Internal Revenue Service

Number: **201315004**
Release Date: 4/12/2013
Index Number: 857.00-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:02
PLR-129378-12
Date:
January 7, 2013

Taxpayer =

State =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

Year 8 =

Year 9 =

Year 10 =

Year 11 =

Year 12 =

Year 13 =

Date A =

Date B =

Date C =

Date D =

Date E =

Project X =

City Y =

City Z =

Site A =

Site B =

Site C =

<u>a</u> =

<u>b</u> =

<u>c</u> =

<u>d</u> =

<u>e</u> =

<u>f</u> =

<u>g</u> =

<u>h</u> =

<u>i</u> =

j =

k =

l =

m =

n =

o =

p =

q =

r =

s =

t =

u =

Dear :

This is in response to your letters dated July 6, 2012, and January 4, 2013, regarding whether proposed dispositions of Taxpayer's assets will give rise to income derived from prohibited transactions within the meaning of I.R.C. § 857(b)(6).

FACTS

Taxpayer was incorporated under the laws of State in Year 2. Taxpayer elected to be treated as a real estate investment trust (REIT) for its first taxable year, and has been taxed as a REIT since its election. Taxpayer uses the accrual method as its overall method of accounting.

Taxpayer's Business Operations

Taxpayer has a shareholders. Taxpayer owns the stock of various qualified REIT subsidiaries (QRSs) and taxable REIT subsidiaries (TRSs). Taxpayer, directly or indirectly, owns interests in commercial real estate directly or through limited liability companies (LLCs) or partnerships having unrelated parties as members or partners.

Taxpayer began its operations in Year 2. As of Date E, Taxpayer's equity investors had invested approximately $b billion in Taxpayer. Taxpayer's objective is to generate investment returns from a portfolio of equity investments in income-producing real estate. Since inception, Taxpayer's investment plan has been to acquire, develop, or redevelop a variety of real estate assets diversified by property type and location. Properties are acquired or developed and held by Taxpayer for long-term investment purposes. When Taxpayer makes an investment in a property, it typically expects the property to be held for at least c years as income-producing property and that a majority of return on its investment will be from rents rather than proceeds of sale. Taxpayer's portfolio is managed to maximize returns over the long term, and properties may be sold at opportune times to achieve this result.

Taxpayer purchased its first property in Year 2. Taxpayer made the following property acquisitions (remaining properties referred to as, "the properties"):

Acquisition Year	Properties
Year 2	d
Year 3	e
Year 4	f
Year 5	g
Year 6	d

Taxpayer did not purchase any properties from Year 7 through Year 10. Taxpayer's portfolio is geographically diverse. As of Date E, the aggregate market value and cost of real estate assets held by Taxpayer through QRSs plus Taxpayer's share of assets held in LLCs and partnerships approximated $h billion and $i billion, respectively. As of Date E, Taxpayer directly or indirectly owned investments in j properties.

Taxpayer represents that its tax returns and other tax filings (and those returns and filings of the pass-through entities in which it has direct and indirect interests) have been and will be consistent with the treatment of Taxpayer and such pass-through entities through which it holds properties as investors that hold real estate for long-term appreciation.

Facts Relating to the Transactions

Economic Conditions

Taxpayer represents that the economic crisis that commenced in Year 6 resulted in significant losses and a liquidity crisis for Taxpayer. New investor capital and mortgage financing represented Taxpayer's sources of cash, and the economic crisis cut off new investor capital as a source of cash. In addition, the crisis resulted in substantial shareholder redemption requests. Thus, Taxpayer's board of directors suspended redemptions to preserve shareholder value, and Taxpayer has not approved any redemptions since the fourth quarter of Year 6.

Commercial credit markets effectively ceased originating loans from mid-Year 6 to late-Year 9. With limited access to mortgage capital, institutional real estate transaction volume was reduced significantly. The lack of buyer demand forced estimated property values steeply downward in all but a few primary markets, making most real estate asset sales uneconomical and difficult to execute.

Taxpayer's economic model was premised on significant returns generated from ground-up development projects to be held for income production. Taxpayer actively managed its portfolio, generating significant amounts of rental income from the portfolio. However, construction financing essentially ceased to exist after Year 6. During Year 6-Year 10, Taxpayer experienced significant cumulative losses. The changed economic circumstances resulted in the suspension of new acquisitions and the postponement of several ongoing development and repositioning projects, placing Taxpayer in a defensive posture from a capital standpoint. There was also limited ability to create substantial liquidity through asset dispositions. As a result, Taxpayer faced a large liquidity gap and needed to undertake a comprehensive debt restructuring with its secured and unsecured lenders in order to remain solvent and manage its way through that economy.

During Date A, Taxpayer presented its shareholders with a plan that outlined the proposed restructuring of a majority of Taxpayer's debt obligations. The restructuring was primarily affected in the last k quarters of Year 8. As part of the restructuring, a number of assets were returned to lenders through deeds in lieu of foreclosure or sold at the value of the debt. In total, Taxpayer undertook d property dispositions during Year 8. Since its inception through the end of Year 7, Taxpayer had disposed of l properties (including properties held through partnerships or joint ventures).

Strategic Plan

Once the debt restructuring was completed, Taxpayer's management developed an initial long-term "Strategic Plan." The Strategic Plan was presented to and approved by Taxpayer's board of directors during Date B and was communicated to Taxpayer's shareholders during Date C. The goal of the Strategic Plan was to manage the portfolio so as to dispose of certain assets in the near term and retain other assets until there was a recovery in the value of such assets. Taxpayer disposed of m properties (or interests in properties) in Year 9, including deeds in lieu of foreclosure to lenders. Several of these dispositions were undertaken pursuant to the Strategic Plan in order to meet projected cash shortfalls and debt maturities.

The Strategic Plan was updated during Date D, and the update was communicated to shareholders. That updated Strategic Plan contemplated the disposition of Taxpayer's entire portfolio over the course of several years. Consistent with the updated Strategic Plan, during Year 10, Taxpayer undertook n property dispositions primarily consisting of properties which were stabilized from a leasing and income perspective and were located in metropolitan areas where buyer demand existed. These dispositions also included c sales of vacant buildings, a sale of a land parcel and o transfers to creditors in lieu of foreclosure.

The Strategic Plan was updated for Year 11 and approved by Taxpayer's board of directors. The updated Strategic Plan contemplates a revised disposition schedule, and Taxpayer expects that it will have an adopted plan of liquidation by the end of Year 12, with Taxpayer's entire portfolio being disposed of in Year 11 to Year 12. While Taxpayer believes that it can dispose of its entire portfolio by Year 12, it is possible that the dispositions may not be completed until Year 13. The anticipated sales year-by-year from now until Year 12 are currently projected to exceed, in most or all of these years, the number of sales described in section 857(b)(6)(C)(iii).

Taxpayer anticipates that it will update the Strategic Plan annually and communicate the update to shareholders. Property dispositions may be accelerated or delayed, possibly substantially, based on future economic developments.

Taxpayer's intent is to continue to hold (and rent) assets until they are fully stabilized (if not already stabilized) and until the particular markets in which they are located have recovered. Then, Taxpayer intends to bring the asset to market for disposition. As assets are sold, the net sales proceeds will be distributed to Taxpayer's shareholders on a pro-rata basis after Taxpayer's credit facility has been extinguished. Taxpayer will engage independent brokers in selling the properties.

Taxpayer does not currently plan to make significant new investments (other than potentially undertaking certain development activities at Project X (as discussed and described below)). Specifically, Taxpayer represents that it will not make any capital expenditures in respect of any real estate asset (except for certain buildings constructed at Project X) during the o-year period preceding any sale of such asset in an amount exceeding p% of the net selling price of such asset. Except for certain buildings constructed at Project X, Taxpayer will have held each real estate asset for at least q years prior to its sale, and based on the most recent Strategic Plan, the holding period of the properties as of their projected dates of disposition would average m years. Taxpayer does not currently plan to permit new investors; however, Taxpayer may do so. Furthermore, it is possible that there will be future modifications to the Strategic Plan.

Project X

Substantially all of Taxpayer's assets were acquired and/or developed prior to Year 6. However, Taxpayer, through a majority-owned limited partnership, is currently in the process of developing r acres of land known as Project X located in City Z. Project X constitutes less than l% (by value) of Taxpayer's portfolio. Taxpayer acquired Project X in Year 4 with plans for the long-term development of residential, retail, and office properties to be leased for an indefinite period. The economic crisis which began in Year 6 adversely affected Taxpayer's development of Project X. Project X was ultimately put on hold from the end of Year 7 through early Year 10. Thus, while some development has occurred and resumed at Project X, the pace of development has been much slower than anticipated. The development that has recently restarted is consistent with that which was originally anticipated, although on a significantly smaller scale.

When Taxpayer acquired Project X, it expected to operate the developed properties for at least c years after they had been completed and leased. Under the approved Strategic Plan, Taxpayer plans to dispose of its entire portfolio, including Project X, over a q-year period. This means that certain portions of Project X may be sold relatively soon after the completion of construction instead of being held for the production of rental income for the long term. In addition, certain development and construction of rental real estate that would otherwise have been undertaken by Taxpayer may not be undertaken. Instead, Taxpayer may dispose of approximately s land parcels that have been held since Year 4. These land parcels have not been developed, although roads and other infrastructure have been constructed. Taxpayer is engaging in limited construction at Project X, in part, to demonstrate the value of the land contributed to the joint ventures, thereby enabling Taxpayer to maximize the selling price of the land parcels that it will be selling. Currently, Taxpayer is developing o vertical projects within Project X – a t square foot stand-alone Site A and a u-unit Site B and horizontal infrastructure work, including a Site C, and the remaining roadway and utility work in the northern portion of the project.

LAW AND ANALYSIS

Section 856(c) of the Code provides that to qualify as a REIT, a corporation must: (1) derive at least 95 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in section 856(c)(2), which includes dividends, interest, rents from real property, and certain other items; and (2) derive at least 75 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in section 856(c)(3), which includes rents from real property and certain other items.

Section 857(b)(6)(A) of the Code imposes a tax for each taxable year of a REIT equal to 100 percent of the net income derived from prohibited transactions. Under section 857(b)(6)(B)(iii), the term "prohibited transaction" means a sale or other disposition of property described in section 1221(a)(1) that is not foreclosure property.

Section 857(b)(6)(C) of the Code excludes certain sales from the definition of a prohibited transaction. Under 857(b)(6)(C), the term “prohibited transaction” does not include a sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) and which is described in section 1221(a)(1) if—

(i) the REIT has held the property for not less than 2 years;

(ii) aggregate expenditures made by the REIT, or any partner of the REIT, during the 2-year period preceding the date of sale which are includible in the basis of the property does not exceed 30 percent of the net selling price of the property;

(iii) (I) during the taxable year the REIT does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all assets of the REIT as of the beginning of the taxable year, or (III) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the fair market value of all the assets of the REIT as of the beginning of the taxable year;

(iv) in the case of property, which consists of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the REIT has held the property for not less than 2 years for production of rental income; and

(v) if the requirement of section 857(b)(6)(C)(iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the REIT itself does not derive any income.

Section 857(b)(6)(F) provides that in determining whether or not a sale constitutes a “prohibited transaction” for purposes of 857(b)(6)(A), the fact that such sale does not meet the requirement of 857(b)(6)(C) or (D) shall not be taken into account; and such determination, in the case of a sale not meeting such requirements, shall be made as if subparagraphs (C), (D), and (E) had not been enacted.

Property described in section 1221(a)(1) includes property held by a taxpayer “primarily for sale to customers in the ordinary course of its trade or business.” The legislative history underlying section 857(b)(6), which was added to the Code by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), indicates that the purpose of that section was to "prevent a REIT from retaining any profit from ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project." S. REP. NO. 94-938, pt. 1, at 470 (1976).

To determine whether a taxpayer holds property "primarily for sale to customers in the ordinary course of its trade or business," the Tax Court has held that several factors must be considered, none of which is dispositive. Among those factors are the following: (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity, and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; and (5) the time and effort the taxpayer habitually devoted to the sale. Generally, it is the purpose for which property is held at the time of the sale that is determinative, although earlier events may be considered to decide the taxpayer's purpose at the time of the sale. See Cottle v. Commissioner, 89 T.C. 467, 487 (1987).

Taxpayer has represented that the properties were acquired, developed, and redeveloped to generate rental income and to maximize returns over the long run. Taxpayer is selling the properties only to obtain liquidity needed under current economic conditions. With the exception of the improvements necessary to sell Project X, Taxpayer generally does not anticipate any extensive improvements to the properties to prepare them for sale, and Taxpayer will engage independent brokers for sales of the properties. Other than the reduced holding period of the new Project X buildings, Taxpayer's average holding period for the properties is expected to be m years, and Taxpayer will have held each real estate asset for at least q years prior to sale. Similarly, Taxpayer will have held the land parcels at Project X for over l years by the time of its projected sales. Taxpayer does not have a history of making numerous, extensive, continuous, or substantial sales of properties, as discussed in Cottle, supra. Rather, Taxpayer, prior to dispositions under the Strategic Plan, has a relatively minimal prior sales history.

CONCLUSION

Based on the facts and representations submitted by Taxpayer, we conclude that net income derived from the proposed sale of the properties and Project X will not be treated as income derived from a prohibited transaction under section 857(b)(6).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed 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. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Susan Thompson Baker
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)