Internal Revenue Service

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Date:
December 05, 2007

Legend:

Taxpayer =

Date 1 =

TRS =

Dear :

This is in reply to a letter dated January 12, 2007, requesting a ruling on behalf of Taxpayer. You have requested a ruling that certain services to be performed by TRS at independent living facilities described herein will not be treated as having been performed at a "health care facility", as defined in section 856(e)(6)(D)(ii) of the Internal Revenue Code, and that those services will not cause rental income from tenants of the independent living facilities to be treated as other than "rents from real property" under section 856(d)(1).

Facts:

Taxpayer is a publicly-traded domestic corporation that elected to be taxed as a real estate investment trust (REIT) beginning Date 1. Taxpayer is engaged in the acquisition, ownership, and management of hospital and senior care properties. Except for certain medical office buildings, Taxpayer's facilities are leased to health care operating companies under triple net leases that require the lessee to pay all property-related expenses.

Taxpayer is currently negotiating to acquire additional properties that will expand its activities in senior care housing by adding independent living facilities. Taxpayer has

determined that it will be able to acquire and operate these facilities more cost-efficiently if the customary and non-customary services rendered at these facilities are provided through a taxable REIT subsidiary, rather than leasing the entire facility to an operator on a long-term basis for a monthly lease amount.

Taxpayer represents that the independent living facilities that they intend to acquire satisfy the generally accepted definition of an independent living facility.[1] Certain customary and all noncustomary services provided at Taxpayers' independent living facilities will be provided by a newly-formed taxable REIT subsidiary, TRS, or through an independent contractor. Taxpayer represents that all services provided at the independent living facilities are services that are customary in the geographic area in which those facilities are located. Services provided by TRS will typically include the preparation and serving of meals at central dining facilities, periodic housekeeping, laundry and linen service, monthly parking, valet and public parking, local transportation (to shopping, physician's offices, hospitals, and churches), social and recreational activities, and the maintenance of resident's rooms and common areas. Other services may include concierge services, exercise and wellness programs, medical alert systems, security services, and daily status checks.

Services that will be provided through an independent contractor include basic utilities, phone service, cable and/or internet services, basic cleaning and janitorial services, and coin operated laundry machines. Additionally, at certain of the independent living facilities, unrelated third parties may lease space to provide beauty and barber services, commercial banking, and a sundry store. The services provided at the independent living facilities will not include assistance with activities of daily living (ADL) such as management of medications, showering and bathing, dressing, personal hygiene and grooming, toileting, mobility, monitoring, and eating. There are no medical or nursing services or skilled nursing licensed beds in the facilities.

Services provided by TRS will be on an arms-length basis. Fees for the services will be collected by Taxpayer from the tenants as part of the monthly resident fee and remitted to TRS. In all cases, the fees remitted to TRS will be no less than 150 percent of the direct costs of those services.

Only those tenants who are physically and mentally capable of providing for their own health care and personal needs, or who individually contract with independent third-party care providers to provide necessary care in their unit, will be permitted to

[1] The National Investment Center for the Seniors Housing & Care Industries and the American Seniors Housing Association published "Classifications for Seniors Housing Property Types". In that publication, the term "independent living communities" is defined as "age restricted multifamily rental projects with central dining facilities that provide residents, as part of their monthly fee, access to meals and other services such as housekeeping, linen service, transportation, social, and recreational activities. Such properties do not provide, in a majority of the units, assistance with daily living (ADLs) such as supervision of medication, bathing, dressing, toileting, etc. There are no licensed skilled nursing beds in the property".

reside in these facilities. The independent living facilities will not be licensed, and the facilities will not participate in the medicare program.

Units in the independent living facilities will be leased for terms of one year or longer. Under the terms of the lease, tenants will pay a monthly charge that covers both charges for occupancy of a unit and the non-customary services provided by TRS. Taxpayer represents that the monthly rent paid by a tenant that is attributable only to the occupancy of the unit (without services) is comparable to monthly apartment rent for a similar size apartment in the geographic area. TRS will collect the monthly payments from tenants and remit all amounts to Taxpayer. At the end of the month, TRS will submit to Taxpayer a statement of the services it has provided to tenants, and Taxpayer will pay TRS the amounts attributable to the services rendered. Taxpayer represents that the payments to the TRS by Taxpayer will be in compliance with the provisions of section 857(b)(7). Taxpayer will not retain any amounts attributable to the services and will not bear any cost for providing such services.

Law and Analysis:

To qualify as a REIT, an entity must derive at least 95 percent of its gross income from sources listed in section 856(c)(2) and at least 75 percent of its gross income from sources listed in section 856(c)(3). “Rents from real property” are among the sources listed in both of those sections.

Section 856(d)(1) defines rents from real property to include rents from interests in real property, charges for services customarily rendered in connection with the rental of real property, and rent attributable to certain leased personal property. However, section 856(d)(2)(C) excludes “impermissible tenant service income” from the definition of rents from real property.

Section 856(d)(7)(A) defines “impermissible tenant service income” to include, with respect to any real or personal property, any amount received or accrued directly or indirectly by a REIT for services furnished or rendered by the REIT to tenants of the property. Section 856(d)(7)(B) provides that if impermissible tenant service income from a property for any tax year exceeds 1 percent of all amounts received or accrued directly or indirectly by the REIT during the tax year from the property, the impermissible tenant service income from the property shall include all amounts received or accrued from the property for the tax year. Section 856(d)(7)(C)(i) provides that services furnished or rendered through a TRS or an independent contractor from whom the REIT does not derive or receive any income are not treated as furnished, rendered, or provided by the REIT for purposes of section 856(d)(7)(A).

Section 856(l) provides that a REIT and a corporation (other than a REIT) may jointly elect to treat such corporation as a taxable REIT subsidiary. To be eligible for treatment as a taxable REIT subsidiary, section 856(l)(1) provides that the REIT must

directly or indirectly own stock in the corporation, and the REIT and the corporation must jointly elect such treatment. The election is irrevocable once made, unless both the REIT and the subsidiary consent to its revocation. In addition, the election and the revocation may be made without the consent of the Secretary. Section 856(l)(3)(A) provides that a taxable REIT subsidiary may not be any corporation that directly or indirectly operates or manages a lodging facility or health care facility.

For purposes of section 856(l)(3), a "health care facility" is defined in section 856(e)(6)(D)(ii) as a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients, and which was operated by a provider of such services that is eligible for participation in the medicare program under Title XVIII of the Social Security Act with respect to the facility.

The independent living facilities described by Taxpayer are not licensed facilities and will not provide any medical, nursing or ADL services to tenants. Also, although not dispositive with respect to REITs, the distinction between a residential rental property and a health care facility is also addressed in other areas of the Code and related sections of the Income Tax Regulations. Section 42 and section 1.42-11(b) of the Income Tax Regulations, which concern the low-income housing credit, provide a distinction between residential real properties and health care facilities by focusing on whether frequent nursing, medical, or psychiatric services are provided to residents. If so, the building is ineligible for the low-income housing credit as is the case with a hospital or nursing home. See also Rev. Rul. 98-47, 1998-2 C.B. 399.

Accordingly, Taxpayer's independent living facilities do not qualify as health care facilities under section 856(e)(6)(D)(ii), for purposes of section 856(l)(3). Therefore, TRS is not precluded from operating or managing the independent living facilities.

All of the services described herein, whether customary or noncustomary, are provided to tenants of the independent living facilities through either a TRS or an independent contractor from whom Taxpayer does not derive income. Accordingly, the services provided to tenants of the independent living facilities will not cause rental income from those tenants to be treated as other than rents from real property under section 856(d)(1).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code. Also, no opinion is expressed concerning the treatment of payments between TRS and Taxpayer for purposes of section 857(b)(7).

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

Sincerely,

William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)