

Internal Revenue Service

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Person To Contact:

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PLR-132566-06

Date:

November 01, 2006

Legend:

Taxpayer =

State A =

a =

LP =

LLC =

Building =

b =

Dear :

This is in reply to a letter dated June 15, 2006, requesting a ruling on behalf of Taxpayer. You requested a ruling that following the proposed transaction described below, Taxpayer's allocable share of rents from Building will be disregarded from Taxpayer's gross income to the extent that it does not exceed Taxpayer's allocable share of LP's deductions for Building lease payments, for purposes of determining Taxpayer's gross income under the income tests of sections 856(c)(2) and (c)(3) of the Internal Revenue Code.

Facts:

Taxpayer is a State A real estate investment trust (REIT) that has elected under section 856(c) to be treated as a REIT for federal income tax purposes. Taxpayer is the managing general partner of LP and owns approximately a percent of the outstanding common units of LP. LP owns and operates numerous real properties throughout the United States through business entities classified as partnerships or disregarded entities for federal income tax purposes.

LLC, a limited liability company that is unrelated to Taxpayer or LP, owns the Building and leases it to LP. LP operates the Building and leases commercial office space in the Building to tenants that are also unrelated to Taxpayer or LP. LP pays rent to LLC that is funded by rents that LP receives from the commercial tenants to whom it leases space. The rents collected by LP from the commercial tenants annually exceed the rent that LP pays to LLC for the Building.

LP holds an option to purchase a b percent interest in LLC and proposes to exercise that option. Following the exercise of the option, LP will continue to pay rent on the Building to LLC (that is funded through rents received from the commercial tenants), but as a member of LLC will be entitled to receive its allocable share of the Building rent.

Law and Analysis:

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

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 1.856-3(g) of the Income Tax regulations provides that a REIT that is a partner in a partnership is deemed (1) to own its proportionate share of each of the assets of the partnership and (2) to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the partner's interest in the partnership's assets is determined in accordance with the partner's capital interest in the partnership.

Upon exercise of the option, Taxpayer will be entitled to an allocable share of the income derived by LP from LP's interest in LLC. To the extent that LP's gross income as a member of LLC is derived from the income paid by LP out of rents from commercial tenants of the Building, LP's income may be double counted because it directly earns gross income from the commercial tenants of the Building which is used by LP to pay the Building rent to LLC. Thus, pursuant to section 1.856-3(g), Taxpayer would be treated as earning the same gross income twice.

Accordingly, for purposes of determining Taxpayer's gross income for purposes of the income tests under sections 856(c)(2) and (c)(3), Taxpayer's allocable share of gross income from the Building will be disregarded as an item of gross income to the extent of Taxpayer's share of LP's deductions for rents paid on the Building to LLC.

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,

William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)