

## Internal Revenue Service

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### Legend:

Taxpayer =

Year 1 =

Parent =

Properties =

a =

OP =

b =

LLC =

LP =

Country =

Year 2 =

Year 3 =

c =

d =

e =

f =

Year 4 =

Dear :

This is in reply to a letter dated January 20, 2010, requesting a ruling on behalf of Taxpayer. Specifically, Taxpayer requests a ruling that it can make a consent dividend under section 565 of the Internal Revenue Code in the year of its liquidation in an amount up to the excess of its taxable income for the year of liquidation, including the gain recognized under section 336, over the net fair market value of the assets distributed in liquidation.

**Facts:**

Taxpayer is a domestic corporation formed in Year 1 that has elected to be taxed as a real estate investment trust (REIT) for federal income tax purposes. Parent is a publicly traded REIT that indirectly owns and operates Properties. Parent conducts its business through its approximately a percent partnership interest in OP. OP owns b percent of the outstanding common stock of Taxpayer. All of the outstanding preferred stock of Taxpayer is owned by employees of LLC, an affiliate of Parent.

Taxpayer's sole asset is a limited partnership interest in LP, which owns a Property. Taxpayer was formed to enable an investor from Country to invest in the Property. Taxpayer was structured as a domestically controlled REIT to facilitate the investment. In Year 2 the investor sold its interest in Taxpayer to OP.

During Year 3, LP refinanced its mortgage and distributed cash to its partners. Taxpayer's share of the refinancing was approximately c dollars. Taxpayer's share of LP's liabilities under section 752 was then d dollars, which exceeded its basis in the partnership by approximately e dollars. The net fair market value of Taxpayer's interest is currently estimated to be f dollars. In Years 3 and 4, Taxpayer made cash distributions that exceeded its current and accumulated earnings and profits (E&P).

OP wants to simplify the ownership structure regarding its ownership interest in LP. Therefore, it proposes that Taxpayer will adopt a plan of complete liquidation under section 331. Pursuant to the plan of liquidation, Taxpayer will distribute cash to preferred shareholders in redemption of their stock and will distribute all remaining assets, including its interest in LP, to OP in complete liquidation of its stock. Taxpayer will timely file a consent dividend election under section 565 with its final tax return. The

consent dividend will equal the amount by which Taxpayer's taxable income for the year of liquidation, including gain recognized under section 336, exceeds the net value of the assets distributed in liquidation. OP will include the consent dividend in income as if there had been an actual distribution in liquidation.

### **Law and Analysis:**

Section 857(a)(1) provides, in relevant part, that a REIT's dividends paid deduction (as defined in section 561, but without regard to capital gains dividends) must equal or exceed 90 percent of its REIT taxable income.

Section 561(a) provides, in relevant part, that the deduction for dividends paid shall be the sum of the dividends paid for the tax year and the consent dividends for the tax year, as determined under section 565.

Under section 562(c), a distribution shall not be considered a dividend for purposes of computing the dividends paid deduction unless the distribution is pro rata, with no preference to any share of stock as compared to any other shares of the same class, and with no preference to one class of stock as compared to any other class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference. Section 1.562-2 provides that the limitation imposed by section 562(c) is unqualified. The existence of a preference is sufficient to prohibit the dividends paid deduction regardless of the fact that the preference is authorized by all the shareholders of the corporation or that the part of the distribution received by the shareholder benefited by the preference is taxable to the shareholder as a dividend. The disallowance resulting from the preferential distribution extends to the entire amount of the distribution and not merely to the portion of the distribution that is preferential.

Section 565(a) provides that if a person owns consent stock in a corporation on the last day of the taxable year of the corporation, and that person agrees in a consent filed with the corporation's federal income tax return to treat the amount specified in the consent as a dividend, the amount shall be treated as a consent dividend for purposes of section 561.

Section 565(b)(1) provides that a consent dividend shall not include an amount specified in a consent which, if distributed in money, would constitute, or be part of, a distribution that would be disqualified for purposes of the dividends paid deduction under section 562(c).

Section 565(f)(1) provides that "consent stock" means the class or classes of stock entitled, after the payment of preferred dividends, to a share in the distribution (other than in complete or partial liquidation) within the taxable year of all the remaining

earnings and profits, which share constitutes the same proportion of such distribution regardless of the amount of such distribution.

The legislative history underlying section 565 provides insight into the meaning of section 565(f)(1). The predecessor of current section 565 was enacted as section 28 of the Revenue Act of 1938. Under that section, the consent dividends credit was intended to provide a method for corporations, with the cooperation of their shareholders, to obtain the tax benefits incident to the actual distribution of earnings and to avoid imposition of the undistributed profits tax without depriving the Government of revenues that would flow from the receipt of dividends by shareholders. See H.R. Rep. No. 1860, 75<sup>th</sup> Cong., 3d Sess., 1939-1 (Part 2) C.B. 728, 745-748. Section 28(a) defined consent stock in a manner that is identical to the current section 565, which includes the parenthetical phrase “other than in complete or partial liquidation”. Section 28(b) provided that the consent dividends credit under section 28 was not available to a corporation for any taxable year if, at any time during the year, the corporation had taken any steps in pursuance of a plan of complete or partial liquidation of all or part of the consent stock.

When current section 565 was enacted as part of the Internal Revenue Code of 1954, the language of section 28(a) of the consent dividends credit was retained. However, the limitation provided in section 28(b) of the former statute was not made part of section 565. Therefore, we believe a proper interpretation of section 565(f)(1) is that the section is intended to limit the availability of consent dividends to those classes of stock that would be entitled to nonliquidating dividend distributions, as opposed to stock having preferences pursuant to a plan of liquidation. Accordingly, we conclude that Taxpayer is not precluded from making a liquidating consent dividend as described above.

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. Furthermore, no opinion is expressed concerning the tax consequences of the liquidation under sections 331 or 336.

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,

Thomas M. Preston

Thomas M. Preston

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Office of Associate Chief Counsel  
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