Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Refer Reply To:
CC:FIP:B01 – PLR-112366-03
Date:

In Re:

Legend

Taxpayer =
Trust =
Subsidiary =
State A =
State B =
Date 1 =
Date 2 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
a =
b =
x =
y =

Dear :

This is in reply to a letter dated February 19, 2003, requesting a ruling on behalf of Taxpayer. You requested a ruling permitting Taxpayer to offset its surplus in accumulated earnings and profits (E&P) by its real estate investment trust (REIT) predecessor's cumulative deficit in E&P for purposes of satisfying the requirement in § 857(a)(2)(B) of the Internal Revenue Code.

FACTS

Taxpayer is a domestic subchapter C corporation (C corporation). Taxpayer uses an overall accrual method of accounting and the calendar year as its taxable year. Taxpayer is a real estate finance company that invests in high-yield lending and investment opportunities in commercial real estate and related assets. Taxpayer also conducts an investment management business through Subsidiary. Subsidiary is a wholly owned subsidiary of Taxpayer and intends to be treated as a taxable REIT subsidiary of Taxpayer.

Taxpayer represents that it is a successor to Trust, a State A business trust, following a § 368(a)(1)(F) reorganization ("F" reorganization) on Date 1. Taxpayer represents that the "F" reorganization was perfected as follows. Trust organized a State B corporation as a wholly owned subsidiary (NewCo). Trust also organized a State B limited partnership (LP) which was owned a% by Trust and b% by NewCo. Trust merged with and into LP with LP as the surviving entity. LP then merged into NewCo with NewCo (Taxpayer) as the surviving entity. Taxpayer represents that both mergers were simultaneous under State B law and treated as an "F" reorganization for federal income tax purposes.

Trust was taxed as a REIT from Year 1 through Year 2 and had a cumulative deficit in E&P of approximately $x during that period. Trust was taxed as a C corporation from Year 3 through Date 1. Taxpayer was taxed as a C corporation from Date 1 through Year 6. Taxpayer has a surplus in E&P of approximately $y that accumulated during the period Year 3 through Year 5. Taxpayer represents that significant losses in Year 6 will offset some or all of its estimated $y in E&P accumulated from Year 3 through Year 5.

Taxpayer intends to elect to be taxed as a REIT under chapter 1, part II of subchapter M of the Code (REIT provisions) for the taxable year ending Date 2.

LAW AND ANALYSIS

Section 857(a)(2)(B) provides that the REIT provisions (other than § 857(d) and § 856(g)) shall not apply to a REIT for a taxable year unless as of the close of the taxable year, the REIT has no E&P accumulated in any non-REIT year. Section 857(a)(2) further provides that the term "non-REIT year" means any taxable year to which the REIT provisions did not apply with respect to the entity.

Section 857(d)(3)(A) provides that any distribution which is made in order to comply with the requirements of § 857(a)(2)(B) shall be treated as made from E&P which, but for the distribution, would result in a failure to meet such requirements.

Section 1.856-1(e) of the Income Tax Regulations provides that to the extent that other provisions of chapter 1 are not inconsistent with the REIT provisions and the regulations thereunder, such other provisions will apply to REITs in the same manner that they would apply to any other domestic corporation. For example, § 1.856-1(e)(6) provides that except as provided in § 857(d), earnings and profits of a REIT are computed in the same manner as in the case of a domestic corporation; and § 1.856-1(e)(7) provides that § 316, relating to the definition of a dividend, applies to distributions by a REIT.

The REIT provisions do not address whether an E&P deficit incurred during the years in which a corporation was taxed as a REIT, can be carried forward to offset an E&P surplus earned during the years in which the corporation was taxed as a C corporation for purposes of satisfying the requirement in § 857(a)(2)(B).

Generally, corporations determine their accumulated E&P on an aggregate basis, in effect, offsetting surpluses from one year with deficits from another. Accordingly, for purposes of Taxpayer satisfying the requirement in § 857(a)(2)(B), the E&P deficit incurred during Year 1 through Year 2 when Trust was taxed as a REIT, is carried forward to offset the E&P surplus earned during Year 3 through the short year ending in Year 4 when Trust was taxed as a C corporation.

With respect to the purported “F” reorganization, § 381 of the corporate provisions provides that when a corporation acquires the assets of a target corporation and the acquisition qualifies as a § 332 liquidation or a reorganization under § 368(a)(1)(A), (C), (D), (F), or (G), the acquiring corporation succeeds to the items listed in § 381(c) of the target corporation. E&P is listed in § 381(c). Section 1.381(b)-1(a)(2) provides, in part, that in the case of an “F” reorganization, that is*,* a mere change in the identity, form, or place of organization of one corporation, however effected, the acquiring corporation shall be treated (for purposes of § 381) just as the transferor corporation would have been treated if there had been no reorganization. In effect, § 1.381(b)-1(a)(2) allows surpluses and deficits to be offset as they normally are in determining accumulated E&P. Therefore, Trust’s cumulative deficit in E&P is taken into account by Taxpayer as if there had been no reorganization on Date 1.

Accordingly, based upon the information submitted and the representations made by Taxpayer, we conclude that Taxpayer can offset its surplus in accumulated E&P by Trust’s cumulative deficit in E&P for purposes of satisfying the requirement in § 857(a)(2)(B).

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. Specifically, no ruling was requested and no opinion is

expressed as to whether the purported "F" reorganization qualifies for tax-free treatment under § 368(a)(1)(F).

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

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Taxpayer and Taxpayer's second representative.

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by a Penalties of Perjury Statement executed by Taxpayer. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

_____
Elizabeth A. Handler
Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions and Products)

Enclosure:
Section 6110 copy of this letter

cc: