the net offering price of $a per share, which would be paid to the dealer manager, who would then reallow up to e percent of the distribution fee to the participating broker-dealer.

Class B-2 shares would be designed for investors who purchase their shares through a registered investment advisor or a registered representative of a participating broker-dealer in wrap or fee-based accounts but who do not pay an upfront selling commission. These shares would be subject to an upfront dealer manager fee of up to c percent of the offering price per share, for a total offering price of $k per share. The upfront dealer manager fee would be paid to the dealer manager, who would then reallow up to e percent of that fee to the participating financial advisor. This class of shares would also be subject to a trailing service fee of up to l percent of the net offering price per share of $a, which is payable to the dealer manager.

Class C-1 shares would be designed to be sold through a registered investment advisor in a wrap or fee based account. These shares would be offered at $k per share and would be subject to an upfront dealer manager fee of c percent per share. Thus, the net proceeds to Taxpayers per Class C-1 share would be $a. The upfront dealer manager fee would be paid to the dealer manager, who would then reallow up to e percent of that fee to the participating registered investment advisor or to a financial intermediary that provides services relating to Taxpayers' shares for clients of the registered investment advisor.

Class C-2 shares would be designed to be sold through a registered investment advisor in a wrap or fee based account. These shares would be offered at $a per share, and would not be subject to an upfront commission or an upfront dealer manager fee. Class C-2 shares would be subject to a trailing dealer manager fee of up to c percent of the net offering price per share ($a), which would be paid to the dealer manager in arrears. The dealer manager would then reallow up to e percent of the trailing dealer manager fee to the participating registered investment advisor or to a financial intermediary that provides services relating to Taxpayers' shares for clients of the registered investment advisor.

Class D shares would be designed for employee benefit plans, and separate accounts of insurance companies supporting variable annuities, variable life insurance products, and 401(k) plans. These shares would be offered at $a per share and would not be subject to an upfront selling commission. Class D shares would be subject to a trailing dealer manager fee of up to m percent of the net offering price per share ($a) and would be payable to the dealer manager in arrears. These shares would also be subject to a service fee of up to n percent of the net offering price per share, which would be paid to financial intermediary providing services relating to Taxpayers' shares.

The final class of common stock, Class E, would be designed to be sold directly to shareholders and would be issued to institutional investors and high net worth individuals. Shares of Class E would be offered at $a per share and would not be subject to an upfront selling commission. However, these shares would be subject to a trailing dealer manager fee of up to o percent of the net offering price per share, which would be paid to the dealer manager. These shares would also be subject to a service fee of up to n percent of the net offering price of $a. The service fee would also be paid to the dealer manager and both fees would be paid in arrears. Taxpayers' anticipate that the minimum investment for Class E shares would be $p.

Shareholders in all of the proposed classes of shares except Class A-1 would be eligible to participate in each Taxpayer's DRIP. During Taxpayers' public offering, under the DRIP, distributions from each share would be automatically reinvested in the same class of shares at a price equal to the offering price less any upfront fees. Accordingly, all DRIP shares would be purchased at $a per share. Distributions from shares in one class are not eligible for reinvestment in shares of a different class. DRIP shares of each class would be subject to the same asset-based fees as other shares of that class. Taxpayers represent that the DRIP shares for each class participating in the DRIP program will not be priced at less than 95 percent of the public offering price for that class and will therefore satisfy the requirements in Rev. Rul. 83-117, 1983-2 C.B. 98.

Following the termination of Taxpayers' respective public offerings, broker dealers that have sold shares of Taxpayers' common stock would not be permitted to report, in their customer account statements, an estimated value per share that is developed from data more than 18 months old. Taxpayers' respective boards of directors intend to determine the estimated value per share for each class of stock within 18 months after the completion of the public offerings, or at such time as required under FINRA rules. As soon as such determination is made, the DRIP price will be based on the estimated value per share per class.

In addition to the commissions and dealer manager, distribution, and service fees that vary according to the placement channel, each class would be allocated fees and expenses attributable to other distribution expenses or expenses for services relating to or provided to that class. None of the fees that vary by class is related to advisory or custodial services provided to Taxpayers or to the management of Taxpayers' assets.

Certain other fees and expenses will be allocated by class. These include a fee that is termed a "subordinated performance fee" and certain organizational and offering expense reimbursements. Upon the occurrence of any of the following alternative events, an Advisor would receive a subordinated performance fee: (i) if Taxpayer's shares are listed on a national securities exchange an Advisor would be entitled to a fee equal to q percent of the amount, if any, by which (1) the market value of Taxpayer's outstanding stock plus distributions paid prior to listing, exceeds (2) the sum of the total amount of capital raised from investors and the amount necessary to generate a r percent annual cumulative, non-compounded return to investors; (ii) if Taxpayers' company is sold or their assets are liquidated, the Advisor will be entitled to a fee equal to q percent of the net sale proceeds after investors have received a return of their capital invested and a r annual cumulative, non-compounded return; or (iii) upon termination of the advisory agreement, the Advisor may be entitled to a fee similar to that to which it would have been entitled had the portfolio been liquidated (based on an independent appraised value of the portfolio) on the date of termination. Thus, the rate of the subordinated performance fee would be the same for each class, but the absolute amount of that fee paid by each class would reflect variations in the performance of each class.

The Advisor may incur or pay a Taxpayer's organization and offering expenses (excluding selling commissions and dealer manager fees). Each Taxpayer may then reimburse the applicable Advisor for these amounts up to c percent of aggregate net offering proceeds. Such costs would be allocated to each class based on the number of outstanding shares in each class.

