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**LEGEND:**

Trust =

Operating Partnership =

Entity A =

State X =

City Y =

Country Z =

Historical Complex =

Date 1 =

Date 2 =

Date 3 =

a =

b =

c =

d =

e =

f =

g =

h =

Dear

This responds to a letter dated June 2, 2005, submitted on behalf of Trust, requesting rulings under § 856 of the Internal Revenue Code.

### FACTS

Trust, a publicly traded State X corporation, elected to be taxed as a real estate investment trust (REIT) beginning with its tax year that ended Date 1. Trust is a fully integrated, self-managed real estate operation that owns all of its assets and conducts all of its activities through Operating Partnership and its various subsidiaries. Trust is the managing general partner of Operating Partnership and owns, directly and indirectly, approximately a percent of the outstanding partnership interests of Operating Partnership.

Pursuant to an international tender procedure, City Y in Country Z granted a bidding group led by Operating Partnership the preliminary award of the right to enter into a "Concession Arrangement" to redevelop, construct, finance, operate, and maintain commercial real property (the Project) located in the Historical Complex, a historical site in City Y. The bidding group was comprised of Operating Partnership in conjunction with h other companies. The proposed development will feature approximately b square feet of retail, dining, entertainment, and office space. Operating Partnership's bidding group (Concession Holder) intends to enter into "subconcessions" and subleases of the premises with unrelated third parties, which are expected to be mainly retailers and commercial center operators, who will actually occupy and operate the shops and other facilities contemplated for the Project.

Concession Holder will hold the Concession rights, the assets to operate the Concession, the financing, and any other assets, liabilities, and contracts related to the Concession through Entity A, a Country Z special purpose business entity. Entity A has filed a Form 8832 and has elected to be taxable as a partnership for U.S. federal income tax purposes. Operating Partnership will indirectly own an interest of c percent in the outstanding equity interests of Entity A.

The redevelopment of the Historical Complex is governed by an urban redevelopment plan (Urban Plan) prepared by City Y. Under the terms of the Urban Plan, the redevelopment of the Historical Complex is mandated to satisfy not only commercial, but also public needs. The Urban Plan requires that the redevelopment of the Historical Complex be carried out both by means of direct intervention by City Y regarding the provision of public services, as well as by involvement of private business entities regarding the commercial portion of the Project.

Complying with the Urban Plan, the administrative orders of City Y providing for the redevelopment of the Project, determined that a concession was the appropriate form of legal rights to be granted to the private business entity selected to redevelop and operate the commercial portion of the Project. A concession, rather than another arrangement, such as a lease, was selected because of the unique public nature and historical nature of the real property involved.

Typically, Operating Partnership owns either directly or indirectly fee simple title to each developed property and the underlying land and leases out space to retail and other tenants. The acquisition of the Concession is the first acquisition by Operating Partnership of this type of legal interest in real property.

The following sets forth some of the key terms of the draft Concession Agreement entered into by City Y and Entity A. The terms of the tender procedure prohibit any change to the draft Concession Agreement following the award of the Concession, unless such change is required by law.

(1) Grant of Rights Under the Concession Agreement The Concession Agreement grants to Entity A the long-term right to use the public real estate described in the Concession Agreement for a specified term in consideration for the payment of a concession fee. The real property described in the Concession Agreement is the real estate portion of the Historical Complex together with certain sections of the roads contiguous to the complex to be used as parking lots and sidewalk, but excluding two parcels that will be used by City Y for public services such as a public library, day care center, senior citizens' center, and local information and services desks. Subject to City Y's right to provide the public services described in the previous sentence, and to the terms contained in the Concession Agreement, the right of use granted under the Concession Agreement is exclusive. Entity A has a right of first refusal in the event that the City decides to sell any of the real property subject to the Concession Agreement.

Under the terms of the Concession Agreement, Entity A is obligated to construct, restore, and redevelop the Project and to operate and maintain the Project following construction. Entity A is required to finance exclusively the performance of the entire undertaking, with the expenses to be recovered from the operation of the Project.

(2) Term The Concession Agreement has a term of f years, with the right of City Y to renew the Concession after the expiration, under terms and conditions to be agreed upon with Entity A. City Y would not have the right to terminate the Concession Agreement prior to the expiration of the f year term unless Entity A defaults in the performance of its obligations under the Concession Agreement or for “higher reasons of public interest” that must be justified by City Y. City Y is required to provide prior notice in the event of a revocation of the Concession Agreement for a general breach of the Concession Agreement or for “public interest” reasons, and would be required to reimburse Entity A for expenses sustained up to the date of the revocation order in the event of a revocation for “public interest” reasons (including all capital expenditures made by Entity A) in connection with the Project.

(3) Required Payments by Entity A The “Concession Fee” payable by Entity A is comprised of a lump sum in the amount of d, paid upon the execution of the Concession Agreement, and a fixed annual payment of e paid on an annual basis over f years, commencing at the time of the opening of g percent of the Project. Under the terms of the Concession Agreement, Entity A is obligated to maintain and preserve the Project and to return the Project whole and in good condition upon the expiration of the Concession term. Entity A is required to bear all of the ordinary and extraordinary maintenance expenses of all the property subject to the Concession, including the short-term parking lots, as well as the taxes, charges, and insurance premiums related to the property subject to the Concession. Entity A must provide a first demand bank or insurance policy guarantee for the purpose of guaranteeing satisfactory performance under the Concession and the proper management of the Project. Entity A is further obligated to take out an insurance policy for the benefit of City Y in the event of the total or partial destruction of the portion of the Project that is subject to the Concession, with the result that Entity A bears the risk of loss with respect to any damage or even the total destruction of the Project. In addition, Entity A is required to pay the Concession Fee without regard to whether it earns a profit from the operation of the Project, with the result that Entity A receives the benefit of any profits, cost savings, or other economies of scale realized from the operation of the Project.

