Internal Revenue Service

Number: **200448015**
Release Date: 11/26/04
Index Number: 47.01-00

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:PSI:B06
PLR-121987-04
Date:
July 29, 2004

LEGEND

Company	=
Historic Building	=
Government Entity 1	=
Government Entity 2	=
Government Entity 3	=
X acres	=
Y acres	=
Building 1	=
Building 2	=
Building 3	=
Lot 1	=
Center 1	=
Center 2	=
North Building	=
Property	=
Hall Property	=
Lot 2	=
City, Inc.	=
A square feet	=
B square feet	=
C square feet	=
D square feet	=
E square feet	=
F square feet	=
G square feet	=
H square feet	=

I square feet =
J square feet =
K square feet =
L square feet =
Numerator total =
Denominator total =
X percent =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
SB/SE Official =

Dear :

This is in response to your letter dated April 19, 2004, and subsequent correspondence requesting rulings under section 168 (h)(1)(B) of the Internal Revenue Code on behalf of Company regarding a multifaceted transaction that includes the rehabilitation of Historic Building.

FACTS

Historic Building is listed in the National Register of Historic Places. Government Entity 2 owns Historic Building and X acres of land underlying, surrounding or located across the road from it (together "Existing Property"). Company will enter into a "Master Lease and Construction Agreement with Option to Purchase" ("Master Lease") under which Company will lease and then acquire Existing Property from Government Entity 2. Company is also acquiring from private property owners other parcels of real property contiguous to, and interlaced with, Existing Property. Ultimately, Company will own a Y-acre contiguous tract of land, including the land under Historic Building (excluding dedicated public streets).

Pursuant to a single "plan," Company will construct three new buildings, Building 1, Building 2, and Building 3 on this Y-acre parcel and will rehabilitate Historic Building. Local law mandates the construction of the structured parking as part of this development. Thus, the lower levels of Building 2 will contain Lot 1, which will be connected to the upper levels by elevators. Lot 1 will have approximately D square feet of "net rentable floor space" defined in part by the Company as the total square footage of floor space measured from the inside surface of the outer building wall, less "vertical penetrations" and common areas. A portion of Lot 1 can be utilized as warehouse space. Buildings 1, 2, and 3 and the renovated Historic Building (together "Campus") will be connected to each other through connectors and enclosed links and will function as a single, integrated campus for the use and occupancy of Government Entity 1.

Construction of the Campus, and of Lot 2, Center 1 and Center 2, all of which are located across the road from the Campus, will occur pursuant to a single construction contract. Construction expenses will be funded by equity from Company and taxable bonds. Company will also receive financial assistance under a tax increment financing plan for certain other expenses related to Campus, construction of Lot 2, renovation of Property and Hall Property, also across the road from Campus, and other properties.

Company will initially lease Existing Property from Government Entity 2 under the Master Lease. Company will hold a construction easement and right-of-way allowing it to demolish certain structures and to do all work required to construct the Campus. Following execution of the Master Lease, Company will begin construction related to Buildings 1, 2 and 3. Company may begin rehabilitation work on Historic Building before it takes title to Historic Building; however, the rehabilitation work on Historic Building will not be completed, and the rehabilitated Historic Building will not be placed in service until after Company takes title to Historic Building. Company will then lease Y acres back to Government Entity 2 and proceed with construction. Government Entity 2 will enter into a sublease with Government Entity 3 for the use and occupancy of the Campus by Government Entity 1 ("Sublease A"). Before Government Entity 1's tenancy under Sublease A begins, title to Existing Property will be transferred to Company and the Master Lease will terminate.

Sublease A consists of three components: the Memorandum of Understanding; Lease Specifications; and General Clauses. Sublease A will be assigned to Company. After the assignment, Company will become the lessor of Campus to Government Entity 3 under Sublease A. Company and Government Entity 2 have agreed that Sublease A will be assigned by Government Entity 2 to Company on the date of substantial completion and acceptance by Government Entity 3 of the entirety of the premises leased to Government Entity 3 under Sublease A. Sublease A provides that the final portion of the premises shall be delivered as substantially complete to Government Entity 3 no later than Date 1 and that subject to extensions granted for excusable delays, if the entire premises are not substantially complete by Date 2, Government Entity 3 will have the right to terminate Sublease A. The term of Company's lease to Government Entity 2 of the premises subleased to Government Entity 3 under Sublease A will commence upon commencement of the term of Sublease A and will terminate simultaneously with the assignment of Sublease A to the Company. Therefore, because the leased premises will be delivered to Government Entity 3 in installments under the terms of Sublease A, Sublease A will not be assigned to Company, and Company's lease to Government Entity 2 of Y acres will not terminate, until after the tenants occupancy under Sublease A begins.

Under section 9 of the Memorandum of Understanding (MOU) attendant to Sublease A, upon Government Entity 3's acceptance of the last increment of space, a series of Rent Commencement Dates (which follows substantial completion and acceptance by Government Entity 3 of certain increments of space) will be blended into a composite weighted average in order to establish the "Lease Commencement Date," which will be computed by taking in account the date of space acceptance by

Government Entity 3 and the percentage of space delivered as of each Rent Commencement Date relative to the total space to be leased by Government Entity 3. The Lease Commencement Date will become the benchmark for the Lease anniversary date for all purposes of Sublease A. Under section 6 of the MOU, the lease term shall be for a period of 15 years from the Lease Commencement Date. Pursuant to section 14 of the MOU, it is anticipated that the first incremental delivery and acceptance date will be Date 3. Pursuant to section 15 of the MOU, if the anticipated Lease Commencement Date is Date 4, then the 15-year term will end on Date 5.

Also attendant to Sublease A is the General Clauses. Section 58 of the General Clauses sets forth certain renewal options involving Sublease A (see also representations 3 and 4 herein). These renewal options are discussed in the Company's supplemental submission of June 16, 2004. A revised Section 58, as executed by the parties, accompanied that submission. Section 58 contains four renewal options. Renewal Option 1 allows Government Entity 3 to renew the initial 15-year lease term for 5 additional years at a fixed-price renewal. This renewal option must be exercised within 12 months after the expiration of the fifth year of the initial lease term. Renewal Option 2 also allows Government Entity 3 to renew the initial 15-year lease term for 5 additional years at a fixed-price renewal. Renewal Option 2 must be exercised within 12 months after the expiration of the tenth year of the initial lease term. As an incentive for Government Entity 3 to make an early commitment to exercise a renewal option, Government Entity 3 will pay a lower renewal rate if it exercises Renewal Option 1. Renewal Option 3 permits Government Entity 3 to extend the term of Sublease A for an additional 5 years after the expiration of the 5-year term in Renewal Option 1 or Renewal Option 2, whichever is chosen. The rental rate for this renewal period shall be set at fair rental value determined at the time of renewal. Renewal Option 4 permits Government Entity 3 to extend the term of Sublease A for an additional 10 years after the end of the initial 15-year lease term if Government Entity 3 does not exercise either Renewal Option 1 or Renewal Option 2. The rental rate for this renewal period shall be set at fair rental value determined at the time of renewal.

Section 58 states "[i]n no event shall the lease period for the firm term of this Lease and the Option 1 or Option 2 renewal period exceed twenty [20] years as measured from the first day any portion of the Premises [Campus] is delivered and accepted as substantially complete by [Government Entity 3] under this Lease (excluding pre-substantial completion access provided to [Government Entity 3] and its contractors to prepare for occupancy)." Section 58 thus places a 20-year limit on the above lease term of Sublease A if Renewal Option 1 or 2 is exercised. Conforming language is included in Section 58(a), which sets forth Renewal Option 1, and Section 58(b), which sets forth Renewal Option 2.

