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Person To Contact:
, ID No.

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CC:FIP:B02
PLR-128935-16

Date:
September 11, 2025

Legend:

Taxpayer =

Investor =

Market Rate Owner =

Affordable Owner =

Date 1 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

State =

Address =

City =

State Agency =

City Housing Program =

City Agency =

Zoning Law =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

Dear :

This letter is in reply to a letter dated September 16, 2016, and supplemental information submitted on behalf of Taxpayer by its authorized representative requesting a ruling that pursuant to the authority of section 856(c)(5)(J) of the Internal Revenue

Code, income from the sale of the Certificate (as defined below) will be considered as qualifying income under sections 856(c)(2) and (c)(3).

Facts:

Taxpayer is a limited liability company organized under the laws of State that elected to be treated as a real estate investment trust ("REIT") under sections 856 through 859 beginning with its taxable year ended Date 1. Taxpayer owns A percent of the interests in Market Rate Owner, a limited liability company organized under the laws of State that is disregarded for U.S. Federal tax purposes. Taxpayer also owns a managing interest in Affordable Owner, a limited liability company organized under the laws of State that is treated as a partnership for U.S. Federal tax purposes. Investor owns the remaining interest in Affordable Owner.

Taxpayer is the owner (through its interest in Market Rate Owner and Affordable Owner) of a mixed income apartment building located at Address in City (the "Project"). Taxpayer represents that the Project constitutes real property within the meaning of section 1.856-10(b) of the Income Tax Regulations. The Project consists of a large residential building with B residential units. Residential units in City that are set aside for occupancy by households whose gross income does not exceed C percent of the area median income for City have a D year low-income restriction period under City law ("Affordable Units"). In the Project, E units are set aside as Affordable Units ("Project Affordable Units") and are treated as a single-building project for section 42 low-income housing tax credit ("LIHTC") purposes. The remaining residential units in the Project are or will be rented out at market rates (the "Market Units"). Market Rate Owner is the owner of the Market Units and Affordable Owner is the owner of the Project Affordable Units. Through its interest in Affordable Owner, Investor is allocated F percent of the depreciation and LIHTC and G percent residual capital gains interest.

In Year 1, for LIHTC purposes, Taxpayer entered into an extended use agreement ("Agreement 1") with State Agency pursuant to the requirement for minimum long-term commitment to low-income housing under Federal LIHTC rules. Agreement 1 provides for a standard H-year extended use period for the project. State Agency subsequently made a LIHTC allocation to the Project under section 42.

The City Housing Program is a voluntary program that City Agency operates to incentivize developers to increase the amount of affordable housing in City. The City Housing Program offers an optional zoning density bonus or "floor area compensation" in designated areas throughout City to developers who agree to permanently set aside and restrict the rents of units for qualifying low-income tenants in LIHTC buildings. Generally, upon application, the owner enters into a separate regulatory agreement with City Agency and receives a certificate describing the bonus zoning or amount of floor area ("Certificate"). The regulatory agreement requires the owner to set aside a certain amount of affordable flooring area in a building as Affordable Units for qualifying low-income residents that meet the relevant income restrictions. The Affordable Units must

be set aside on a permanent basis under the regulatory agreement. The regulatory agreement must be recorded with Register Agency against the tax lots comprising the project and any obligations set forth therein run with the tax lot of the project. For developers that decline to participate in the City Housing Program, Affordable Units can generally be rented at market rates following the end of any other low-income restriction period applicable to the building. The Certificate may be used by developers either on- or off-site in an adjacent district and may be sold to be used for the benefit of unrelated developers subject to the same use restrictions. The Certificate is designed to compensate a developer for the loss of future rental income the affordable housing project would otherwise benefit from if the Affordable Units were allowed to transition to units charging market rate rents after the end of any other applicable low-income restriction period.

At the time of entering into Agreement 1 with State Agency for purposes of LIHTC in Year 1, Taxpayer committed to City Agency to enter into a separate regulatory agreement ("Agreement 2") as part of the City Housing Program described above. Taxpayer finalized Agreement 2 with City Agency in Year 2. As part of this second regulatory agreement, Taxpayer promised to set aside and maintain the Project Affordable Units at issue permanently and, in exchange, Taxpayer received one Certificate that allows a zoning bonus in another development project per the terms of Agreement 2 and the City Housing Program. Taxpayer's commitment to permanently set aside these low-income units is considered by State Agency as a factor in making the LIHTC allocation.

