Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:05
PLR-138380-13

Date:
January 16, 2014

In Re:

LEGEND:

Taxpayer	=
State A	=
State B	=
Date A	=
Date B	=
Date C	=
Date D	=
Date E	=
Date F	=
x square feet	=
y square feet	=
z square feet	=
$x	=
Term A	=
x %	=
y %	=
z %	=
Partnership	=
LLC 1	=
LLC 2	=
LLC 3	=
Manager	=
Finance	=
Master Tenant	=
Fund	=
Sublessee	=
Building 1	=
Building 2	=

Vacant land =
Block =

Community =

Dear :

This is in response to Taxpayer's request for a private letter ruling dated on July 31, 2013, and subsequent correspondence requesting a ruling that the rehabilitation of two contiguous properties be treated as part of the same project and thus be considered one property for purposes of § 168(h)(1)(B) of the Internal Revenue Code ("Code").

FACTS

Taxpayer is a State A limited liability company organized in Date B to acquire, develop, renovate and construct three adjacent properties into a mixed-use commercial development containing a cultural center, a performing arts facility, office space, educational classroom space, educational studio space and a commercial surface parking lot. The three properties are Building 1, Building 2, and Vacant land. The three properties are located on separate, but contiguous, parcels that run the entire length of Block and are located in a low-income district known as Community. Only Building 1 and Building 2 (collectively "Buildings") are subject to this ruling request.

Taxpayer is operating pursuant to its Amended and Restated Operating Agreement dated Date F, by an among Partnership, a State B non-profit corporation, as a member with an x % ownership interest, LLC 1, a State A limited liability company, as a member with an y % ownership interest, LLC 2, a State A limited liability company, as a member with an z % ownership interest, and LLC 3, a State B limited liability company, as non-member manager.

Taxpayer acquired Building 1, a historic building; Building 2, a historic building; and Vacant land in Date B. Taxpayer transferred Vacant land to Finance in Date C. Taxpayer retains site control over Buildings. Buildings are physically connected by an existing party wall which they share. Building 1 will be renovated as office space, educational classroom space, and architectural space. The projected completion date and placed-in-service date for Building 1 is on or about Date D. Building 2 will be renovated as a cultural center and performing arts facility. The projected completion date and placed-in-service date for Building 2 is on or about Date E, which is a few months after Date D. Building 1 will contain approximately x square feet of office space, educational classroom space and educational studio space. Building 2 will contain y square feet of cultural center space and performing arts space. Vacant land will be used as a shared surface parking lot serving both Buildings. A legal servitude executed

and recorded in Date C ensures that during and following the renovation and construction period, vehicular and pedestrian access between Buildings will be in place.

On Date F, Taxpayer closed on $x in Federal new markets credit financing for the renovation of the two historic Buildings and the construction of improvements for a surface parking lot on the contiguous parcels that comprise this project. The financing includes a combination of debt and equity that originated from a single community development entity lender. The loans are evidenced by promissory notes and loan agreements and secured by guaranties.

Taxpayer represents that it plans to operate, lease, market, manage, and otherwise deal with the historic Buildings as a single, integrated, mixed-use development. Taxpayer envisioned and will carry out this project as a "cultural hub," as all tenants will be engaged in creative endeavors and cultural activities within their respective spaces. Taxpayer's selection of creative tenants was intentional. Buildings will be managed as one project under a single Asset Management Agreement with Manager, which will oversee rent collection and contracting for shared repair and maintenance services for Buildings.

Taxpayer leased Buildings to Master Tenant, a State A limited liability company pursuant to a Master Lease Agreement. To provide for the coordinated, combined management of Buildings by a single management entity, Taxpayer and Master Tenant will execute a single asset management agreement with Manager, which will manage Buildings. Pursuant to his agreement, an asset management fee will be paid to Manager for its management services.

