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Department of the Treasury
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Date:
January 28, 2020

Legend:

Taxpayer	=
Subsidiary	=
Fund	=
General Partner	=
Operator	=
Country	=
State A	=
Region A	=
Region B	=
Communities	=
Community	=
Employees	
a	=
b	=
c	=

Dear :

This ruling responds to a letter dated July 31, 2019, submitted on behalf of Taxpayer. Taxpayer requests a ruling that Subsidiary, a taxable REIT subsidiary (a "TRS") of Taxpayer, will not be considered to be operating or managing a health care facility within the meaning of section 856(l)(3)(A).

FACTS

Taxpayer is a State A corporation that has elected to be taxed as a real estate investment trust ("REIT") under sections 856 through 859. Taxpayer, directly and

indirectly through subsidiaries, owns a portfolio of senior housing and health care properties.

Fund is a Region A limited partnership that owns a Communities, each through a separate limited partnership organized under the laws of Country (each, a "Sub LP"). Fund is the limited partner of each Sub LP. General Partner, a corporation incorporated under the laws of Country, is the general partner of Fund. A corporate subsidiary of General Partner ("Sub GP") owns a nominal economic interest in each Sub LP and is the general partner of each Sub LP. General Partner has all management rights with respect to Fund, and Sub GP has all management rights with respect to the Sub LPs. Taxpayer represents that the Communities are or will be "qualified health care properties" within the meaning of section 856(e)(6)(D).

Operator is a corporation incorporated under the laws of Country and an affiliate of a minority partner in Fund. Operator currently operates each completed Community pursuant to an arm's-length management contract with the Sub LP that owns the Community.

Subsidiary is a Region B corporation and a TRS of Taxpayer. Subsidiary entered into an agreement to purchase a b-percent limited partnership interest in Fund and c percent of the stock of General Partner (the "Acquisition").

At the time of the Acquisition, the existing management contracts between the Sub LPs and Operator will be terminated and new arm's-length management contracts will be entered into between the Sub LPs and Operator. Upon completion of a Community, the Sub LP that owns the Community will enter into an arm's-length management contract with Operator under the same terms as the existing management contracts for the completed Communities. Under the management contracts, Operator will have the exclusive right to manage the day-to-day operation of the Communities and to provide daily supervision and direction of the employees at the Communities. Operator will be responsible for collecting revenues from, and paying the expenses of, the operation of the Communities. Operator will be responsible for setting the policies of each Community; maintaining and insuring the Communities; procurement for the Communities; recruiting, hiring, supervision, training, and discharge of employees; setting and collecting all fees; obtaining permits or licenses for operating the Communities; and managing and directing day-to-day activities at the Communities. Operator provides and approves all forms of, and manages the execution, maintenance, compliance, and cancellation of, all resident agreements, leases, and occupancy agreements. Operator will be responsible for all accounting and financial matters relating to each of the Communities.

Under the terms of the management agreements, Subsidiary will not be involved in any component of the day-to-day operations of, or services provided at, the Communities. Subsidiary has no employees. Subsidiary will not have any employees who perform any services relating to the Communities.

Community Employees at each Community are employed directly by the Sub LP that owns that Community. This employment structure has been in place prior to the Acquisition. Maintaining this arrangement is more efficient for Sub LPs in Region A.

After the Acquisition, each Sub LP will continue to employ directly the Community Employees of the Sub LP's Community. All employees with supervisory roles over Community Employees will be employed by Operator. Operator will have the exclusive authority to supervise and control the Community Employees of each Community. Operator has and will continue to have and exercise the exclusive right and responsibility to recruit, train, supervise, hire, and terminate all employees at all levels, irrespective of the identity of the legal employer.

Taxpayer represents that Operator is, and after the Acquisition will be, an independent contractor with respect to Taxpayer under section 856(d)(3) from whom Taxpayer receives no income. After the Acquisition, the Communities will be the only qualified health care properties managed by Operator, and the Sub LPs will be Operator’s only customers.

LAW AND ANALYSIS

Section 856(c)(4)(B)(iv) provides that a corporation shall not be considered a REIT for any taxable year unless, at the close of each quarter of the taxable year, except with respect to a TRS, (I) not more than 5 percent of the value of its total assets is represented by securities of any one issuer, (II) the corporation does not hold securities possessing more than 10 percent of the total voting power of the outstanding securities of any one issuer, and (III) the corporation does not hold securities having a value of more than 10 percent of the total value of the outstanding securities of any one issuer.

Section 856(d)(2)(B) provides that the term “rents from real property” does not include, except as provided in section 856(d)(8), any amount received or accrued directly or indirectly from any person if the REIT owns, directly or indirectly: (i) in the case of a corporation, stock possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total value of shares of all classes of stock of such corporation; or (ii) in the case of any person that is not a corporation, an interest of 10 percent or more in the assets or net profits of such person.

Section 856(d)(2)(C) provides that the term “rents from real property” does not include any impermissible tenant service income.

Section 856(d)(7)(A) provides that, for purposes of section 856(d)(2)(C), the term “impermissible tenant service income” means, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for (i) services furnished or rendered by the REIT to the tenants of such property, or (ii) managing or operating such property.

