Internal Revenue Service

Number: **200949019**
Release Date: 12/4/2009

Index Number: 168.20-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:7
PLR-121674-09
Date:
August 31, 2009

Re:

Legend

Taxpayer =

Building A =
Building B =
Building C =
State 1 =
Location =

Agreement 1 =
Agreement 2 =

Agreement 3 =

Agreement 4 =
State 2 =
Authority =
City =
A =
B =

C =

D =

E =

F =

G =

H =
I =
J =
K =
L =
M =
N =
Q =
R =
S =
T =
U =
V =
W =
X =
Y =
Z =

Dear :

This letter responds to a letter dated April 20, 2009, and subsequent correspondence, submitted by Taxpayer, requesting a letter ruling under § 168(e)(2) of the Internal Revenue Code regarding a mixed-use development of three buildings.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer, a State 1 limited liability company, was organized on A, to acquire, develop, renovate, and construct three adjacent properties into a mixed-use development containing hotel rooms, commercial retail space, commercial parking garage, and residential apartments (the "Project"). The three properties are existing Building A, Building B, and Building C. The Project is owned by Taxpayer.

Taxpayer is currently operating pursuant to its Agreement 1, dated K, by and among B, a State 2 limited liability company, as a member, C, a State 2 limited liability company, as a member, and D, a State 2 limited liability company, as the initial Manager. D's members are E, a Subchapter S corporation formed under the laws of State 2, and individuals, F and G.

Taxpayer acquired Building A and Building C from Authority, an urban renewal agency of City, on H, and acquired Building B from Authority on I. Building A, Building B, and Building C are located on contiguous parcels of real property in downtown City. Specifically, these three buildings occupy Location in downtown City and are located in a low-income community.

Building A and Building C are physically connected and are being renovated together. Building A will be renovated for use as commercial and residential space. Building C will be renovated for use as a commercial parking garage. Demolition work on Building A and Building C commenced in the month of acquisition, and construction work on these two buildings commenced shortly after K. The projected completion date and placed-in-service date for Building A and Building C are on or about L. During the renovation, Building A and Building C have not been and will not be in use. Building A will contain approximately M hotel rooms, commercial retail space, and approximately N residential apartments. Building C will contain T parking spaces. With respect to the hotel in Building A, Taxpayer represents that for more than one-half of the days in which a dwelling unit in the hotel will be occupied on a rental basis during Taxpayer's taxable year, such unit will be occupied by a tenant or series of tenants each of whom occupies the unit for less than 30 calendar days.

Building B also will be renovated for use as commercial and residential space. Construction work for the renovation of Building B commenced shortly after I, with a projected completion date in Q, and placed-in-service date on or about R. During the renovation, Building B has not and will not be in use. Building B will contain approximately S residential units and a small amount of commercial space on the ground floor.

After the renovations are completed, Building C will be connected to Building A by a breezeway. This breezeway leads to the residential elevator bank in Building A, with direct access to the residential apartments in that building as well as the amenities located on Building A's rooftop for the residential residents. These rooftop amenities will serve the residential residents located in Building A and Building B.

In addition to the T parking spaces in Building C, U surface parking spaces will be available on Project property outside of Building A, Building B, and Building C. Taxpayer is not obligated under any of the Project financing documents or the hotel franchise agreement to reserve or set aside a specific number of parking spaces for either hotel guests or apartment residents. As such, all of the parking spaces on the Project property will be available both to apartment residents and hotel guests on as as-needed basis. If an apartment resident or a hotel guest elects to utilize on-site parking, the resident or guest will be charged a separate parking fee over and above the monthly apartment rent or hotel room charges, as applicable. All spaces not contracted for by the hotel guests or apartment residents will be available to the general public.

On V and K, Taxpayer closed on a coordinated, common plan of approximately $W of Federal new markets tax credit financing for the renovation of Building A and Building C with one conventional lender and several community development entity lenders (the "CDE Lenders"). The loans of each of these lenders are evidenced by promissory notes and loan agreements and secured by deeds of trust on Building A and Building C. Some of the loans will convert to equity in Taxpayer upon completion of the renovation. Each of these lenders executed an intercreditor and subordination agreement establishing its respective right to repayment and the collateral securing its loan. The overall financing terms were simultaneously negotiated among Taxpayer and the CDE Lenders.

After acquisition of Building B on I, two of the CDE Lenders and the conventional lender increased their loans and Taxpayer obtained additional local governmental financing to fund the acquisition and rehabilitation of Building B. Regardless of any limits on the use of loan proceeds, the loans of each of the CDE Lenders are evidenced by existing and/or additional promissory notes and amended and restated loan agreements and secured by amended deeds of trust on Building A, Building B, and Building C; and the new local governmental financing is also secured by deeds of trust on the entire Project.

In addition to the above financing, financing for the Project will come from historical rehabilitation credits, Opportunity Zone tax incentives, and State 1 tax incentives.

Taxpayer plans to operate, lease, market, manage, and otherwise deal with the buildings composing the Project as a single, integrated, mixed-use development. The Project will be operated under a single security services contract, a single elevator contract, a single on-site Project maintenance director, a single leasing director to whom all leasing agents report, shared services, shared parking facilities, and a single, supervisory on-site general manager.

Taxpayer leased Building A, Building B, and Building C to X, pursuant to a master lease, Agreement 4. To provide for unitary management of the Project by a single management entity, X, in turn, executed Agreement 2 with Taxpayer's affiliate, Y, who will manage (a) the hotel and parking garage (the "Hotel Unit") pursuant to a franchise agreement with a major hotel flag and (b) the apartments, and the retail space in, and surface parking outside of, Building B (the "Residential Unit"). Pursuant to Agreement 2, a base management fee and an incentive management fee will be paid to Y for its management services.

Under Agreement 2, the operation of the Hotel Unit is under the exclusive supervision and control of X which is responsible for the proper and efficient operation of the Hotel Unit. Further, Agreement 2 provides that, among other functions, X establishes prices, rates, and charges for parking in Building C, including allocation of

spaces within Building C, if any, to the Residential Unit of the Project. However, no specific allocations of parking to the various Project activities (hotel, apartments, and retail space) will be made until the market need and demand can be assessed.

Moreover, under Agreement 2, the operation of the Residential Unit is under the exclusive supervision and control of X which is responsible for the proper and efficient operation of the Residential Unit. As recognized in Agreement 2, Y subcontracted the management and operation of the Residential Unit of the Project through Agreement 3 to Z, an affiliate of X. Under Agreement 3, Y retained Z to perform any and all functions, including managerial, coordination of pre-opening activities, accounting services, and management of repairs with regard to the Residential Unit that Y is required to provide to X under Agreement 2. However, pursuant to Agreement 2, Y retains overall management responsibilities to X and will oversee the operation of all business activities of the Project, including hotel, parking, and residential operations. Additionally, Z has no contractual relationship with X, and will report directly to Y, who retains supervisory management responsibilities over the performance of Z with respect to management of the Residential Unit of the Project.

Moreover, Taxpayer is rehabilitating the entire Project utilizing a single comprehensive development and construction budget. Each month during the construction phase of the Project, a single draw is submitted to the Project lenders requesting loan proceeds to be utilized to make progress payments to the contractors.

Agreement 2 provides for separate pre-opening budgets for the Hotel Unit, for the residential apartments in Building A, and the residential apartments in Building B. Taxpayer represents that these separate pre-opening budgets are necessary given the need to comply with contractual hotel operating standards, the advance booking of group business for the hotel, and the separate marketing and lease-up requirements for the residential apartments. While Agreement 2 also provides for separate budgets for the Hotel Unit and the Residential Unit, these budgets flow into a single set of books, a consolidated income statement and balance sheet, and a single Federal tax return reflecting the aggregate operations of the Project.

