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Electing to Be Taxable: Motivations to Give Up Real Estate Investment Trust (REIT) Qualification

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In the United States, a company can elect to be taxed as a real estate investment trust (REIT) by using Form 1120-REIT to file its income tax return. The benefits of qualifying as a REIT primarily include tax advantages for both the company and its shareholders. However, these benefits may be less significant for corporations with low or no taxable income or those that require more financial flexibility. In this study, I explore the motivations behind the decisions of corporations to relinquish their REIT status. My findings indicate that the cumulative abnormal returns (CARs) for REITs announcing their transition to taxable corporation status are positive but not statistically significant. Specifically, the CAR over the event window (-10, +10) is 3.38%. Additionally, I document that the REITs that make this transition tend to have smaller market capitalizations, higher financial leverage, and lower profitability compared to control REITs. Furthermore, the results suggest that any potential benefits from electing to become taxable are likely tied to enhanced financial flexibility rather than increased tax exposure.

Keywords

REIT, REIT status termination, financial flexibility, capital structure, cumulative abnormal return

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1. Introduction

A real estate investment trust (REIT) is a company, trust, or other entity that invests in and manages a portfolio of commercial properties or mortgages. A REIT is typically a pass-through entity that distributes a significant portion of its earnings and capital gains to its shareholders. An organization may qualify under the U.S. Internal Revenue Code (Sections 856-858) and choose to be taxed as a REIT by using Form 1120-REIT to file its income tax return.

REITs can avoid paying corporate income taxes if they meet certain requirements; however, the income that is distributed to shareholders is taxed at the individual level, with REIT dividends typically taxed at the ordinary income rate of the individual. REIT requirements include the following:

- At least 75 percent of the assets must consist of real estate assets.
- At least 75 percent of the income must be derived from rents, mortgages, and gains from real estate sales.
- At least 90 percent of the taxable income must be distributed to shareholders each year.
- No more than 50 percent of the shares can be held by five or fewer individuals.

These requirements ensure that qualifying organizations primarily invest in real estate, distribute most of their earnings to investors, and maintain diverse ownership, all in exchange for avoiding entity-level taxation.

REITs represent another form of securitized real estate investments that allow greater dispersion of real estate ownership. REITs offer investors the opportunity to invest in a professionally managed portfolio of highly liquid real estate assets. Together with the availability of REIT type structures across the globe, investors may reduce their overall portfolio risk by spreading their real estate investments across different geographical regions, thus mitigating the impact of economic fluctuations in any single country, while potentially accessing higher returns from emerging markets with strong real estate growth potential.

The tax advantages of REITs are substantial, as evidenced by existing research. However, converting to a taxable corporation can offer significant benefits that may outweigh the loss of REIT tax status. The primary advantage of becoming a taxable entity lies in the increased financial flexibility that it provides. This includes the ability to transition assets more freely, retain cash flow by reducing dividend payouts, and potentially utilize accumulated losses to offset future tax liabilities.

In this study, I examine the implications of REITs that voluntarily elect to become taxable corporations. This analysis is valuable for investors, who may

need to reassess their portfolio holdings, as well as for REITs that are considering strategic alternatives for the future direction of the firm.

I find that the cumulative average abnormal returns for REITs that have announced a conversion to taxable corporations are positive but statistically insignificant. The cumulative abnormal return (CAR) over the event window (-10, +10 days) is 3.38 percent. Additionally, I document that event REITs tend to have lower market capitalization, higher financial leverage, and lower profitability compared to control REITs. My analysis also shows that the benefits of electing for taxable status are likely linked to more financial flexibility rather than increased tax exposure. These findings suggest that taxable conversion can be a viable option for firms that are facing significant financial constraints due to REIT qualification requirements. This implies that the advantages of enhanced financial flexibility can outweigh the potential corporate tax burden associated with forfeiting REIT status. For REIT sponsors, these findings underscore a practical constraint embedded in the REIT structure itself: the mandatory distribution requirement and leverage limits that define REIT qualification can become binding when a firm faces deteriorating profitability or needs to restructure its capital base. For investors, the announcement of a financially constrained firm to become a taxable corporation should not be interpreted as a value-destroying signal *per se*, but rather as a strategic response to operational distress, one that may preserve long-run firm value by restoring financial flexibility.

The remainder of the paper is organized as follows: Section 2 reviews the limited literature on related studies. Sections 3 and 4 describe the data and methodologies employed. Section 5 presents the results, and Section 6 concludes the paper.