Accordingly, the 20-year limitation in Section 58 above means that the renewal term of Renewal Option 1 or 2 will end no later than Date 7, which is a period not

exceeding 20 years from Date 3, the anticipated date any part of the leased premises (i.e., the Campus) is first made available to Government Entity 3.[1]

During the term of Sublease A, Government Entity 1 will have the flexibility to convert warehouse space into additional parking spaces or to convert some of the original parking spaces into warehouse or office space, at its discretion. Government Entity 1 will have the exclusive right to possession, use and occupancy of Building 2, including Lot 1, which will not be available or accessible to the public or to anyone other than the employees and other personnel of Government Entity 1 and such access will be limited by the security requirements of Government Entity 1. Government Entity 1 or Government Entity 3 will maintain security around the perimeter of the Campus, including check points at all entrances to Lot 1. Government Entity 1 or 3 will maintain security also at Center 2, which will restrict access to an underground tunnel connecting Historic Building with North Building and running beneath the road between the two.

Sublease A will state that the lessor leases to Government Entity 1 office and related space equal to L rentable square feet and that the rental due from Government Entity 3 will be for no more than L square feet regardless of any overage. Sublease A provides that Lot 1 is available only for use by Government Entity 1. Lot 1 has net rentable floor space equal to D square feet. Under Sublease A, Government Entity 1 will have the exclusive right to possess, use and occupy the Campus.

Across the road from the Campus is Property, which is owned by City, Inc., a tax-exempt entity not related to Government Entities 1, 2 or 3. As part of this development, Company will lease from City, Inc. and sublease to Government Entity 2 space in

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[1] This is significant because the Lease Commencement Date (Date 4), which is the measuring date for the combination of the 15-year initial lease term and the 5-year renewal lease term set forth in Renewal Options 1 and 2, occurs after Date 3, the anticipated earliest date on which any part of the leased property is made available to Government Entity 3. For purposes of the lease term rules under section 168(i)(3), the Service's rulings position is that the term of a lease to a tax-exempt entity begins on the earliest date on which any part of the leased property is made available to a tax-exempt entity (or a related party). Therefore, since the date on which the term of Sublease A ends, taking into account both the 15-year initial lease term and the 5-year renewal term under either Renewal Option 1 or 2, could, without the limitation in section 58, occur more than 20 years from the earliest date on which any part of the leased premises is made available to Government Entity 3, the entire property (i.e., the Campus) would be subject to a lease to a tax-exempt entity with a term in excess of 20 years. Under section 168(h)(1)(B)(ii)(III), the Campus would be subject to a disqualified lease and thus would be tax-exempt use property. However, by providing that in no event shall the renewal term of Renewal Option 1 or 2 end after Date 7, Section 58 of the General Clauses ensures that for purposes of sections 168(h) and (i), the term of Sublease A (not including renewal options at fair rental value) will not exceed 20 years from the earliest date any portion of that property is made available to Government Entity 3. Consequently, it will not be subject to a disqualified lease under section 168(h)(1)(B)(ii)(III).

Property for the relocation of Government Entity 2's operations currently conducted in Historic Building. Company will lease this property from City, Inc., perform substantial renovations to North Building and will also prepare Hall Property, a small space in the Property for use by Government Entity 2 and then lease this space to Government Entity 2. North Building and Hall Property are owned by City, Inc. These leases and subleases will each be for a term in excess of 20 years (collectively, "Sublease B"). During renovation, Company will lease Historic Building to Government Entity 2 for its continuing operations. Upon completion of the renovations, Government Entity 2 will relocate to the properties across the road from Historic Building.

Government Entity 2 will use part of North Building for its operations. North Building has never been owned by Government Entity 2 nor any entity related to Government Entity 2 within the meaning of section 168(h)(4). However, Government Entities 1, 2 and 3 are related parties within the meaning of section 168(h)(4).

The cost to Company of renovating North Building will be the main consideration to be paid by Company for the Existing Property, that is the Company is essentially renovating the North Building in exchange for ownership of Existing Property.

In order to meet certain obligations under the above leases, Company has agreed to construct Lot 2 on Property. City, Inc. will own Lot 2, but Company as owner of Campus will hold a long-term easement to use Lot 2 to meet the parking needs of its tenants. A large number of parking spaces in Lot 2 will be provided to Government Entity 1 under Sublease A, which will be apportioned out according to a schedule for use by employees of Government Entity 1 or by such employees and other tenants. A smaller number of spaces will be provided to Government Entity 2 under Sublease B. The remaining parking spaces will be made available for use by Property. Construction work in North Building and Hall Property will occur under a construction contract separate and apart from the construction contract for Campus.

