Internal Revenue Service

Number: **201016014**
Release Date: 4/23/2010

Index Number: 856.03-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-130377-09
Date:
December 17, 2009

Legend:

Taxpayer	=
Date 1	=
Type A	=
Type B	=
Type C	=
Type D	=
Business	=
Corporation A	=
Corporation B	=
Corporation C	=
Corporation D	=
a	=
b	=
Corporation E	=

Corporation F =

Corporation G =

Dear :

This is in reply to a letter dated June 23, 2009, and a subsequent submission, requesting rulings on behalf of Taxpayer. The requested rulings concern the treatment of a taxable REIT subsidiary (TRS) of Taxpayer under section 856(l)(3) of the Internal Revenue Code in the circumstances described below.

Facts:

Taxpayer is a publicly traded domestic corporation that elected to be taxed as a real estate investment trust (REIT) for its tax year beginning Date 1. Taxpayer is engaged in the acquisition, ownership, and management of Type A, Type B, Type C, and Type D properties (the Facilities). Except for the Type C buildings and some Type D Facilities, the properties are master-leased to Business operating companies under triple net or absolute net leases that require the lessees to pay all property related expenses.

The majority of Taxpayer's Type D Facilities are master-leased to unrelated operating corporations under triple net or similar lease arrangements. These operating companies are generally publicly held corporations or their subsidiaries or parents. A small number of the Facilities are leased to operating companies that are private corporations, their subsidiaries, or parents that are in the business of operating and managing Business facilities for other corporations unrelated to Taxpayer. The publicly held operating corporations include Corporation A, Corporation B, and Corporation C. Corporation D is a privately held operating company. Corporations A, B, C, and D will cumulatively be designated the Operating Companies.

The remaining Type D facilities are either wholly owned by a TRS of Taxpayer or by a partnership in which the TRS is a majority partner. In the latter situation, the TRS owns between a and b percent of the capital and profits interests in its respective partnership. Each minority partner is a subsidiary of Corporation E, an unrelated publicly held corporation actively engaged in operating Business facilities. Facilities owned by TRS partnerships are managed and operated by the minority partner, as are Facilities that are wholly owned by the TRS. Managers and operators of Facilities owned by the TRS currently include Corporation F and Corporation G, which are subsidiaries of Corporation E. Taxpayer represents that Corporations F and G are separate legal entities for state law purposes and that they maintain their own bank

accounts, books and records. Also, Corporations F and G have their own employees under their separate control.

Taxpayer represents that not one of Corporations A – G owns more than 35 percent of the shares of Taxpayer and that no one or more persons owning more than 35 percent of the shares of Taxpayer owns more than 35 percent of the shares of Corporations A – G.

Corporation E has been experiencing significant financial problems that it is seeking to remedy. In some cases it may be necessary for Taxpayer or the TRS to have Corporation F or Corporation G replaced as the manager and operator at one or more of its Type D Facilities to ensure uninterrupted operation of the Facilities. Due to the small number of high quality manager/operators that are capable of managing and operating the Type D Facilities, it may become necessary to replace Corporations F and G with one of the Operating Companies or a subsidiary of an Operating Company. Taxpayer represents that it anticipates and fully expects that any Operating Company or its subsidiary that would manage or operate its Type D Facilities will be a separate legal entity for state law purposes and will maintain its own separate books, records, and accounts.

To ensure that Taxpayer's Facilities have continuous, dependable, and high quality management and operations, it may become necessary for Taxpayer to provide financial assistance to an Operating Company and Company E, or their subsidiaries. Taxpayer and its TRSs propose to provide various forms of financial assistance, including investments in secured and unsecured loans, and equity investments such as common stock, preferred stock, warrants or options to acquire stock, convertible preferred stock, convertible debt, and loans with warrants. The loans will have market based terms and recipients of the loans will continue to be paid a market fee for their services. In all cases in which financial assistance is provided, the relationship among the Taxpayer, its TRSs, and the financial assistance recipients will continue to be on an arm's length basis. Taxpayer represents that such financial assistance will not be provided to any manager or operator of a TRS owned Facility. Taxpayer further represents that in situations in which Taxpayer or a TRS makes a loan that is determined to be a security under section 856(c)(4)(B)(iii), the loan will represent less than 10 percent of the value of the total outstanding securities of the recipient of the loan. Taxpayer also represents that in cases in which Taxpayer or a TRS makes an equity investment, the equity investment will represent less than 10 percent of the vote or value of the total outstanding securities of the issuer.

