Chapman and Cutler LLP

Chapman Client Alert

May 15, 2020 Current Issues Relevant to Our Clients

IRS Lowers Cash Limitation Percentage for RICs and REITs

On May 4th, the IRS issued Revenue Procedure 2020-19, which provides temporary relief to publicly-offered regulated investment companies ("RICs") and publicly-offered real estate investment trusts ("REITs"), with respect to stock distributions that are intended to qualify for the dividends-paid deduction. Pursuant to this guidance, RICs and REITs will only be required to provide their shareholders in the aggregate with the option to receive 10%, rather than 20%, of the total stock distribution in cash. This guidance is intended to enable publicly-offered RICs and REITs to conserve their capital and thereby enhance their liquidity, and it applies to qualifying stock distributions declared after March 31, 2020, and before January 1, 2021.

Stock Distributions by RICs and REITs

RICs and REITs must annually pay dividends at least equal to a specified percentage of their income in order to avoid entity-level taxation and applicable excise taxes. These distributions are deductible when computing the entity's taxable income, and shareholders of a RIC or REIT that satisfies this minimum distribution requirement may be entitled to conduit treatment with respect to the character of certain of the entity's underlying net capital gains, income (but not losses) and credits, to the extent that the RIC or REIT elects to be treated as a conduit for such amounts and reports such amounts to its shareholders accordingly.

For RICs and REITs with significant non-cash taxable income or that are otherwise experiencing liquidity issues, meeting the annual minimum distribution requirements can be a stumbling block for avoiding entity-level taxation and excise taxes. Very generally, section 305(b) of the Internal Revenue Code of 1986 (the "Code") provides that a distribution that may be made, at the option of a shareholder, either in stock or property may qualify as a dividend notwithstanding the general rule that distributions of stock are not treated as qualifying distributions. The term "property" includes cash for these purposes. Code section 305(b) and the related Treasury Regulations only apply, however, to the portion of the distribution that a shareholder can elect to receive as cash or property.

In 2017 the IRS issued Revenue Procedure 2017-45, which provides a safe harbor enabling publicly-offered RICs and publicly-offered REITs to make stock distributions that qualify for purposes of the minimum distribution requirements described above. In general, that guidance provides that the declaration of a stock distribution will be treated as a deductible distribution of property if each shareholder is given a cash-or-stock election with respect to all or a portion of the distribution, and the distribution in the aggregate offers shareholders at least 20% to be taken in cash (the "Cash Limitation Percentage"). Despite the reference in Code section 305(b) to distributions of "property," Revenue Procedure 2017-45 does not provide a safe harbor for property-or-stock elections, but rather, only for cash-for-stock elections.

Revenue Procedure 2017-45 is effective with respect to distributions declared on or after August 11, 2017, and does not provide for a sunset date.

Cash Limitation Percentage

Revenue Procedure 2020-19 modifies the requirement with respect to the amount of cash that must be offered to shareholders as part of a cash-or-stock distribution safe harbor. The Cash Limitation Percentage described above is reduced from 20% to 10%, with respect to any stock distribution declared after March 31, 2020, and before January 1, 2021, provided that the stock distribution otherwise meets the requirements of Revenue Procedure 2017-45.

Publicly-Offered RICs and REITs

A publicly-offered RIC is a RIC the shares of which are continuously offered pursuant to a public offering, regularly traded on an established securities market, or held by or for no fewer than 500 persons at all times during the taxable year.

A publicly-offered REIT is a REIT that is required to file annual and periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

For More Information

If you would like further information concerning the matters discussed in this article, please contact any of the following attorneys or the Chapman attorney with whom you regularly work:

Colman J. Burke
San Francisco
415.278.9033
cburke@chapman.com

Paul D. Carman
Chicago
312.845.3443
carman@chapman.com

Craig M. Cohen
New York
212.655.2552
ccohen@chapman.com

Steven L Kopp
New York
212.655.2505
steven.kopp@chapman.com

David Z. Nirenberg
New York
212.655.2522
david.nirenberg@chapman.com

Colleen Kushner
Chicago
312.845.3771
gartland@chapman.com

Chapman and Cutler LLP

Attorneys at Law · Focused on Finance®