Under Sublease A, Company will sublease to Government Entity 3 a small space in the lower level of North Building for use by Government Entity 1 as an employment application/testing center ("Center 1"), and another small space, which will be newly-constructed and will be near North Building, adjacent to Lot 2 ("Center 2"). Center 1 will be accessible through a staircase in Lot 2. Center 1 and Center 2 will be owned by City, Inc. The two centers will be linked by a newly-constructed tunnel. There will be no open means of access between Center 1 and North Building. Center 2 will be operated by Government Entity 1 solely for its own purposes. Government Entity 2 will have no right to use, occupy or enter Center 1 or Center 2. Government Entity 1 and Government Entity 3 will have no right to use, occupy or enter North Building.

Company will acquire from Government Entity 2 a parcel of unimproved real property near Historic Building upon which it will construct another parking structure. It will then exchange the parking structure and the underlying land (collectively "Exchanged Property") for privately owned land near Historic Building. Company will have no continuing ownership interest in the Exchanged Property. The property constructed on the land received will be included in this plan.

The following shows the net rentable floor space of the components of the Campus: (1) Historic Building: A square feet; (2) Building 1: B square feet; (3) Building 2, which consists of office space equal to C square feet, and Lot 1 equal to D square feet; and (4) Building 3: E square feet. The total net rentable floor space is F square feet.

The following shows the net rentable floor space of the properties across the road from the Campus, which are being constructed or renovated as part of this plan: (1) North Building: G square feet; (2) Hall Property: H square feet; (3) Lot 2: I square feet; (4) Center 1: J square feet; and (5) Center 2: K square feet.

Company makes these additional representations:

1. The economic substance of Sublease A between Company and Government Entity 3 will be a "true lease," and Company will own Historic Building for federal income tax purposes.

2. The rehabilitation of Historic Building and the construction of the other three buildings that comprise the Campus and the construction of Center 1 and Center 2 are all part of one plan or scheme to provide facilities for the use and occupancy by Government Entity 1 under Sublease A.

3. The initial term of Sublease A will be 15 years with the lease commencement date deemed to be the average weighted date of Government Entity 3's acceptance of substantially completed space in the various buildings leased to Government Entity 3 under Sublease A. Section 58 of the General Clauses to Sublease A provides for two separate options for Government Entity 3 to extend the lease term for a period of 5 years from the expiration of the initial 15-year term, each such option providing for a predetermined renewal rental rate. These options are mutually exclusive so that only one of these first renewal options may be exercised by Government Entity 3. In any event, the lease period for the initial term and the renewal period under either of these two predetermined rate renewal options may not exceed 20 years as measured from the first day any part of the property leased under Sublease A is delivered and accepted as substantially complete by the tenant (excluding pre-substantial completion access allowed to the tenant and its contractors to complete tenant improvements or prepare for occupancy).

4. Section 58 of the General Clauses to Sublease A provides Government Entity 3 with two other mutually exclusive renewal options, each at a rental rate equal to fair market value, determined at the time of renewal. One of these options is for a renewal term of 5 years, beginning upon the expiration of the five-year renewal period under either of the two first renewal options (i.e., the options to renew at a predetermined rate, as described in representation number 3 above). The other of these options is for a renewal term of 10 years, beginning upon expiration of the initial 15-year term of Sublease A, and is available only if Government Entity 3 has not exercised either of its options to renew at a predetermined rate.

5. There are no up-front understandings, informal arrangements or similar agreements between Company and Government Entity 3 to the effect that Government Entity 3's fair market value renewal option under Sublease A will be applied by the parties without regard to the actual fair market value rental of the premises at the time of renewal.

6. No portion of the Campus or the improvements constructed thereon (including rehabilitation of Historic Building) and no portion of the construction of Center 1, Center 2 or Lot 2 will be financed, directly or indirectly, by an obligation the interest on which is exempt from tax under section 103(a) of the Code.

7. Sublease A will not include, and Government Entity 3 and parties related to Government Entity 3 under section 168(h)(4) will not hold, a fixed or determinable price purchase or sale option or its equivalent with respect to Campus or any part thereof or with respect to Center 1, Center 2 or Lot 2.