2. Literature Review

The benefits to qualified corporations for electing REIT status are well-documented. Gyourko and Sinai (1999) estimate that based on 1997 data, the REIT structure contributes between 2 and 5 percent to the aggregate market capitalization of REITs. This value addition is particularly pronounced for firms with lower payout ratios. Furthermore, Gyourko and Sinai (1999) suggest that the value of the REIT structure is likely to grow over time as REITs attract an ownership clientele capable of avoiding taxes on distributions received from REITs.

Sun et al. (2013) examine four types of changes in timberland ownership between 1997 and 2010, including five REIT conversions. They find that the cumulative average abnormal return for REIT conversions is 6.45 percent over the event window (-1, +1) around the announcement date. However, they do not investigate the underlying sources of these gains.

Sahin (2019) analyzes a sample of 38 REIT conversion announcements between 1991 and 2015 to evaluate the wealth effects associated with these events. The study shows a significant shareholder wealth gain of approximately 6 percent around REIT conversion announcements. Sahin (2019) attributes these gains to tax-based explanations, thus providing evidence in support of this hypothesis.

Ling et al. (2025) examine both conversions to REIT status and transitions from REITs to taxable corporations. Their sample includes 47 REIT conversions and 29 conversions from REITs to taxable corporations during the period of 1992 to 2018. They report that REIT conversions generate an abnormal return of 2.2 percent around announcement dates, while announcements of becoming taxable corporations result in an average abnormal return of -4.4 percent. The negative abnormal returns are more pronounced for firms with high taxable income and low payout ratios.

This study makes two incremental contributions beyond Ling et al. (2019). First, by extending the sample through to 2022, I incorporate the period following the Tax Cuts and Jobs Act (TCJA) of 2017, which introduced a flat corporate tax rate and narrowed a key advantage of the REIT status. While Table 1 does not show a pronounced surge in taxable elections immediately following 2017, the TCJA nonetheless altered the tax calculus for marginal cases, and its effects may be manifested with a lag as firms reassess their structural options over time. Second, and more substantively, I examine the financial circumstances that motivate REITs to relinquish their tax-exempt status, a question that Ling et al. (2019) do not directly address. REITs already operate under significant financial constraints to maintain qualification requirements, and their heavy reliance on leverage and short-term borrowing limits access to external capital. By documenting that event REITs exhibit systematically higher leverage, lower profitability, and greater reliance on short-term debt relative to the control REITs, this study provides direct evidence that financial constraint (not tax optimization) is the primary driver of electing to become taxable corporations.

Duchin et al. (2010) highlight that external shocks can impose severe financing constraints on firms in industries like REITs, which depend heavily on external financing, maintain low cash reserves, and have substantial short-term borrowing. Similarly, Howton et al. (2018) identify financially constrained REITs by using measures of financial leverage. These constraints are particularly critical for firms with available growth opportunities, as their ability to capitalize on such opportunities is diminished under constrained financial conditions.

I test the two following hypotheses based on the preceding discussion:

Hypothesis 1: There is no abnormal market reaction around the announcement of REITs that elect to become taxable corporations.

Hypothesis 2: Financial constraints do not influence the decision of REITs to elect for taxable corporation status.

Table 1 **Sample of REITs that Announce Status as Taxable Corporations**

Year	All Conversions	Non-Merger	Merger
1991	1	0	1
1992	0	0	0
1993	2	1	1
1994	1	1	0
1995	1	1	0
1996	3	2	1
1997	0	0	0
1998	0	0	0
1999	2	1	1
2000	3	2	1
2001	0	0	0
2002	2	2	0
2003	2	0	2
2004	1	1	0
2005	0	0	0
2006	1	1	0
2007	1	1	0
2008	2	2	0
2009	3	2	1
2010	0	0	0
2011	1	0	1
2012	3	2	1
2013	0	0	0
2014	0	0	0
2015	0	0	0
2016	1	1	0
2017	0	0	0
2018	0	0	0
2019	0	0	0
2020	1	1	0
2021	1	1	0
2022	2	1	1
Total	34	23	11

Notes: The sample builds on Ling et al. (2019), updated to include more recent announcements. Announcement dates are collected through searches of SEC filings, Nexis Uni, and firm websites, which results in 34 announcements between 1991 and 2022. Approximately one-third of these announcements are observed to occur in the context of mergers.

3. Data

I begin with a sample of announcements in which REITs elect to become taxable corporations, originally compiled by Ling et al. (2019). Ling et al. (2019) use the two-digit CRSP share code to identify REITs that transition to taxable organizations by classifying a change in the second digit of the share code from 8 to any other number as a taxable election. I update their sample by following the same procedure to include more recent announcements.