Pursuant to the amendment of section 856(d)(9)(A) by the Housing Assistance Act of 2008, P.L. 110-289, Taxpayer proposes to restructure the Facilities that are currently owned by its TRSs. Under the proposed restructuring, Taxpayer will acquire the Facilities from the TRS and then lease them back to the TRS. All leases between Taxpayer and its TRSs will be negotiated at arm's length and reflect market rates and

commercially reasonable terms. Each TRS that leases the Facilities from Taxpayer will enter into a management and operating agreement (Agreement) with an entity that will meet the definition of an eligible independent contractor (EIK) under section 856(d)(9). The TRS will bear all the expenses for the operation of the Facilities and will receive all the revenues, net of operating expenses and fees payable to the EIK, from the operation of the Facilities pursuant to the Agreement. Neither Taxpayer nor any TRS will make a loan to or make an equity investment in any of the entities that will be an EIK at Taxpayer's Facilities.

Taxpayer represents that with respect to the Business Facilities that are owned by the TRS as well as Facilities that will be leased to Taxpayer's TRS pursuant to section 856(d)(8)(B), any loan made by the TRS or equity investment made by the TRS in Corporation E, when combined with any loan made to or equity investment made in Corporation E by Taxpayer, will represent less than 35 percent of the vote or value of the total outstanding securities of Company E. Accordingly, no investment will be made in any corporation that leases a Facility from Taxpayer so as to violate the 10 percent limitation under section 856(d)(2)(B).

Taxpayer further represents that all of the agreements between Taxpayer and the TRS and the Operating Companies or Company E, or their respective subsidiaries will reflect market terms and will be negotiated by the parties at arm's length. Specifically, Taxpayer represents that each of the lease agreements with an Operating Company or its subsidiary will be negotiated at arm's length and its terms will represent fair market value for the Facility leased.

Law and Analysis:

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of rents from real property. Section 856(d)(7)(A) defines

impermissible tenant service income to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants at the property, or for managing or operating the property.

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C) provides that for purposes of section 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income shall not be treated as furnished, rendered, or provided by the REIT, and there shall not be taken into account any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Section 856(d)(8)(B) provides that amounts paid to a REIT by a TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) when a REIT leases a qualified lodging facility or qualified health care facility to a TRS, and the facility or property is operated on behalf of the TRS by a person who is an eligible independent contractor.

Section 856(d)(3) defines an independent contractor as any person who does not own, directly or indirectly, more than 35 percent of the REIT's shares and, if such person is a corporation, not more than 35 percent of the total combined voting power of whose stock (or 35 percent of the total shares of all classes of whose stock) is owned directly or indirectly, by one or more persons owning 35 percent or more of the shares of the REIT.

Section 856(d)(9)(A) provides that the term eligible independent contractor means, with respect to any qualified lodging facility or qualified health care property, any independent contractor if, at the time such contractor enters into a management agreement or similar service contract with the TRS to operate the facility or property, the contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities or qualified health care properties for any person who is not a related person with respect to the REIT or the TRS.

Section 856(l) provides that a REIT and a corporation (other than a REIT) may jointly elect to treat such corporation as a TRS. To be eligible for treatment as a TRS, 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.

Section 856(l)(2) provides that any corporation in which a TRS owns directly or indirectly more than 35 percent of the total voting power or value of the outstanding securities shall be treated as a TRS. Section 856(l)(3)(A) provides that a TRS cannot directly or indirectly operate or manage a lodging facility or a health care facility.

Rev. Rul. 75-136, 1975-1 C.B. 195 concerns whether a wholly owned subsidiary of a REIT's corporate investment adviser can serve as an independent contractor to manage the REIT's property, as required under section 856(d)(3). In determining that the subsidiary may qualify as an independent contractor, the ruling states that it is the relationship of the entity or individual (such as an employee or trustee) to the trust itself that precludes the entity from qualifying as an independent contractor for the management of the property. A relationship between the entity or individual and the trustee, or employee, or investment adviser of the REIT would not in itself disqualify the entity, assuming the other requirements for qualification as an independent contractor are met. Accordingly, the ruling holds that the wholly owned subsidiary of the investment adviser is not precluded from qualifying as an independent contractor if it operates as a separate entity with its own separate officers and employees and keeps its own separate books and records that clearly reflect its activities in the management of the property.

