Internal Revenue Service

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Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:7
PLR-115299-10
Date:

October 05, 2010

Re: Request for Private Letter Ruling Regarding § 168

Legend

Taxpayer =

Agreement 1 =
Agreement 2 =
Agreement 3 =
Agreement 4 =
Agreement 5 =
Agreement 6 =
State 1 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
Date 10 =
Date 11 =
A =
B =
C =
D =
E =
F =

G =
I =
J =
K =
M =
N =
O =
P =
Q =
R =
S =

$H =
$L =
Bank 1 =
Bank 2 =
Year 1 =

Dear :

This letter responds to a letter dated April 2, 2010, and subsequent correspondence dated August 20, 2010, submitted by Taxpayer, requesting a letter ruling under § 168(e)(2) of the Internal Revenue Code regarding a mixed-use development of a single structure that will consist of five condominium units.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is a State 1 limited liability company, and was organized on Date 1. Taxpayer is currently operating pursuant to its Agreement 1, dated Date 11. Agreement 1 states that the purpose of Taxpayer is to acquire, develop, construct, manage, lease, finance, refinance, sell, exchange or otherwise dispose of or deal with interests in the real estate and improvements at A, and to do any and all other things necessary, customary, related or incidental to any of the foregoing. Taxpayer owns the property at A. C, a State 1 general partnership, is the sole member of Taxpayer. D and E, individuals, each own equal partnership interests in C.

Beginning on or about Date 2 until Date 3, Taxpayer acquired G contiguous vacant lots in State 1. On or about Date 4, Taxpayer merged these G contiguous lots into a single lot, which is located at A. On or about Date 5, Taxpayer borrowed $H in conventional construction loans from Bank 1 in order to finance the acquisition of the lots and the construction of a building at A (hereinafter, this building is referred to as "Building"). Construction of Building began on or about Date 6, and Building was placed

in service on or about Date 7. Taxpayer constructed Building using a single comprehensive development and construction budget.

Building is a mixed-use development comprised of B residential apartments, approximately I square feet of commercial space, and a commercial parking garage with J below-ground parking spaces. Building is located in a low-income community as defined in section 45D(e)(1) of the Internal Revenue Code. Taxpayer depreciates Building under § 168(a) as nonresidential real property.

As of Date 11, Taxpayer had entered into leases with third-parties for the rental of various residential units, commercial space, and below-ground parking spaces. Also, on Date 11, Taxpayer, as master landlord, entered into Agreement 2 with K, as master tenant, for the remaining commercial space and parking spaces, either currently vacant or that become vacant during the term of the lease. However, all rents payable to K under the subleases will ultimately be paid to Taxpayer. Individuals D and E own equal interests in K. K does not engage in, and does not anticipate engaging in, any management activities in Building.

The parking garage in Building is connected to, and located underneath, Building. Taxpayer gives residential and commercial tenants priority in renting the parking spaces in Building. However, Taxpayer also rents parking spaces to non-tenants on a month-to-month basis. Except for the rentals of parking spaces with R and S, who are tenants of Building, Taxpayer rents parking spaces pursuant to Agreement 6. Taxpayer does not permit the parking spaces to be used for a daily fee.

Taxpayer operates Building as a single integrated, mixed-use development. For instance, on Date 8, Taxpayer contracted with O for security services to protect Building, and on Date 10, Taxpayer entered into an elevator maintenance agreement with N to examine and maintain the elevators of Building.

Taxpayer accounts for the operations of Building using a single set of books, single income statement and balance sheet. The operation of Building as a whole is reflected on a single Federal income tax return.

On Date 9, Taxpayer entered into Agreement 3 with M. M is a limited liability company owned in equal amounts by individuals D and E. M is responsible for management of the entire Building. Under Agreement 3, M hires, pays, and supervises any employees to maintain and operate the Building. M manages an on-site superintendant at Building to be responsive to all tenants. The on-site superintendant is responsible for keeping the common areas of the building clean, and making any repairs to any portion of Building which are not made by residential or commercial tenants. Also under Agreement 3, M maintains insurance coverage, purchases all necessary supplies, and enters into utility and service contracts for Building. Additionally, M collects the rents from the tenants of Building and maintains all licenses

and permits required for the operation and management of Building. A single integrated management office exists for the entire Building. Taxpayer and M operate out of the same office, located at F.

Further, pursuant to Agreement 3, M maintains records pertaining to the operations of Building (other than the books of account maintained by Taxpayer's accountants). For example, M maintains the rent records, bills and vouchers, leases and subleases, and insurance policies. Moreover, Agreement 3 provides that M will assist in the preparation, and submit annually to Taxpayer, an operating budget for Building.

In order to utilize the Federal new markets tax credit, Taxpayer refinanced the acquisition and construction loans from Bank 1 by obtaining financing from Bank 2, on Date 11. Bank 2 formed a limited liability company by making an equity investment. Additional funds were loaned to this limited liability company. The additional funds were combined with Bank 2's equity and used by the limited liability company to make a qualified equity investment (QEI) to P, a qualified community development entity (CDE). P used 100 percent of the QEI to make a qualified low-income community investment (QLICI) loan to Taxpayer. P loaned an aggregate $L to Taxpayer. The CDE loan is a single loan agreement evidenced by Q promissory notes and secured by Agreement 4 and Agreement 5, which were entered into on Date 11. Agreement 4 is a valid and perfected first lien on the real property at A, including Building. Under Agreement 5, Taxpayer grants to P a security interest in, and to all of, Taxpayer's right, title, and interest in and to all personal property and fixtures of Taxpayer.

Plan of Condominium

Taxpayer proposes to establish a plan of condominium ownership under the laws of State 1. The plan of condominium will divide Building into five condominium units: Units 1, 2, 3, 4, and 5 (collectively, Units). Taxpayer will continue to own all of the Units and will be the landlord for all of the Units. Under Agreement 2, K will sublease Units 3, 4, and 5. However, all rents payable to K under these subleases will continue to be paid to Taxpayer. Unit 1 will consist of the residential apartments and the parking spaces. Unit 2 will consist of commercial space at the cellar and first-floor of Building. Unit 3 and Unit 4 will each consist of a community facility unit on the first-floor of Building. Unit 5 of Building will consist of commercial space on the first-floor. Unit 3 is leased to R. Units 4 and 5 are leased to S. All of the Units will be placed in service by Taxpayer in Year 1.

The Units are physically connected. Parking space tenants have access to their parking spaces by driving or walking down a ramp. Once inside Building, parking space tenants have access to Building's elevators and stairways which access: (a) the apartments, or (b) the lobby of Building to exit and reach the exterior entrances of the

commercial businesses. For security reasons, the residential tenants must exit Building through the first-floor lobby to access the commercial tenant space.

Taxpayer represents that the operation, accounting procedures, management, and financing of Building will not be altered by the establishment of the plan of condominium. All outstanding loans will continue to be secured with a valid and perfected first lien on Building as a whole, which includes all of the Units. Taxpayer also provided the following representation from M: "M is currently managing and will continue to manage the property at A (the building that is the subject of [this letter ruling request]) as one building/property for all purposes (including the management plan, accounting system, annual budget, preventative maintenance procedures)."

RULING REQUESTED

Taxpayer requests the Internal Revenue Service issue the following ruling:

The separate condominium Units 1, 2, 3, 4, and 5 of Building 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 § 1.1250-1(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 Units 1, 2, 3, 4 and 5 of Building 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 Units are located on the same single lot of real property, located at A, and contained within Building.

Further, in this case, Taxpayer represents that the operation, management, financing, and accounting for Building will not change as result of the establishment of the plan of condominium. Based solely on this representation, the determination of whether all of the Units are operated as a single integrated unit is made by evaluating the actual operation, management, financing, and accounting for Building.

With regard to operation of Building, Taxpayer represents that the entire Building was placed in service on the same date. Currently, Building is operated under a single security services contract, a single elevator contract, and a single on-site building superintendant for all tenants. Moreover, the residential and commercial tenants are given priority in renting the parking spaces in Building. The tenants of Building who rent the parking spaces have access to Building's elevators or stairways to reach the residential apartments or the lobby to exit Building and enter the commercial space.

The operation of the Units will be the same as the operation of Building. Taxpayer will continue to own the Units. The Units will be placed in service during the same taxable year and will continue to be operated under the same elevator contract, security services contract, and on-site building superintendent that currently exists for Building. Further, the residential and commercial tenants in any of the Units will continue to be given priority in renting the parking spaces, which will be in Unit 1. Moreover, the tenants access to any of the Units will not change as a result of the establishment of the plan of condominium.

With regard to management of Building, Taxpayer leased Building to residential and commercial tenants and, pursuant to Agreement 2, leased the remaining vacant commercial space and parking spaces to K. To provide for unitary management of Building, Taxpayer entered into Agreement 3 with M, a related person, to manage and operate the entire Building. Taxpayer represents that the management of Building will not change as a result of the establishment of the plan of condominium.

Consequently, the management of the Units will be the same as the management of Building. Taxpayer will continue to be the landlord for the Units. M will continue to be the manager of the Units pursuant to Agreement 3. M represents that it will continue to manage the Units as one building/property for all purposes (including the management plan, accounting system, annual budget, and preventative maintenance procedures).

With regard to financing of Building, Taxpayer represents that the acquisition and construction of Building were financed with conventional loans provided by Bank 1. Subsequently, Taxpayer refinanced the loans from Bank 1 by obtaining the $L loan, which is a QLICI, from P. This loan is evidenced by promissory notes, and secured with a valid and perfected first lien on the real property at A, including Building as a whole. Taxpayer represents that this financing will not be changed as a result of the establishment of the plan of condominium. Thus, there is one overall plan of financing for the development of the Units and the financing is secured by a valid and perfected first lien on Building as a whole, which includes the Units.

Finally, with regard to the accounting for Building, Taxpayer represents that the acquisition and construction of Building were done using a single comprehensive development and construction budget. Currently, the accounting for Building is done

using a single set of books for balance sheets, income statements and Federal income tax returns. Also, there is one operating budget for the entire Building. Taxpayer represents that these accounting measures will not change as a result of the establishment of the plan of condominium. Therefore, the accounting for the Units will be the same as the accounting for Building (a single set of books for balance sheets, income statements, and Federal income tax returns, and a single operating budget for the Units).

Taxpayer's facts and representations about the operation, management, financing, and accounting of Building show that Units 1, 2, 3, 4, and 5 of Building will be operated as a single integrated unit. As previously discussed, Taxpayer represents that these Units are on a single tract of land. Accordingly, Taxpayer's facts and representations support treating these five condominium units as a single building for purposes of determining whether Units 1, 2, 3, 4, and 5 (and their structural components) 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 Units 1, 2, 3, 4 and 5 of Building 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).

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 Units comprising Building are nonresidential real property or residential rental property for any taxable year under § 168(e)(2); (ii) what components of such Units are section 1245 property (as defined in § 1245(a)(3)); (iii) whether any of the Units composing Building qualify for the rehabilitation credit under § 47 (including whether such Units may be treated as a single building under § 47); and (iv) whether the requirements of the new markets tax credit under § 45D are satisfied.

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 Chief of Planning & Special Programs, SBSE.

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