The announcement dates are identified through a comprehensive search of U.S. Securities and Exchange Commission (SEC) filings, Nexis Uni, and firm websites. This process yields 34 announcements made between 1991 and 2022, with approximately one-third associated with mergers. In such cases, the merger leads to the REIT no longer meeting the qualification requirements. The annual distribution of these announcements is presented in Table 1. Notably, no elections to become taxable corporations are recorded in 2017, 2018, or 2019, thus suggesting that the TCJA did not immediately trigger a wave of transitions away from REIT status. Although not directly tested, factors such as transaction costs, existing contractual obligations, and the time required for strategic deliberation may contribute to delays in firms acting on changes in the tax environment. This study does not intend to test the effects of the TCJA on elections to become taxable corporations, and I leave this examination to future research when a sufficient number of post-TCJA observations are available for meaningful statistical inference. The extended sample period nonetheless remains important for capturing any longer-term behavioral responses to the TCJA, and the post-2017 observations, including two announcements in 2022, ensure the analysis reflects the current tax environment rather than one that no longer applies.

I use revenue as a matching criterion to identify control REITs that have not announced that they elect to become taxable corporations. Characteristics of the sample and control REITs are reported in Table 2. This table includes descriptive statistics of key financial metrics from Compustat as of the fiscal year-end prior to the announcements. The metrics include:

- Pretax income margin: Pretax income divided by revenue.
- Financial leverage: Book value of debt divided by market capitalization of equity.
- Tax rate: Tax expense divided by pretax income.
- Payout ratio: Dividend payments divided by net income.
- Growth: Market price per share divided by the book value of common equity per share.

The descriptive statistics indicate the presence of extreme observations among both the event and control REITs. In general, the event REITs exhibit significant outliers in these financial metrics. They tend to have low market value, lack profitability and growth, and show high financial leverage.

Table 2 Descriptive Statistics

Variable	Mean	Median	Standard Deviation	Minimum	Maximum	N
Panel A. Event REITs						
Total Assets	3,128.29	519.72	5,062.86	2.27	18,040.35	31
Market Capitalization	604.15	66.12	1,148.98	3.55	4,741.79	31
Pretax Income	-15.04	-0.99	139.05	-505.92	268.79	30
Pretax Income Margin	-0.9257	-0.0535	4.0050	-20.6742	4.5244	30
Financial Leverage	46.7164	1.8763	243.4985	0.0000	1358.4724	31
Tax Rate	0.0135	0.0000	0.0361	-0.0095	0.1711	27
Payout Ratio	0.7894	0.0000	2.4216	-0.9070	12.2432	29
ST to LT Debt	1.0138	0.1026	1.9187	0.0000	6.8430	24
Growth	0.1219	0.8328	4.4458	-23.2300	3.6680	31
Panel B. Control REITs						
Total Assets	6,137.82	541.58	15,968.89	2.37	83,850.00	29
Market Capitalization	3,010.69	275.32	5,792.12	1.45	24,360.90	28
Pretax Income	111.14	17.29	280.52	-169.00	1,160.00	29
Pretax Income Margin	-0.0720	0.1872	2.0589	-9.4800	4.8800	29
Financial Leverage	1.6698	0.7471	2.8273	0.0000	14.0700	28
Tax Rate	0.0015	0.0000	0.0049	0.0000	0.0231	28
Payout Ratio	1.6942	0.9482	3.1588	-0.9981	15.8200	28
ST to LT Debt	0.2897	0.0244	0.8497	0.0000	4.1810	26
Growth	1.2983	1.3199	1.7102	-5.8900	4.3600	28

Notes: The sample is derived from Ling et al. (2019) and has been updated to include more recent announcements. Announcement dates are collected by searching SEC filings, Nexis Uni, and firm websites, thus resulting in a total of 34 announcements between 1991 and 2022. Revenues are used to identify control REITs. Descriptive statistics for key financial metrics from Compustat as of the fiscal year-end prior to the announcements, comparing event REITs with control REITs. The metrics are: Pretax Income Margin is the pretax income divided by revenues. Financial Leverage is the book value of debt divided by the market capitalization of equity. Tax Rate is the tax expense divided by pretax income. Payout Ratio is the dividend payments divided by net income. Short-Term to Long-Term Debt Ratio (ST to LT Debt) is the ratio of short-term debt to long-term debt. Growth is the market price per share divided by the book value of common equity per share.

4. Methodology

I employ the standard market model, as outlined by Kothari and Warner (2007), to estimate abnormal returns that surround the announcement dates of REITs that elect to be taxed as corporations. The market model parameters for each announcement are estimated by using daily returns from trading days -115 to -16 relative to the event day. To test the significance of abnormal returns and CARs, I apply the methodology developed by Boehmer et al. (1991).

Abnormal returns for each event firm are calculated by using the market model:

$$AR_{i,t} = R_{i,t} - \alpha_i - \beta_i R_{m,t} \quad (1)$$

where $AR_{i,t}$ is the abnormal return on the event firm i on day t , $R_{i,t}$ is the rate of return on the event firm i on day t , and $R_{m,t}$ is the rate of return on the CRSP value-weighted market index on day t . The α_i and β_i are the ordinary least square (OLS) estimates of the coefficients by using returns over days (-115, -16) relative to the event.

The CAR is based on:

$$CAR_{i,t} = \sum_{t=T1+1}^{T2} AR_{i,t} \quad (2)$$

where $CAR_{i,t}$ represents the CAR for event firm i on day t , and $T1$ and $T2$ denote the event window boundaries over which the abnormal returns are aggregated..

Abnormal returns and CARs are standardized by using the procedure outlined by Boehmer et al. (1991) to account for event-induced volatility, as follows:

$$SAR_{i,t} = \frac{AR_{i,t}}{\sqrt{\sigma_{\varepsilon ARi}^2}} \quad (3)$$

$$SCAR_{i,t} = \frac{CAR_{i,t}}{\sqrt{N \times \sigma_{\varepsilon ARi}^2}} \quad (4)$$

where $\sigma_{\varepsilon ARi}^2$ represents the variance of the residuals from the market model for event firm i and N denotes the number of trading days in the estimation window, which is 100.

The t-statistics for SAR and $SCAR$ are calculated by using Equation (5), where M represents the number of event firms:

$$t_{SAR} = \frac{\frac{1}{M} \sum_{i=1}^M SAR_i}{\sqrt{\frac{1}{M(M-1)} \sum_{i=1}^M \left[SAR_i - \frac{1}{M} \sum_{i=1}^M SAR_i \right]^2}} \quad (5)$$

$$t_{SCAR} = \frac{\frac{1}{M} \sum_{i=1}^M SCAR_i}{\sqrt{\frac{1}{M(M-1)} \sum_{i=1}^M \left[SCAR_i - \frac{1}{M} \sum_{i=1}^M SCAR_i \right]^2}} \quad (6)$$

I perform univariate comparisons of event and control REITs across various firm characteristics, and use both parametric and nonparametric tests to account for small sample sizes and extreme observations. In the multivariate analysis, I use robust regression models to investigate the determinants of firm-level CARs during the three-day event window surrounding the announcement dates.

5. Results

I present the market reaction to the election of REITs to become taxable corporations in Table 3. Panel A of Table 3 reports the average abnormal returns for the period that spans ten days before and ten days after the announcements. On the day following the announcements, the average abnormal returns are negative and statistically significant for both the full sample and the non-merger subsample. Notably, significant increases in average abnormal returns occur prior to the announcement dates, thus suggesting potential information leakage.

On the announcement days, the average abnormal returns are positive across the full sample and subsamples, but these gains are quickly reversed in the days following the announcements. For the merger subsample, the average abnormal return is notably influenced by Homeplex Mortgage Investments Corp., which announced a merger with privately held home builders on June 3, 1996. This merger would result in disqualification of Homeplex as a REIT. A review of firm-specific abnormal returns reveals that Homeplex experienced a large and unusual stock price gain four days before the announcement, which further suggests the possibility of pre-announcement information leakage.

Panel B of Table 3 presents the CARs for the period that spans ten days before the announcements to ten days after, reported at each event day increment. The CARs are similar ten days post-announcement across the full sample, and non-merger and merger subsamples, which are 3.38 percent, 3.32 percent, and 3.50 percent, respectively. Figure 1 illustrates the trend of cumulative average abnormal returns over this period of time. However, none of these CARs are statistically significant. Panel C of Table 3 presents the CARs over three-day event windows (-1, +1) for the full sample and subsamples. The CARs are small and negative for both the full sample and the non-merger subsample, while they are positive for the merger subsample. However, none of these CARs are statistically significant. This lack of significance may suggest that investors had already anticipated these actions by REITs prior to the announcements. Panel D of Table 3 presents the CARs over the event window (0, +2) for the full sample and subsamples. The CARs are negative across the full sample, and non-merger and merger subsamples. However, none of these CARs are statistically significant. Taken together with the results in Panels B and C, the evidence does not definitively indicate that electing to become taxable corporations is a net value-destroying action. While the short-window returns following the announcement are negative, the absence of statistical significance across all windows and subsamples suggests that the market does not consistently interpret these elections as value-destroying events.

Table 3 **Abnormal Returns to REITs Announcing their Elections to be Taxable Corporations**

Panel A. Abnormal returns							Panel B. Cumulative abnormal returns			
Day Relative to Event	Full Sample		Non-Merger		Merger		Cumulative Abnormal Return			
	Abnormal Return	T Statistic	Abnormal Return	T Statistic	Abnormal Return	T Statistic	Day Relative to Event	Full Sample	Non-Merger	Merger
-10	-0.0029	-0.2994	-0.0060	-0.5332	0.0027	0.1468**	-10	-0.0029	-0.0060	0.0027
-9	0.0022	0.2268	0.0093	0.6198	-0.0106	-3.6235*	-9	-0.0007	0.0033	-0.0079
-8	-0.0001	-0.0074	-0.0034	-0.1778	0.0059	0.3882	-8	-0.0008	-0.0001	-0.0020
-7	0.0030	0.3251	0.0013	0.1167	0.0061	0.3641	-7	0.0022	0.0012	0.0041
-6	0.0239	1.7176*	0.0365	1.8249*	0.0010	0.0774	-6	0.0262	0.0377	0.0051
-5	-0.0162	-1.5309	-0.0234	-1.4904	-0.0031	-0.3752	-5	0.0100	0.0143	0.0020
-4	0.0111	1.0099	0.0008	0.0609	0.0299	1.5527	-4	0.0211	0.0151	0.0319
-3	0.0009	0.1111	-0.0023	-0.1818	0.0068	1.0131	-3	0.0220	0.0129	0.0387
-2	-0.0012	-0.1785	-0.0012	-0.1222	-0.0013	-0.1508	-2	0.0208	0.0117	0.0374
-1	-0.0021	-0.2629	-0.0094	-0.8748	0.0112	1.1087	-1	0.0187	0.0023	0.0486
0	0.0176	0.9667**	0.0123	0.7619	0.0273	0.6271	0	0.0363	0.0145	0.0759
1	-0.0150	-3.1964*	-0.0202	-3.5253***	-0.0054	-0.7154	1	0.0214	-0.0056	0.0705
2	-0.0124	-1.4923	-0.0009	-0.1524	-0.0333	-1.6700	2	0.0090	-0.0065	0.0372
3	0.0068	0.8287	0.0114	1.0120	-0.0015	-0.1402	3	0.0158	0.0048	0.0356
4	0.0076	0.8684	0.0081	0.6130	0.0069	0.9163	4	0.0234	0.0129	0.0425
5	0.0050	0.4366	0.0161	0.9786	-0.0151	-1.4029	5	0.0284	0.0290	0.0274
6	-0.0050	-0.6205	-0.0032	-0.3010	-0.0085	-0.6382	6	0.0234	0.0258	0.0189
7	-0.0094	-0.8149	-0.0114	-0.6565	-0.0057	-0.6419	7	0.0140	0.0145	0.0132
8	0.0123	1.3615	0.0154	1.2302	0.0066	0.5556	8	0.0263	0.0299	0.0198
9	0.0046	0.5222	0.0020	0.1617	0.0093	0.8232	9	0.0308	0.0318	0.0290
10	0.0030	0.5304	0.0014	0.2544	0.0060	0.4587	10	0.0338	0.0332	0.0350

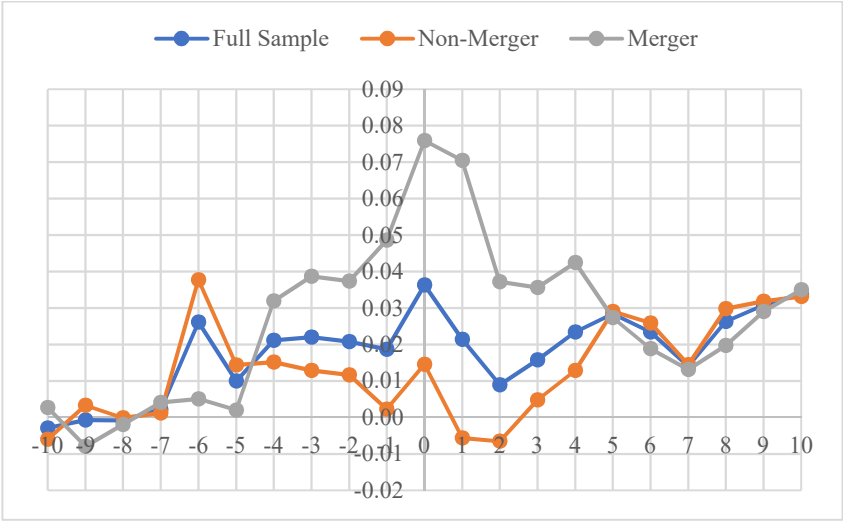
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(Table 3 Continued)

Panel C. Cumulative return (CAR) over days -1 to +1 relative to event day.						
CAR (-1, +1)	0.0006	0.0179	-0.0173	-1.1646	0.0331	0.6703
Panel D. Cumulative return (CAR) over days 0 to +2 relative to event day.						
CAAR (0, +2)	-0.0097	-0.3006	-0.0088	-0.5912	-0.0115	-0.2324

Notes: Abnormal returns for REITs that announced electing to become taxable corporations. The sample builds on Ling et al. (2019) and has been updated to include recent announcements. Announcement dates are identified through searches of SEC filings, Nexis Uni, and firm websites, thus resulting in a total of 34 announcements made between 1991 and 2022. The market model, as outlined by Kothari and Warner (2007), is applied by using an estimation period that ends 11 days prior to the announcement dates. T-statistics are calculated by using the methodology developed by Boehmer et al. (1991), which adjusts for event-induced volatility.

Figure 1 Cumulative Abnormal Returns



The announcement reaction results I report differ from those presented by Ling et al. (2019). One potential explanation for these differences lies in the sample restrictions applied by Ling et al. (2019), specifically their exclusion of announcements made around earnings releases. This restriction reduces their sample to just nine announcements. In contrast, I do not impose this restriction, as disentangling such announcements from profitability concerns is inherently challenging. In other words, even when there are no explicit earnings announcements, the REITs in these events are clearly experiencing profitability pressure. Additionally, two other factors may contribute to the differences in the results:

- Differences in Announcement Dates: It is possible that the event dates identified in the two studies do not fully overlap. Given that event firms are relatively small, finding reliable news articles about them can be difficult.
- Sample Time Period: The inclusion of announcements after 2018 in my study could also account for the discrepancies. With a small sample size, extending the time frame may significantly influence the results.

I present the results of univariate comparisons between the event and control REITs in Table 4, which include the entire sample and two subsamples. The table reports both parametric and nonparametric tests of differences. Panel A of Table 4 indicates that the market capitalization of event REITs is significantly smaller than that of the control REITs. Additionally, event REITs rely significantly more on short-term borrowing compared to the control REITs. This reliance represents an important source of financial constraint, as excessive short-term borrowing reduces the flexibility of event REITs when seeking external financing. Event REITs also exhibit proportionately higher financial leverage and lower growth prospects. The results for the non-merger subsample closely resemble those of the full sample. However, the results for the merger subsample show no statistically significant differences between the event and control REITs, except for market capitalization

The results in Table 4 also shed light on the distinction between REITs that transition to taxable corporation status through a merger and those that do so through a non-merger route. Panel C of Table 4 indicates that the merger subsample event REITs differ from their control counterparts only in market capitalization, with no statistically significant differences in leverage, profitability, or short-term borrowing. This stands in contrast to the non-merger subsample, where event REITs exhibit significantly higher leverage, lower profitability, and greater reliance on short-term debt relative to control REITs. These results suggest that the two groups are motivated by different considerations. For non-merger event REITs, the evidence is consistent with financial constraint being the primary driver of the decision to become a taxable corporation. For merger event REITs, the smaller market capitalization relative to control REITs may make them attractive acquisition targets, while the absence of significant differences in leverage and profitability suggests that financial distress is not the defining characteristic of this group. The case of Homeplex Mortgage Investments Corp., as discussed earlier, further illustrates that merger-driven taxable elections can reflect strategic transactions rather than financial necessity. Taken together, these findings suggest that the motivation to elect for taxable corporation status is not uniform across firms and that the merger and non-merger routes represent meaningfully distinct pathways.

Table 4 Financial Circumstances of Event and Control REITs

	Mean Difference	Standard Error	Percent Negative	T Test		Sign Test		Signed Rank Test		N
Panel A. All Taxable Conversions										
Total Assets	-2,847.72	2,573.30	0.5172	-1.1066		-0.50		-11.50		29
Market Capitalization	-2,343.10	989.82	0.7500	-2.3672	**	-7.00	**	-158.00	***	28
Pretax Income	-109.25	51.09	0.6552	-2.1385		-4.50		-98.50	**	29
Pretax Income Margin	-1.0416	0.8403	0.6552	-1.2397		-4.50		-113.50	**	29
Financial Leverage	49.5239	48.3146	0.2857	1.0250		5.00	*	110.50	***	28
Tax Rate	0.0123	0.0074	0.0800	1.6627		2.00		15.00	**	25
Payout Ratio	-0.8765	0.7724	0.6071	-1.1348		-4.00		-68.50	*	28
ST to LT Debt	0.8292	0.3844	0.2273	2.1573	**	6.00	**	88.50	***	22
Growth	-1.3468	0.9355	0.7857	-1.4397		-8.00	***	-128.00	***	28
Panel B. Non-Merger										
Total Assets	-408.21	1,438.88	0.4737	-0.2837		0.50		2.00		19
Market Capitalization	-3,165.71	1,492.65	0.7778	-2.1209	**	-5.00	**	-6,905.00	***	18
Pretax Income	-99.86	61.93	0.6316	-1.6123		-2.50		-39.00		19
Pretax Income Margin	-1.3233	1.2647	0.6316	-1.0463		-2.50		-54.00	**	19
Financial Leverage	76.6877	75.1366	0.1667	1.0206		5.00	**	47.00	**	18
Tax Rate	0.0160	0.0113	0.1250	1.4083		1.00		7.50		16
Payout Ratio	-1.7871	0.8624	0.6667	-2.0722	*	-4.00	*	-43.00	**	18
ST to LT Debt	1.0395	0.5632	0.2857	1.8457	*	3.00		36.50	**	14
Growth	-0.5568	0.5290	0.7778	-1.0526		-5.00	**	-53.50	**	18

(Continued...)

(Table 4 Continued)

	Mean Difference	Standard Error	Percent Negative	T Test	Sign Test	Signed Rank Test	N
Panel C. Merger							
Total Assets	-7,482.79	6,945.00	0.6000	-1.0774	-1.00	-5.50	10
Market Capitalization	-862.41	525.09	0.7000	-1.6424	-2.00	-19.50	** 10
Pretax Income	-127.10	94.43	0.7000	-1.3459	-2.00	-14.50	10
Pretax Income Margin	-0.5065	0.4931	0.7000	-1.0271	-2.00	-9.50	10
Financial Leverage	0.6291	0.4147	0.5000	1.5169	0.00	10.50	10
Tax Rate	0.0059	0.0048	0.0000	1.2363	1.00	1.50	9
Payout Ratio	0.7625	1.4208	0.5000	0.5367	0.00	-1.50	10
ST to LT Debt	0.46	0.40	0.1250	1.1617	3.00	13.00	* 8
Growth	-2.77	2.46	0.8000	-1.1257	-3.00	-16.50	10

Notes: The sample builds on Ling et al. (2019) and has been updated to include more recent announcements. Announcement dates are obtained through searches of SEC filings, Nexis Uni, and firm websites, thus resulting in 34 announcements between 1991 and 2022. Revenues are used to identify control REITs. Descriptive statistics of key financial metrics from Compustat as of the fiscal year-end preceding the announcements for both event and control REITs. The metrics are: Pretax Income Margin is the pretax income divided by revenues. Financial Leverage is the book value of debt divided by the market capitalization of equity. Tax Rate is the tax expense divided by pretax income. Payout Ratio is the dividend payments divided by net income. Short-Term to Long-Term Debt Ratio (ST to LT Debt) is the ratio of short-term debt to long-term debt. Growth is the market price per share divided by the book value of common equity per share.

The results suggest that electing to become taxable corporations is not necessarily a value-destroying announcement for REITs. While the overall market reaction is not statistically significant, exploring the factors that influence firm-level reactions to these announcements provides valuable insights. To investigate this further, I analyze firm-level CARs over a three-day event window (-1, +1) in a multivariate framework. The results of this analysis are presented in Table 5. I employ a robust regression method to estimate the variable coefficients, with chi-square test statistics provided under the coefficient estimates.

Table 5 Firm Characteristics and Announcement Abnormal Returns

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
Intercept	0.0102	0.0104	0.0176	0.0171**	0.0106
	0.5800	0.4300	1.5600	1.2200	0.2700
Financial Leverage	-0.0032	-0.0035	-0.0036	-0.0036*	-0.0032*
	2.3500	3.9800**	5.4500**	4.6900	3.2200
Pretax Income Margin			0.0104***	0.0103*	0.0100*
			3.7500	3.3000	3.2200
Tax Rate	-0.5256*	-0.4997**	-0.5480***	-0.5454	-0.4982**
	3.2100	4.2400	6.6200	5.6400**	4.2500
Payout Ratio	-0.0122***	-0.0125***	-0.0131***	-0.0131***	-0.0138***
	8.1600	13.3000	19.3000	16.9600	16.3900
ST to LT Debt		0.0053	0.0044	0.0045	0.0053
		1.2100	1.0400	0.9300	1.1800
Growth				-0.0001	0.0001
				0.0100	0.0000
Merger					0.0115
					0.2400
N	25	19	19	19	19
R-squared	0.2329	0.3500	0.3983	0.3984	0.4005

Notes: Effects of firm characteristics on CARs of REITs that announce their election to become taxable corporations. The sample is based on the work of Ling et al. (2019), and updated to include recent announcements. Announcement dates are identified by searching SEC filings, Nexis Uni, and firm websites, thus resulting in 34 announcements between 1991 and 2022. The dependent variable is the firm-level CAR over the three-day event window (-1, +1). Financial variables are sourced from Compustat. Pretax income margin is calculated as pretax income divided by revenue. Financial leverage is measured as the book value of debt divided by the market capitalization of equity. The tax rate is determined as tax expense divided by pretax income. The payout ratio is defined as dividend payments divided by net income. The short-term to long-term debt ratio (ST to LT Debt) represents the proportion of short-term debt relative to long-term debt. Growth is measured as the market price per share divided by the book value of common equity per share. Chi-square test statistics for the coefficients are reported below the estimates.

The results indicate that financial leverage, tax rate, and payout ratio have significantly negative impacts on the CAR around announcements. REITs with high financial leverage, substantial tax exposures, and elevated payout ratios experience worse market reactions to announcements. High financial leverage reflects the financial constraints faced by these firms. In this context, electing to be taxable could provide financial flexibility by allowing the firm to retain more of its earnings rather than distributing them. However, on average, REITs that elect to be taxable are not profitable, which means that any improvement in financial constraints would first require a restoration of operating profitability. Overall, the negative coefficient for financial leverage likely reflects the financial constraints that these firms face.

The positive coefficient for the pretax income margin is intriguing. Higher pretax income margins are associated with an increase in CARs. This suggests that investors may prioritize the positive financial impact of being taxable over concerns about potential tax exposures. Conversely, the negative coefficient for the tax rate highlights the potential tax burden firms might face when electing to become taxable corporations. Similarly, a high payout ratio correlates with a less favorable market reaction to announcements, which likely reflects the anticipation of investors of potential dividend cuts following the election to be taxable. Lastly, electing to become taxable corporations in the context of mergers shows positive but statistically insignificant effects on abnormal returns.

I include an additional variable, the ratio of short-term to long-term debt, to capture the effects of financial constraints alongside financial leverage. In Models 4 and 5, the coefficients for this financial constraint variable are positive but not statistically significant. The positive sign indicates higher abnormal returns during the announcement period for REITs with relatively larger short-term debt balances compared to their long-term debt. Although this gain is not statistically significant, it suggests that electing to be taxable could positively impact valuation by enhancing financial flexibility. Given the positive sign of the pretax income margin coefficient, this flexibility gain should not be overlooked. The combined positive effects of the pretax income margin and the short-term to long-term debt ratio on CARs underscore the potential financial flexibility benefits associated with electing a taxable status.

To further examine whether the financial constraint motivation is supported by post-transition evidence, I compare financial leverage before and after the taxable election for the non-merger subsample. This comparison is limited to the non-merger subsample, as firm combinations in the merger subsample introduce confounding factors that make pre- and post-event comparisons difficult to interpret meaningfully. A Wilcoxon signed-rank test was conducted to evaluate the difference in financial leverage between the pre- and post-event periods. The non-parametric test was selected over a paired t-test given the relatively small sample size ($N = 20$) and the presence of extreme observations documented in Table 2, which could distort the parametric test results. The

analysis revealed no statistically significant difference in financial leverage following the election to become a taxable corporation ($S = -20$, $p = 0.3225$), with a median change of zero. While this result does not confirm an immediate reduction in financial leverage, it is consistent with the financial circumstances of these firms documented in Table 4. Event REITs enter the transition with significantly higher leverage and lower profitability relative to the control REITs, and restoring financial flexibility under these conditions is unlikely to be immediate. The absence of a significant change in leverage does not contradict the financial constraint motivation; rather, it suggests that the benefits of enhanced financial flexibility may materialize over a longer horizon than the post-event window examined here.

6. Conclusions

In this study, I examine the implications of REITs that voluntarily elect to be taxable corporations. This analysis is valuable for both investors, who may need to reconsider their portfolio allocations, and REITs that are exploring strategic alternatives for the future direction of their firms.

The results show that CARs for REITs that announce their decision to be taxable corporations are positive but not statistically significant. Specifically, the CAR over the event window $(-10, +10)$ is 3.38 percent. Additionally, I find that these event REITs tend to have lower market capitalization, higher financial leverage, and are less profitable compared to the control REITs. My analysis also suggests that any benefits from electing to be taxable are likely associated with improved financial flexibility rather than increased tax exposure.

A notable limitation of my findings is the relatively small sample size, which is predominantly composed of smaller market capitalization firms. This limitation reduces the statistical power of the tests conducted. Furthermore, collecting data on smaller firms poses challenges, as they tend to receive less coverage from journalists and analysts, thus making relevant information harder to obtain.

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