8. Upon completing construction, the three buildings located on the Campus will contain approximately the number of square feet of "net rentable floor space" set forth above.

9. Upon their respective dates of availability for use after construction/renovation, the properties across the road from the Campus will contain approximately the above number of square feet of net rentable floor space.

In your request for rulings you asked us to consider the following issues:

1. Whether Historic Building will be treated as "tax-exempt use property" under section 168(h)(1)(B).

2. Whether the "property" for purposes of applying section 168(h)(1)(B) to the rehabilitation and leasing of Historic Building will include all of the net rentable floor space in Historic Building, Building 1, Building 2 (including Lot 1), Building 3, Center 1 and Center 2, but exclude all of the net rentable floor space in Lot 2, North Building, Hall Property and Exchange Property.

LAW AND ANALYSIS

Section 168(h)(1)(B)(i) defines the term "tax-exempt use property" to mean that portion of the property leased to a tax-exempt entity in a disqualified lease.

Under section 168(h)(1)(B)(ii), the term "disqualified lease" means any lease of the property to a tax-exempt entity, but only if – (I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a) and such entity (or a related entity) participated in such financing, (II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an

option, (III) such lease has a term in excess of 20 years, or (IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

Section 168(h)(1)(B)(iii) provides that section 168(h)(1)(B)(i) shall apply to any property but only if the portion of such property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property.

Section 168(h)(1)(B)(iv) provides that improvements to a property (other than land) shall not be treated as a separate property.

The only issue in this case is whether Historic Building is tax-exempt use property under section 168(h)(1)(B). In making this determination, two questions must be resolved: (1) Whether Historic Building is subject to a disqualified lease under section 168(h)(1)(B)(ii); and (2) Whether more than 35-percent of the "property" is leased to tax-exempt entities in disqualified leases.

Company represents that no portion of the Campus or the improvements to be constructed (including rehabilitation of Historic Building) will be financed, directly or indirectly, by an obligation the interest on which is exempt from tax under section 103(a), and therefore, no part of the Campus will be subject to a disqualified lease by reason of section 168(h)(1)(B)(ii)(I). Company further represents that Sublease A will not include, and Government Entity 3 and parties related to Government Entity 3 will not hold, a fixed or determinable price purchase or sale option or its equivalent with respect to Campus or any part thereof. Thus, Campus will not be subject to a disqualified lease by reason of section 168(h)(1)(B)(ii)(II). The initial term of Sublease A will not exceed the 20th anniversary of the first day any part of the Campus is made available to Government Entity 1 under Sublease A with Government Entity 3. Government Entity 3 will be able to exercise renewal options for 5 or 10 years at a rental rate equal to fair market value rental, determined as of the date of renewal. However, under section 168(i)(3), fair market value rental renewal options are not included in the term of the lease with respect to leases of real property. Since the rental renewal options in the instant case are for fair market value, the terms of such rental renewal options are not included in the term of the lease. Thus, no portion of the Campus is subject to a lease with a term in excess of 20 years and, as a consequence, no portion of the Campus would be subject to a disqualified lease by reason of 168(h)(1)(B)(ii)(III).

In the instant case, Government Entity 2 owned and used Historic Building before this transaction, and Government Entity 3 (and its tenant, Government Entity 1) will be using Historic Building after the transaction. Company acknowledges that Government Entities 1, 2, and 3 are all related entities for purposes of section 168(h). See 168(h)(4). Consequently, because a tax-exempt entity owned Historic Building before the transaction and a related tax-exempt entity will be leasing Historic Building after the transaction, standing alone Historic Building would be subject to a disqualified lease under the "use-after-transfer" rule in section 168(h)(1)(B)(ii)(IV).

Pursuant to Sublease B, North Building and Hall Property are subject to leases to tax-exempt entities with a lease term in excess of 20 years. As a result, North Building and Hall Property will be subject to disqualified leases under section 168(h)(1)(B)(ii)(III).