Further, pursuant to Agreement 2, the books of control and account pertaining to the operations at the Hotel Unit and Residential Unit of the Project (including, but not limited to, preparation of tax filings, employment reports, and returns required by any federal, state, or local authority) are kept by Y. Further, Agreement 2 provides that Y must deliver monthly an interim accounting to X showing Gross Revenues, Deductions, Operating Profit, and applications and distributions thereof, and that Y must deliver to X for its review an annual operating projection of, among other things, Gross Revenues. For these purposes, Gross Revenues, Deductions, and Operating Profit are defined in Agreement 2 as the sum of such amounts from all mixed-use activities conducted in the Project. Moreover, Gross Revenues is the base number upon which Y, the single

manager of the Project, is compensated. The cost of Z is an expense of Y, not a Project cost, because Z works for and is directly accountable to Y.

RULINGS REQUESTED

Taxpayer requests the Internal Revenue Service issue the following ruling:

Building A, Building B, and Building C may be treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2).

LAW AND ANALYSIS

Section 168(e)(2) defines the terms “residential rental property” and “nonresidential real property” for purposes of determining depreciation under § 168. Section 168(e)(2)(A)(i) provides that the term “residential rental property” means any building or structure if 80 percent or more of the gross rental income from such building or structure for the taxable year is rental income from dwelling units. For this purpose, § 168(e)(2)(A)(ii) provides that the term "dwelling unit" means a house or apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, or other establishment more than one-half of the units in which are used on a transient basis.

Section 168(e)(2)(B) provides that the term "nonresidential real property" means section 1250 property which is not (i) residential rental property, or (ii) property with a class life of less than 27.5 years.

Section 168(i)(12) provides that the term “section 1250 property” has the meaning given such term by § 1250(c). Section 1250(c) provides that the term “section 1250 property” means any real property (other than section 1245 property, as defined in § 1245(a)(3)) that is or has been property of a character subject to the allowance for depreciation provided in § 167. See also § 1250-1(e) of the Income Tax Regulations.

Section 1.1250-1(a)(2)(ii) provides that, for purposes of applying depreciation recapture rules of § 1250, the facts and circumstances of each disposition is considered in determining what is the appropriate item of section 1250 property. In general, a building is an item of section 1250 property, but in an appropriate case more than one building may be treated as a single item. For example, if two or more buildings or structures on a single tract or parcel (or contiguous tracts or parcels) of land are operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting), they may be treated as a single item of section 1250 property.

Section 168(e)(2)(A) was amended by § 11812(b)(2)(A) of the Revenue Reconciliation Act of 1990, Pub. L. 101-508, 1991-2 C.B. 484, 543 (the "1990 Act"). Prior to this amendment, § 168(e)(2)(A) provided that the term "residential rental property" has the meaning given such term by § 167(j)(2)(B).

Prior to the enactment of the 1990 Act, § 167(j)(2)(B) provided in pertinent part that a building or structure shall be considered to be residential rental property for any taxable year only if 80 percent or more of the gross rental income from such building or structure for such year is rental income from dwelling units (within the meaning of former § 167(k)(3)(C)).

Former § 1.167(j)-3(b)(1)(ii) provided that in any case where two or more buildings or structures on a single tract or parcel (or contiguous tracts or parcels) of land are operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting), they may be treated as a single building for purposes of determining whether the building or structure is residential rental property.

Thus, for purposes of determining if Building A, Building B, and Building C are residential rental property or nonresidential real property under § 168(e)(2), these buildings may be treated as a single building when they are on a single tract of land or parcel (or contiguous tracts or parcels) and they are operated as a single integrated unit. For making the latter determination, the relevant factors are the actual operation, management, financing, and accounting for the buildings. See § 1.1250-1(a)(2)(ii); see also former § 1.167(j)-3(b)(1)(ii).

In this case, Taxpayer represents that Building A, Building B, and Building C are located on contiguous parcels of real property in downtown City.

With regard to operation of the Project, Taxpayer represents that Building A, Building B, and Building C will be placed in service within the same 12-month period. Moreover, the Project will be operated under a single security services contract, a single elevator contract, a single on-site Project maintenance director, a single leasing director to whom all leasing agents report, shared services, shared parking facilities, and a single, supervisory on-site general manager.

