Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
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Refer Reply To:
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PLR-131978-17

Date:
April 18, 2018

Legend:

Taxpayer =

Partner =

PropCo =

Domestic TRS =

OpCo =

Manager =

State =

Date 1 =

Date 2 =

a =

Dear :

This is in reply to a letter dated September 28, 2017, and supplemental correspondence requesting a ruling on behalf of Taxpayer. Taxpayer has requested a ruling regarding whether the rents received by Taxpayer qualify as rents from real property for purposes of section 856(d) of the Internal Revenue Code ("Code").

Facts:

Taxpayer was incorporated under the laws of State on Date 1. Taxpayer intends to qualify and elect to be taxed as a real estate investment trust ("REIT") under sections 856 through 859 of the Code beginning with its taxable year ended Date 2.

Taxpayer's primary business is the acquisition, ownership, and leasing of assisted living ("AL") facilities. Taxpayer recently acquired fee ownership of a portfolio of a AL facilities located in the United States. Taxpayer also acquired a leasehold interest in one AL facility that is currently under construction, subject to Taxpayer's option to purchase. All of the AL facilities ("AL Facilities") are intended to qualify as qualified health care properties within the meaning of section 856(e)(6)(D).

Taxpayer holds its AL Facilities through PropCo, a State limited liability company that is treated as a partnership for U.S. federal income tax purposes. PropCo, in turn, holds its interests in the AL Facilities through subsidiary entities ("PropCo Subs") that are each disregarded as a separate entity from PropCo for U.S. federal income tax purposes. Taxpayer formed Domestic TRS, a State limited liability company that will jointly elect with Taxpayer to be treated as a taxable REIT subsidiary ("TRS") of Taxpayer. Domestic TRS and Partner, an entity unrelated to Taxpayer or Domestic TRS within the meaning of section 856(d)(2)(B), formed OpCo, a State limited liability company taxed as a partnership for U.S. federal income tax purposes. Pursuant to the structure permitted by the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 3061, 122 Stat. 2654, 2901-02 (2008) ("RIDEA"),[1] each PropCo Sub that holds an AL Facility leases the facility to a subsidiary of OpCo (each, an "OpCo Sub") that is disregarded as a separate entity from OpCo for U.S. federal income tax purposes. Each OpCo Sub has entered into a management contract with Manager to manage and operate its AL Facility.

Law & 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

[1] Sections 3031-3071 of the Housing and Economic Recovery Act incorporated significant portions of proposed legislation introduced as the REIT Investment Diversification and Empowerment Act of 2007, or "RIDEA". See H.R. 1147 and S. 2002, 100th Cong. (1st Sess. 2007).

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 taxable year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(B) provides that rents from real property do not include amounts received directly or indirectly from a corporation if the REIT owns 10 percent or more of the total combined voting power or 10 percent or more of the total value of the shares of the corporation.

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 property 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)(9)(A) provides that the term "eligible independent contractor" ("EIK") with respect to any qualified lodging facility or qualified health care property (as defined in section 856(e)(6)(D)(i)) means any independent contractor if, at the time such contractor enters into a management agreement or other similar service contract with the TRS to operate such qualified lodging facility or qualified health care property, such contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities or qualified health care properties, respectively, for any person who is not a related person with respect to the REIT or the TRS.

Section 856(e)(6)(D)(i) defines qualified health care property as any real property that is a health care facility.

A "health care 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 XVII of the Social Security Act (42 U.S.C.A. § 1395 et seq.) with respect to such facility.

Ruling Request: Whether rental income received directly or indirectly by PropCo from the lease (or sublease) of an AL Facility to a disregarded subsidiary of OpCo or a partnership subsidiary of OpCo will qualify as "rents from real property" for purposes of section 856(d).

The related-party rent exception of section 856(d)(8)(B) is only available for amounts paid by a TRS to the REIT and only when the qualified health care facility is operated on behalf of a TRS by an EIK. In this case, although the amounts paid are for

the lease of qualified health care properties, the amounts are not paid by a TRS directly. Instead, the amounts are paid by OpCo and OpCo Subs, which each constitute a partnership that is owned by Domestic TRS and one unrelated party, Partner. Therefore, the question here is whether the related-party rent exception can apply to amounts paid by a partnership where the partners are a TRS and only one other unrelated party.

Under the facts as represented, the amounts paid by OpCo and OpCo Subs may qualify as rents from real property for purposes of section 856(d) by analyzing the income attributable to the partnership interest held by a TRS separately from the income attributable to any remaining partnership interest. If Domestic TRS were the sole, direct lessee of each AL Facility, the related-party rent exception of section 856(d)(8)(B) would apply to amounts received directly from Domestic TRS. Therefore, in this case, amounts attributable to the partnership interest held by Domestic TRS satisfy the requirements of section 856(d)(8)(B) so long as an EIK manages and operates the AL Facility rented by the partnership. If Partner, which Taxpayer represents is not related to Taxpayer within the meaning of section 856(d)(2)(B), were the sole direct lessee of each AL Facility, the amounts would also qualify as rents from real property (without the need for any exception). Therefore, in this case, amounts attributable to the partnership interest held by Partner qualify as rents from real property.

In conclusion, rental income received directly or indirectly by PropCo from the lease of an AL Facility to a partnership between Domestic TRS and a single partner unrelated to Taxpayer within the meaning of section 856(d)(2)(B), shall not be excluded from rents from real property by reason of section 856(d)(2)(B) so long as the facility is operated by an EIK.

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.

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

Sincerely,

Andrea M. Hoffenson
Andrea M. Hoffenson
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)