In the instant case, Company is constructing three new buildings for use with Historic Building. Company is engaged in the rehabilitation and construction of certain other buildings and facilities close to Historic Building. Section 168(h)(1)(B)(iv) provides that improvements to a property (other than land) shall not be treated as a separate property. The Report of the Senate Finance Committee, S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. (1984) ("Senate Report") to the Deficit Reduction Act of 1984, which enacted section 168(j), the predecessor of present section 168(h) above, states:

> The bill provides that improvements to property (other than land) will not be treated as separate property, but only for purposes of determining whether there is tax-exempt use of property not owned by a tax-exempt entity under the tax-exempt financing rule or the use after transfer rule. For example, if a governmental unit issues tax-exempt obligations, the proceeds of such issue are used by a taxpayer to acquire a building shell from a third party, and the taxpayer improves the building shell using other funds and leases the improved building to the governmental unit, the governmental unit will be treated as having participated in the tax-exempt financing of the entire property. Similarly, if a tax-exempt entity sells a building shell to a taxpayer and the taxpayer rehabilitates the building shell and leases the rehabilitated building back to the tax-exempt entity, the tax-exempt entity will be treated as using one property after a sale-leaseback.
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> On the other hand, if unimproved land is disposed of by a tax-exempt entity, a building is constructed on the land by the new owner, and the improved land is leased to the tax-exempt entity, the building will not be treated as having been the subject of a sale-leaseback.
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> Tax-exempt use property does not include improvements constructed by a taxable entity on underlying land or other property leased from a tax-exempt entity merely because the tax-exempt entity is the owner of the land or other property. For example, assume that a tax-exempt university leases land to a taxable entity for 45 years. The taxable entity constructs a building, which has an economic useful life of 40 years, on the land and leases it to a third-party taxpayer (or the university) for not more than 20 years. The building is not tax-exempt use property.

Senate Report at 132. See also, the Report of the House Ways and Means Committee, H. Rep. No. 432, Pt 2, 98th Cong., 2d Sess 1147 (1984) ("House Report").

Clearly, standing alone Historic Building would be covered by the first example where a tax-exempt entity sells a building shell to a taxpayer and the taxpayer rehabilitates the building shell and leases the rehabilitated building back to the tax-exempt entity. In such case, the tax-exempt entity will be treated as using one property after a sale-leaseback. However, the next example above provides that buildings constructed on land previously owned by a tax-exempt entity will not be treated as having been the subject of a sale-leaseback for purposes of section 168(h)(1)(B) even if leased back to the tax-exempt entity. Therefore, Buildings 1, 2 and 3, which are new buildings being constructed by Company for lease to Government Entity 3 on land previously owned in part by Government Entity 2, would not be treated as the subject of a sale-leaseback to a tax-exempt entity under this separate properties rule.

The second question therefore is whether the taint of the "use-after-transfer" rule is removed from Historic Building by virtue of the fact that Company is constructing three new buildings on land contiguous to Historic Building and engaged in the rehabilitation and construction of other buildings and facilities across the road from Campus. The answer to this question is addressed in section 1.168(j)-1T, A-6, of the temporary Income Tax Regulations. That temporary regulation provides that the phrase "more than 35 percent of the property" in section 168(h)(1)(B)(iii) of the Code means more than 35 percent of the net rentable floor space of the property. The net rentable floor space in a building does not include the common areas of the building, regardless of the terms of the lease. For purposes of the "more than 35 percent of the property" rule, two or more buildings will be treated as separate properties unless they are part of the same project in which case they will be treated as one property. Two or more buildings will be treated as part of the same project if the buildings are constructed, under a common plan, within a reasonable time of each other on the same site and will be used in an integrated manner.

Section 1.168(j)-1T, A-6 is consistent with the Senate Report, which states:

> However, in no event will any portion of any 15-year or 20-year real property be treated as tax-exempt use property unless more than 50 percent (35 percent in the case of use by one tax-exempt entity and related tax-exempt entities) of the property is used by tax-exempt entities in a use of a type or types described above. For purposes of this rule, each building will be treated as a separate property unless two or more buildings are part of one project. In the latter case, the entire project will be treated as one property. …
>
> The committee intends that a tax-exempt entity or entities will be treated as using the percent of a building equal to the percent of the net rentable floor space in the building it or they are leasing. Net rentable floor space is not to include common areas.

Senate Report at 129. See also, the House Report at 1144.

As noted above, Historic Building, North Building and Hall Property are all subject to disqualified leases to tax-exempt entities. Concerning such situations, section 1.168(j)-1T, A-7 provides that disqualified leases to different tax-exempt entities (regardless of whether they are related) are aggregated in determining whether real property is tax-exempt use property. The regulation contains the following example:

> Ex*ample.* A tax-exempt entity participates in industrial development bond financing for the acquisition of a new building by a taxable entity. The tax-exempt entity leases 60 percent of the net rentable floor space in the building for 5 years. Sixty percent of the building is tax-exempt use property. If the same tax-exempt entity leased only 19 percent of the net rentable floor space in the building for 5 years, no portion of the building would be tax-exempt use property because not more than 35 percent of the property is leased to a tax-exempt entity pursuant to a disqualified lease. If such tax-exempt entity leased only 19 percent of the net rentable floor space in the building for 5 years and another tax-exempt entity leased 20 percent of the net rentable floor space in the building for a term in excess of 20 years (or a related entity leased 20 percent of the building for 5 years), 39 percent of the building would be tax-exempt use property.

In our view, Historic Building, Buildings 1, 2 (which includes Lot 1) and 3, Center 1, Center 2, North Building, Hall Property, and Lot 2 are all part of the same project. For instance, even though a public road separates the Campus from the other buildings, a road is an inconsequential barrier that would not preclude a series of buildings from being considered part of the same project. Moreover, a tunnel runs under that road and connects Campus with the other buildings. Consequently, we think that all of these buildings would be considered to be constructed on the same site as Historic Building.

In addition, construction of all buildings and Lots 1 and 2 is being conducted as part of the same common scheme or plan as the renovation of Historic Building, even if more than one construction company is used. Company is a party to all construction contracts and has planned and financed the acquisition of land, construction of improvements and renovation of those buildings being renovated. Further, all of the construction regarding the Campus (i.e., Buildings 1, 2 and 3), the renovation of Historic Building, the work on the North Building and the Hall Property, the construction of Lot 2, etc. will be done within a reasonable time of each other. All buildings and properties will be connected and used by the personnel or employees of government entities that are related to each other within the meaning of section 168(h)(4) of the Code. Thus, these buildings and properties will be used in an integrated manner, and the construction, lease and development of these buildings and properties are being planned and undertaken by Company in an integrated manner. We therefore conclude

that Buildings 1, 2 (which includes Lot 1), and 3, Historic Building, Lot 2, Center 1 and Center 2, North Property and Hall Property are all part of the same project, and that this project constitutes the "property" for purposes of applying section 168(h)(1)(B)(iii).

In our view, the Exchange Property is not to be included in the project since Company represents that it will be immediately exchanged for privately owned land south of Historic Building. At that point, Company will have no continuing ownership interest in the Exchange Property. Consequently, the Exchange Property does not appear to be part of this project. The land received in exchange for the Exchange Property underlies part of the Y-acre campus. That portion of any building or buildings that are constructed on land received for the Exchange Property are included in the calculation of net rentable floor space for purposes of application of the 35-percent rule.

The remaining inquiry is whether more than 35-percent of the net rentable floor space in the Campus is subject to a disqualified lease. Since only Historic Building, North Building and Hall Property will be subject to disqualified leases, the amount of net rentable floor space that would be considered tainted equals Numerator Total. If Lot 1 in Building 2, which equals D square feet, is considered part of net rentable floor space of the Campus, then the total net rentable floor space in Campus equals F square feet. In our view, Lot 1 should be considered part of the net rentable floor space rather than part of the common areas (and thus excluded from net rentable floor space) because Government Entity 1 is the only user of Lot 1. Further, security for Lot 1 is provided by Government Entity 1 (or Government Entity 3) and access is limited to the employees and other personnel of Government Entity 1. There is no other user of this area. That is, Lot 1 is not open to the public, to any other entity or to any other user. Lot 1 cannot therefore be considered a common area dedicated to more than one user.

