

Internal Revenue Service

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Date:

July 3, 2007

Legend:

Taxpayer =

State A =

LP =

a =

Month 1 =

Year 1 =

Year 2 =

Year 3 =

Dear :

This is in reply to a letter dated March 7, 2007, requesting a ruling on behalf of Taxpayer. The requested ruling concerns the treatment of partnership debt and temporary investments held by Taxpayer through its interest in LP, for purposes of section 856(c) of the Internal Revenue Code.

Facts:

Taxpayer is a State A real estate investment trust (REIT) that has elected under section 856(c) to be treated as a REIT for federal income tax purposes. Taxpayer is the

managing general partner of LP and owns approximately a percent of the outstanding common units of LP. LP owns and operates numerous real properties throughout the United States through business entities classified as partnerships or disregarded entities for federal income tax purposes.

In Month 1, Taxpayer raised capital through a public offering of senior convertible debentures (Year 1 Debentures). The Year 1 Debentures, which mature in Year 2, are convertible under certain circumstances into common shares of Taxpayer stock. The net proceeds from the Year 1 Debentures were loaned to LP for convertible debt of LP with terms that substantially mirror the Year 1 Debentures. The convertible debt is convertible into ownership shares in LP upon the occurrence of certain events. LP will ultimately use the proceeds of the public offering of the Year 1 Debentures to acquire real estate assets and fund working capital. However, in the interim, LP has temporarily invested, and will continue to invest, the proceeds in stock and debt instruments, including money market funds, during the 1-year period beginning on the date on which Taxpayer received the net proceeds from the Year 1 Debentures.

Taxpayer presently intends to raise additional capital through a public offering of additional convertible senior debentures with terms similar to the Year 1 debentures (Year 3 Debentures). Taxpayer intends to use the proceeds from the Year 3 debentures to fund its operations conducted by LP by loaning the net proceeds from the Year 3 debentures to LP in exchange for convertible LP debt with terms that substantially mirror the terms of the Year 3 Debentures. LP will ultimately use the net proceeds from the Year 3 Debentures to acquire real estate assets and to fund working capital. In the interim, LP will use the proceeds from the Year 3 Debentures to temporarily invest in stock and debt instruments, including money market funds, during the 1-year period beginning on the date that Taxpayer receives the net proceeds from the Year 3 Debentures.

Neither the Year 1 LP debt nor the Year 3 LP debt (collectively, the LP Debt) will be secured by an interest in real property. Taxpayer represents that the LP Debt will be treated as indebtedness for federal income tax purposes.

Law and Analysis:

Section 856(c)(2) provides a REIT must derive at least 95 percent of its gross income from certain enumerated sources, including dividend, interest, and rents from real property.

Section 856(c)(3) provides that a REIT must derive at least 75 percent of its gross income from certain enumerated real estate sources, including rents from real property and qualified temporary investment income.

Section 856(c)(5)(D)(i) defines “qualified temporary investment income” as any income which—(I) is attributable to stock or a debt instrument (within the meaning of section 1275(a)(1)), (II) is attributable to the temporary investment of new capital, and (III) is received or accrued during the 1-year period beginning on the date on which the REIT receives such capital. Section 856(c)(5)(D)(ii) provides that “new capital” means any amount received by the REIT either in exchange for stock (or certificates of beneficial interests) in the REIT (other than amounts received pursuant to a dividend reinvestment plan), or in a public offering of debt obligations of the REIT which have maturities of a least 5 years.

Under § 1.856-3(g) of the Income Tax Regulations, a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of § 856, the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners for all purposes of § 856.

Taxpayer is required to account for its proportionate share of LP's income and assets pursuant to § 1.856-3(g). Therefore, the assets or income with which LP would repay the loan to Taxpayer will be accounted for by Taxpayer in accordance with § 1.856-3(g). If payments on the debt from LP to Taxpayer are treated as income by Taxpayer, double counting of income will result. Accordingly, to the extent payments on the loan from Taxpayer to LP are reflected in Taxpayer's income and assets derived from its capital interest in LP, those payments should not be treated by Taxpayer as separate items of income or assets, but rather should be disregarded for purposes of § 856(c). Similarly, a portion of the loan by Taxpayer to LP should not be treated as a separate asset of Taxpayer to the extent of Taxpayer's proportionate interest in LP.

Taxpayer's proportionate share of the income and assets of LP are treated by Taxpayer as if it earned the income and held the assets directly. Therefore, the character and attributes of the income and assets will be the same whether Taxpayer earns income and holds assets directly or through its interest in LP. Accordingly, for purposes of §856(c)(3) any income that satisfies the definition of “qualified temporary investment income” may be treated as such by Taxpayer, whether earned by Taxpayer directly or through its interest in LP, beginning on the dates on which Taxpayer receives the proceeds from the Debentures. Also, for purposes of section 856(c)(4)(A), any property attributable to the temporary investment of new capital, whether held directly by Taxpayer or through its interest in LP, will be treated as a real estate asset for the 1-year period beginning on the dates on which Taxpayer receives the proceeds from the Debentures, as provided in § 856(c)(5)(B).

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.

Sincerely,

William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)