Internal Revenue Service

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Legend:

Taxpayer =

Year 1 =

Business =

Properties =

Year 2 =

OP =

GP =

TRS =

LLC 1 =

Facility =

Lessee =

Year 3 =

Date 1 =

LLC 2 =

Date 2 =

Date 3 =

New TRS =

a =

b =

c =

LLC 3 =

LLC 4 =

d =

e =

Agreement =

LLC 5 =

LLC 6 =

LLC 7 =

LLC 8 =

LLC 9 =

Dear :

This is in reply to a letter dated November 25, 2009, and subsequent submissions, requesting rulings on behalf of Taxpayer. The requested rulings concern the operation and management of Taxpayer's Business Properties for purposes of sections 856(c)(2) and (c)(3) of the Internal Revenue Code.

Facts:

Taxpayer is a domestic corporation that was formed in Year 1 to invest in, own, and lease commercial real estate. Taxpayer's primary business is to acquire and develop real property and improvements primarily for long-term lease to providers of Business services such as those provided at the Properties. Taxpayer also makes mortgage loans to Business operators that are secured by their real estate assets. Taxpayer elected to be taxed as a real estate investment trust (REIT) on its Year 2 federal income tax return. Taxpayer is a public REIT and to its knowledge no person owns more than 5 percent of its outstanding stock.

Taxpayer conducts all of its real estate operations through a limited partnership, OP. The sole general partner of OP is GP, which is wholly-owned by Taxpayer. Taxpayer directly owns substantially all of the limited partnership interests in OP.

Taxpayer owns all of the issued and outstanding stock of TRS. Taxpayer and TRS have jointly elected to have TRS treated as a taxable REIT subsidiary under section 856(l). TRS has made loans secured by non-real estate assets to tenants of Taxpayer's properties for operating or working capital purposes.

OP is the sole owner of LLC 1, which is treated as a disregarded entity for federal income tax purposes. LLC 1 owns certain real estate including the Facility, a Business property. LLC 1 leased the Facility to Lessee in Year 3. However, due to defaults and the inability of Lessee to meet its obligations to LLC 1 and other creditors, LLC 1 terminated the lease on Date 1. Lessee then filed for bankruptcy protection and submitted a Plan of Reorganization (Plan) to the Bankruptcy Court. On Date 2, LLC 1, Lessee, and LLC 2, an entity that was formed to become the new operator of the Facility entered into a Term Sheet that contemplated an amendment to the Plan. Subsequently, on Date 3 the parties submitted the Second Amended Plan of Reorganization (Amended Plan) to the Bankruptcy Court.

Upon approval of the Amended Plan the following steps will be taken:

1. Taxpayer will create a new wholly-owned subsidiary, New TRS, with which it will jointly elect to have treated as a TRS of Taxpayer under section 856(l).
2. LLC 1 will lease the Facility to New TRS under terms similar to those used for unrelated lessees.
3. New TRS will sublease the Facility to LLC 2 on terms similar to the terms of the New TRS lease with LLC 1.
4. In consideration of (i) the costs, expenses, and damages incurred by LLC 1 as a result of the default by Lessee and the reletting of the Facility, (ii)

Taxpayer's services in locating a replacement operator, and (iii) the financing that Taxpayer or its affiliate is willing to provide to LLC 2, New TRS will receive an a percent membership interest in LLC 2. New TRS's membership interest in LLC 2 does not grant New TRS any authority to direct the operations or management of the Facility. New TRS's governance rights in LLC 2 only arise in extraordinary circumstances set forth in an operating agreement between the members of LLC 2 (Operating Agreement). New TRS's a percent interest in the profits, losses, and distributions of LLC 2 will be reduced to a b percent interest in those items if and when New TRS receives after-tax distributions of c million dollars from LLC 2.

5. The remaining d percent equity interest in LLC 2 will be owned by LLC 3, which will be owned by LLC 4 and certain other owners. When New TRS's interest in LLC 2 is reduced, LLC 3's interest in LLC 2 will increase to e percent.
6. LLC 2 will assume Lessee's Agreement for the Facility and will employ the persons providing services at the Facility.
7. New TRS will provide LLC 2 a working capital loan to be secured by, among other things, a first priority security interest in LLC 2's accounts receivable.
8. A wholly-owned subsidiary of LLC 4, LLC 5, will manage the Facility pursuant to a management services agreement between LLC 2 and LLC 5 for a percentage of net revenues. This fee will be subordinated to the rent and loan obligations to New TRS. Taxpayer represents that LLC 5 and affiliated entities are engaged in the active conduct of the trade or business of managing Business facilities and have managed or are managing the operation of Business facilities for entities unrelated to Taxpayer or New TRS.
9. LLC 4 and LLC 5 are owned by persons unrelated to Taxpayer for purposes of section 856(d)(8) and section 52(a) and (b). Under the Operating Agreement and the management services agreement, all decisions regarding the operations and management of the Facility are made by either LLC 5 or LLC 3.
10. Under the Operating Agreement, New TRS, or another person designated by New TRS is given the authority to take certain "extraordinary actions" following either the delivery to LLC 2 of notice of the occurrence of certain material events of default or notice to LLC 2 from Taxpayer of termination of the sublease. The "extraordinary actions" include the right to terminate the management agreement; the right to remove and replace the general manager; and the right to dissolve LLC 2. The "extraordinary actions" do not confer on New TRS a right to operate or manage the Facility.

LLC 4 is owned equally by LLC 6 and LLC 7, who are both in the business of operating Business facilities. LLC 6 is owned by an individual who also owns a controlling majority interest in and is the chief executive officer of LLC 8. The owners of LLC 6 and LLC 7 also own LLC 9. LLC 8 and LLC 9 are privately-held companies that manage multiple Business facilities in several states through subsidiaries. Through its

subsidiaries or OP, Taxpayer currently leases Business facilities to subsidiaries of both LLC 6 and LLC 7. Taxpayer represents that all transactions between its affiliates and either LLC 8 or LLC 9 have been negotiated on an arm's length basis. To Taxpayer's knowledge, no owner or affiliate of LLC 8 or LLC 9 owns any Taxpayer stock.

When LLC 8 or LLC 9 acquire or develop a Business facility, it does so through a new LLC or subsidiary. These subsidiary entities have their own assets, employees, suppliers and vendors. Taxpayer represents that the subsidiary entities are separate, independent operating entities as set forth in their organizational documents. In addition, Taxpayer represents that all of its existing leases with subsidiaries of LLC 8 and LLC 9 require those entities to form separately organized single purpose subsidiaries to lease Business facilities from a Taxpayer subsidiary.

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(d)(9)(F) provides that for purposes of section 856(d)(8) persons shall be treated as related to each other if such persons are treated as a single employer under subsections (a) or (b) of section 52.

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. A "healthcare facility" is defined in section 856(e)(6)(D)(ii) as a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients, and which was operated by a provider of such services that is eligible for participation in the Medicare program under Title XVIII of the Social Security Act with respect to the facility.

In Rev. Rul. 75-136, 1975-1 C.B. 195, a corporation acting as an investment advisor to a REIT formed a wholly-owned subsidiary that entered into a property management agreement with the REIT. The ruling holds that the subsidiary is not precluded from qualifying as an independent contractor if the subsidiary operates as a separate entity with its own officers and employees and keeps separate books and records that clearly reflect its activities in the management of the property.

In Rev. Rul. 76-534, 1976-2 C.B. 215, a REIT's property manager was a wholly-owned subsidiary of the REIT's investment advisor. While the management company was operated as a separate company with separate officers and employees, an employee of the investment advisor served as a director of both the investment advisor and the management company. The revenue ruling concludes that the relationship of the director to both the investment advisor and the management company does not preclude the property manager from qualifying as an independent contractor.

Rev. Rul. 77-23, 1977-2 C.B. 197, involves a situation in which an individual was both a trustee and a salaried employee of a REIT and was also the sole shareholder and a director of a corporation that served as the REIT's property manager. The ruling holds that although the property management company is directly related to the individual that is a trustee and employee of the REIT, the property manager is not precluded from qualifying as an independent contractor. The ruling explains that the proper relationship to be examined to determine independent contractor status is the relationship between the REIT and the property manager, and not the relationship between the property manager and the REIT trustee.

Taxpayer represents that LLC 5 qualifies as an independent contractor under section 856(d)(3). LLC 5 represents that it and its affiliates are engaged in the active conduct of the trade or business of managing healthcare facilities and are managing the operation of healthcare facilities unrelated to those owned by Taxpayer or New TRS.

Accordingly, we conclude that LLC 5 will be treated as an eligible independent contractor with respect to the management and operation of the Facility, for purposes of section 856(d)(9)(A). Also, LLC 5 will be treated as managing and operating the Facility on behalf of New TRS for purposes of section 856(d)(8)(B) and with respect to the Facility, New TRS will not be treated as operating or managing a Business facility in violation of section 856(l)(3)(A). Rent paid by New TRS to LLC 1 is qualifying income for purposes of the income tests under section 856(c)(2) and (c)(3).

In this case, Taxpayer, through OP, leases Business facilities to subsidiaries of either LLC 8 or LLC 9. As stated above, these lessees are in part owned through certain individuals or entities by the owners of LLC4, which owns LLC 5. The lessees are separate, independent entities from LLC 4 and LLC 5 and are unrelated to Taxpayer. It is represented that the leases, and any future leases were or will be entered into on an arms-length basis. Accordingly, we conclude that the leases to

subsidiaries of LLC 8 and LLC9 will not affect whether LLC 5 may be considered an eligible independent contractor with respect to the Facility under section 856(d)(9)(A).

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,

Thomas M. Preston
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