Internal Revenue Service

Number: **200451020**
Release Date: 12/17/04
Index Number: 168.29-02

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:4 – PLR-131163-04
Date:
August 31, 2004

In Re:
TIN:

DO:

TY:

Corporation =
City X =
State X =
Year 1 =
Year 4 =

Dear

This responds to your request for a private letter ruling, dated June 4, 2004, addressing the question of whether Corporation should be treated as a tax-exempt entity within the meaning of § 168(h) of the Internal Revenue Code.

STATEMENT OF FACTS:

Corporation (the taxpayer herein) is a private social club located in City X. Services offered by Corporation to its members include general dining, use of private dining/meeting rooms, overnight accommodations, and parking. Corporation was incorporated in State X in Year 1, and is currently a State X not-for-profit corporation, taxed for federal income tax purposes as a § 501(c)(7) social club.

Corporation operates its club in a single 4-story building, originally constructed in Year 4, and an adjacent parking garage (together hereinafter referred to as the

"Facility"). The building is listed in the National Register for historic buildings. Corporation intends to undertake a substantial renovation of the Facility. The renovations will include the addition of a new fitness center, general refurbishing and reconfiguration of all dining areas, and the relocation of administrative offices. Corporation intends to structure a transaction that will qualify these renovations for the federal historic rehabilitation tax credit, as provided in § 47.

Prior to placing the renovated building back in service, Corporation will convert from a § 501(c)(7) organization to a corporation taxable under Subchapter C of the Internal Revenue Code. However, for state law purposes, Corporation will remain a State X not-for-profit corporation. In addition, to finance these renovations and qualify the renovation expenditures for the § 47 rehabilitation tax credit, Corporation will structure the transaction as follows:

> First, Corporation will lease the Facility to a State X limited partnership (the "Tax Credit Partnership"), which will operate as a for-profit entity under a 29-year lease.
>
> Second, the Tax Credit Partnership will issue a 99% limited partner interest to a corporate investor which will contribute equity capital to the Tax Credit Partnership to partially fund the renovations.
>
> Third, the 1% general partner of the Tax Credit Partnership will be a for-profit subsidiary of Corporation.
>
> Fourth, in order to effectively operate the Club, the Tax Credit Partnership will lease the facility back to Corporation for a lease term of 10 years.

Corporation represents that it both is and expects to remain the owner of the Facility for federal income tax purposes throughout the entire 29-year term of the lease with the Tax Credit Partnership. Corporation has requested a ruling that it not be treated as a tax-exempt entity for purposes of § 168(h).

<u>STATEMENT OF LAW</u>:

Section 47(a) provides, in part, that the rehabilitation credit for any taxable year includes 20 percent of the qualified rehabilitation expenditures for any certified historic structure.

Section 47(c)(2)(B)(v)(I) provides that the term "qualified rehabilitation expenditure" does not include any expenditure in connection with the rehabilitation of a building allocable to a portion of such property that is (or may reasonably be expected to be) tax-exempt use property (within the meaning of § 168(h)).

Section 168(h)(1)(B)(i) provides that, in the case of nonresidential real property, the term "tax-exempt use property" means that portion of the property leased to a tax-exempt entity in a disqualified lease.

Section 168(h)(1)(B)(ii) provides, in part, that the term "disqualified lease" means any lease of nonresidential real property to a tax-exempt entity, but only if one (or more) of four disqualifying factors is present. One of the disqualifying factors is a lease occurring "after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease [*i.e.*, a sale-leaseback or a lease-leaseback arrangement]."

Section 168(h)(2)(A)(ii) generally provides that the term "tax-exempt entity" includes any organization exempt from tax imposed by Chapter 1 of the Internal Revenue Code.

Under § 168(h)(2)(E)(i), a former tax-exempt entity is treated as a tax-exempt entity for purposes of § 168(h)(2)(A)(ii) under certain circumstances. Section 168(h)(2)(E)(i) provides, in part, that "an organization shall be treated as an organization described in [§168(h)(2)(A)(ii)] with respect to any property (*other than property held by such organization*) if such organization was an organization . . . exempt from tax imposed by this chapter at any time during the 5-year period ending on the date such property was first used by such organization." [Emphasis added.]

ANALYSIS:

Under § 47(c)(2)(B)(v)(I), a credit for rehabilitation expenditures made with respect to the Facility is not available if the Facility is tax-exempt use property under §168(h). The term "tax-exempt use property" includes property leased under a disqualified lease to a tax-exempt entity. Corporation's arrangement with the Tax Credit Partnership is one described in § 168(h)(1)(B)(ii)(IV) because Corporation's lease of the Facility will occur after a lease of the property from Corporation to the Tax Credit Partnership and the Facility has been used by Corporation before such lease. Thus, if Corporation is a tax-exempt entity, or is treated as one under § 168(h)(2)(E)(i), then the Facility is, and will remain, tax-exempt use property.

Section 168(h)(2)(E)(i) deems even a fully taxable C corporation to be a tax-exempt entity for purposes of the tax-exempt use property rule if the corporation was a tax-exempt entity within a period of five years ending on the date such property was first used by such corporation. However, § 168(h)(2)(E)(i) does not apply if the property in question is actually "held" by the former tax-exempt entity. As further explanation of this provision, the legislative history underlying § 168(h)(2)(E)(i) provides that the 5-year look back rule "does not treat property owned by any such former tax-exempt organization as tax-exempt use property." S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 127 (1984).

In the present case, Corporation owns the Facility prior to the arrangement with the Tax Credit Partnership and expects to remain the owner of the Facility, for federal income tax purposes, throughout the 29-year term of the lease to Tax Credit Partnership. Thus, § 168(h)(2)(E)(i) does not apply and Corporation will not be treated as a tax-exempt entity with respect to the Facility following Corporation's conversion to a taxable C corporation.

RULING:

Assuming Corporation remains the owner of the Facility for federal income tax purposes after it leases the Facility to the Tax Credit Partnership, the provisions of § 168(h)(2)(E) will not cause Corporation to be treated as a tax-exempt entity with respect to the Facility.

DISCLAIMER(S):

Except as specifically provided above, we express no opinion as to the federal tax treatment of the transaction at issue under any other provisions of the Internal Revenue Code or the Income Tax Regulations that may apply or under any other general principles of federal income taxation. We specifically disclaim any opinion about whether: (1) Corporation is, or will remain, the owner of the Facility under the given facts for federal income tax purposes; (2) the renovations described will constitute a substantial rehabilitation; or (3) the expenses incurred will constitute qualified rehabilitation expenditures under § 47.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter showing the deletions proposed to be made when it is disclosed under § 6110. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel

(Income Tax & Accounting)