In Rev. Rul. 73-194, a REIT entered into a partnership with X corporation to construct and hold apartment buildings for investment. The partnership agreement provided that the partners would engage a management company to manage an apartment building. The management company was employed in an arm's length transaction and was paid a market rate for its services. X corporation was a wholly-owned subsidiary of Y corporation, which owned a substantial percentage of the stock of the management company. In concluding that the income received by the REIT from the partnership will not be disqualified as rents from real property due to the relationship between X, Y, and the management company, the ruling cites the legislative history underlying section 856(d), which states that the restrictions imposed by that section were intended to prevent income from active business operations from being included in a REIT's income. The legislative history indicates that for this requirement to be satisfied, the REIT and the independent contractor must have an arm's length relationship. See H.R. No. 2020, 86th Cong., 2d Sess.6, 1960-2 C.B. 819, 825.

In Rev. Rul. 2003-86, 2003 C.B. 290, a REIT owned all of the stock of a TRS that owned an interest in a partnership. The partnership was an independent contractor under section 856(d). The partnership provided certain noncustomary services to the REIT's tenants. Although the REIT did not directly receive payments from the independent contractor, the REIT indirectly held an equity interest in the independent contractor through its ownership of the TRS. The revenue ruling states that section 856(d)(7)(C)(i) provides an exception for services furnished or rendered through a TRS. Noting that the REIT's only interest in the independent contractor is through the TRS, the ruling states that the services provided by the independent contractor are provided by the TRS to the extent of the TRS's interest in the independent contractor. Accordingly, the ruling concludes that the REIT will not be treated as providing impermissible tenant services.

In the present case, Taxpayer or its TRS may provide loans or financial assistance to a parent corporation or affiliates of a manager or operator of Taxpayer's Facilities. Taxpayer or its TRS may also receive income from an equity investment in the parent corporation or an affiliate of a company operating or managing one or more of the Facilities. Finally, a TRS may receive rental income from a parent corporation or affiliate of a company that is a manager or operator of the TRS's Facilities. In each situation, the income received by Taxpayer or its TRS is not derived from or dependent upon its relationship with the company operating or managing any of the Facilities. All of the agreements entered into by Taxpayer or its TRS for the management or operation of the Facilities is represented to be arm's length and reflecting market terms.

Accordingly, based on the information received and representations made, we conclude that:

1) A TRS of Taxpayer that owns Business Facilities will not be treated as directly or indirectly operating or managing those Facilities within the meaning of section 856(l)(3)(A) because Taxpayer receives rental income from the parent or affiliate of the Operating Company that is the manager or operator of a Business Facility.

2) A TRS of Taxpayer that owns Business Facilities will not be treated as directly or indirectly operating or managing the Business Facilities within the meaning of section 856(l)(3)(A) because Taxpayer or the TRS makes a loan to either Corporation E, an Operating Company parent, or their respective subsidiaries, which do not manage or operate a Business Facility.

3) A TRS of Taxpayer that owns Business Facilities will not be treated as directly or indirectly operating or managing the Business Facilities within the meaning of section 856(l)(3)(A) because Taxpayer or the TRS makes an equity investment in Corporation E, an Operating Company parent, or any of their respective subsidiaries, other than Corporation F, Corporation G, a subsidiary of either Corporation F or Corporation G, or any subsidiary of an Operating Company that is managing or operating a Business Facility.

4) In situations in which a TRS of Taxpayer leases Business Facilities from Taxpayer and engages Corporation F, Corporation G or a subsidiary of an Operating Company as an eligible independent contractor to manage or operate a Business Facility, the TRS will not be treated as directly or indirectly managing or operating the Business Facility under section 856(l)(3)(A). Rents received by Taxpayer from the TRS under the lease of the Business Facility will not be treated as other than rents from real property because Taxpayer or its TRS makes a loan or equity investment as described herein, provided the loan or equity investment represents less than 10 percent of the vote or value of the total outstanding securities of the corporation to whom the loan is made or in which an equity investment is made.

5) A TRS of Taxpayer that owns Business Facilities or that leases Business Facilities from Taxpayer and engages Corporation F, Corporation G, or an Operating Company subsidiary as an eligible independent contractor to manage or operate a Business Facility pursuant to section 856(d)(9) will not be treated as directly or indirectly managing or operating the Facility under section 856(l)(3)(A) and rents received from the Business Facilities by Taxpayer will not be treated as other than rents from real property under section 856(d) because the TRS makes a loan as described herein or makes an equity investment in Corporation E provided that the loan or equity investment when combined with any loan or equity investment by Taxpayer in Corporation E represents less than 35 percent of the vote or value of the total outstanding securities of Corporation E.

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 Taxpayer's 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,

Thomas M. Preston
Thomas M. Preston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)