(4) Subconcessions, Leasing, and Parking Lot Management by Entity A Pursuant to the Concession Agreement, Entity A may enter into “Subconcession Arrangements” or “Subleases” relating to portions of the Project, subject to the restrictions applicable to the Concession. Entity A, however, may not enter into such an arrangement with regard to the entire Project. The Operating Partnership anticipates that Entity A will ultimately enter into a number of Subconcession Agreements or Subleases covering all of the commercial venues within the Project. Entity A may also lease the multi-purpose

center constructed under the terms of the Concession Agreement. In addition, Entity A is required to manage, or enter into a management agreement with a third party to manage the parking lots of the Project. Any such subconcession or sublease arrangement will provide for rent payments based solely on a fixed dollar amount or specified percentages of the gross revenues derived by the subconcessionaires or sublessees from the operations of their portion of the Project, and not upon the income or profits of any subconcessionaire or sublessee.

## **LAW AND ANALYSIS**

Section 856(c) of the Code provides that to qualify as a REIT, a corporation must: (1) derive at least 95 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in § 856(c)(2), which include dividends, interest, rents from real property, and certain other items; and (2) derive at least 75 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in § 856(c)(3), which include rents from real property and certain other items.

Section 856(d)(1) provides that "rents from real property" include (subject to exclusions provided in § 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(c)(5)(B) defines the term real estate assets to include real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interests) in other REITs which meet the requirements of the Code.

Section 856(c)(5)(C) provides that the term interests in real property includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

Section 1.856-3(b)(1) of the Income Tax Regulations provides that the term real estate assets means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or improvements thereon), and shares in other qualified REITs. Section 1.856-3(c) provides that the term interests in real property includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements

thereon, and options to acquire leaseholds of land or improvements thereon. The term also includes timeshare interests that represent undivided fractional fee interests, or undivided leasehold interests, in real property, and that entitle the holders of the interests to the use and enjoyment of the property for a specified period of time each year. Such term does not, however, include mineral, oil, or gas royalty interests, such as a retained economic interest in coal or iron ore with respect to which the special provisions of § 631(c) apply.

Section 1.856-3(d) provides that the term real property means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items that are structural components of those buildings or structures). In addition, the term real property includes interests in real property. Local law definitions do not control for purposes of determining the meaning of the term real property as used in § 856 and the regulations thereunder. The term includes, for example, the wiring in a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in the building, or other items that are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment that is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc., even though those items may be termed fixtures under local law.

In this case, the Concession granted by City Y to Entity A is tantamount to a leasehold. It grants Entity A the long-term right to construct and use specified real estate portions of the Project for the purpose of operating and maintaining a retail and entertainment complex. The term is significant in its length, which is indicative of the intent of the parties that Entity A have a long-term possessory interest in the Project. Further, subject to certain conditions, Entity A's right to use the real property is exclusive, and Entity A has a right of first refusal in the event that City Y decides to sell any of the real property that is subject to the Concession. City Y has no right to terminate Entity A's right to occupy the premises for purposes of operating the facility if Entity A is not in breach of its obligations, except for "higher public purposes." Such a revocation of the Concession is intended to occur only under very unusual circumstances. This revocation power may be viewed as analogous to the power of eminent domain by City Y.

Like under a leasehold, Entity A is required to make specified periodic payments to City Y in return for the rights granted with respect to the premises under the Concession Agreement, and those periodic payments are similar to the rent payments that would be required under a lease because they are not determined by or contingent on Entity A's profits or losses from the operation of the Project. Consequently, the Concession Fee is analogous to ground rent. Moreover, like a tenant subject to a lease, Entity A bears all of the expenses of operating the Project. While City Y has established certain

specifications, guidelines, and regulations regarding Entity A 's construction, use, and maintenance of the Project, those requirements are not materially different from the types of restrictions that an owner of a similar facility customarily enters into when leasing the facility to a third party operator for an extended period of time. Finally, Entity A will have a significant capital investment in the Project, which investment will be returned to Entity A only through the operation of the Project and the revenues it derives from its Subconcession Arrangements and subleases.

Under the unique facts and circumstances of the instant case, the relationship between City Y and Entity A is most closely analogous to that of a lessor and lessee, and the Concession is analogous to a long-term leasehold of real property.

### **CONCLUSIONS**

Accordingly, based on the information submitted and representations made, we conclude as follows:

The Concession entered into by City Y with Entity A relating to the Project is an "interest in real property" for purposes of § 856(c)(5)(C) of the Code and therefore the Concession qualifies as a "real estate asset" for purposes of § 856(c)(4)(A).

Furthermore, payments received by Entity A from the subconcessionaires and sublessees of the Project under agreements that convey to them the exclusive right, subject to the terms of the Concession Agreement, to occupy and use specified positions of the Project will qualify as "rents from real property" under § 856(d) of the Code, so long as all the conditions set forth in § 856(d)(2) are satisfied.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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. In particular, no opinion is expressed with regard to whether Trust qualifies as a REIT under subchapter M of the Code.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Alice M. Bennett  
Chief, Branch 3  
Office of Associate Chief Counsel  
(Financial Institutions & Products)

Enclosures:

Copy of this letter  
Copy for section 6110 purposes

cc: