



b =  
c =  
d =  
e =

Dear :

This letter responds to your letter dated October 29, 2018, requesting a ruling on behalf of Taxpayer that, pursuant to section 856(c)(5)(J)(ii) of the Internal Revenue Code, income from the Grant (as defined below) is considered qualifying income for purposes of Taxpayer's gross income tests under sections 856(c)(2) and (c)(3).

**Facts:**

Taxpayer is a State A corporation that has elected to be treated as a real estate investment trust ("REIT") under sections 856 through 859. Taxpayer uses an accrual method of accounting and the calendar year as its taxable year. Taxpayer and its subsidiaries are involved in the acquisition, ownership, redevelopment, management, and leasing of regional and community shopping centers located throughout the United States. Taxpayer is the sole general partner of, and owns an a% partnership interest in Operating Partnership. Operating Partnership is a State B limited partnership that serves as Taxpayer's operating partnership and conducts substantially all of Taxpayer's operations. Operating Partnership owns substantially all of the operating assets of the business, either directly or indirectly through other partnerships, limited liability companies, subsidiary REITs, and taxable REIT subsidiaries.

In Year, Taxpayer, along with JV Partner, a State C business trust that has elected to be treated as a REIT under sections 856 through 859, formed joint ventures to develop certain regional shopping centers, including Property. Taxpayer and JV Partner, through other owned entities that are either disregarded or treated as tax partnerships, indirectly own e interests in the following joint ventures that will develop Property: Company A, Company B, and Company C (collectively referred to as the "Owners"). The Owners own the individual properties that comprise Property, which is constructed on land leased from City and currently under redevelopment. The redevelopment of Property will be funded by a grant through Program (the "Grant").

A Program grant is administered by State C, acting through Office, for the acquisition and construction of economic development projects, with intended regional or multi-jurisdictional impact, that are expected to substantially increase or maintain current levels of employment, tax revenues, or other measures of economic activity. Generally, in order to receive a Program grant, the applicant is required to apply for the

grant, which must be approved by the legislature and selected by the governor of State C. The recipient of the grant is then required to enter into an agreement with Agency and Office.

Property has been approved for a Program grant. As the owner of the underlying land on which Property was built, City is the recipient (i.e., the grantee) of the Grant. Agency, acting on behalf of City as the grantee, will formalize a contract with State C, acting through Office, that will set the responsibilities and obligations of the parties involved with the Grant. Agency will then approve the Grant payments to the various sub-grantees. The Owners, as sub-grantees, will enter into a subcontract with Agency to be approved by Office for the development of Property.

Pursuant to Program, Agency, as grantee, will apply for periodic project payments to cover a portion of paid eligible and reimbursable project expenses, including construction costs, land acquisition costs, and interest costs paid as a result of the use of interim or bridge financing for the project during construction. The amounts received from the Grant will then be used to subsidize the Owners, as sub-grantees and developers, for the costs directly associated with the development of Property.

Agency was approved for the release of \$b in payments from the Grant for funding the redevelopment of Property, of which \$c has been paid to other predecessor entities that predated the Owners, leaving \$d outstanding to be paid to the Owners as costs directly associated with the development of Property are incurred.

Taxpayer represents that Property, after the redevelopment, will qualify as a real estate asset for purposes of section 856 and that substantially all of the other income Taxpayer derives from Property will be qualifying income for purposes of sections 856(c)(2) and (c)(3). Taxpayer also represents that substantially all of the Grant payments will be for construction of real property (within the meaning of section 1.856-10 of the Income Tax Regulations) at Property. Taxpayer further represents Taxpayer intends to report its allocable share of the Grant payments as gross income under section 61 and will take its share of the Grant payments into account for the taxable year in which such income is recognizable.

### **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, which include dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property not described in section 1221(a)(1), 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 on interests in real property, gain from the sale or other disposition of real property not described in section 1221(a)(1), certain dividends or distributions on, and gains from the sale or disposition of, shares in other REITs, 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(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 sections 856(c)(2) or (c)(3) may be considered as not constituting gross income for purposes of sections 856(c)(2) or (c)(3), or (ii) whether any item of income or gain that otherwise constitutes gross income not qualifying under sections 856(c)(2) or (c)(3) may be considered as gross income that qualifies under sections 856(c)(2) or (c)(3).

Section 1.856-3(g) of the regulations provides that a REIT that is a partner in a partnership is deemed to own its proportionate share of each asset of the partnership and will be deemed to be entitled to the income of the partnership attributable to its share.

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 from the Grant constitutes gross income not listed as qualifying income under sections 856(c)(2) or (c)(3). Taxpayer represents that Property, after the redevelopment, will qualify as a real estate asset for purposes of section 856 and that substantially all of the other income Taxpayer derives from Property will be qualifying income for purposes of sections 856(c)(2) and (c)(3). Taxpayer will earn the Grant payments for developing real property in State C in accordance with Program. Treating income from the Grant as qualifying income does not interfere with or impede the objectives of Congress in enacting sections 856(c)(2) and (c)(3). Accordingly, pursuant to section 856(c)(5)(J)(ii), it is appropriate for the Secretary to determine that income from the Grant is treated as qualifying income for purposes of Sections 856(c)(2) and (c)(3).

**Conclusion:**

We hereby rule that, pursuant to section 856(c)(5)(J)(ii), Taxpayer's income attributable to receipt of Grant payments is considered qualifying income for purposes of sections 856(c)(2) and (c)(3).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. 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 with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code. Additionally, no opinion is expressed regarding income from a sale of an interest in the Grant.

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 ruling letter to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While 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,

Andrea M. Hoffenson

Andrea M. Hoffenson

Chief, Branch 2

Office of Associate Chief Counsel

(Financial Institutions & Products)