Master Tenant subleased Building 1 to The Administrators of the Fund, a State A nonprofit corporation for the use of Building 1 as office space, educational classroom space and educational studio space. The sublease is for the approximately x square feet for Building 1, which includes z square feet of built out net rentable area contained in Building 1, and non-exclusive access to sidewalks, parking, access, landscaped areas, and other areas serving Building 1. The sublease term is ten years with an option to renew for another five years. The sublease term began on Date F. The sublease contains an option to purchase the property by the Fund at other than the property's fair market value. Accordingly, the sublease of Building 1 to Fund is a disqualified lease for purposes of § 168(h)(1)(B).

Taxpayer represents Master Tenant subleased the y square feet in Building 2 to Sublessee pursuant to a sublease agreement that is not a disqualified lease.

Taxpayer further represents that it is constructing the entire project involving Building 1 and Building 2 under a single comprehensive development and construction budget. Each month during the construction phase of the project, Taxpayer will submit

a single draw to the lender of the debt requesting that loan proceeds be used to make progress payments to the construction contractors.

Taxpayer requests a ruling that Building 1 and Building 2 be considered part of the same project and thus treated as one property for purposes of the 50-percent threshold test is § 168 (h)(1)(B)(iii) of the Code.

LAW AND ANALYSIS

Section 47(c)(2)(B)(v)(I), as amended by section 3025(a) of the Housing Assistance Tax Act of 2008, provides that the term "qualified rehabilitation expenditure" does not include any expenditure in connection with the rehabilitation of a building which is allocable to the portion of the property which is (or may reasonably be expected to be) tax-exempt use property (within the meaning of § 168(h)), except that "50 percent" shall be substituted for "35 percent" in § 168(h)(1)(B)(iii). Section 3025(b) of the Act provides that the amendment made by section 3025 shall apply to expenditures properly taken into account for periods after December 31, 2007.

Section 168(h)(1)(B)(i) states that, in the case of non-residential real property, the term "tax-exempt use property" means that portion of the property leased to a "tax-exempt entity" in a "disqualified lease." Under section 168(h)(1)(B)(ii), the term "disqualified lease" means any lease of the property to a tax-exempt entity, but only if: (I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a) and such entity (or a related entity) participated in such financing, (II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an option, (III) such lease has a lease term in excess of 20 years, or (IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

Under § 168(h)(1)(B)(iii), property will be considered "tax-exempt use property" only if the portion of the property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property (the "35-percent exception"). Section 168(h)(1)(B)(iv) provides that improvements to a property (other than land) will not be treated as a separate property.

Section 1.168(j)-1T, Q&A-6, of the temporary Income Tax Regulations provides that the phrase "more than 35 percent of the property" means more than 35 percent of the net rentable floor space of the property. The net rentable floor space in a building does not include the common areas of the building, regardless of the terms of the lease. For purposes of the "more than 35 percent of the property" rule, two or more buildings will be treated as separate properties unless they are part of the same project, in which

case they will be treated as one property. Two or more buildings will be treated as part of the same project if the buildings are constructed under a common plan, within a reasonable time of each other, on the same site and will be used in an integrated manner.

Section 168(h)(1)(B)(iii) provides that property will not be treated as "tax-exempt use property" if the portion of the property leased to tax-exempt entities in disqualified leases is no more than 35 percent of the property. Under § 47(c)(2)(B)(v)(I), the test is no more than 50 percent for purposes of the rehabilitation credit. Taxpayer posits that, even if Building 1 is leased to tax-exempt entities in disqualified lease, the determination of whether the 50-percent threshold is crossed should be made by reference to the total net rentable floor space in the Buildings combined because the Buildings are part of the same "project" under Q&A-6 of the temporary regulations and thus the Buildings together constitute one "property" for purposes of § 168(h). Therefore, if this 50-percent threshold is not crossed with respect to the total net rentable floor space in the Buildings, no portion of the "property" will be "tax-exempt use property" within the meaning of § 168(h)(1)(B) as modified for purposes of the rehabilitation credit by § 47(c)(2)(B)(v)(I).

