

## Internal Revenue Service

## Department of the Treasury

Number: **200132008**

Washington, DC 20224

Release Date: 8/10/2001

Index Number: 856.00-00, 856.01-00,  
856.04-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:FIP:B03/PLR-109995-01

Date:

May 4, 2001

### LEGEND:

Taxpayer =

Lessee =

Bankruptcy Court =

Properties =

Industry =

Claims =

Z =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

This responds to your request for a ruling filed on behalf of Taxpayer dated February 8, 2001, and subsequent correspondence, requesting that, based upon the facts and representations submitted, a portion of the stock that Taxpayer is to receive under a plan of reorganization for Lessee will not be treated as securities held by Taxpayer for purposes of determining the percentage of total voting power or value held by Taxpayer under the asset test of § 856(c)(4) of the Internal Revenue Code (the "Code") or under the gross income test of § 856(d)(2).

### FACTS

Taxpayer elected status as a real estate investment trust (REIT) under §§ 856 through 859 of the Code on its federal income tax return for its taxable year beginning on Date 1. Taxpayer is in the business of owning or leasing the Properties, which are

primarily leased to and operated by Lessee or its subsidiaries. Taxpayer conducts all of its business through a wholly owned operating partnership.

On Date 2, Lessee filed a petition for protection under Chapter 11 of the Federal Bankruptcy Code. Taxpayer filed a proof of claim on Date 3 listing numerous claims against Lessee, including a claim for unpaid rent. At or about the time Lessee filed its petition in bankruptcy, Taxpayer leased substantially all the Properties to Lessee under four master lease agreements and a single facility lease (collectively, the "Leases") and derived approximately Z percent of its income from Lessee.

On Date 4, Lessee and its creditors, including Taxpayer, submitted an amended plan of reorganization (the "Plan"). The Bankruptcy Court confirmed the Plan on Date 5. In accordance with the Plan, Taxpayer and Lessee have restructured the existing Leases to grant the newly reorganized Lessee substantial rent concessions, effective retroactively to Date 3. In exchange for these concessions, Taxpayer will receive equity interests in the newly reorganized Lessee.

Under the Plan, Taxpayer will receive a distribution of Lessee's common stock. Taxpayer anticipates that the distribution of common stock will be less than 10 percent by vote or value of Lessee's total common stock outstanding immediately upon Lessee's emergence from bankruptcy. If, however, the distribution represents 10 percent or more by vote or value of Lessee's total common stock outstanding, Taxpayer will assign, immediately prior to the effective date of the Plan, its rights to receive that number of Lessee shares that exceed 9.99 percent by vote or value to certain trusts established for the benefit of Taxpayer's shareholders (the "Trusts"). Taxpayer will declare a dividend to each of its shareholders of record that will irrevocably assign a pro-rata interest in Taxpayer's right to receive that number of Lessee shares that exceed 9.99 percent (the "Excess Shares"). In addition to the right to receive the Excess Shares, the assets of the Trusts will include any actual Excess Shares received, registration rights, other property and securities issued in exchange for the same, and any income or distributions earned on the assets (collectively, the "Trust Assets"). The date on which Taxpayer declares the dividend and assigns its rights to receive the Excess Shares is known as the "Dividend Record Date."

Taxpayer will establish a separate Trust for the benefit of each shareholder of record on the Dividend Record Date (the "Beneficiaries"). Taxpayer represents that the Trusts will be treated, for federal income tax purposes, as liquidating trusts under § 301.7701-4(d) of the Procedure and Administration Regulations for the purpose of holding the Excess Shares until the shares may be distributed to the Beneficiaries of all the Trusts and that, as a result of the distribution, the shares are freely tradeable in the hands of the Beneficiaries. Taxpayer will treat the Trusts as grantor trusts for federal income tax purposes under § 671, *et. seq.*

Interests in the Trusts are separate from interests in Taxpayer's stock, and no person acquiring Taxpayer's stock after the Dividend Record Date may acquire an interest in any of the Trusts. Subsequent issues of common stock in Taxpayer will not dilute the rights of holders in the Trusts, and, subject to limited transferability rights, the Trusts will be owned only by those Beneficiaries identified on the Dividend Record Date. In addition, Taxpayer represents that no Beneficiary will own 1 percent or more of Lessee's shares issued on the effective date of the Plan.

## LAW AND ANALYSIS

Section 856(c)(4)(B) provides that a corporation, trust, or association ("trust") shall not be considered a REIT for any taxable year unless, at the close of each quarter of the taxable year: (1) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under section 856(c)(4)(A)), (2) not more than 20 percent of the value of its total assets is represented by securities of one or more taxable REIT subsidiaries, and (3) except with respect to a taxable REIT subsidiary and securities includible under section 856(c)(4)(A), (a) not more than 5 percent of the value of its total assets is represented by securities of any one issuer, (b) the trust does not hold securities possessing more than 10 percent of the total voting power of the outstanding voting securities of any one issuer, and (c) the trust does not hold securities having a value of more than 10 percent of the total value of the outstanding securities of any one issuer.

Section 856(c)(2) requires at least 95 percent of a REIT's gross income to be derived from passive sources, including rents from real property.

Section 856(c)(3) requires at least 75 percent of a REIT's gross income to be derived from real property interests, including rents from real property.

Section 856(d)(2)(B) generally excludes from the term "rents from real property" any amount received or accrued directly or indirectly from any person if the REIT owns, directly or indirectly (i) in the case of any person which is a corporation, stock of such person 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 such person; or (ii) in the case of a person which is not a corporation, an interest of 10 percent or more in the assets or net profits of such person.

Section 856(d)(5)(A) provides that for purposes of § 856(d), the rules prescribed by § 318(a) for determining the ownership of stock shall apply in determining the ownership of stock, assets, or net profits of any person; except that "10 percent" shall be substituted for "50 percent" in subparagraph (C) of §§ 318(a)(2) and 318(a)(3).

Section 318(a)(2)(B)(ii) provides that stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E or part

I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

The legislative history to the rent exclusionary provision described above is found in H.R.Rep. No. 2020, 86<sup>th</sup> Cong., 2<sup>nd</sup> Sess. 6 (1960). The legislative history provides that the reason for the limitations found in § 856(d)(2) is to prevent the avoidance of the gross income requirements under § 856(d)(1) through the device of related organizations and to foreclose the opportunity of any substantial relationship between the trust and the business of any tenant.

The Service has considered the treatment of the momentary ownership of stock for purposes of facilitating a divisive reorganization in the context of a small business corporation. In Rev. Rul. 72-320, 1972-1 C.B. 270, a small business corporation created another corporation and transferred assets in connection with a reorganization under § 368(a)(1)(D) in exchange for stock in the new corporation. Immediately thereafter, stockholders of the original corporation exchanged their stock for the stock of the new corporation in a transaction that qualified under § 355. The ruling holds that the momentary ownership of stock in the new corporation did not terminate the original corporation's election as a small business corporation because more than momentary control of the new corporation was never contemplated.

Based solely upon the facts presented and the representations made, we conclude that Lessee's common stock that is irrevocably assigned to the Trusts under the proposed Trust Agreement presented by Taxpayer will not be treated as securities held by Taxpayer for purposes of determining the percentage of total voting power or value held by Taxpayer under the asset test of § 856(c)(4) or under the gross income test of § 856(d)(2).

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 concerning whether Taxpayer qualifies as a REIT under § 856 of the Code prior to or following the proposed transaction described above. Further, no opinion is expressed whether the Trusts qualify as liquidating trusts under § 301.7701-4(d) for federal income tax purposes. Taxpayer has represented that it intends to treat the Excess Shares as additional rental income, so that Taxpayer will be deemed to have received such excess shares for federal tax purposes and that Taxpayer will recognize gross income equal to their fair market value. No opinion is expressed as to whether any of the shares received by Taxpayer in accordance with the Plan, including the Excess Shares, qualify as "rents from real property" under § 856(d).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely yours,  
Acting Associate Chief Counsel  
(Financial Institutions & Products)  
By: Alice M. Bennett  
Chief, Branch 3

Enclosure: 6110 copy