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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:FIP:B01  
PLR-133554-14  
Date:  
January 09, 2017

**Legend:**

|                  |   |
|------------------|---|
| Taxpayer         | = |
| Subsidiary 1     | = |
| Subsidiary 2     | = |
| City             | = |
| State            | = |
| State Act        | = |
| State Authority  | = |
| State Official A | = |
| State Official B | = |

Project Area =

A =

B =

C =

D =

E =

F =

G =

H =

Dear :

This letter responds to your letter dated September 9, 2014 and supplemental correspondence requesting a ruling on behalf of Taxpayer that, pursuant to Internal Revenue Code Section 856(c)(5)(J), income from the Grant (as defined below) is considered qualifying income for purposes of Taxpayer's gross income tests under Sections 856(c)(2) and (c)(3).

**Facts:**

Taxpayer is a limited liability company that has elected to be taxed as a corporation for U.S. federal tax purposes and has elected to be treated as a "real estate investment trust" ("REIT") under Section 856. Taxpayer wholly owns Subsidiary 1 and Subsidiary 2 (the "Subsidiaries"), which are limited liability companies disregarded as separate from their owner for U.S. federal tax purposes. Taxpayer uses an accrual method of accounting and a calendar tax year.

The Subsidiaries were organized to own a real estate development project (the "Project") in City. The Project will include the development and construction of a transit-oriented mixed-use development property of approximately A square feet incorporating retail, office, and light industrial uses. Taxpayer represents that the Project constitutes real property within the meaning of Section 856. The Project will be constructed on land

that is eligible for an economic redevelopment and growth incentive grant (the "Grant") through State that was established under State Act.

State Act provides state incentive reimbursement grants to developers to address project financing gaps by reimbursing certain construction costs using a portion of new state incremental taxes derived from a project's development (the "State Grant Program"). The State Grant Program was established to help municipalities targeted for growth to improve their business districts through comprehensive redevelopment. The State Grant Program may provide grants for a variety of types of redevelopment projects including commercial, retail, and residential projects.

Under State Act, a developer is required to first apply for a state incentive grant and provide adequate support requested by State including the estimated cost of the project, estimated revenue increment base and projection of eligible revenues for the project, and a description of how the project addresses various economic and social factors that further State's interest in the proposed redevelopment.

Once State approves a developer's application for an incentive grant, State and the developer enter into an incentive grant agreement. The incentive grant agreement describes the terms and conditions of the arrangement between the developer and State, including the maximum percentage of the actual eligible project costs that is eligible for reimbursement, the maximum aggregate dollar amount of the incentive grant to be awarded to the developer, the maximum annual percentage of eligible tax revenues that may be used for reimbursement of eligible project costs, and the particular tax or taxes referenced to determine the amount of the grant.

Project Area is owned by the Subsidiaries and was determined to be a qualifying economic redevelopment and growth incentive area for purposes of the Grant Program. The Subsidiaries filed an application with State Authority and State Official A (collectively, the "State Authorities") to receive the Grant for the Project, and the State Authorities approved the Subsidiaries' application for the Grant in the maximum amount of B percent of the actual eligible project costs, not to exceed a maximum aggregate amount of \$C. Accordingly, the Subsidiaries are entering into an incentive grant agreement (the "Agreement") with the State Authorities. Under the Agreement, the State Authorities determined that the Project has estimated total project costs of \$D and eligible project costs of \$E.

Pursuant to the Agreement, the aggregate amount of the Grant shall not exceed E percent of the eligible tax revenues out of which the Grant is payable and the annual amount of the reimbursement shall not exceed E percent of the eligible tax revenues in each year. The eligible tax revenues for purposes of the Grant include corporate taxes, a tax imposed on marine insurance companies, public utility franchise and excise taxes, taxes derived from distributive shares of partnership and S corporation income, a tax imposed on the purchase of materials used in certain construction, a hotel and motel

occupancy fee, and a portion of a certain fee imposed on the sale of real property at the site of the Project.

