HUNTON& WILLIAMS

# Client Alert

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## IRS Addresses REIT Income Test Treatment of Offsetting Hedges

The Internal Revenue Service ("IRS") recently released a private letter ruling regarding the treatment of income from "offsetting" or "counteracting" hedges for purposes of the REIT gross income tests. Click here for a copy of the private letter ruling.

Income from properly identified hedges with respect to liabilities incurred to acquire or carry qualifying REIT assets is ignored for purposes of the REIT 75% and 95% gross income tests. Under general tax principles, a hedging transaction includes a transaction that is entered into to offset part or all of an existing hedge. These types of transactions are often referred to as "offsetting" or "counteracting" hedges. However, prior to the issuance of the recent private letter ruling, there was no guidance indicating whether the concept of an offsetting hedge applies in the context of the REIT income tests.

The recent private letter ruling concludes that income from properly identified transactions that offset or counteract existing hedges of liabilities incurred to acquire or carry qualifying REIT assets will be ignored for purposes of the REIT income tests. This ruling is important because:

- it provides more certainty regarding the treatment of offsetting hedges in the REIT context; and
- in many cases, an offsetting or counteracting hedge may be a more efficient or cost-effective way to economically reduce the amount hedged than a termination of the existing hedge.

If you would like more information about the treatment of hedging transactions by REITs or the REIT gross income tests generally, please contact one of the attorneys listed below.

### Contacts


**George C. Howell, III**
ghowell@hunton.com

**Mark C. Van Deusen**
mvandeusen@hunton.com

**Kendal A. Sibley**
ksibley@hunton.com

**Christopher Mangin, Jr.**
cmangin@hunton.com