Further, the apartment amenities located on the rooftop of Building A will serve the residential residents located in Building A and Building B. Moreover, Building C will be connected to Building A by a breezeway that leads to the residential elevator bank in Building A, providing direct access to the residential apartments and rooftop amenities in that building. While none of the parking spaces in Building C or the surface parking lot are currently reserved for the residential residents or hotel guests, Taxpayer has determined that no specific allocations of parking will be made until the market need and demand can be assessed.

With regard to management of the Project, Taxpayer leased Building A, Building B, and Building C to X, pursuant to Agreement 4. To provide for unitary management of the Project by a single management entity, X, in turn, executed Agreement 2 with Taxpayer's affiliate, Y. Pursuant to Agreement 2, Y will manage and operate the entire Project. While Y subsequently subcontracted the management of the apartments through Agreement 3 to Z, Y, pursuant to Agreement 2, retains overall management responsibilities to X and will oversee the operation of all business activities of the Project, including hotel, parking, and residential operations. Additionally, Z has no contractual relationship with X, and will report directly to Y, who retains supervisory management responsibilities over the performance of Z with respect to management of the residential component of the Project.

With regard to financing of the Project, Taxpayer initially closed on a coordinated, common plan of Federal new markets tax credit financing for the renovation of Building A and Building C with one conventional lender and the CDE lenders. However, after acquisition of Building B on I, the loans of each of the CDE Lenders are evidenced by existing and/or additional promissory notes and amended and restated loan agreements and secured by amended deeds of trust on Building A, Building B, and Building C. Moreover, new local governmental financing obtained upon acquisition of Building B is also secured by deeds of trust on the entire Project. Thus, there is one overall plan of financing for the development of the Project and the financing is secured by deeds of trust on the entire Project.

Finally, with regard to the accounting for the Project, Taxpayer is rehabilitating the entire Project utilizing a single comprehensive development and construction budget. While there will be separate pre-opening budgets and separate budgets for the various profit centers of the Project (Hotel Unit and Residential Unit), these budgets are needed for business reasons. Further, these budgets will flow into a single set of books, a consolidated income statement and balance sheet, and a single Federal tax return reflecting the aggregate operations of the Project. Moreover, interim accounting reports and annual operating projections will pertain to the entire Project. Also, the books of control and account pertaining to the entire Project will be kept by Y.

Taxpayer's facts and representations about the operation, management, financing, and accounting of the Project show that the three buildings composing the Project (Building A, Building B, and Building C) are to be operated as a single integrated unit. As previously discussed, Taxpayer represents that these three buildings are on contiguous tracts of land. Accordingly, Taxpayer's facts and representations support treating the three buildings composing the Project as a single building for purposes of determining whether Building A, Building B, and Building C are residential rental property or nonresidential real property under § 168(e)(2).

CONCLUSION

Based solely on the facts and representations submitted and the relevant law and analysis as set forth above, we conclude that Building A, Building B, and Building C may be treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2).

We also note that if Building A, Building B, and Building C are treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2), then Building A, Building B, and Building C also are treated as a single item of section 1250 property for purposes of § 1250.

Except as specifically set forth above, we express no opinion concerning the tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed or implied on (i) whether the buildings composing the Project are nonresidential real property or residential rental property for any taxable year under § 168(e)(2), (ii) what components of such buildings are section 1245 property (as defined in § 1245(a)(3)), (iii) whether any of the buildings composing the Project qualify for the rehabilitation credit under § 47 (including whether such buildings may be treated as a single building under § 47); (iv) whether the requirements of the new markets tax credit under § 45D are satisfied; and (v) whether any Gulf Opportunity Zone tax benefits under § 1400N apply.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representative. We are also sending a copy of this letter to the appropriate Industry Director, LMSB.

Sincerely,

Kathleen Reed

KATHLEEN REED
Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax and Accounting)

Enclosures (2):
copy of this letter
copy for section 6110 purposes