

## Internal Revenue Service

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## Department of the Treasury

Washington, D.C. 20224

**Person to Contact:**

**Telephone Number:**

**Refer Reply to:**

CC:FIP:3/PLR-119008-00

**Date:**

February 9, 2001

### LEGEND:

Trust	=
Operating Partnership	=
Subsidiary A	=
Subsidiary B	=
Subsidiary C	=
Subsidiary D	=
Date 1	=
State X	=
<u>a</u>	=

Dear

This ruling responds to a letter dated September 29, 2000, as well as subsequent correspondence, submitted on behalf of Trust, requesting a ruling concerning the treatment of certain reimbursement payments under § 856 of the Internal Revenue Code.

### FACTS

Trust, a State X corporation, elected to be treated as a real estate investment trust (REIT) effective for its tax year ended Date 1. Trust's multi-family properties, property interests, and business assets are owned by and its operations are conducted through Operating Partnership. Trust currently is the sole general partner of, and an owner of a partnership interest of, approximately a percent in Operating Partnership.

Operating Partnership owns and operates, directly and through partnerships and limited liability companies in which it owns substantially all of the economic interests, multifamily apartment communities. Trust, through Operating Partnership, owns interests in Subsidiary A, Subsidiary B, Subsidiary C, and Subsidiary D (the "Subsidiaries"). Trust, through Operating Partnership, does not own 10 percent or more of the voting stock of any of the Subsidiaries, but owns at least 95 percent of the nonvoting stock of each of the Subsidiaries. Each of the Subsidiaries will join with Trust to make an election under section 856 of the Code to have each of the Subsidiaries be treated as a taxable REIT subsidiary effective January 1, 2001.

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The sole purpose of Trust is to serve as the general partner of, and to own units of, Operating Partnership. Operating Partnership owns an economic interest of 90 percent or more in each of the Subsidiaries. As part of a restructuring of its employment arrangements, certain executive officers of Trust who have been employed by Operating Partnership will now be employed by Trust. Moreover, certain executive officers who have been employed by the Subsidiaries will now be employed by Trust. Trust will enter into one or more sharing agreements with Operating Partnership and the Subsidiaries pursuant to which Trust will agree to share the executives with Operating Partnership and the Subsidiaries.

With respect to Operating Partnership, Trust will pay the expenses associated with the executives that are attributable to time spent by the executives working on behalf of Operating Partnership, including salaries, benefit plans, and fringe benefits. In this regard, Trust intends to adopt a stock option plan for these executives. Pursuant to Operating Partnership's Partnership Agreement, the salaries and other costs related to the executives that are attributable to time spent by those executives in connection with the operation of Operating Partnership will be reimbursed by Operating Partnership. The Partnership Agreement provides that all such reimbursements are treated for federal income tax purposes as expenses of Operating Partnership incurred on its behalf and not as expenses of the general partner.

Moreover, Trust will also pay the expenses associated with the executives' time spent working on behalf of the Subsidiaries, including salaries, benefit plans, and fringe benefits. Each of the Subsidiaries will agree to reimburse Trust for its proportionate share of the expenses associated with the executives. Each of the Subsidiaries will deduct as expenses its proportionate share of the expenses associated with the executives' time spent working on behalf of the Subsidiary.

Pursuant to the reimbursement arrangements, the amount of costs to be reimbursed will be determined on an arm's length basis and will include a proportionate share of the costs reasonably related to the performance of services by the executives, including a proportionate share of the executives' salaries and benefit plans, which includes the "spread" on any stock options issued. The proportionate share of costs will be determined on the basis of the relative amount of time such executives spend performing services for Operating Partnership or the respective Subsidiaries, as applicable.

Trust represents that neither Trust, Operating Partnership, nor the Subsidiaries (i) is in the business of providing services of the type that will be covered by these reimbursement arrangements or (ii) will derive any profit from this reimbursement arrangement. Trust will not deduct any of the Subsidiaries' or Operating Partnership's share of the reimbursed

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costs as expenses. Trust will treat the reimbursements as a repayment of a non-interest bearing advance.

To the extent that section 7872 of the Code applies to either the advances made by Trust on behalf of Operating Partnership or to the advances made by Trust on behalf of the Subsidiaries, Trust will account for any amounts imputed on such advances in a manner that is consistent with the requirements of section 7872 of the Code in computing its real estate investment trust taxable income.

#### LAW AND ANALYSIS

Section 856(c)(2) of the Code provides that at least 95 percent of a REIT's gross income must be derived from the categories of income listed in §§ 856(c)(2)(A) through (H).

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from the categories of income listed in §§ 856(c)(3)(A) through (I).

Section 1.856-3(g) of the Income Tax Regulations provides that a REIT that is a partner in a partnership will be deemed to own its proportionate share of each of the assets of the partnership and will be deemed to be entitled to the income of the partnership attributable to such share. Section 1.856-2(c)(1) provides that the term gross income has the same meaning as that term has under Section 61 of the Code and the regulations thereunder. Section 61(a) of the Code defines gross income as all income from whatever source derived.

In Rev. Rul. 84-138, 1984-2 C.B. 123, a regulated investment company ("RIC") owned all of the stock of a subsidiary corporation that was also a RIC. The parent and the subsidiary shared the same facilities and some of the same personnel. Pursuant to an agreement, the parent RIC paid all of the overhead expenses, including personnel costs. The subsidiary then would reimburse the parent for its pro rata share of the expenses determined on an arms' length basis. Neither the parent nor the subsidiary RIC was in the business of providing services of the type that were reimbursed. The issue considered in the revenue ruling was whether reimbursements received by the parent were gross income for purposes of the gross income test of § 851(b)(2) of the Code. If the reimbursements were considered gross income to the parent, the parent would not have satisfied the § 851(b)(2) gross income test. The Service held that the reimbursement payments paid by the subsidiary to the parent represented funds advanced by the parent RIC on behalf of the subsidiary. Accordingly, the advanced funds were not includible in the parent RIC's gross income and were therefore excluded from the application of § 851(b)(2).

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In a situation similar to that described in Rev. Rul. 84-138, Trust will incur overhead and personnel costs on behalf of Operating Partnership and the Subsidiaries, and Operating Partnership and the Subsidiaries will reimburse Trust for their pro rata share of these expenses determined on an arm's length basis. Furthermore, neither Trust, Operating Partnership, nor the Subsidiaries is in the business of providing services of the type that will be covered by these reimbursement arrangements. Trust has represented that neither Trust, Operating Partnership, nor the Subsidiaries will profit from the reimbursement arrangement. Based on the holding in Rev. Rul. 84-138, the reimbursement of expenses is a repayment of amounts advanced by Trust and is not includible in gross income. Accordingly, we conclude that the proposed reimbursement payments to be made by Operating Partnership and the Subsidiaries to Trust will not constitute gross income to Trust for purposes of § 856(c) of the Code.

HOLDING

Based upon the information submitted and representations made in the ruling request, we hold that amounts paid by Operating Partnership and the Subsidiaries to Trust under the cost reimbursement arrangement described above will not constitute gross income to Trust for purposes of § 856(c).

Except as specifically ruled upon above, no opinion is expressed or implied regarding the consequences of this transaction under any other provision of the Code. In particular, no opinion is expressed whether Trust qualifies as a REIT under § 856 of the Code.

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

In accordance with the provisions of a Power of Attorney currently on file, we are sending a copy of this ruling letter to your authorized representative.

Sincerely yours,  
Acting Associate Chief Counsel  
(Financial Institutions and Products)

By: Alice M. Bennett  
Chief, Branch 3

Enclosures:

Copy of this letter  
Copy for section 6110 purposes