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Date:
January 03, 2008

Legend:

Taxpayer =

Partnership =

Investment Subsidiary =

State A =

Year 1 =

Date 1 =

a =

Dear :

This is in reply to your letter dated September 21, 2007 requesting a ruling on behalf of Taxpayer regarding investment portfolios held by a taxable REIT subsidiary ("TRS"). Taxpayer and Investment Subsidiary seek guidance as to whether certain investments will disqualify Investment Subsidiary as a TRS under §856(l) of the Internal Revenue Code.

Facts:

Taxpayer is a State A corporation that has elected to be treated as a real estate investment trust ("REIT") under §856(c). Taxpayer is a calendar year taxpayer and uses the accrual method of accounting.

Taxpayer is an a% partner in Partnership which operates numerous real properties throughout the United States.

Partnership wholly owns Investment Subsidiary. Taxpayer and Investment Subsidiary have jointly elected to treat Investment Subsidiary as a TRS under §856(l).

Investment Subsidiary currently owns real estate and various portfolio investments. Investment Subsidiary is seeking to invest in portfolio investments which will contain the stock of certain corporations ("Portfolio Corporations"), both public and private, that (1) own, operate, or manage lodging facilities and in some cases casinos associated with such lodging facilities, or (2) issue franchises for the operation of lodging facilities.

Taxpayer represents that Investment Subsidiary will not operate or manage a lodging or healthcare facility, nor will it provide any other person with rights to a brand name under which a lodging or health care facility is operated. Taxpayer also represents that Investment Subsidiary will not directly or indirectly own more than 35 percent of the total voting power or value of the outstanding securities of any such corporation. Additionally, Taxpayer represents that no Portfolio Corporation will be treated as a TRS under §856(l)(2).

Law and Analysis:

Section 856(c) provides that to qualify as a REIT, a corporation must: (i) derive at least 95 percent of its gross income (excluding gross income from prohibited transactions) from sources listed therein which include dividends and interest; (ii) derive at least 75 percent of its gross income (excluding gross income from prohibited transactions) from sources listed therein, including rents from real property and interest on obligations secured by mortgages on real property or on interests in real property.

Section 856(c)(4)(A) requires that, at the close of each quarter of the taxable year, at least 75 percent of the value of a REIT's assets is represented by real estate assets, cash, cash items, and government securities.

Section 856(c)(4)(B) requires that (i) not more than 25 percent of the value of a REIT's assets be represented by securities (other than those included under §856(c)(4)(A)), (ii) not more than 20 percent of the value of a REIT's assets be represented by securities of one or more taxable REIT subsidiaries and (iii) except with respect to a TRS and securities included under §856(c)(4)(A), (I) not more than 5 percent of the value of a REIT's assets be represented by securities of any one issuer, (II) the REIT must not hold securities possessing more than 10 percent of the total voting power of the outstanding securities of any one issuer and (III) the REIT must not hold securities having a value of more than 10 percent of the total value of the outstanding securities of any one issuer.

Section 1.856-3(g) of the Income Tax Regulations provides that a REIT that is a partner in a partnership is deemed (1) to own its proportionate share of each of the assets of the partnership and (2) to be entitled to the income of the partnership attributable to that share. For purposes of §856, the partner's interest in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners for all purposes of §856.

Section 856(l)(1) provides that the term "taxable REIT subsidiary" means, with respect to a REIT, a corporation (other than a REIT) if the REIT directly or indirectly owns stock in such corporation and the REIT and such corporation jointly elect that such corporation shall be treated as a TRS of such REIT.

Section 856(l)(2) provides that with respect to a REIT, a TRS includes any corporation (other than a REIT) with respect to which a TRS of a REIT owns directly or indirectly securities possessing more than 35 percent of the total voting power or the total value of the outstanding securities of that corporation.

Section 856(l)(3) excepts from the definition of "taxable REIT subsidiary" any corporation that directly or indirectly operates or manages a lodging facility or health care facility or any corporation which directly or indirectly provides any other person rights to any brand name under which any lodging facility or health care facility is operated.

While §1.856-3(g) requires that REITs "look-through" a partnership and attribute the proportionate share of income and assets of the partnership to a REIT, no similar provision requires a corresponding look-through for a REIT's interest in a corporation. Instead, stock in a corporation is subject to the REIT asset requirements of §856(c)(4) and income from a corporation is subject to the REIT income requirements of §§856(c)(2) and (3). Under these provisions, there is no "look-through" to the assets and activities of the corporation.

Under §856(l)(2), TRS status is conferred on any corporation in which the TRS owns more than 35 percent of the voting power or value of outstanding securities. Thus, corporations in which a TRS owns greater than 35 percent of the voting rights or value of outstanding securities are subject to the same limitations of §856(l)(3) as a jointly-elected TRS. They may not directly or indirectly operate or manage lodging or health care facilities or provide to any other person the rights to any brand name under which any lodging or health care facility is operated. Therefore, if a TRS owns in excess of 35 percent of the vote or value of the outstanding shares of a corporation that operates or manages a lodging or health care facility or provides rights to any such brand name, the TRS will fail to qualify as a TRS. No such rule exists, however, for corporations in which a TRS owns no more than 35 percent.

Thus, the issue becomes whether owning stock in a corporation that operates or manages a lodging or health care facility is considered indirectly participating in such activity as prohibited under §856(l)(3). If, under §§856(c)(2), (3), and (4), the assets and activities of a corporation are not attributable to a REIT, then similarly, they cannot be attributable to a TRS. Thus, a TRS is not required to "look through" a corporation in which it holds stock, provided it owns no more than 35 percent of the voting rights or value of the corporation.

Owning less than 35 percent of total voting power or value of outstanding securities is not enough to attribute the activities of that corporation to the TRS for purposes of §856(l). Owning securities in a corporation that operates or manages a lodging or health care facility or provides the rights to a brand name in such facility will not disqualify a company's TRS status so long as the TRS owns no greater than 35 percent of the total voting power or value of outstanding securities of the corporation.

Conclusion:

Based on the facts as represented by the Taxpayer, we conclude that Investment Subsidiary's investments in Portfolio Corporations will not disqualify Investment Subsidiary's TRS status provided that no investment in such corporation exceeds the 35 percent threshold of §856(l)(2).

Except as specifically set forth above, no opinion is expressed regarding the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed regarding the qualification of the Taxpayer as a REIT or Investment Subsidiary as a TRS for federal tax purposes. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be cited as precedent.

A copy of this letter should be attached to the federal income tax returns of the Investment Subsidiary for the taxable year in which the transactions covered by this ruling are consummated. In accordance with the power of attorney on file, we are sending this letter to Taxpayer, and a copy of this letter to Taxpayer's authorized representatives.

Sincerely,

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