Section 856(d)(7)(C)(i) provides that, for purposes of section 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income or through a TRS of the REIT shall not be treated as furnished, rendered, or provided by the REIT.

Section 856(d)(3) defines an independent contractor as any person (A) who does not own, directly or indirectly, more than 35 percent of the shares, or certificates of beneficial interest, in the REIT; and (B) if such person is a corporation, not more than 35 percent of the total combined voting power of whose stock (or 35 percent of the total shares of all classes of whose stock), or, if such person is not a corporation, not more than 35 percent of the interest in whose assets or net profits is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the REIT.

Section 856(d)(8)(B) provides that amounts paid to a REIT by a TRS of the REIT for an interest in real property that is a qualified lodging facility or qualified health care property leased by the REIT to the TRS and operated on behalf of the TRS by an EIK shall not be excluded from rents from real property by reason of section 856(d)(2)(B).

Section 856(d)(8)(B)(ii) provides that a TRS is not considered to be operating or managing a qualified health care property or qualified lodging facility solely because it employs individuals working at such facility or property located outside the United States, but only if an EIK is responsible for the daily supervision and direction of such individuals on behalf of the TRS pursuant to a management agreement or similar service contract.

Section 856(d)(9)(A) provides that the term EIK with respect to any qualified lodging facility or qualified health care property means any independent contractor if, at the time such contractor enters into a management agreement or other similar service contract with the TRS to operate such qualified lodging facility or qualified health care property, such contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities or qualified health care properties, respectively, for any person who is not a related person with respect to the REIT or the TRS.

Section 856(e)(6)(D)(i) defines “qualified health care property” as any real property (including interests therein), and any personal property incident to such real property, which is a health care facility or is necessary or incidental to the use of a health care facility.

Section 856(e)(6)(D)(ii) defines a “health care facility” as a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients and which, immediately before the termination,

expiration, default, or breach of the lease of or mortgage secured by such facility, was operated by a provider of such services which was eligible for participation in the Medicare program under Title XVIII of the Social Security Act with respect to the facility.

Section 856(l)(1) provides that a TRS of a REIT is a corporation (other than a REIT) in which the REIT directly or indirectly owns stock and for which the REIT and the corporation jointly elect treatment as a TRS.

Section 856(l)(2) provides that any corporation (other than a REIT or a qualified REIT subsidiary) in which a TRS owns directly or indirectly securities having more than 35 percent of the total voting power or total value of the corporation's outstanding securities shall be treated as a TRS.

Section 856(l)(3)(A) provides that any corporation that directly or indirectly operates or manages a lodging facility or a health care facility is not a TRS.

After the Acquisition, Subsidiary will own, indirectly through Fund and the Sub LPs, a majority interest in the Communities, each of which is or will be a health care facility. No provision of section 856 prohibits a TRS from owning a health care facility. If Subsidiary operates or manages a Community, however, Subsidiary will not qualify as a TRS under section 856(l)(3).

Based on Taxpayer's representations, Subsidiary has no direct involvement in the management of the Communities. Subsidiary has no legal or contractual rights to participate in the daily operation of the Communities. Operator, an independent contractor with respect to Taxpayer, has the exclusive authority to supervise and direct the employees of each Sub LP.

Community Employees will be employees of the Sub LP that owns the Community, and Subsidiary will have an indirect majority interest in each Sub LP through Fund. Therefore, Subsidiary bears a share of the expenses of employing Community Employees. The prohibition on a TRS operating a health care facility is not meant to prevent the TRS from bearing the expenses of operating a health care facility. Section 856(d)(9), for example, acknowledges that a TRS may bear the expenses of operating a qualified health care property in the context of the structure described in section 856(d)(8)(B).

Section 856(d)(8)(B)(ii) establishes that mere legal employment of an individual working in a qualified health care property is not, per se, operation of the qualified health care property. The Community Employees will be part of an arrangement similar to that described in section 856(d)(8)(B)(ii), in which employees of a TRS are supervised by an EIK. The Community Employees supervised by Operator, however, will not be employees of Subsidiary, the TRS, but of the Sub LPs, which are limited partnerships with respect to which Sub GP has all management rights.

CONCLUSION

Based on the facts submitted and representations made, we conclude that, following the Acquisition, Subsidiary will not be considered to be directly or indirectly operating or managing a health care facility within the meaning of section 856(l)(3)(A) as a result of Subsidiary's indirect majority ownership interests in the Sub LPs, each of which will own a Community and employ Community Employees that work in such property under the control of Operator pursuant to the management agreements as described in this letter.

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 as to whether Taxpayer otherwise qualifies as a REIT or whether Subsidiary otherwise qualifies as a TRS of Taxpayer under part II of subchapter M of chapter 1 of the Code. Furthermore, no opinion is expressed as to whether the Communities qualify as health care facilities within the meaning of section 856(e)(6)(D)(ii).

This ruling is directed only to the taxpayers that requested 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.

Sincerely,

_____

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

cc: