

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

April 16, 1999

Legend

Company	=
Operating Partnership	=
Date	=
State A	=
<u>w</u>	=
<u>x</u>	=
<u>y</u>	=
<u>z</u>	=

This letter responds to your request dated December 9, 1998 and subsequent correspondence, submitted by your authorized representative requesting a ruling that certain rental payments will not be excluded as “rents from real property” under section 856(d)(1) because of the proposed transaction described below.

Company is a publicly-traded State A corporation that elected to qualify as a real estate investment trust (“REIT”) within the meaning of section 856 of the Code, beginning with its taxable year ended Date 1. No shareholder of Company owns 10% or more of the Company’s stock taking into account the constructive stock ownership rules of section 856(d)(5) of the Code.

Company is the sole general partner of, and currently owns a partnership interest of w% in Operating Partnership, a State A limited partnership. The remaining x% of the partnership interests in Operating Partnership are owned by y limited partners.

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Company, through Operating Partnership and its subsidiary partnerships, owns z hotels. Operating Partnership currently leases the majority of its hotels, although a limited number are operated by independent third party managers.

For valid business reasons, Operating Partnership plans to form a new corporation ("Newco") that will be taxable as a C corporation for federal tax purposes. Operating Partnership will contribute cash or other liquid assets to Newco, and distribute all of Newco's common stock proportionately to its partners, including Company. Company will immediately distribute the Newco stock it receives from the Operating Partnership to its shareholders (the "Distribution"). The temporary ownership of Newco stock by both Operating Partnership and Company will be solely for the purpose of facilitating the Distribution. Company does not intend to treat the Distribution as a tax free spin-off under section 355 of the Code.

In connection with the Distribution, Newco's stock will be registered with the Securities and Exchange Commission so that it will be freely tradeable by the shareholders following the Distribution. There will be no requirement that Company and Newco stock be traded on a paired or stapled basis. Because the common stock of Company and Newco are traded independently, it is expected that the ownership of the two companies will diverge significantly over time. After the Distribution neither the Company, nor any of the Company's corporate, partnership or trust subsidiaries will own any equity interest in Newco.

After the Distribution, it is expected that Newco will form wholly owned corporate subsidiaries ("Subsidiaries"). Both Newco and its Subsidiaries will be fully subject to corporate income tax with respect to taxable income from their activities. It is anticipated that Newco will engage in activities including the leasing and operating of hotels owned by Operating Partnership. However, Newco will not have entered into, or reached a binding agreement to enter into, any leases with the Company or the Operating Partnership prior to the Distribution. Newco or a Subsidiary may enter into leases with Company or Operating Partnership after the Distribution ("Leases") and Company has represented that the terms of any Leases will be negotiated at arm's length.

Company has represented that at no time after the Distribution will Company or Operating Partnership own directly, indirectly, or pursuant to the constructive ownership rules of section 318(a) of the Code, as modified by section 856(d)(5) of the Code, stock of Newco possessing 10% or more of Newco's total combined voting power or representing 10% or more of the total number of shares of all classes of Newco stock. In addition, no shareholder of either Company or Newco will own 10% or more of the shares of stock of the other, taking into account the same constructive stock ownership rules of the Code.

Based on the information submitted, a ruling is requested that rents received by

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Operating Partnership from a Subsidiary with respect to Leases entered into after the Distribution but before the end of the taxable year in which the Distribution occurs will not be excluded as "rents from real property" within the meaning of section 856(d)(1) solely because the Company will own stock of Newco immediately before the Distribution.

Section 856(c)(2) of the Code provides that a corporation, trust, or association shall not be considered a REIT for any taxable year unless at least 95 percent of its gross income (excluding gross income from prohibited transactions) is derived from certain sources among which is rents from real property.

Section 856(c)(3) of the Code provides that at least 75 percent of the gross income of a REIT must come from particular sources among which is rents from real property.

Section 856(c)(4)(B) of the Code provides that not more than 25 percent of the value of a REIT's total assets may be represented by securities (other than those includible under subparagraph A), not greater than 5 percent of the value of the total assets of the REIT may be invested in one issuer, and the securities may not represent more than 10 percent of the outstanding voting securities of the issuer.

Section 856(d)(1) of the Code defines for purposes of sections 856(c)(2) and (3) the term "rents from real property" to include: rents from interests in real property, charges for services customarily furnished or rendered in connection with the rental of real property, and rent attributable to personal property which is leased under or in connection with a lease of real property if such personal property does not exceed 15 percent of the total rental for the taxable year attributable to both the real and personal property so leased.

Section 856(d)(2) of the Code provides, in part, that for purposes section 856(c)(2) and (3) the term "rents from real property" excludes any amount received or accrued directly or indirectly from any person if the REIT owns directly or indirectly in the case of a corporation, stock of the corporation 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 number of shares of all classes of stock of such corporation or in the case of any person which is not a corporation, an interest of 10 percent or more in the assets or net profits of such person. Section 1.856-4(b)(4) of the Income Tax Regulations interprets section 856(d)(2)(B) to disqualify amounts received by persons owned in whole or part by a REIT at any time during the taxable year. The regulation requires, in relevant part, that where a REIT receives, directly or indirectly, any amount of rent from any corporation in which it owns any proprietary interest, the REIT shall submit, at the time it files its return for the taxable year a schedule setting forth the name and address of the corporation, the amount received as rent from the corporation, and the highest percentage of the total combined voting power of all

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classes of its stock entitled to vote, and the highest percentage of the total number of shares of all classes of its outstanding stock owned by the REIT at any time during the REIT's taxable year.

Section 856(d)(5) of the Code provides that for purposes of section 856(d), the rules prescribed by section 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 section 318(a)(2) and 318(a)(3).

Under section 1.856-3(g), 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 section 856, the interest of a partner in the partnership's assets shall be 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 shall retain the same character in the hands of the partners for all purposes of section 856.

Rev. Rul. 72-320, 1972-1 C.B. 270, holds that an S corporation's momentary ownership of a newly formed corporation does not terminate the corporation's S election because the S corporation never contemplated more than momentary control of the newly formed entity. In the present case, Company does not contemplate more than momentary control of Newco, and Company's momentary ownership of Newco is an intermediate step in the overall transaction. As such, rental payments from the Leases will not be excluded as "rents from real property" within the meaning of section 856(d)(1) solely because the Company will own stock of Newco immediately before the Distribution.

Based on the facts as represented, we conclude that the momentary ownership of Newco by Company in the proposed transaction will not result in the disqualification of rental payments from the Leases as "rents from real property" within the meaning of sections 856(d) of the Code.

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. No opinion is expressed concerning whether Company qualifies as a REIT under section 856 of the Code prior to or following the proposed transaction described above. In particular, except as ruled above, no opinion is expressed as to whether the income from the Leases otherwise qualifies as "rents from real property" under section 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.

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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,

Assistant Chief Counsel
(Financial Institutions and Products)

By: _____
William Coppersmith
Chief, Branch 2