Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B02
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Date:
July 27, 2009

Legend:

Taxpayer =

State A =

LP =

a =

b =

c =

d =

e =

Year 1 =

f =

Year 2 =

g =

City A =

h =

City B =

i =

j =

State A =

Date 1 =

k =

l =

Property A =

LLC =

Month 1 =

Type 1 =

Type 2 =

Month 2 =

m =

n =

o =

Date 2 =

Month 3 =

Date 3 =

Month 4 =

p =

g =

r =

Dear :

This is in reply to a letter dated April 27, 2009, requesting a ruling on behalf of Taxpayer. You have requested a ruling that the net income derived by Taxpayer from the sale of Property A will not be treated as net income derived from a prohibited transaction under section 857(b)(6)(B) of the Internal Revenue Code and, therefore, the tax under section 857(b)(6) will not apply to Taxpayer's sale of that Property.

Facts:

Taxpayer is a State A real estate investment trust (REIT) that has elected under section 856(c) to be treated as a REIT for federal income tax purposes. Taxpayer is the managing general partner of LP and owns approximately a percent of the outstanding common units of LP. LP, through business entities classified as taxable REIT subsidiaries (TRSs), partnerships, or disregarded entities, owns and operates a diversified portfolio of real properties and makes loans to third parties. Taxpayer currently has a market capitalization of b dollars. Taxpayer has total debt outstanding of approximately c dollars, of which d dollars will come due over the next three years.

Through its interest in LP, Taxpayer owns a portfolio of rental real estate that has ranged from e properties in Year 1 to approximately f properties in Year 2. As of Date 1, Taxpayer's portfolio included g office properties located in the City A metropolitan area, h office properties in the City B metropolitan area, i retail properties located in various areas, j industrial properties located in State A, and other properties. The gross value of the portfolio as of Date 1 was in excess of k dollars. Taxpayer's gross rental income for Year 2 was approximately l dollars. Taxpayer represents it acquired each of the properties in its real estate portfolio with the intention to hold it on a long-term basis for the production of rental income and appreciation in value.

Taxpayer intends to sell Property A, which is owned by the property partnership, LLC. Taxpayer has acquired interests in LLC both directly and through LP. LP has owned nearly r percent of LLC at all times since Month 1. To date, LLC has never owned other real estate assets and has made no sales.

Taxpayer's intent was to convert Property A from a Type 1 building to a Type 2 building and to hold the building on a long-term basis for rental to tenants. As of the end of Month 2, Taxpayer had spent approximately m dollars in reconstruction costs for Property A and has budgeted another n dollars to cover additional costs. Additionally,

Taxpayer will also pay approximately o dollars to reimburse the sole tenant of Property A for the tenant's costs of improvements to the building.

On Date 2, LLC entered into a lease in which it agreed to lease the entire office space in Property A to a tenant for 15 years with rent payable beginning in Month 3. On Date 3, LP entered into a lease with a tenant to occupy the retail space at Property A.

In Month 4, Taxpayer was contacted by an independent, unrelated real estate broker concerning whether Taxpayer would be interested in selling one of its Type 2 properties in City B. The real estate broker was seeking property on behalf of a client and Property A matched the buyer's criteria. Taxpayer represents that the broker's inquiry was wholly unsolicited and that the Taxpayer had not previously intended to sell the property or engage in any marketing or advertising activity with respect to selling Property A.

It is anticipated that Taxpayer and the buyer will reach an agreement for the purchase and sale of Property A and that the sale will close in Month 3. The gross proceeds of the sale are expected to be approximately p dollars. The aggregate expenditures made by Taxpayer during the 2-year period that will end on the date of sale that are includible in the basis of Property A will exceed 30 percent of the net selling price of Property A.

LLC has never owned any other real estate assets and has made no sales. From time to time, Taxpayer has made a limited number of property sales from its portfolio of rental real estate. Taxpayer represents that each of those sales was motivated by its own unique business reasons and circumstances and none of the prior sales constituted the sale of property held for sale to customers in the ordinary course of the Taxpayer's business. Over the course of the past twelve years in which Taxpayer's rental real estate portfolio has grown from approximately e properties to f properties, Taxpayer has made, on average, one sale per year. The highest number of sales made in any year during that period was g.

In light of the current extreme economic conditions, Taxpayer is now willing to sell Property A. As a result of the current credit crisis, Taxpayer has limited access to financing to meet its operating cash needs and repay debt obligations. Taxpayer intends to use the proceeds from the sale of Property A to fund those cash needs.

Law and Analysis:

Section 857(b)(6)(A) of the Code imposes a tax for each taxable year of a REIT equal to 100 percent of the net income derived from prohibited transactions. Under § 857(b)(6)(B)(iii), the term "prohibited transaction" means a sale or other disposition of property described in § 1221(a)(1) that is not foreclosure property.

Section 857(b)(6)(C) excludes certain sales from the definition of a prohibited transaction. Under § 857(b)(6)(C), the term "prohibited transaction" does not include a sale of a property that is a real estate asset (as defined in § 856(c)(5)(B)) and that is described in section 1221(a)(1) if –

(i) the REIT has held the property for not less than 2 years;
(ii) the aggregate expenditures made by the REIT, or any partner of the REIT, during the 2-year period preceding the date of sale that are includible in the basis of the property do not exceed 30 percent of the net selling price of the property;
(iii) (I) during the taxable year the REIT does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or (II) the aggregate bases (as determined for computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, or (III) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the fair market value of all the assets of the REIT as of the beginning of the taxable year;
(iv) In the case of property, which consists of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the REIT has held the property for not less than 2 years for production of rental income; and
(v) If the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the REIT itself does not derive or receive any income.

Property described in section 1221(a)(1) includes property held by a taxpayer "primarily for sale to customers in the ordinary course of its trade or business". The legislative history underlying section 857(b)(6), which was added to the Code by the Tax Reform Act of 1976, indicates that the purpose of that section was to "prevent a REIT from retaining any profit from ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project." S. Rep. No. 938, 84th Cong., 2d Sess. 470 (1976, 1976-3 (Vol. 4) C.B. 508.

To determine whether a taxpayer holds property "primarily for sale to customers in the ordinary course of its trade or business", the Tax Court has held that several factors must be considered, none of which is dispositive. Among those factors are: (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the

number, extent, continuity, and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; and (5) the time and effort the taxpayer habitually devoted to the sales. Generally, it is the purpose for which property is held at the time of the sale that is determinative, although earlier events may be considered to decide the taxpayer's purpose at the time of the sale. See Cottle v. Commissioner, 89 T.C. 467, 487 (1987).

Under section 1.856-3(g), a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the interest of a partner 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 section 856.

Taxpayer has represented that Property A was acquired to generate rental income and to hold as a long-term investment for appreciation in value. Taxpayer made no affirmative effort to sell the property and is only selling Property A to obtain needed liquidity due to the current extreme economic conditions. Taxpayer did not use a sales office or have a sales representative acting on its behalf with respect to the sale of Property A. Neither Taxpayer nor LLC has a history of making numerous, extensive, continuous, or substantial sales of properties, as discussed in Cottle, supra. Rather, Taxpayer has a minimal prior sales history and LLC has not held or sold any other property.

Accordingly, we conclude that Property A is not held by LLC or Taxpayer for sale in the ordinary course of its trade or business. Therefore, the net income derived by Taxpayer from the proposed sale of Property A will not be treated as income derived from a prohibited transaction under section 857(b)(6)(B) and no tax under section 857(b)(6)(A) will be imposed on the income derived by Taxpayer from the sale.

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.

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,

David B. Silber_____
David B. Silber
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)