

- (1) The right to receive the Brownfield Credits (defined below) will be considered a “receivable” or other asset of taxpayer described in § 856(c)(4)(A); and
- (2) Pursuant to § 856(c)(5)(J)(ii), any gross income of Taxpayer arising from the receipt or accrual of the Brownfield Credits will be considered qualifying income for purposes of § 856(c)(2) and (3).

Facts:

Taxpayer is a corporation formed under the laws of State A that will elect to be taxed as a REIT under §§ 856 through 860 effective Date 1. Taxpayer is the sole member of Subsidiary, a limited liability company that is a disregarded entity for Federal income tax purposes.

Charity, a non-profit corporation formed under the laws of State B, owns a majority of the shares of Taxpayer. Charity n is the sole member of Owner, a limited liability company that is a disregarded entity for Federal income tax purposes. Owner owns the Site, which is located in State A. Owner has leased the Site to Subsidiary under a long-term lease (the “Lease”). Prior to and subsequent to the execution of the Lease, Taxpayer and Subsidiary have incurred significant expenditures in connection with the remediation of adverse environmental conditions at the Site and with the rehabilitation and development of the Site. Taxpayer represents that the expenditures have been for the remediation, rehabilitation, or development of real property within the meaning of § 1.856-10.

As a result of remediation, rehabilitation, and development expenditures of Taxpayer and Subsidiary, Taxpayer is eligible for brownfield redevelopment tax credits (the “Brownfield Credits”). The amount of the Brownfield Credits is a percentage of the costs of (1) site preparation, (2) certain tangible property (including buildings and structural components placed in service at the Site), and (3) on-site groundwater remediation. Taxpayer expects the Brownfield Credits to exceed Taxpayer’s State A income tax liability. Taxpayer represents that, under State A law, the excess is treated as an overpayment of tax and that Taxpayer will elect to receive a refund of the overpayment. Taxpayer represents that the right to receive the Brownfield Credits is properly treated as a receivable on Taxpayer’s balance sheet under generally accepted accounting principles (“GAAP”). The Brownfield Credits are allowable and refundable only with respect to Taxpayer’s State A income tax liability and are not abatements or refunds of taxes on real property under State A law.

Taxpayer represents that Taxpayer, acting through Subsidiary, intends to sublease space at the site to third parties not related to taxpayer as described in § 856(d)(2)(B) in order to generate income that will qualify as rents from real property for purposes of § 856(c)(2) and (3). Taxpayer represents that it expects substantially all of the income derived from the Site (other than income arising from the receipt or

accrual of the Brownfield Credits) to be qualifying income for purposes of § 856(c)(2) and (3).

Law and Analysis:

Asset Test

Section 856(c)(4)(A) provides that, in order for a corporation to qualify as a REIT for a taxable year, at the close of each quarter of the taxable year, at least 75 percent of the value of the corporation's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

Section 1.856-2(d)(1) of the Income Tax Regulations defines the term "receivables" for purposes of § 856(c)(4)(A) to mean only those receivables that arise in the ordinary course of a REIT's operation, excluding receivables purchased from another person.

Section 1.856-2(d)(3) provides that in determining the investment status of a REIT, the term "total assets" means the gross assets of the REIT determined in accordance with GAAP.

Taxpayer will not purchase the Brownfield Credits from another person. The right of Taxpayer to receive the Brownfield Credits arises from the development of real property on land in connection with the leasing business of Taxpayer and Subsidiary. Therefore, the right is a receivable that arises in the ordinary course of Taxpayer's operations within the meaning of § 1.856-2(d)(1).

Income Tests

Section 856(c)(2) provides that in order for a corporation to qualify as a REIT for a taxable year, at least 95 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from certain enumerated sources, which include dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (other than property in which the corporation is a dealer), abatements and refunds of taxes on real property, income and gain derived from foreclosure property, and certain commitment fees.

Section 856(c)(3) provides that in order for a corporation to qualify as a REIT for a taxable year, at least 75 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from certain enumerated sources, which include rents from real property, interest on obligations secured by real property, gain from the sale or other disposition of real property (other than property in which the corporation is a dealer), distributions on and gain from the sale of REIT stock, abatements and refunds of taxes on real property, income and gain derived from

foreclosure property, certain commitment fees, 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 § 856(c)(2) or (3) may be considered as not constituting gross income for purposes of § 856(c)(2) or (3), or (ii) whether any item of income or gain that otherwise constitutes gross income not qualifying under § 856(c)(2) or (3) may be considered as gross income that qualifies under § 856(c)(2) or (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 attributable to the receipt or accrual of the Brownfield Credits is not derived from any source listed in § 856(c)(2) or (3). Pursuant to § 856(c)(5)(J), the Secretary has the authority to determine that the income attributable to the receipt or accrual of the Brownfield Credits be considered as qualifying gross income under those provisions. On the basis of all of the facts and circumstances, including Taxpayer's representations that it intends to sublease the Site to generate rents from real property and that it expects substantially all of the income generated by the Site to be qualifying income for purposes of § 856(c)(2) and (3), treating the income attributable to the receipt or accrual of the Brownfield Credits as qualifying income does not interfere with or impede the objectives of Congress in enacting § 856(c)(2) and (3).

Conclusion

We hereby rule as follows:

- (1) Taxpayer's right to receive the Brownfield Credits, to the extent the right is an asset under GAAP, is a receivable for purposes of § 856(c)(4); and
- (2) Pursuant to § 856(c)(5)(J)(ii), Taxpayer's income attributable to the receipt or accrual of the Brownfield Credits is considered qualifying income for purposes of § 856(c)(2) and (3).

The rulings in this letter are conditioned upon the sublease of the Site by Taxpayer to derive income substantially all of which is qualifying income to Taxpayer, consistent with Taxpayer's represented expectation.

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. Except as specifically ruled upon above, no opinion is expressed concerning any Federal income tax consequences related to the facts herein under any other provisions of the Code. Specifically, we do not rule whether Taxpayer qualifies as a REIT under Part II of Subchapter M of Chapter 1 of the Code.

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 letter ruling 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. Although 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
Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: