



Date 1 =

Date 2 =

A =B =C =D =E =

Dear :

This letter responds to your letter dated February 23, 2016, in which Taxpayer requests a ruling that the sale of Taxpayer's assets pursuant to a proposed plan of liquidation will not be considered prohibited transactions for purposes of section 857(b)(6) of the Internal Revenue Code.

#### Facts:

Taxpayer was incorporated in State A in Month 1 of Year 1. Taxpayer completed its initial public offering ("IPO") in Month 2 of Year 1, and elected to be treated as a "real estate investment trust" ("REIT") for its first tax year ending Date 1.

Taxpayer was formed to focus on the \_\_\_\_\_ in select markets throughout the United States. In connection with its IPO, Taxpayer \_\_\_\_\_

\_\_\_\_\_ of more than A properties from Company A and the owners of the membership interests of entities managed by Company B. Prior to the IPO, Taxpayer owned \_\_\_\_\_ properties and held \_\_\_\_\_ Taxpayer has acquired additional properties each year subsequent to the IPO and, as of Date 2, Taxpayer owned approximately B \_\_\_\_\_ properties.

Taxpayer conducts its business and owns all of its properties through Operating Partnership, a State B limited partnership. As of Date 2, Taxpayer owned, through a combination of direct and indirect interests, C percent of the partnership interests in Operating Partnership.

, in the third quarter of Year 2, Taxpayer's board of directors, together with an outside financial advisor, began pursuing a review of alternatives available to enhance shareholder value. After considering several alternatives, Taxpayer now contemplates a complete liquidation of its portfolio through a sale of its assets.

Taxpayer represents that its stated intention has always been to hold its properties over the long-term to generate income and value. Taxpayer has engaged in some disposition activity since its inception. Through Date 2, Taxpayer has sold D of its properties. Of these sales, E were sold in a single transaction

Taxpayer represents the remainder of its sales met the requirements of the prohibited transaction safe harbor under section 857(b)(6). Taxpayer also represents that all of its properties acquired in Year 2 were acquired prior to Taxpayer's consideration of a liquidation.

Taxpayer anticipates that the time to fully liquidate its portfolio will take between 6 months and 2 years, depending upon whether Taxpayer's properties are

The sale of Taxpayer's properties could extend beyond 2 years in the event Taxpayer needs to wait Taxpayer represents that substantially all of the marketing expenditures with respect to sales of its properties will be made through an independent contractor (as defined in section 856(d)(3)) from whom the Taxpayer does not derive or receive any income or a taxable REIT subsidiary of Taxpayer.

Before Taxpayer pursues a plan of complete liquidation, Taxpayer's board of directors plans to take several steps following the receipt of this ruling. First, the board will perform an updated assessment of the state of Taxpayer's business. The assessment will involve a review of the current state of Taxpayer's strategic plan and projections and an updated review of strategic alternatives. Taxpayer's board will then initiate a portfolio liquidation following this updated review

Subsequently, Taxpayer's board would formally adopt a plan of liquidation, which Taxpayer would publicly disclose and would likely need to pursue a stockholder vote to pursue such a plan and a sale of substantially all of its assets.

### **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 a sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) if—

- (i) the REIT has held the property for not less than 2 years;
- (ii) 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 (as so determined) of all of 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 of the assets of the REIT as of the beginning of the taxable year, or (IV) the REIT satisfies the requirements of subclause (II) applied by substituting “20 percent” for “10 percent” and the 3-year average adjusted bases percentage for the taxable year (as defined in subparagraph (G)) does not exceed 10 percent, or (V) the REIT satisfies the requirements of subclause (III) applied by substituting “20 percent” for “10 percent” and the 3-year average fair market value percentage for the taxable year (as defined in subparagraph (H)) does not exceed 10 percent;
- (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 or a taxable REIT subsidiary.

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. 84-938, at 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).

Taxpayer has made the following representations that address its purposes with respect to the properties at issue. Taxpayer represents that its intention has always been to hold the properties over the long-term to generate rental income and appreciated value. Taxpayer's disposition of the properties in issue is due to a plan of liquidation, and Taxpayer adopted such a plan only after exploring alternatives that would allow Taxpayer to continue holding the properties. Since its incorporation in Year 1, Taxpayer has sold only a small percentage of its properties. The properties Taxpayer acquired in Year 2 were acquired prior to Taxpayer's consideration of a plan of liquidation. Substantially all of the marketing expenditures with respect to sales of Taxpayer's properties will be made through an independent contractor (as defined in section 856(d)(3)) from whom the Taxpayer does not derive or receive any income or a taxable REIT subsidiary of Taxpayer.

### **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).<sup>1</sup>

---

<sup>1</sup> Section 4 of Rev. Proc. 2016-3 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. 2016-3, sec. 2.01. Section 4.02(5) of Rev. Proc. 2016-3 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.

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. 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 otherwise 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,

Robert A. Martin  
Senior Technician Reviewer, Branch 1  
Office of Associate Chief Counsel  
(Financial Institutions & Products)

cc: