



Dear \_\_\_\_\_ :

This responds to a letter, dated December 14, 2018, requesting certain rulings on behalf of Taxpayer under section 856 of the Internal Revenue Code ("Code"). Specifically, Taxpayer requests the following rulings:

1. The Proposed Structure (as described below) will not result in any entity other than EIK Manager being treated as managing and operating State A Facilities within the meaning of section 856(l)(3).
2. The Proposed Structure will not cause the rent paid by a taxable REIT subsidiary ("TRS") of Taxpayer to fail to qualify for the section 856(d)(8)(B) exception for related party rents received from a TRS.
3. The Proposed Structure will not result in Taxpayer being considered to own any securities of a License Holder (as defined below) for purposes of section 856(c)(4) or stock of a License Holder for purposes of section 856(l).

#### FACTS

Taxpayer is a publicly traded State B corporation that elected to be a real estate investment trust ("REIT") beginning with its tax year ended Date 1 and has intended to qualify as a REIT for all subsequent periods. Taxpayer invests primarily in real estate serving the health care industry in the United States. Taxpayer owns, through certain entities that are disregarded as separate from Taxpayer for federal income tax purposes, a portfolio of Facilities. Each Facility is a qualified health care property and is currently leased to an unrelated third party pursuant to a triple-net lease.

EIK Manager is a State C corporation that is actively engaged in the business of operating Facilities. EIK Manager is not an affiliate of Taxpayer. EIK Manager currently manages Taxpayer's Facilities pursuant to management agreements with the third-party tenants.

Taxpayer intends to transition the leasing, operation, and management of the Facilities to the structure described in section 856(d)(8)(B) (the "Statutory Structure"). Lessee is a State D limited liability company that has elected to be treated for tax purposes as a corporation and a TRS of Taxpayer. Taxpayer intends to lease each of its Facilities not located in State A to Lessee, which will enter into an arms-length management contract with EIK Manager to operate each Facility.

The State A Facilities are Taxpayer's Facilities located in State A. State A imposes a number of regulatory requirements on the operation of certain facilities (including Facilities), including a requirement that licenses to operate facilities be

granted only to natural persons or certain entities that are either (a) not owned publicly or by other companies or (b) operated on a not-for-profit or governmental basis.

State A regulations also require the holder of the license for a Facility to retain certain elements of control, including: (i) authority to hire and discharge workers, dispose of assets, incur liabilities, and adopt certain policies on behalf of the Facility, (ii) control of the Facility's accounts and books and records; and (iii) approval of certain budgets, contracts, and settlements.

Taxpayer intends to implement a structure similar to the Statutory Structure (the "Proposed Structure") for its State A Facilities to comply with these State A regulatory requirements. Taxpayer intends to implement the Proposed Structure for each State A Facility as follows:

1. Taxpayer (or a disregarded entity of Taxpayer) will lease the State A Facility to Lessee. The lease will conform to the leases between Taxpayer and Lessee for Taxpayer's Facilities not located in State A.
2. Lessee will sublease the State A Facility to one of the License Holders, each of which is a State C non-stock company that will hold a State A license to operate the State A Facility. (Each State A Facility will be subleased to a separate License Holder.) Rent under the sublease will be a fixed amount intended to convey annual operating income, net of operating and management expenses, from the State A Facility to Lessee.
3. The License Holder will enter into a management agreement with EIK Manager, pursuant to which EIK Manager will operate the State A Facility, subject to the managerial rights that the License Holder must retain under State A regulations. The License Holder will satisfy State A regulatory requirements by retaining its authority to exercise the specified powers but will not have employees or the capacity to perform meaningful daily operational or managerial functions. Under the management agreement, EIK Manager will perform the same functions for the State A Facility as for Taxpayer's non-State A Facilities. EIK Manager will manage day-to-day operation of the State A Facility, which will not differ from the operation of Taxpayer's non-State A Facilities. EIK Manager will earn an arm's-length, market-rate fee comprising a fixed percentage of the gross revenues and an incentive fee. Lessee will guarantee the License Holder's obligations under the management agreement.
4. Lessee and EIK Manager will enter into a side letter providing that: (a) the intended net economic effect of the structure is that the License Holder facilitates Lessee's engagement of EIK Manager in a direct management agreement; (b) the purpose of the License Holder in the structure is to comply with State A regulatory requirements; (c) Lessee and EIK Manager will make periodic true-up payments to each other if necessary to ensure that the economic arrangements for the State A Facility are the same as the economic arrangements that exist with respect to

Taxpayer's non-State A Facilities, including payments upon dissolution of the License Holder, which may result in amounts attributable to the residual income of the License Holder, if any, or a portion thereof, being paid to Lessee by EIK Manager; and (d) to the extent practical and consistent with State A law, the State A Facility will be operated and managed by EIK Manager in the same manner as the non-State A Facilities that EIK Manager operates and manages for Lessee.

Taxpayer will appoint directors of the License Holders, and such directors may be employees and officers of Taxpayer or EIK Manager. The board of each License Holder will have sole authority to manage the affairs of the company. The board of directors will have separate fiduciary duties to the License Holder, and Taxpayer will have no contractual or other right to control the decisions or behavior of the officers and directors in such capacities. Taxpayer will insure and indemnify the officers and directors of the License Holders against any personal liability to which they may be exposed by acting in such capacities.

Neither of the Non-Stock Companies will have members. The articles of incorporation of each Non-Stock Company will provide that, upon dissolution, assets will be distributed: first, to any creditors in satisfaction of any liabilities and obligations owed by the License Holder; second, to any other claimholders of the License Holder; and finally, the residual to EIK Manager.

Each License Holder will be accountable for regulatory compliance to State A. Penalties can be imposed by State A on a License Holder for noncompliance with State A rules and regulations, and financial reports must be periodically submitted by the License Holders to the relevant State A licensure body.

Taxpayer makes the following additional representations:

1. Each of the State A Facilities is a qualified health care property within the meaning of section 856(e)(6)(D).
2. The Proposed Structure is necessary and appropriate to enable the License Holders to comply with State A Law and is designed to ensure that each License Holder will be financially able to satisfy its obligations in accordance with state law requirements. The arrangements will enable the License Holders to secure the proper licenses, management services, and funding necessary to operate the State A Facilities while also ensuring that the net economic effect of the arrangement effectively replicates that of the Statutory Structure.
3. Although State A law requires the License Holders to retain certain indices of control over the State A Facilities, the License Holders will not perform management or operational functions at the State A Facilities on a daily basis. The daily activities will be the responsibility of EIK Manager. The EIK Manager has complete and full control and discretion in the operation, direction, management, and supervision of the State A

Facility, subject only to regulatory control requirements. The day-to-day involvement of the non-stock company will be limited to (i) approval of proposed annual budgets and specified contracts and (ii) ensuring there is adequate working capital available to EIK Manager for operations and repairs.

4. Taxpayer will have no direct or indirect, current or residual equity interest in any of the License Holders. Upon liquidation of a License Holder, none of the remaining assets will be distributed to Taxpayer or its affiliates, officers, or directors.

5. Taxpayer may, from time to time, make loans to a License Holder if the License Holder's revenue is inadequate to pay its obligations as they come due. Any such loans will constitute "straight debt" under section 856(m).

6. Upon entering into the management agreement for each State A Facility, EIK Manager will qualify as an "eligible independent contractor" as defined in section 856(d)(9)(A) with respect to the Facility.

#### 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, including dividends; interest; rents from real property; gain from the sale or other disposition of stock, securities, and real property (other than section 1221(a)(1) property); 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 interests in real property; gain from the sale or other disposition of real property (other than section 1221(a)(1) property); dividends from REIT stock 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; gain from certain sales or other dispositions of real estate assets; and qualified temporary investment income.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year

does not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(B) provides that rents from real property do not include 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 the 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)(8)(B) provides that amounts paid to a REIT by a TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) if the amounts are paid for a qualified lodging facility or qualified health care property leased by the REIT to a TRS of the REIT, and the facility or property is operated on behalf of the TRS by a person who is an eligible independent contractor. For this purpose, section 856(d)(8)(B)(i) provides that a TRS is not considered to be operating or managing a qualified health care property or qualified lodging facility solely because it directly or indirectly possesses a license, permit, or similar instrument enabling it to do so.

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 REIT's shares, or certificates of beneficial interest; 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 of the REIT.

Section 856(d)(9)(A) provides that the term eligible independent contractor means, with respect to any qualified lodging facility or qualified health care property, any independent contractor if, at the time such contractor enters into a management agreement or similar service contract with the TRS to operate the facility or property, the 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(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 a TRS. Section 856(l)(3)(A) provides as an exception that a

corporation that directly or indirectly operates or manages a lodging facility or a health care facility is not a TRS.

The License Holders should not be treated as managing or operating the State A Facilities merely because they hold the licenses for the State A Facilities and retain certain control over the State A Facilities as required by State A. Section 856(d)(8)(B)(i) shows that Congress did not equate holding a license for a property with operating or managing the property. The entity that is actually responsible for the operation and day-to-day management of a property should be treated as managing or operating the property. Notwithstanding the rights License Holder is required to retain under state law, EIK Manager will be responsible for the day-to-day management of the State A Facilities under the Proposed Structure to the same extent as for non-State A Facilities under the Statutory Structures.

The economics of the Proposed Structure are not materially different from those of the Statutory Structure. The Statutory Structure allows an eligible independent contractor with no leasehold or other property interest in a qualified health care property leased by a REIT to a TRS to manage such property in exchange for a fee. Based on Taxpayer's representations, the net economic effect of the Proposed Structure is that EIK Manager will receive a fee for managing each State A Facility by operation of a management agreement and side letter. The interposition of the License Holders to satisfy the requirements of State A law should not disqualify the Proposed Structure under section 856(d)(8)(B) because, under the arrangement among the parties, the License Holders effectively function as conduits through which Lessee hires EIK Manager.

Based on Taxpayer's representations that (a) neither Taxpayer nor Lessee holds any equity interest in the License Holders and (b) the true-up payments under the side letters are to replicate the economics of the Statutory Structure, neither Taxpayer nor Lessee has an economic interest in a License Holder that is equivalent to the stock or securities of a License Holder.

### CONCLUSION

Based on the information submitted and the representations made, we rule as follows:

1. The Proposed Structure will not result in Lessee or License Holder being treated as managing and operating the State A Facilities within the meaning of section 856(l)(3).
2. The Proposed Structure will not cause the rent paid by Lessee to Taxpayer under the lease for a State A Facility to fail to qualify for the section 856(d)(8)(B) exception for related party rents received from a TRS.

3. The Proposed Structure will not result in Taxpayer being considered to own any securities of a License Holder for purposes of section 856(c)(4) or stock of a License Holder for purposes of section 856(l).

Except as specifically ruled upon above, no opinion is expressed or implied concerning any federal income tax consequences related to the facts herein under any other provisions of the Code. Specifically, no opinion is expressed or implied on whether Taxpayer otherwise qualifies as a REIT under subchapter M of chapter 1 of the Code. Further, no opinion is expressed or implied on any structure resulting from liquidation of a License Holder.

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. The ruling contained in this letter is based upon information and representations submitted by the Taxpayer under a penalties of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this ruling request, it is subject to verification on examination.

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

Sincerely,

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

cc: