

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:
August 13, 2013

Legend

Taxpayer =

LP =

University =

State A =

State B =

Project =

Initial Year =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

a =

b =

c =

d =

e =

f =

g =

Dear :

This responds to a letter dated March 21, 2013, submitted on behalf of Taxpayer. Taxpayer requests a ruling that sales of its assets pursuant to a plan of liquidation under the below circumstances will not constitute prohibited transactions within the meaning of section 857(b)(6).

FACTS

Taxpayer is a State A corporation that has elected to be taxed as a real estate investment trust ("REIT") under section 856(c)(1) beginning with its first taxable year, Initial Year, and for each taxable year thereafter. Through subsidiary entities that are generally taxed as disregarded entities for federal income tax purposes, Taxpayer primarily owns and leases residential real estate to third parties.

LP, a State B limited partnership, is a closed-end private equity fund that commenced operations on Date 1. LP owns in excess of a percent of all classes of the stock of Taxpayer and all of its voting common stock. The remaining non-controlling interest of Taxpayer is made up of preferred stock owned by b persons. In order to facilitate the winding down and dissolution of LP, Taxpayer intends to adopt a plan of liquidation pursuant to which it will dispose of its remaining assets during Year 2, Year 3, and Year 4, and liquidate.

Taxpayer makes the following additional representations that address its purposes with respect to the properties at issue. Taxpayer represents that it acquired the properties with the intent to own the properties for a long-term holding period and to derive its profits from capital appreciation and rental income from the properties. The disposition of the properties is pursuant to a plan of liquidation. No individual property

to be disposed of has been owned for fewer than c years. All the individual properties will have been operated as rental properties for at least 2 years at the time of the proposed sale, with the sole exception of a portion of Project. The weighted average holding period of the properties (based on current estimated fair market value) was e months as of the close of Year 1. Taxpayer will use one or more independent third party broker from which Taxpayer will derive no income to dispose of the properties.

Project is a collaboration with University to develop a community that provides student housing. A subsidiary of Taxpayer entered a joint venture in Initial Year to be the University's development partner for phase one of Project. Due to circumstances beyond Taxpayer's control, a master ground lease for Project was not signed until Date 2, over d years behind schedule. The intent of the parties at that time was to operate Project as rental property and derive profit from long-term holdings of the property. Project began receiving rental income on Date 3, when part of the first phase was completed. The last phase of Project is scheduled to be complete on Date 4. The expenditures relating to the first phase account for approximately f percent of the total cost of Project. Accordingly, by the end of Year 2, prior to the anticipated sale date of Project, Taxpayer will have derived rental income for 2 years from over half of the total investment in Project.

Taxpayer estimates that the ratio of development expenses to estimated fair market value during the two years immediately prior to the proposed sale of the properties at issue will be less than g percent.

LAW AND ANALYSIS

Section 857(b)(6)(A) imposes a 100 percent tax on a REIT's net income from prohibited transactions. Section 857(b)(6)(B)(iii) defines the term "prohibited transaction" as the sale or other disposition of property described in section 1221(a)(1) that is not foreclosure property. Section 1221(a)(1) property, in turn, consists of property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Section 857(b)(6)(B)(ii) provides that losses attributable to prohibited transactions are not taken into account in determining the amount of net income derived from prohibited transactions.

Section 857(b)(6)(C) excludes certain sales from the definition of a prohibited transaction. Under section 857(b)(6)(C), the term "prohibited transaction" does not include the sale of property which is a real estate asset (as defined in section 856(c)(5)(B) and which is described in section 1221(a)(1)) if --

- (i) the REIT has held the property for not less than 2 years;
- (ii) the aggregate expenditures made by the REIT, or any partner of the REIT, during the 2-year period preceding the date of sale which are

includible in the basis of the property do not exceed 30 percent of the net selling price of the property;

(iii) (I) during the taxable year the REIT does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, or (III) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the fair market value of all the assets of the REIT as of the beginning of the taxable year;

(iv) in the case of property, which consists of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the REIT has held the property for not less than 2 years for production of rental income; and

(v) if the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the REIT itself does not derive or receive any income.

The legislative history underlying section 857(b)(6), which was added to the Code by the Tax Reform Act of 1976, indicates that the purpose of that section was to “prevent a REIT from retaining any profit from ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project.” S. Rep. No. 938, 84th Cong., 2d Sess. 470 (1976, 1976-3 (Vol. 4) C.B. 508).

To determine whether a taxpayer holds property “primarily for sale to customers in the ordinary course of its trade or business”, the Tax Court has held that several factors must be considered, none of which is dispositive. Among those factors are: (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer’s efforts to sell the property; (3) the number, extent, continuity, and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; and (5) the time and effort the taxpayer habitually devoted to the sales. Generally, it is the purpose for which property is held at the time of the sale that is determinative, although earlier events may be considered to decide the taxpayer’s purpose at the time of the sale. See Cottle v. Commissioner, 89 T.C. 467, 487 (1987).

CONCLUSION

Based on the facts presented and representations made, we conclude that sales of Taxpayer's assets pursuant to a plan of liquidation under the above circumstances will not constitute prohibited transactions within the meaning of section 857(b)(6).¹

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 Taxpayer qualifies as a REIT under subchapter M of the Code.

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

In accordance with the terms of a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Andrea M. Hoffenson
Assistant to the Branch Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures (2):

Copy of this letter
Copy for section 6110 purposes

cc:

¹ Section 4 of Rev. Proc. 2013-3 sets forth those areas in which rulings or determination letters will not ordinarily be issued by the Service. "Not ordinarily" means that unique and compelling reasons must be demonstrated to justify the issuance of a ruling or determination letter. See Rev. Proc. 2013-3, sec. 2.01. Section 4.05 of Rev. Proc. 2013-3 provides that one of the areas in which rulings or determination letters will not ordinarily be issued is any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of a trade or business. In this case, Taxpayer has demonstrated unique and compelling reasons to justify issuance of the ruling.