Internal Revenue Service

Number: **201429024**
Release Date: 7/18/2014

856.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B01
PLR-143265-13
Date:
March 28, 2014

Legend:

Taxpayer =

Company =

Club-1 =

Date 1 =

Year 1 =

A =

B =

C =

D =

E =

F =

Dear :

This letter responds to your letter dated October 14, 2013 and subsequent correspondence dated March 10, 2014, requesting a ruling on behalf of Taxpayer

regarding the definition of a "qualified lodging facility" within the meaning of Section 856(d)(9)(D) of the Internal Revenue Code. Specifically, you have requested the following rulings:

(1) The sports clubs owned indirectly by Taxpayer through a subsidiary of Taxpayer under the circumstances described below will not constitute part of a "qualified lodging facility" within the meaning of Section 856(d)(9)(D).

(2) The Subsidiary will not be treated as directly or indirectly operating or managing a "qualified lodging facility" within the meaning of Sections 856(d)(9)(D) or 856(l) by reason of operating the sports clubs as described below.

Facts:

Taxpayer is a newly formed corporation that intends to elect to be taxed as a real estate investment trust ("REIT") beginning Date 1. Taxpayer will adopt the calendar year for Federal income tax reporting and will use the accrual method as its overall method of accounting. Taxpayer was formed to acquire a portfolio of hotels that Taxpayer represents constitute qualified lodging facilities within the meaning of Section 856(d)(9)(D).

Taxpayer's acquisition of the hotels will be effectuated by a contribution of the properties into an operating partnership (the "OP") that will be controlled by Taxpayer. Through the OP, Taxpayer intends to lease these hotels to a taxable REIT subsidiary ("Hotel TRS") that will engage an eligible independent contractor to operate the hotels on behalf of the Hotel TRS. As part of a related transaction, Taxpayer will also contribute its sports club business, as described more fully below, to the OP; the sports club business will be operated in a separate taxable REIT subsidiary (the "Sports Club TRS").

Company operates under the name Club-1, and comprises a fitness center operator and A sports clubs in A different cities. Company is a partnership that holds its interests in the various clubs through a series of wholly-owned limited liability companies ("LLCs") that are treated as entities disregarded as separate from their owner for U.S. federal income tax purposes. The sports clubs owned by Company are located in urban locations with an average size of approximately B square feet. The clubs owned by Company have approximately C members.

Upon the formation of Taxpayer and the OP, the Company will contribute its LLC interests to the OP in exchange for partnership units. The OP will concurrently form an entity to which these LLC interests will be contributed. That entity will, jointly with Taxpayer, make an election effective upon the date of the contribution by the OP to be treated as a taxable REIT subsidiary ("TRS") and this newly formed TRS, the Sports Club TRS, will assume the ongoing operations of the sports clubs.

Of the A sports clubs that will be owned by the Sports Club TRS, D are located adjacent or contiguous to one of the hotel properties that will be owned by Taxpayer, and E is located on a floor within one of the hotels. The remaining F sports clubs are stand-alone locations not located near any hotel. The sports clubs deliver a range of programs and services including cardiovascular and weight training, group exercise programs, sports and aquatic programs, spa and salon services, food cafes, child care services, private training, and nutritional counseling.

The sports clubs offer membership to the general public. There are also arrangements between the clubs that are located adjacent to a hotel property and the adjoining hotels such that the guests of the hotels may gain access to the respective club. The hotels generally pay a fixed monthly or annual fee to the respective club for this service. This fee may be offset by either (i) the daily member fee charged by the hotel to the guest user and turned over to the respective club, or (ii) the payment directly to the respective club of the daily use fee by hotel guests who wish to use the club facilities. The sum of all fees paid to the Company by the hotels in Year 1 accounted for less than F percent of Company's total revenues.

Taxpayer represents that the sports clubs described above and operated by the Company are not amenities and facilities that are customary for other lodging properties of a comparable size and class owned by other owners unrelated to Taxpayer within the meaning of Section 856(d)(9)(iii).

Law and Analysis:

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from specified sources that include rents from real property, and Section 856(c)(3) provides that at least 75 percent must be derived from sources, that likewise include, rents from real property.

Section 856(d)(2)(B) provides that rents from real property do not include any amount received or accrued directly or indirectly from any person if the REIT owns directly or indirectly: (1) in the case of a corporation, stock possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total value of shares of all classes of stock of the corporation; or (2) in the case of any person that is not a corporation, an interest of 10 percent or more in the assets or net profits of the person.

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(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)(A) provides that any corporation in which a TRS owns directly or indirectly more than 35 percent of the total voting power of the outstanding securities of another corporation shall be treated as a TRS. Section 856(l)(2)(B) provides that any corporation in which a TRS owns directly or indirectly more than 35 percent of the total value of the outstanding securities of another corporation shall be treated as a TRS. Section 856(l)(2) provides that for purposes of Section 856(l)(2)(B), securities described in section 856(m)(2)(A) are not taken into account.

Section 856(l)(3)(A) provides that a TRS cannot directly or indirectly operate or manage a lodging facility or a health care facility. Section 856(l)(4)(A) provides that the term “lodging facility” has the meaning given such term in Section 856(d)(9)(D)(ii).

Section 856(d)(9)(D)(i) provides that the term “qualified lodging facility” means any lodging facility unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility.

Section 856(d)(9)(D)(ii) provides that the term “lodging facility” means a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis.

Section 856(d)(9)(D)(iii) provides that the term “lodging facility” includes customary amenities and facilities operated as part of, or associated with, the lodging facility so long as such amenities and facilities are customary for other properties of a comparable size and class owned by other owners unrelated to such real estate investment trust.

Taxpayer has represented that the sports clubs described above and operated by the Company are not amenities and facilities that are customary for other lodging properties of a comparable size and class owned by other owners unrelated to Taxpayer with the meaning of Section 856(d)(9)(D)(iii). Because the sports clubs are not such customary amenities and facilities, they are not included in the definitions of “lodging facility” or “qualified lodging facility” in Section 856(d)(9)(D). The fact that several of the sports clubs are located either on a floor of a hotel or in close proximity to a hotel that is a qualified lodging facility does not change the nature of whether the amenities and services offered by the sports clubs are customary. Moreover, the sports clubs offer their services primarily to the general public. While the sports clubs located

adjacent to hotels also offer services to hotel guests through arrangements with the hotel, a relatively small percentage of their revenue is attributable to hotel guests. Additionally, the sports clubs do not have any dwelling units. As a result, the sports clubs will not be considered part of a qualified lodging facility nor will the Sports Club TRS be considered as directly or indirectly operating a qualified lodging facility by reason of owning and operating the sports clubs.

Conclusion:

We hereby rule as follows:

(1) The sports clubs owned indirectly by Taxpayer through the Sports Club TRS and operated by the Sports Club TRS under the circumstances described above will not constitute part of a "qualified lodging facility" within the meaning of Section 856(d)(9)(D).

(2) The Sports Club TRS will not be treated as directly or indirectly operating or managing a "qualified lodging facility" within the meaning of Sections 856(d)(9)(D) or 856(l) by reason of operating the sports clubs as described above.

This ruling's application is limited to the facts, representations, Code Sections, and regulations cited herein. 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 with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Robert A. Martin
Senior Technician Reviewer, Branch 1
(Financial Institutions & Products)