The Subsidiaries and the State Authorities agree that actual costs incurred to complete the Project may vary from the amounts approved. If the actual costs incurred exceed the amounts approved, the Grant will not be adjusted upwards, but if the actual costs incurred are less than the estimated amounts, the Grant will be reduced. The Agreement further provides that if the Project does not provide the estimated amount of eligible tax revenues in a given tax year, the Grant shall continue to be limited to E percent of the actual eligible tax revenues received for that tax year. The Agreement also states that the Project will be completed within G years of the execution of the Agreement.

Upon receipt of the verified and actual eligible project costs from the State Authorities, State Official B will calculate the maximum Grant to which the Subsidiaries may be entitled, subject to the limitations described above and in the Agreement. For such year, and on an annual basis thereafter, State Official B will calculate the appropriate annual grant payment based on the revenues collected in the prior calendar year from the eligible tax revenues and subject to the limitations in the Agreement. State Official B is required to pay the Subsidiaries annual installments for a period of B years.

Taxpayer has represented that it expects the amount of the Grant to exceed H percent of Taxpayer's gross revenues. Taxpayer expects that substantially all of the other income (other than income from the Grant) derived from the Project will be qualifying income for purposes of Sections 856(c)(2) and (c)(3).

### **Law and Analysis:**

Section 856(c)(2) provides that in order for a corporation to qualify as a REIT, at least 95 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from specified sources, which include dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property not described in Section 1221(a)(1), abatements and refunds of taxes on real property, income and gain derived from foreclosure property, certain commitment fees, and gain from certain sales or other dispositions of real estate assets.

Section 856(c)(3) provides that in order for a corporation to qualify as a REIT, at least 75 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from rents from real property, interest on obligations secured by mortgages on real property or on interests on real property, gain from the sale or other disposition of real property not described in Section 1221(a)(1), certain dividends or distributions on, and gains from the sale or disposition of, shares in

other REITs, abatements and refunds of taxes on real property, income and gain derived from foreclosure property, certain commitment fees, gain from certain sales or other dispositions of real estate assets, and qualified temporary investment income.

Section 856(c)(5)(J) provides that to the extent necessary to carry out the purposes of Part II of Subchapter M of the Code, the Secretary is authorized to determine, solely for purposes of such part, (i) whether any item of income or gain that does not otherwise qualify under Sections 856(c)(2) or (c)(3) may be considered as not constituting gross income for purposes of Sections 856(c)(2) or (c)(3), or (ii) whether any item of income or gain that otherwise constitutes gross income not qualifying under Sections 856(c)(2) or (c)(3) may be considered as gross income that qualifies under Sections 856(c)(2) or (c)(3).

The legislative history underlying the tax treatment of REITs indicates that a central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, "[o]ne of the principal purposes of your committee in imposing restrictions on types of income of a qualifying real estate investment trust is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business."

Income from the Grant constitutes gross income not listed as qualifying income under Sections 856(c)(2) or (c)(3). Taxpayer represents that the Project, once completed, will be real property for purposes of Section 856 and that substantially all of the other income Taxpayer derives from the Project will be qualifying income for purposes of Sections 856(c)(2) and (c)(3). Taxpayer will earn the Grant for developing real property in State in accordance with the State Grant Program. Treating income from the Grant as qualifying income does not interfere with or impede the objectives of Congress in enacting Sections 856(c)(2) and (c)(3). Accordingly, pursuant to Section 856(c)(5)(J)(ii), it is appropriate for the Secretary to determine that income from the Grant is treated as qualifying income for purposes of Sections 856(c)(2) and (c)(3).

### **Conclusion:**

We hereby rule that, pursuant to Section 856(c)(5)(J), income from earning the Grant will be qualifying income for purposes of Taxpayer's gross income tests under Sections 856(c)(2) and (c)(3).

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. Additionally, no opinion is expressed regarding income from a sale of an interest in the Grant.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representatives.

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.

Sincerely,

Steven Harrison  
Branch Chief, Branch 1  
Office of Associate Chief Counsel  
(Financial Institutions & Products)