Internal Revenue Service

Number: **201139005**
Release Date: 9/30/2011

Index Number: 856.01-00

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:FIP:B03
PLR-152459-10

Date:
June 22, 2011

Legend

Taxpayer	=
Hotel	=
OP	=
GP	=
TRS	=
LLC 1	=
LLC 2	=
LLC 3	=
Company	=
LP	=
Year 1	=
State A	=
a	=
b	=
c	=
d	=
e	=

Dear :

This responds to a letter, dated December 20, 2010, on behalf of Taxpayer. Taxpayer requests rulings under sections 856(c), (d), and (l) of the Internal Revenue Code ("Code) concerning the leasing and the operation and management of Hotel.

FACTS

Taxpayer is a domestic corporation that was formed in Year 1 to invest in and lease commercial real estate. Taxpayer owns real property and improvements comprising Hotel, which is leased and operated as described below. Taxpayer elected to be taxed as a real estate investment trust (REIT) on its Year 1 Federal income tax return. Taxpayer's stock is owned by, among others, OP, a limited partnership approximately a percent of the interests in which are owned by GP, a publicly traded REIT.

Taxpayer represents that Hotel is a "qualified lodging facility" within the meaning of section 856(d)(9)(D) of the Code. Hotel is owned by LLC 1, a State A limited liability company that is wholly owned by Taxpayer and is disregarded as separate from Taxpayer for Federal income tax purposes. Hotel is leased by LLC 1 to TRS, a State A corporation that is wholly owned by Taxpayer. Taxpayer represents that the terms of the lease are consistent with those customarily used for leases of similar property between unrelated parties. Taxpayer and TRS have jointly elected to have TRS treated as a taxable REIT subsidiary under section 856(l).

Pursuant to a management agreement, Hotel is managed by LLC 2, a State A limited liability company. LLC 2 is wholly owned by Company, a State A corporation, and is disregarded as separate from Company for Federal income tax purposes. LP, a State A limited partnership, employs the persons providing services at Hotel. LLC2 owns a b percent limited partnership interest in LP. LLC 3, a State A limited liability company that is wholly owned by LLC 2 and is disregarded as separate from LLC 2 for Federal income tax purposes, owns a c percent general partnership interest in LP.

Taxpayer represents that Company is an "independent contractor" within the meaning of section 856(d)(3) with respect to Taxpayer and that Company is actively engaged in the trade or business of operating qualified lodging facilities, within the meaning of section 856(d)(9)(A), for entities unrelated to Taxpayer or TRS. Taxpayer also represents that LLC 2 and Company are owned by persons unrelated to Taxpayer for purposes of section 856(d)(8) and sections 52(a) and 52(b).

For reasons specified, Taxpayer desires to restructure the current arrangement. Taxpayer represents that while Hotel will continue to be owned by LLC 1 and leased from LLC 1 to TRS under terms consistent with those customarily used for leases of similar property between unrelated parties, the organizational structure related to the operation of Hotel will be modified as follows:

a. TRS will sublease Hotel to LP. LP will continue to employ the persons currently providing services at Hotel.

b. TRS will own the b percent limited partnership interest in LP that currently is owned by LLC 2. LLC 3 will continue to own the c percent general partnership interest in LP.

c. TRS's limited partnership interest in LP will not grant TRS any authority to direct the operations or management of Hotel. TRS may have certain governance rights in LP which will arise only in extraordinary circumstances that will be set forth in an agreement between the members of LP (Limited Partnership Agreement).

d. Company will own the d percent membership interest in LLC 3 that currently is owned by LLC 2.

e. LLC 2 and LP will enter into a management agreement under which LLC 2 will continue to manage Hotel.

f. LLC 2 will continue to be wholly owned by Company and disregarded as separate from Company for Federal income tax purposes. Company will continue to be actively engaged in the trade or business of operating qualified lodging facilities, within the meaning of section 856(d)(9)(A), for entities unrelated to Taxpayer or TRS. LLC 2 and Company will continue to be owned by persons unrelated to Taxpayer for purposes of section 856(d)(8) and sections 52(a) and (b).

g. Under the Limited Partnership Agreement, TRS will be given the authority to take certain "extraordinary actions" following either the delivery to LP of notice of the occurrence of certain material events of default or notice to LP from Taxpayer of termination of the sublease. The "extraordinary actions" include the right to terminate the management agreement, the right to remove and replace the general manager, and the right to dissolve LP. The "extraordinary actions" do not confer on TRS a right to operate or manage Hotel.