In Year 3, Taxpayer sold approximately I% of the Certificate in an installment sale to a 3rd party developer, who is entitled under local law to use the Certificate in its construction project in the same district or an adjacent zoning district. In Year 4, Taxpayer contributed approximately J% of the original issued Certificate to a wholly owned subsidiary that elected to be treated as a taxable REIT subsidiary (the "TRS"). Taxpayer continues to directly hold K% of the original Certificate issuance. The TRS conducted one sale in Year 5 since the Taxpayer's Certificate contribution to the TRS, incurring taxable income at the TRS level on the gain resulting from such disposition. Taxpayer is seeking a ruling under section 856(c)(5)(J) that the income from the sale of the remaining Certificate held by Taxpayer is qualifying income for purposes of the REIT income tests under section 856(c)(2) and (c)(3).

Law and Analysis:

Section 856(c)(2) provides that for a corporation to qualify as a REIT for any taxable year, at least 95% of its gross income (excluding gross income from prohibited transactions) must be derived from dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (other than property described in section 1221(a)(1)), abatements and refunds of taxes on real property, income and gain derived from foreclosure property, certain commitment fees,

gain from certain sales or other dispositions of real estate assets, and certain mineral royalty income.

Section 856(c)(3) provides that for a corporation to qualify as a REIT for any taxable year, at least 75% of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from rents from real property, interest on obligations secured by mortgages on real property or on interests in real property, gain from the sale or other disposition of real property (other than property described in section 1221(a)(1)), dividends or other distributions on, and gains from the sale or disposition of, shares in other REITs, abatements and refunds of taxes on real property, income and gain derived from foreclosure property, certain commitment fees, gain from certain sales or other dispositions of real estate assets, and qualified temporary investment income.

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 real property, whether or not such charges are separately stated; and (C) rent attributable to personal property which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property for the taxable year does not exceed 15% of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such lease.

Section 1.856-4(a)(1) provides that, subject to the exceptions of section 856(d) and section 1.856-4(b), the term “rents from real property” means, generally, the gross amounts received for the use of, or the right to use, real property of the REIT.

Section 856(c)(5)(J) provides that, to the extent necessary to carry out the purposes of part II of subchapter M of Chapter 1 of the Code, the Secretary is authorized to determine, solely for purposes of such part, whether any item of income or gain which (i) does not otherwise qualify under section 856(c)(2) or (3) may be considered as not constituting gross income for purposes of section 856(c)(2) or (3), or (ii) otherwise constitutes gross income not qualifying under section 856(c)(2) or (3) may be considered as gross income which qualifies under section 856(c)(2) or (3).

Section 1.856-10(f) provides that to the extent an intangible asset derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of space, the intangible asset is real property or an interest in real property.

Legislative history indicates that Congress intended part II of subchapter M to apply to certain “organizations specializing in investments in real estate and real estate mortgages.” H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960), 1960-2 C.B. 819, 820. Congress intended to restrict the beneficial tax treatment of part II of subchapter M to

"what is clearly passive income from real estate investments, as contrasted to income from the active operation of businesses involving real estate." Id.

Since the Certificate does not qualify as real property, income from the sale of a Certificate is not specifically enumerated as qualifying income in section 856(c)(2) or (c)(3). The Certificate, however, is tied to real property and the rental of real property. To obtain a Certificate, a building owner must sign a regulatory agreement that requires the owner to permanently set aside a certain amount of affordable flooring area in a building for qualifying low-income residents that meet the relevant income restrictions. Thus, under the City Housing Program, the Certificate generally represents compensation to Taxpayer for the loss of future market-rate rents resulting from its agreement to make the Project Affordable Units permanently affordable. This commitment to permanent affordability is a factor considered by State Agency in making a LIHTC allocation. Ultimately, the Certificate, once utilized, will be perpetually tied to real property not only in the binding low-income commitment for the Project Affordable Units but also in the form of additional bonus floor area in a future residential building. Therefore, the Certificate derives its value from and is inextricably tied to both the Project Affordable Units and the future residential building that utilizes the extra density provided for in the Certificate. Given the Certificate's close connection to real property and its furtherance of affordable housing policy goals as part of the City Housing Program and LIHTC consideration, treating Taxpayer's income from the sale of the Certificate as qualifying income for purposes of section 856(c)(2) and (c)(3) is consistent with the purposes of part II of subchapter M.

Conclusion:

Based on the information submitted and the representations made, we rule that, pursuant to the authority of section 856(c)(5)(J), income from the sale of the Certificate will be considered as qualifying income under sections 856(c)(2) and (c)(3).

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 or whether a Certificate sale constitutes a prohibited transaction as described in section 857(b)(6)(B)(iii). Furthermore, no opinion is expressed or implied with respect to the LIHTC regime under section 42. Lastly, no opinion is expressed or implied with respect to the tax status of Affordable Owner, or the allocations (such as income, deductions, and credits) by Affordable Owner to its interest holders.

The ruling contained in this letter is based upon information submitted and representations made by Taxpayer and accompanied by penalties of perjury statements executed by the appropriate parties. While this office has not verified any of the

material submitted in support of the request for a ruling, it is subject to verification on examination.

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.

Sincerely,

Andrea M. Hoffenson
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: