

Internal Revenue Service

Department of the Treasury

Index Number: 856.00.00

Washington, DC 20224

Number: **199926024**
Release Date: 7/2/1999

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:FI&P:2-PLR-122325-98

Date:

March 31, 1999

Legend:

Company	=
Subsidiary	=
Operating Partnership	=
Newco	=
Trust	=
State A	=
B	=
C	=
D	=

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This letter responds to your request dated December 11, 1998, as supplemented by your correspondence dated February 12, 1999, on behalf of the Company for a ruling under §856 of the Internal Revenue Code.

FACTS

The Company, a State A corporation, owns hotels that third parties operate pursuant to management agreements. It intends to elect Real Estate Investment Trust (REIT) status for Federal income tax purposes for its year ending in B.

Subsidiary, a wholly owned subsidiary of the Company, and D, an officer of the Company, currently own the Operating Partnership, a limited partnership organized under the laws of State A. After the restructuring, The Company will own a C general partnership interest in the Operating Partnership, and outside parties will acquire the balance of the interests in the Operating Partnership.

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The Trust is a statutory business trust organized under the laws of State A. The purpose of the Trust is acquire, own, hold, manage, invest, and reinvest certain assets.

The Operating Partnership and the Trust formed Newco, a corporation organized under the laws of State A. The Operating Partnership owns 100% of the nonvoting common stock, and the Trust owns 100% of the voting common stock. Newco has been organized to hold (i) partnership and other interests in hotels; (ii) furniture, fixtures, and equipment; and (iii) minority interests in certain public partnerships.

The Operating Partnership anticipates sharing with Newco some of the same office personnel, facilities, and administrative office overhead, and the costs of certain insurance policies. The shared office personnel will participate in the provision of treasury, accounting, tax, legal, and real estate advisory services. The shared facilities will include office space, record retention, and photocopy facilities, facsimile, and telephone equipment. The administrative office overhead will include the cost-of-benefit plans, personnel costs, office supplies, and computer services. The Operating Partnership and Newco also intend to procure jointly owned insurance policies for property, general liability, and directors' and officers' liability.

The Operating Partnership anticipates entering into a reimbursement arrangement with Newco whereby the Operating Partnership will pay all of the expenses for the shared facilities, the general and administrative overhead, and the premiums on the jointly procured insurance. Newco will reimburse the Operating Partnership quarterly for its pro-rata share of the above expenses. Newco's pro-rata share will be based the product of such expenses times a ratio of Newco's gross revenue to the gross revenue of both entities. Neither the Company nor the Operating Partnership (i) is in the business of providing services of the type described above; (ii) will derive any profit from the above reimbursement arrangement; or (iii) will deduct any of Newco's share of the expenses.

REQUESTED RULING

The Company requests the following ruling: Amounts paid by Newco to the Operating Partnership under the above reimbursement arrangement will not constitute gross income to the Operating Partnership or the Company for purposes of §856.

LAW AND ANALYSIS

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 and interest on obligations secured by mortgages on real property or on interests in real property.

Section 1.856-2(c)(1) of the Income Tax Regulations 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 of the Code and the related regulations generally provide that gross income means all income from whatever source derived.

Section 1.856-3(g) of the Income Tax Regulations provides that if a REIT is a partner in a partnership, the REIT will be deemed to be entitled to the income of the partnership attributable to such share.

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 and all personnel costs. The subsidiary would then reimburse the parent for expenses incurred on behalf of the subsidiary. The question presented was whether reimbursements received by the parent were gross income for purposes of the gross income test of section 851(b)(2) of the Code. If the reimbursements were considered gross income to the parent, the parent would not have satisfied the section 851(b)(2) test. The Service held that the reimbursements paid by the subsidiary to the parent were not gross income to the parent because a reimbursement is tantamount to the repayment of a loan. Incurring an expense on behalf of another is in effect the extension of credit to the person for whom the expense is incurred. Thus, reimbursement of the expense is simply a repayment of amounts advanced and is not includible in gross income.

The situation in the instant case is analogous to that described in Rev. Rul. 84-138. The Operating Partnership will incur costs on behalf of Newco, and Newco will reimburse Operating Partnership for its pro-rata share of those costs. Based on the above, the reimbursement of expenses is a repayment of amounts advanced and is not includible in gross income. The Company represents that neither the Operating Partnership nor the Company will profit from the reimbursement arrangement. Accordingly, we conclude that the proposed reimbursement payments to be made by Newco to the Operating Partnership will not constitute gross income to the Operating Partnership or the Company for purposes of the section 856(c) of the Code.

Except as specifically ruled upon above, no opinion is expressed or implied regarding: (1) whether the Company otherwise qualifies as a REIT under §856; (2) the

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consequences of this transaction under any other provision of the Code; or (3) whether the Company meets the 10 percent voting securities requirement of §856(c)(4)(B) through its interest in the non-REIT subsidiary.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this ruling should be attached to the Federal income tax return of the Company for the taxable year in which the transactions covered by this ruling are consummated.

Sincerely,

Assistant Chief Counsel
(Financial Institutions & Products)

By: William Coppersmith
William E. Coppersmith
Chief, Branch 2

Enclosures:

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