Economy

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Taxation of Real Estate Investment Trusts (REITs) in the United States and of their German Shareholders

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TAXATION OF REAL ESTATE INVESTMENT TRUSTS (REITS) IN THE UNITED STATES AND OF THEIR GERMAN SHAREHOLDERS

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ABBREVIATIONS

$	U.S. Dollar
%	Percent
ABS	Asset-Backed Securities
AMT	Alternative Minimum Tax
Bn	Billion
Code	Internal Revenue Code
Cp.	Compare
DEFRA	Deficit Reduction Act 1984
DTA	Double Taxation Treaty
E&P	Earnings and Profits
E.g.	For example (lat. exempli gratia)
EStG	Einkommensteuergesetz
Fig.	Figure
FFO	Funds from Operations
FIRPTA	Foreign Investment in Real Property Tax Act
G-REIT	German Real Estate Investment Trust
Id.	Identical
IPO	Initial Public Offering
IRC	Internal Revenue Code
IRS	Internal Revenue Service
L.P.	Limited Partnership
MTC	Multistate Tax Compact
NAREIT	National Association of Real Estate Investment Trusts
NCL	Net Capital Loss

NOL	Net Operating Loss
OP	Operating Partnership
PLR	Private Letter Ruling
QRS	Qualified REIT Subsidiary
Reg.	Regulation
RIDEA	REIT Investment Diversification and Empowerment Act
REIT	Real Estate Investment Trust
REITTI	Real Estate Investment Trust Taxable Income
REMIC	Real Estate Mortgage Investment Conduit
Rev. Rul.	Revenue Ruling
RIC	Regulated Investment Company
RMA	Real Estate Modernization Act
TRS	Taxable REIT subsidiary
UBTI	Unrelated Business Taxable Income
UDITPA	Uniform Division of Income for Tax Purposes Act
UBTI	Unrelated Business Taxable Income
UPREIT	Umbrella Partnership Real Estate Investment Trust
USRPHC	United States Real Property Holding Company
USRPI	United States Real Property Interest
Vs.	Versus

1 INTRODUCTION

1.1 PROBLEM DEFINITION

This Bachelor Thesis about the taxation of Real Estate Investment Trusts (REIT) in the United States and of German investors gives an overview over the provisions of the Internal Revenue Code and some special rules and regulations for REITs issued by the United States Treasury and the Internal Revenue Service. Furthermore, it regards withholding tax issues for foreign investors constituted by U.S. tax law, in addition to the provisions of the Double Taxation Treaty between the U.S. and Germany.

The object of this thesis is to provide potential German investors with an insight into the tax situation of REITs in the United States of America and to present the possibility of relatively save investments with a tax reduction aspect. Furthermore this document can be used for the U.S. perspective in an evaluation of similarities and differences between the long established U.S. REITs and the new German REITs (G-REITs) that have been introduced in Germany in 2007 through an act (*Gesetz zur Schaffung deutscher Immobilien-Aktiengesellschaften mit börsen-notierten Anteilen*) of May 28, 2007, which was dated back to January 1, 2007.[1]

Real Estate Investment Trusts have a special position in U.S. federal and state tax law, which is only recognized if all the prerequisites described in the thesis are being met. Additionally, the REIT status has to be actively elected before the taxation according to those principles is possible.

Real Estate Investment Trusts have their origin in the United States, from where they spread out into the whole world. Today, this way for rather small investors to invest in real estate is possible and established in over 20 countries around the globe. Depending on the country, entities have to meet different standards, usually concerning organization and income and asset types as well as the distribution of that income, to qualify for the REIT status and enjoy certain tax benefits.

[1] see Zucker, O. (2007), p.1, www.kpmg.de

1.2 APPROACH OF INVESTIGATION

This paper is divided into six chapters. At the beginning the reader will obtain some general information about REITs, their history and legal developments as well as an overview over two special REIT structures that developed over time. This is followed by a brief description of the economic progress and situation over the last four decades.

Chapter three describes the important requirements concerning organization, management and ownership, as well as income the REIT can receive and assets it can hold. Furthermore, the distribution requirements are explained. All of those standards are in accordance with §856 of the Internal Revenue Code (IRC), which especially treats REITs.

The fourth chapter covers the taxation of REITs. It is shown, which kinds of income are taxed in special ways and how the REIT can avoid taxation almost completely. Another important point is the state and city taxation. Every federal state in the U.S. and some cities, like New York City have the right to impose their own taxes and there are some differences between the states, which will be shown.

The fifth chapter treats the tax treatment of the REIT's shareholders. It depends on the fact whether the investors are U.S. citizens or foreigners, because for foreign shareholders U.S. law, the tax treaties and the specific laws of the home country are different. For German investors, especially the double taxation treaty with the United States as well as the German Income taxation are important for calculating the taxes.

Finally, to conclude the thesis, the last chapter will give a short future forecast about the expected economic situation and pending tax law, which will have an influence on REITs in the next years.