In connection with the leasing of Hotel, the portion of the rent that will be attributable to personal property will not exceed e percent of the total rent attributable to both the real and personal property.

LAW AND ANALYSIS

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(d)(1) provides that the term "rents from real property" includes (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 which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such 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, such lease.

Section 856(d)(2)(C) provides that any "impermissible tenant service income" is excluded from the definition of "rents from real property." Section 856(d)(7)(A) defines "impermissible tenant service income" to mean, 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 tenants at the property, or (ii) managing or operating the property.

Section 856(d)(7)(C) provides certain exclusions from "impermissible tenant service income." One such provision states 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 taxable REIT subsidiary ("TRS") of the REIT, are not treated as furnished, rendered, or provided by the REIT.

Section 856(d)(3) provides that a person which is a corporation is an "independent contractor" if --

> (A) it does not own, directly or indirectly, more than 35 percent of the shares or certificates of beneficial interest in the REIT, and
>
> (B) not more than 35 percent of the total combined voting power of its stock (or 35 percent of the total shares of all classes of its stock) 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)(2)(B) states that, except as provided in section 856(d)(8), the term "rents from real property" does 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 any person which is a corporation, stock of the person 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 person; or

(ii) in the case of any person which is not a corporation, an interest of 10 percent or more in the assets or net profits of the person.

Section 856(d)(8)(B) provides that amounts paid to a REIT by a TRS of the REIT will not be excluded from qualifying as "rents from real property" by reason of section 856(d)(2)(B) when a REIT leases a "qualified lodging facility" or "qualified health care property" 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."

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 the contractor enters into a management agreement or similar service contract with a 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" for any person who is not a related person with respect to the REIT or the TRS. Section 856(d)(9)(F) provides that, for purposes of section 856(d)(8)(B), persons are treated as related to each other if they are treated as a single employer under subsections (a) or (b) of section 52.

Section 856(d)(9)(D)(i) defines a "qualified lodging facility" as "any lodging facility unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility." Under section 856(d)(9)(D)(ii), a "lodging facility" is a "hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis."

Section 856(l)(1) provides that, if a REIT directly or indirectly owns stock in a corporation (other than a REIT), the REIT and the corporation may jointly elect for the corporation to be treated as a TRS.

Section 856(l)(3)(A) provides that a TRS cannot directly or indirectly operate or manage a "lodging facility" or a "health care facility."

In this case, Taxpayer represents that Company (i) qualifies as an "independent contractor" under section 856(d)(3) with respect to Taxpayer and (ii) is actively engaged in the trade or business of operating qualified lodging facilities, within the meaning of section 856(d)(9)(A), for entities unrelated to Taxpayer or TRS. Thus, under section 856(d)(9)(A), Company meets the definition of an “eligible independent contractor” with respect to the management and operation of Hotel.

Under the proposed structure, Company, through LLC 2, will continue to manage and operate Hotel. Although TRS will own an interest in LP, TRS will have no authority to direct the operations or management of Hotel. TRS will have only limited governance rights in LP arising in extraordinary circumstances. Thus, Company will be treated as managing and operating Hotel on behalf of TRS for purposes of section 856(d)(8)(B), and TRS will not be treated as operating or managing a lodging facility under section 856(l)(3)(A).

In addition, because, an interest in a qualified lodging facility will be leased by a REIT to a TRS of the REIT and the qualified lodging facility will be managed and operated on behalf of the TRS by an eligible independent contractor, the requirements of section 856(d)(8)(B) will be met. Therefore, under section 856(d)(8), rent paid by TRS to LLC 1 will not be excluded from "rents from real property" by reason of section 856(d)(2)(B).

Accordingly, based on the facts and representations submitted by Taxpayer, we conclude that under the circumstances described above:

1. Company will be treated as an "eligible independent contractor" with respect to the management and operation of Hotel for purposes of section 856(d)(9)(A).

2. Company will be treated as managing and operating Hotel on behalf of TRS for purposes of section 856(d)(8)(B) and, with respect to Hotel, TRS will not be treated as operating or managing a lodging facility in violation of section 856(l)(3)(A).

3. Rent paid by TRS to LLC 1 will be qualifying income for purposes of the REIT gross income tests under sections 856(c)(2) and (c)(3).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

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 this ruling 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,

Alice M. Bennett
Branch Chief, Branch 3
Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:
Copy of this letter
Copy for section 6110 purposes