



Inland Insights

The Power of Preferential Tax Treatment in REIT Investments Understanding the Impact of After-Tax Yields

Real estate investment trusts (REITs) generate income and may offer portfolio diversification, regular cash flow, capital appreciation, and long-term wealth planning strategies for investors seeking portfolio stability during turbulent economic environments.¹

When it comes to evaluating a REIT's benefits, investors should understand all tax advantages. Income distributions to REIT investors receive preferential tax treatment and can be compared to other investment vehicles on an after-tax yield basis. After-tax yield takes into consideration the taxes that may be due on the distribution, and can be useful when comparing fully taxable investments to tax-advantaged investments.²

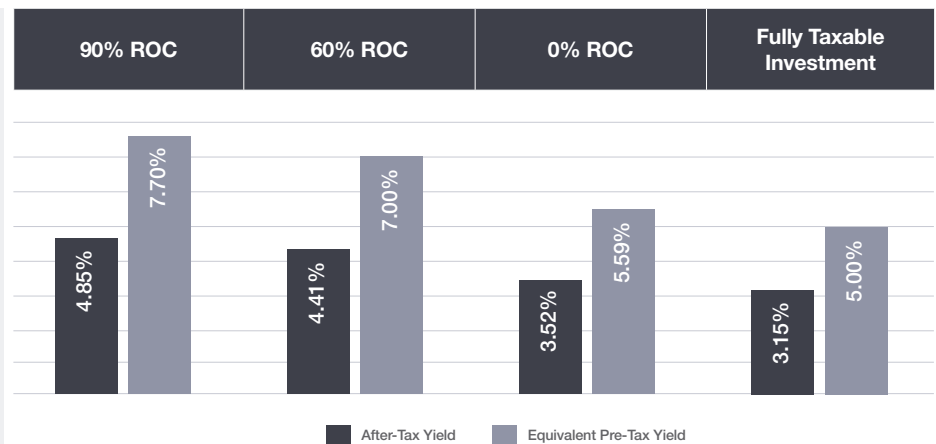
RETURN OF CAPITAL (ROC)

REIT distributions benefit from real estate-related tax deductions for depreciation and amortization, reducing a REIT's net taxable income but not reducing its cash. The ROC distributions may reduce the taxable portion of distributions by an estimated 60% to 90%.

Hypothetical Example³

Preferential Tax Treatment Using Various Levels of ROC Assumptions:

- \$100,000 Investment
- 5% Distribution Rate



| | | | | |
|-------------------------------|--------------|--------------|--------------|--------------|
| Annual Cash Flow (before tax) | \$5,000.00 | \$5,000.00 | \$5,000.00 | \$5,000.00 |
| Return of Capital | \$(4,500.00) | \$(3,000.00) | \$ - | \$ - |
| Taxable Portion | \$500.00 | \$2,000.00 | \$5,000.00 | \$5,000.00 |
| Tax Rate | 37.0% | 37.0% | 37.0% | 37.0% |
| REIT Rate Reduction | 20.0% | 20.0% | 20.0% | 0.0% |
| Tax Rate After REIT Reduction | 29.6% | 29.6% | 29.6% | 37.0% |
| Tax Payable | \$(148.00) | \$(592.00) | \$(1,480.00) | \$(1,850.00) |
| After-tax Distribution Amount | \$4,852.00 | \$4,408.00 | \$3,520.00 | \$3,150.00 |
| Effective Federal Tax Rate | 3.0% | 11.8% | 29.6% | 37.0% |

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Additional REIT Advantages

A REIT is a company that owns, operates, and/or finances a portfolio of income-generating real estate. Subject to certain suitability standards, REIT investors indirectly own part of the REIT's professionally managed real estate portfolio.

- **Pass-through taxation:** REITs are not taxed at the corporate level if at least 90% of taxable income is distributed to shareholders. Less money taxed allows for more funds available to distribute to investors.
- **Distribution taxation at favorable rates:** The ordinary income portion of REIT distributions are eligible for a 20% tax deduction as part of the Tax Cuts and Jobs Act of 2017.
- **No federal and state income tax:** REITs are not required to pay federal income, and in many cases, state income tax. It's important to note that all state tax scenarios are different and investor benefits will vary from state-to-state.
- **Capital gains treatment:** If a portion of a REIT's distributions comes from long-term capital gains, they are taxed at lower rates than ordinary income. REITs can also defer capital gains taxes by executing certain tax-deferred investment strategies, such as a Section 1031 exchange.
- **Estate planning advantages:** When REIT shares are inherited, heirs receive a step-up in basis to fair market value without having to pay taxes on the appreciation of the shares.

Understanding a REIT's preferred tax treatment is particularly beneficial for investors seeking an attractive long-term investment strategy, as it highlights the value of REIT distribution rates, their tax advantages, and potential income.

¹ The value of underlying REIT assets will fluctuate and may be worth less than the real estate program initially paid, and the investor may not be able to sell the investment.

² REIT distributions cannot be guaranteed, may be modified at management's discretion, and may be paid from sources other than cash flow from operations, including borrowing and net offering proceeds.

³ The hypothetical example and any accompanying communications have been prepared for informational purposes only, and are not intended, and should not be construed, as tax, accounting or legal advice to any potential investor. All prospective investors are strongly encouraged to consult with and rely on their own tax, legal, accounting, financial or other professionals. This model contains several assumptions about future events of a hypothetical real estate investment trust. These assumptions are arbitrary and do not correspond to any specific real estate investment trust.

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Important Risk Factors to Consider

Investments in real estate assets are subject to varying degrees of risk and are relatively illiquid. Several factors may adversely affect the financial condition, operating results and value of real estate assets. These factors include, but are not limited to:

- changes in national, regional and local economic conditions, such as inflation and interest rate fluctuations;

- local property supply and demand conditions;
- ability to collect rent from tenants;
- vacancies or ability to lease on favorable terms;
- increases in operating costs, including insurance premiums, utilities and real estate taxes;
- federal, state or local laws and regulations;
- changing market demographics;
- changes in availability and costs of financing;
- acts of nature, such as hurricanes, earthquakes, tornadoes or floods
- economic risks associated with a fluctuating U.S. and world economy, including those resulting from the novel coronavirus and resulting pandemic.

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