

**Internal Revenue Service**

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Legend

Taxpayer =

Holding LLC =

Parent Partnership =

Affiliate 1 =

Affiliate 2 =

Parent Corporation =

HoldCo =

Target =

x% =

y% =

Date 1 =

Date 2 =

Dear :

This letter responds to the letter from your authorized representatives, dated July 15, 2011, requesting rulings under sections 565 and 1374 of the Internal Revenue Code of 1986 (Code). The information submitted is summarized below.

### SUMMARY OF FACTS

Taxpayer is a corporation that has elected to be taxed as a real estate investment trust ("REIT") pursuant to section 856 of the Code, effective with its initial taxable year ending on Date 2. All of Taxpayer's common shares are held by Holding LLC, a limited liability company classified as a partnership for Federal income tax purposes. Taxpayer has also issued shares of preferred stock to more than 100 individual investors.

The managing member of Holding LLC is Parent Partnership, a partnership that holds all of the common member interests in Holding LLC. A group of individual investors own preferred member interests in Holding LLC.

The partners of Parent Partnership are Affiliate 1 and Affiliate 2 (collectively, the "Affiliates"). Affiliate 1 is a corporation holding an x% general partner interest, and Affiliate 2 is a corporation holding a y% limited partner interest. The Affiliates are each a member of an affiliated group of corporations filing a consolidated Federal income tax return of which Parent Corporation is the common parent.

Taxpayer owns all of the member interests in HoldCo, which is a disregarded entity for Federal income tax purposes.

On Date 1, HoldCo purchased for cash all of the shares of a target corporation ("Target"). As a result of the purchase, Target became a qualified REIT subsidiary of Taxpayer pursuant to section 856(i)(2) of the Code and was treated as liquidating into Taxpayer pursuant to section 332 of the Code.

Target did not make a deemed sale election pursuant to Treas. Reg. §1.337(d)-7(c). Therefore, Taxpayer was deemed to acquire Target's property portfolio with a carryover basis.

Prior to its acquisition by Taxpayer, Target owned a large portfolio of industrial properties that were leased to tenants (unrelated to Taxpayer or its beneficial owners)

under traditional leases. Taxpayer (through Target) continues to hold and lease the property portfolio, subject to mortgage debt and other portfolio-related liabilities. At the present time, Taxpayer's aggregate liabilities exceed the aggregate tax basis of its real property and other assets.

Subject to obtaining the requested rulings, Taxpayer intends to undergo a complete liquidation for Federal income tax purposes by implementing the following steps on or before December 31, 2011:

- 1) Target will merge into HoldCo or otherwise merge or convert into a wholly owned LLC subsidiary of Taxpayer ("Property LLC").
- 2) Taxpayer will adopt a plan of complete liquidation under section 331 of the Code. Pursuant to such plan, Taxpayer will redeem its outstanding preferred shares for cash in an amount equal to their specified liquidation preference (including any accrued but unpaid dividends) and will distribute the interests in Property LLC to Holding LLC, which is the sole owner of the common shares. Alternatively, Taxpayer may effect the liquidation by merging Taxpayer into a single member limited liability company ("Successor LLC"), with the preferred shareholders of Taxpayer receiving cash in exchange for their preferred shares of Taxpayer and Holding LLC receiving all of the member interests in Successor LLC in exchange for its common shares of Taxpayer.

Taxpayer has asked for rulings that:

- a) Section 1374(d)(7)(B) applies to the liquidation of Taxpayer described in the preceding paragraph (step 2 of the proposed transaction).
- b) Taxpayer will be allowed to make a consent dividend under section 565 in the year of liquidation in an amount up to the excess of (i) its taxable income from the year of liquidation, including the gain recognized under section 336, over (ii) the net fair market value of the assets distributed in liquidation. Accordingly, the consent dividend will be treated by Holding LLC as liquidating proceeds received under section 331, followed by a deemed contribution by Holding LLC of such amount to Taxpayer, thereby increasing the tax basis of Holding LLC's common shares of Taxpayer.

## REPRESENTATIONS

- a) Taxpayer has met the requirements for qualification and taxation as a REIT commencing with its initial tax year ending on Date 2 and continuing through to the date of its ruling request. Taxpayer intends to maintain its qualified REIT status through the date of Taxpayer's proposed liquidation.
- b) Each of the distributions made by Taxpayer pursuant to a plan of complete liquidation, including the consent dividend, will be made in accordance with the

respective rights of its outstanding preferred and common shares, as set forth in Taxpayer's articles of incorporation, and will not be preferential dividends within the meaning of section 562(c) of the Code.

c) Taxpayer will not be classified as a personal holding company within the meaning of section 542 of the Code for the taxable year ending with the date of its proposed liquidation.

## RULINGS

### Issue One

Section 1374(d)(7)(B) applies to the liquidation of Taxpayer described in step 2 of the proposed transaction.

### Issue Two

## 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(c) states that the amount of a consent dividend shall be considered as distributed in money by the corporation to the shareholder on the last day of the taxable year of the corporation and as contributed to the capital of the corporation by the shareholder on such day.

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, 75th 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. Further, we conclude that under section 565 the consent dividend will be treated by Holding LLC as a liquidating distribution to it by Taxpayer followed by a deemed

contribution by Holding LLC of such amounts to Taxpayer as a contribution to capital.

#### PROCEDURAL STATEMENTS

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 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. 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, copies of this letter are being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Alfred C. Bishop, Jr.  
Branch Chief, Branch 6  
(Corporate)

cc: