

## Internal Revenue Service

Department of the Treasury  
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Date:

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### Legend:

Taxpayer =

Year 1 =

Properties =

LP =

a =

b =

c =

d =

e =

f =

g =

h =

Month 1 =

i =

j =

k =

l =

m =

n =

Dear :

This is in reply to a letter dated March 11, 2009, and subsequent correspondence, requesting a ruling on behalf of Taxpayer. You have requested a ruling that certain sales of properties, as described below, will not be characterized as net income from prohibited transactions under section 857(b)(6) of the Internal Revenue Code. Additionally, you have requested a ruling that dividend distributions and security repurchases described herein will not be characterized as partial liquidations under sections 302(b)(4) and (e)(1).

**Facts:**

Taxpayer is a publicly traded domestic corporation that has been taxed as a real estate investment trust since Year 1. Taxpayer is engaged in the of Properties located throughout the United States.

Taxpayer conducts its business through LP, an operating partnership in which Taxpayer owns approximately a percent of the equity interests. Taxpayer is the sole managing partner of LP. LP directly owns approximately b percent of the Properties. The remaining Properties are held by lower tier partnerships and taxable REIT subsidiaries that are directly or indirectly wholly-owned by LP, as well as by partnerships with third-parties in which LP is generally the property manager and directly or indirectly the sole managing partner.

Taxpayer regularly reviews its portfolio to identify Properties that do not meet its long-term investment criteria. Taxpayer represents that it has historically sold properties to reposition its holdings and remained within the prohibited transactions safe harbor provided in section 857(b)(6)(C). For example, Taxpayer represents that as of January 1, 2008, its aggregate adjusted bases of its properties for purposes of computing earnings and profits was c dollars, which made its

10 percent safe harbor limitation d dollars for purposes of section 857(b)(6)(C). The properties sold in 2008 had aggregate bases of e dollars, thereby satisfying the bases limitation. Taxpayer also represents that it satisfied the other prohibited transactions safe harbor conditions.

Taxpayer represents that it presently has f dollars of debt that needs to be repaid and approximately g dollars of mortgage debt. Taxpayer's current h dollar working capital line of credit matures in Month 1. In addition, Taxpayer has Properties in certain major markets that are experiencing . These factors have made refinancing these liabilities difficult. Taxpayer has also experienced a precipitous drop in its common stock price over the past twelve months that makes it impractical and inefficient to use stock issuance as a capital raising strategy.

To generate cash to address , Taxpayer proposes to sell approximately i Properties (the Sale Properties) having an aggregate asset value of approximately j dollars out of Taxpayer's estimated total gross asset value of approximately k dollars. The Sale Properties are secured by mortgage debt, and have a net value of approximately l dollars. Taxpayer seeks to act quickly to capitalize on its current capacity to sell the Sale Properties at attractive prices so that it may move forward .

The Sale Properties are expected to generate additional proceeds of approximately l dollars to Taxpayer after satisfaction of associated property-level debt of approximately m dollars. Taxpayer intends to use the proceeds to repay debt, establish a cash reserve for other maturing mortgage debt, and increase its working capital position. Taxpayer may also use some of the proceeds to repurchase stock. There is no current plan or intention to acquire additional properties with the proceeds. Taxpayer represents that they have never been and have no intention of becoming a "dealer" as the term is used in reference to the prohibited transaction provision of section 857(b)(6).

The proposed sales will generate taxable income for Taxpayer. Taxpayer indicates that any dividend distributions resulting from the property sales will be in the form of a 10 percent cash / 90 percent stock distribution that will conform to the provisions of Rev. Proc. 2009-15, 2009-4 I.R.B. 356. Although Taxpayer expects the proposed property sales to result in a in revenue and employees, the net reduction in Taxpayer's net asset value is expected to be less than n percent of its pre-transaction net asset value. In addition, Taxpayer represents that the total amount of cash proceeds from the proposed sales (i) that may be distributed in the cash portion of the dividend distributions attributable to income from the proposed sales and (ii) that may be used for equity repurchases will not exceed n percent of Taxpayer's net asset value prior to the proposed sales. The majority of the proceeds from the proposed property sales are expected to be used for corporate purposes other than the payment of a dividend, such as repayment of debt, increasing working capital, and

repurchasing stock. Taxpayer further represents that in no event will the cash portion of the 10/90 stock election dividend, when combined with any equity repurchases, constitute 50 percent or more of Taxpayer's net transaction proceeds.

## **Law and Analysis:**

### Issue 1: Prohibited Transactions

Section 857(b)(6) of the Code imposes a tax for each taxable year of a REIT equal to 100 percent of the net income derived from prohibited transactions. Under § 857(b)(6)(B)(iii), the term "prohibited transaction" means a sale or other disposition of property described in § 1221(a)(1) that is not foreclosure property.

Section 857(b)(6)(C) excludes certain sales from the definition of a prohibited transaction. Under § 857(b)(6)(C), the term "prohibited transaction" does not include the sale of property which is a real estate asset (as defined in § 856(c)(5)(B) and which is described in section 1221(a)(1) if –

- (i) the REIT has held the property for not less than 2 years;
- (ii) the aggregate expenditures made by the REIT, or any partner of the REIT, during the 2-year period preceding the date of sale that are includible in the basis of the property do not exceed 30 percent of the net selling price of the property;
- (iii) (I) during the taxable year the REIT does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or (II) the aggregate bases (as determined for computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, or (III) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the fair market value of all the assets of the REIT as of the beginning of the taxable year;
- (iv) In the case of property, which consists of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the REIT has held the property for not less than 2 years for production of rental income; and
- (v) If the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the REIT itself does not derive or receive any income.

Property described in section 1221(a)(1) includes property held by a taxpayer “primarily for sale to customers in the ordinary course of its trade or business”. The legislative history underlying section 857(b)(6), which was added to the Code by the Tax Reform Act of 1976, indicates that the purpose of that section was to “prevent a REIT from retaining any profit from ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project.” S. Rep. No. 938, 84<sup>th</sup> Cong., 2d Sess. 470 (1976, 1976-3 (Vol. 4) C.B. 508.

To determine whether a taxpayer holds property “primarily for sale to customers in the ordinary course of its trade or business”, the Tax Court has held that several factors must be considered, none of which is dispositive. Among those factors are: (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer’s efforts to sell the property; (3) the number, extent, continuity, and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; and (5) the time and effort the taxpayer habitually devoted to the sales. Generally, it is the purpose for which property is held at the time of the sale that is determinative, although earlier events may be considered to decide the taxpayer’s purpose at the time of the sale. See Cottle v. Commissioner, 89 T.C. 467, 487 (1987).

Taxpayer has made the following representations that address its purposes with respect to the Sale Properties. It acquired and has held the Sale Properties for long-term investment and rental purposes, and its plan to sell the Sale Properties has arisen in response to extreme economic conditions. It has actively managed all of the Sale Properties as rental properties during its entire period of ownership, generating significant amounts of rental income and cash flow from the Sale Properties. Taxpayer will have held each of the Sale Properties for at least two years prior to its sale and has an average holding period in the Sale Properties of approximately nine years. Capital spending on the Sale Properties has been to maintain the Sale Properties or to offset depreciation. Substantially all marketing and development expenditures with respect to the Sale Properties are performed by independent third parties.

The facts and representations in this case amply demonstrate that Taxpayer’s need to sell the Sale Properties results from the extreme economic conditions. Taxpayer is not holding the Sale Properties for sale to customers in the ordinary course of its trade or business. Rather, Taxpayer is engaged in the business of acquiring, managing, and holding Properties for investment purposes. Accordingly, we conclude that the gain recognized from the proposed sale of the Sale Properties will not be characterized as net income from prohibited transactions under section 857(b)(6).

Issue 2: Partial Liquidation

Section 302(a) provides that a redemption of stock to which section 302(b)(4) applies shall be treated as a distribution in part or full payment in exchange for the redeemed stock.

Section 302(b)(4) provides that section 302(a) applies to a distribution if the distribution is in redemption of stock held by a shareholder who is not a corporation and the distribution is in partial liquidation of the distributing corporation.

Section 302(e)(1) provides that a distribution shall be treated as a partial liquidation of the corporation if the distribution is not essentially the equivalent of a dividend (determined at the corporate level rather than the shareholder level), and the distribution is pursuant to a plan and occurs within the taxable year in which the plan is adopted or within the succeeding taxable year.

Based upon the information received and the representations made by Taxpayer, we conclude that the dividend distributions and security repurchases described above will not be characterized as partial liquidations under sections 302(b)(4) and (e)(1).

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,

David B. Silber  
David B. Silber  
Chief, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions & Products)