For purposes of determining if the Buildings in this case should be considered part of a single project for purposes of Q&A-6 of the temporary regulations and § 168(h)(1)(B)(iii), Taxpayer represents that the Buildings are constructed under a common plan, within a reasonable time of each other, located on the same site, and will be used in an integrated manner. With respect to the same site requirement, Taxpayer represents that Building 1 and Building 2 are historic buildings physically connected by an existing party wall. They are on contiguous parcels of land. There is a legal recorded servitude that allows direct access to the shared parking lot at Vacant land from both Buildings. Further, Buildings will be placed in service within a few months of each other which is certainly within a reasonable time. Concerning the integrated use factor, both Building 1 and Building 2 will be managed under a single Asset Management Agreement with Manager, which will oversee rent collection and contract for shared repair and maintenance services for Buildings. Taxpayer plans to operate, lease, manage and otherwise deal with Buildings as a single, integrated, mixed-use development. Taxpayer envisioned, and will carry out, the use of the Buildings as a cultural hub, as all tenants will be engaged in creative endeavors and cultural activities. The selection of creative tenants was intended by Taxpayer.

Concerning management of the Buildings, Taxpayer leased both Buildings pursuant to a Master Lease Agreement with Master Tenant. To provide for the combined, coordinated management of the Buildings as a single project by a single management entity, Taxpayer represents that an Asset Management Agreement will be executed with Manager which will manage and operate the Buildings as a single property.

Concerning financing the Buildings, Taxpayer represents that it closed on a coordinated, common plan of Federal new markets tax credit financing for the renovation of the Buildings with one community development entity lender. The loans are evidenced by promissory notes and loan agreements and are secured by a mortgage on Buildings.

With respect to accounting, Taxpayer is utilizing a single comprehensive development and construction budget for the renovation of the Buildings. The budget will flow into a single set of books, a consolidated income statement and balance sheet, and a single Federal income tax return reflecting the aggregate operations of this project. Interim accounting reports and annual operating projections will pertain to the Buildings as a single project.

We have no facts or reason to doubt or challenge these representations. The facts show that the Buildings will be renovated at the same time and on the same site separated only by an existing wall. Construction and renovation will be completed and the Buildings placed in service within a reasonable time of each other (i.e., approximately a couple of months). The facts and representations in the submission indicate that the Buildings will be operated in an integrated manner and developed as a cultural and entertainment hub. In addition, the Buildings will be managed by the same Manager and be treated as one project on the Taxpayer's books and records

CONCLUSION

Based on the facts submitted and representations made, the Buildings constitute one project for purposes of §1.168(j)-1T, Q&A-6, of the temporary regulations. Accordingly, we conclude that for purposes of the rehabilitation tax credit and the application of §§ 47(c)(2)(B)(v)(I) and 168 (h)(1)(B)(iii) to Taxpayer's rehabilitation and leasing of Buildings, the "property" will include all of the net rentable floor space in the Building 1 and Building 2.

No opinion is expressed or implied regarding the application of any other provision in the Code or regulations. Specifically, no opinion is expressed or implied regarding whether the rehabilitation of Buildings is a "substantial rehabilitation" or "certified rehabilitation," or whether expenditures incurred to rehabilitate Historic Building are "qualified rehabilitation expenditures" under section 47(c). In addition, no opinion is expressed or implied concerning whether any lease or sublease mentioned in this ruling letter is a true lease for Federal income tax purposes.

This ruling is directed only to the taxpayer that requested it. Under § 6110(k)(3), it may not be used or cited as precedent. In accordance with a power of attorney filed with the request, a copy of this letter is being sent to your authorized representative. We are sending a copy of this letter to the appropriate SBSE office.

Sincerely,

William A. Jackson
Chief, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)

Copy of this letter
Copy for section 6110 purposes