This view is buttressed by Congress in its discussion of Small Issue Industrial Development Bonds ("IDB") in the Senate Report to the Deficit Reduction Act. This discussion provides some insight into what may be included in "common facilities," a concept analogous to the common area concept in the tax-exempt use property rules. Specifically, the Senate Report states:

> The bill provides a special rule which prevents avoidance of the limitations on small issue IDBs through division of the ownership of a project. Under the rule, where two or more issues of IDBs are used to finance a single building, an enclosed shopping mall, or a strip of offices, stores, or warehouses which use substantial common facilities, the two or more issues are treated as a single issue for purposes of determining qualification under the small issue exception, and all principal users of any of the facilities financed with the issue are treated as principal users of a single facility. … .
>
> Examples of common facilities include situations where there are (1) common heating, cooling and other facilities or (2) common entrances, plazas, malls, lobbies, parking,

> elevators, and stairways for use by employees or patrons of the facilities. In order for there to be common facilities, the two facilities used by the different users generally must be contiguous. For example, all units in a strip shopping center which use a common parking lot would be treated as a single facility (regardless of whether the strip shopping center is physically divided into more than one structure) because the structures are essentially contiguous to each other. However, two or more stores located in a downtown redevelopment project which are not contiguous to each other generally would not be treated as a single project. Structures which are separated by inconsequential barriers, such as rights of way, would be treated as contiguous for this purpose.

Senate Report at 701. See also House Report at 1694.

The above language indicates that for a facility, such as a parking lot, to be considered common, there must be more than one user of a facility. In the instant case, because there is not more than one user of Lot 1, it cannot be considered common, i.e., a "common area." Since Lot 1 is not tainted property subject to a disqualified lease, it would be excluded from the numerator but included in the denominator for purposes of the 35-percent test in section 168(h)(1)(B)(iii). However, with respect to Lot 2, there is more than one user. Consequently, Lot 2 would be considered a common area and therefore would be excluded from all computations involving the 35-percent rule.

In this case, we conclude that, for purposes of the more than 35-percent rule in section 168(h)(1)(B)(iii), the amount of net rentable floor space subject to a disqualified lease as a percentage of the total amount of net rentable floor space should be computed by reference to the following: The amount of tainted net rentable floor space in Historic Building, North Building and Hall Property equals Numerator Total. The total net rentable floor space of this project equals the total net rentable square feet in Campus (including Lot 1), North Building, Hall Property, Center 1 and Center 2. The total net rentable floor space in the project thus approximates Denominator Total. Accordingly, Numerator Total as a percentage of Denominator Total approximates X percent, which is far less that 35-percent. Because not more than 35 percent of the property is subject to disqualified leases, under section 168(h)(1)(B)(iii), no portion of the property, which would include Historic Building, will be treated as tax-exempt use property.

CONCLUSIONS

1. Historic Building will not be treated as tax-exempt use property because, for purposes of applying section 168(h)(1)(B)(iii), not more than 35 percent of the "property" is leased to tax-exempt entities in disqualified leases.

2. Historic Building, Building 1, Building 2 (including Lot 1), Building 3, Center 1, Center 2, Lot 2, North Building, and Hall Property are included in

the “property” for purposes of applying section 168(h)(1)(B) because they are part of a single, integrated “project.”

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of the transaction described above under any other provision of the Code, including section 47. Accordingly, no opinion is expressed regarding whether the rehabilitation of Historic Building is a “substantial rehabilitation” or a “certified rehabilitation” within the meaning of the applicable rehabilitation credit provisions under section 47, or whether expenditures incurred to rehabilitate Historic Building are “qualified rehabilitation expenditures” under those provisions.

This ruling is directed only to the taxpayer on whose behalf it was requested. Section 6110(k)(3) provides that it may not be cited or used as precedent.

In accordance with the power of attorney, we are sending copies of this letter to your authorized representatives. We are also sending a copy of this letter to the SB/SE Official.

Sincerely,

Mark Pitzer
Senior Counsel, Branch 6
(Passthroughs & Special Industries)