Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
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Refer Reply To:
CC:FIP:B02
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Date:
August 21, 2009

Legend:

Taxpayer =

Properties =

OP =

LLC =

Corporation A =

Dear :

This is in reply to a letter dated May 13, 2009, and a subsequent submission, requesting a ruling on behalf of Taxpayer. You have requested a ruling that amounts collected by Taxpayer under a reimbursement arrangement for shared overhead, personnel, and facilities under a proposed restructuring of property management and leasing activities will not constitute gross income under section 856 of the Internal Revenue Code.

Facts:

Taxpayer is a domestic corporation that has elected to be treated as a real estate investment trust (REIT) for federal tax purposes. Taxpayer owns, acquires, renovates, develops, leases, and manages Properties. Taxpayer is organized as an umbrella partnership REIT, or UPREIT, which conducts substantially all of its operations through a subsidiary operating partnership, OP. Taxpayer indirectly holds substantial partnership interests in OP.

OP currently engages in property management and leasing activities for wholly-owned properties and for properties that are owned by third parties (including OP's joint ventures with third parties). The services performed by OP pursuant to its property management and leasing contracts include: negotiating, administering, and enforcing leases (including billing and collections); operating, maintaining, repairing, and cleaning the property; employing and directing on-site personnel; paying capital and operating expenses of the property, such as property taxes, utilities, lighting and HVAC maintenance, advertising and promotional costs of the property; procuring insurance and managing claims; managing and administering the advertising, merchandising, and promotion of the property; managing audit and accounting for the property; complying with all legal and insurance requirements; and supervising design and construction associated with maintenance, repair, or leasing of the property (excluding design and construction associated with property expansion, redevelopment, or refurbishment, as well as any actual design or construction work). The property management and leasing activities are currently conducted by employees of LLC, a limited liability company that is wholly-owned by OP and is treated as a disregarded entity for federal income tax purposes. Taxpayer treats any income it derives with respect to OP's joint venture partners on account of the property management and leasing activities as non-qualifying income for purposes of the 95 percent income test under section 856(c)(2).

OP also currently engages in development activities for properties it wholly owns, and for properties of third parties (including its joint ventures with third parties). Pursuant to development contracts, OP performs services including selecting and supervising all design and construction personnel; enforcing the development contracts; procuring, reviewing, approving, and coordinating designs; negotiating with regulatory and governmental authorities; negotiating with prospective tenants; conducting demographic analyses; conducting pre-opening marketing; and making construction schedules and cost estimates. The development activities are currently conducted by employees of OP. Taxpayer treats any gross income it derives from third parties from the development activities as non-qualifying income for purposes of the 95 percent income test of section 856(c)(2).

Taxpayer plans to restructure its leasing and management activities to ensure its continued compliance with the gross income requirements of section 856(c). OP intends to contribute all of its third party leasing and property management contracts (including those with its joint venture partners) to either Corporation A or a wholly-owned subsidiary of Corporation A (collectively, "TRS"). Pursuant to section 856(l), TRS and Taxpayer have jointly elected to have TRS treated as a taxable REIT subsidiary of Taxpayer. OP will no longer engage in any leasing or property management activities for third parties (including joint ventures with third parties).

For administrative convenience and to avail itself of economies of scale with respect to employment costs, the employees performing the leasing and property management services on behalf of TRS for the joint venture property owners will remain employees of OP for administrative purposes. OP and TRS intend to enter into an employee sharing agreement under which these employees will be treated as loaned or advanced to TRS. Under the terms of the Employee Sharing Agreement, TRS will reimburse OP for TRS's allocable share of the employee costs including salaries, benefits, and other compensation, costs associated with payroll administration, and allocable overhead costs including, but not limited to office space and office equipment. The amount of such reimbursements will be computed quarterly and will be determined on the basis of the relative amount of time such employees spend performing leasing or property management services on behalf of TRS. TRS represents that it will deduct or capitalize those costs, as appropriate. The reimbursements will be solely for costs, both direct and indirect, and OP will not charge for profit. It is further represented that the allocation of general and administrative overhead expenses will be on an arm's length basis and will be equitable. Also, OP will not profit from the reimbursement arrangement, because reimbursements will only be made on a cost basis. OP and Taxpayer will not deduct the costs reimbursed by TRS. Finally, neither OP nor Taxpayer will be in the business of providing leasing or property management services to third parties.

Law and Analysis:

To qualify as a REIT, an entity must derive at least 95 percent of its gross income from sources listed in § 856(c)(2) and at least 75 percent of its gross income from sources listed in § 856(c)(3).

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.

In Rev. Rul. 84-138, 1984-2 C.B. 123, a regulated investment company (RIC) and its wholly-owned subsidiary shared facilities and some personnel. It was agreed that the RIC would pay all the expenses for general and administrative overhead, including personnel costs and the subsidiary would reimburse the RIC for its pro rata share of the expenses on an arm=s length basis. The ruling, in distinguishing Jergens Co. v. Commissioner, 40 B.T.A. 868 (1939), states that the RIC was not engaged in the business of receiving compensation for services of the type that were reimbursed. Instead, reimbursements to the RIC from the subsidiary were merely repayments of advances made on behalf of the subsidiary. Accordingly, the ruling holds that the reimbursements were not included in the RIC's gross income under § 61, and, therefore, were not subject to the gross income requirement of § 851(b)(2).

Rev. Rul. 57-104, 1957-1 C.B. 166, considers whether the amount paid by a taxpayer to an independent contractor as reimbursement for the costs of a union negotiated qualified pension plan for the contractor=s employees will be deductible to the taxpayer and included in the income of the contractor. The taxpayer, a ship owner, contracted with a stevedore contractor to handle its cargoes. Pursuant to their contract, the taxpayer reimbursed the contractor for the amount required to be contributed by the contractor to the pension trust. The ruling holds that the amount paid by the taxpayer as a reimbursement is part of the cost of the services rendered by the independent contractor to the taxpayer, and, as such, is a deductible expense to the taxpayer under § 162. The ruling also holds that the reimbursement of amounts contributed to the trust on behalf of its employees is includible in gross income by the contractor under § 61.

In the present case, the reimbursement arrangement between OP and TRS is analogous to the situation in Rev. Rul. 84-138. During the term of the Employee Sharing Agreement, neither Taxpayer nor OP will engage in the business of providing property management and leasing services. Accordingly, based on the information provided and representations made, we conclude that the amounts paid to OP by TRS as reimbursement for TRS's allocable share of employee costs and other shared expenses described above, will not be treated as gross income received by either OP or Taxpayer. Also, neither OP nor Taxpayer will be entitled to a deduction for the reimbursed expenses.

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 or whether TRS qualifies as a taxable REIT subsidiary of Taxpayer under section 856(l) 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)