In summary, Taxpayers represent that distributions payable to holders of the various classes under the proposed multi-class structure will differ only by reason of the special allocation of the dealer manager fee, upfront selling commissions, distribution fees, stockholder servicing fees, and certain class-specific expenses depending on the placement channel or other factors unique to each class. The advisory fee, acquisition fee, the acquisition and offering and expense reimbursement, and the disposition fee would be allocated to each class based on the number of outstanding shares of the class in relation to the number of outstanding shares of all classes.

Law and Analysis:

Section 857(a)(1) of the Code requires, in part, that a REIT's deduction for dividends paid for a tax year (as defined in section 561, but determined without regard to capital gains dividends) equals or exceeds 90% of its REIT taxable income for the tax year (determined without regard to the deduction for dividends paid and by excluding any net capital gain).

Section 561(a) defines the deduction for dividends paid, for purposes of section 857, to include dividends paid during the taxable year.

Section 561(b) applies the rules of section 562 for determining which dividends are eligible for the deduction for dividends paid under section 561(a).

Section 562(c) provides that the amount of any distribution will not be considered as a dividend for purposes of computing the dividends paid deduction under section 561 unless the distribution is pro rata. The distribution must not prefer any shares of stock of a class over other shares of stock of that same class. The distribution must not prefer one class of stock over another class except to the extent that one class is entitled (without reference to waivers of their rights by stockholders) to that preference.

Section 1.562-2(a) of the Income Tax Regulations provides that a corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class. Nor will a corporation be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock. A preference exists if any rights to preference inherent in any class of stock are violated. The disallowance, where any preference in fact exists, extends to the entire amount of the distribution and not merely to a part of such distribution.

Rev. Proc. 99-40, 1999-2 C.B. 565, describes conditions under which distributions made to a shareholder of a regulated investment company ("RIC") may vary and nevertheless be deductible as dividends under section 562. Rev. Proc. 99-40 holds, in part, that variations in distributions to shareholders that exist solely as a result of certain allocations of fees and expenses described in the revenue procedure do not prevent the distributions from being dividends under section 562. The requirements of Rev. Proc. 99-40 are based on similar requirements contained in Rule 18f-3, 17 C.F.R. 270.18f-3, under the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq. ("1940 Act") that are meant to ensure the fair and equal treatment of shareholders. One requirement of Rev. Proc. 99-40 is that the advisory fee must not be charged at different rates for different groups of shareholders. The groups of shareholders may be allocated and may pay a different advisory fee, however, to the extent that any difference in amount paid is the result of the application of the same performance fee provisions in the advisory contract to the different investment performance of each group of shareholders.

As a REIT, Taxpayer is not within the scope of Rev. Proc. 99-40. Nevertheless, Congress and the Service have acknowledged the similarity between RICs and REITs in many areas and have afforded them similar treatment in many situations. The legislative history underlying the tax treatment of REITs indicates Congress generally intended to equate the tax treatment of REITs with the treatment accorded RICs. REITs were created to provide an investment vehicle similar to the RIC for small investors to invest in real estate and real estate mortgages. See H.R. Rep. No. 2020, 86th Cong., 2d Sess. 3 (1960). Consequently, the rationale underlying Rev. Proc. 99-40 is instructive by analogy in determining whether the distribution of fees and expenses to different classes of shareholders results in the fair and equal treatment of those shareholders. [1]

In Rev. Rul. 83-117, the Service indicated that a 5 percent discount to certain shareholders participating in a dividend reinvestment plan (DRIP) would not be considered to be a preferential dividend. In that ruling, a REIT established a DRIP in which shareholders could elect to receive dividends either in cash or in the REIT's stock at a price equal to 95 percent of the stock's fair market value on the distribution date. The DRIP was intended as a means for the REIT to raise capital, and the discount approximated the underwriting and other costs that the REIT would have incurred in issuing new stock. The revenue ruling notes that the plan treated all shareholders with impartiality by giving them an equal opportunity to invest and that the savings passed along as a discount was relatively small and resulted in only minor differences in distributions. Accordingly, the 5 percent discount for shareholders that elected to participate in the DRIP did not preclude the REIT from qualifying for the dividends paid deduction as long as the discount did not exceed five percent.

[1] Publicly offered RICs are no longer subject to section 562(c) with respect to distributions in tax years beginning after December 22, 2010.

Based on the above facts and representations, we conclude that Taxpayers' issuance of the Class A-1 Shares, Class A-2 Shares, Class B-1 Shares, Class B-2 Shares, Class C-1 Shares, Class C-2 Shares, Class D Shares and Class E Shares as described above will not cause dividends paid by each respective Taxpayer with respect to the Class A-1 Shares, Class A-2 Shares, Class B-1 Shares, Class B-2 Shares, Class C-1 Shares, Class C-2 Shares, Class D Shares and Class E Shares to be preferential dividends within the meaning of section 562(c). Furthermore, the issuance of the Class A-1 Shares, Class A-2 Shares, Class B-1 Shares, Class B-2 Shares, Class C-1 Shares, Class C-2 Shares, Class D Shares and Class E Shares will not cause either Taxpayer to fail to qualify as a REIT. Finally, the issuance of shares pursuant to Taxpayers' DRIPs at a price net of upfront fees will not cause dividends paid by Taxpayers with respect to their shares to be preferential under section 562(c).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether each Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Susan Thompson Baker
Susan Thompson Baker
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)