Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: Unrelated Taxpayer
Date of Communication: April 17, 2009
Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:7
PLR-106574-09
Date:
August 14, 2009

Re:

Legend

Taxpayer	=
Company	=
Parent	=
City	=
State 1	=
State 2	=
Partnership	=
Location 1	=
Location 2	=
Building A	=
Building B	=
Garage	=
Street	=
Management Company	=
a	=
b	=
c	=
d	=
e	=
f	=
g	=

h =
i =
j =
k =
l =
m =
n =
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q =
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x =
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Dear :

This letter responds to a letter dated February 13, 2009, and subsequent correspondence, submitted on behalf of Taxpayer, requesting letter rulings under §§ 168(e)(2) and 45D(d)(3) of the Internal Revenue Code regarding a mixed-use development of three buildings.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is a member of an affiliated group that files a consolidated return. Taxpayer's parent company is Parent. Taxpayer is planning to develop three properties, located in City, into a single business and commercial complex that will include residential units (the "Project"). Taxpayer will develop the Project at Location 1, which is located in a low-income community. The three properties are existing Building A, Building B, and Garage.

Taxpayer (either directly or through related parties) will create a Community Development Entity ("CDE"), which is expected to receive a new market tax allocation from the Secretary of the Treasury. The CDE will invest in a qualified active low-income community business ("QALICB"). Taxpayer and Company formed Partnership, a State 1 limited liability company, which will be the QALICB that will invest in the Project. If favorable letter rulings are received by Taxpayer and Company, Building A, Building

B, and Garage will be transferred to Partnership and Partnership then will own the three buildings composing the Project.

Building B and Garage are contiguous. Building A is separated from Building B and Garage by Street, a public street. The three buildings composing the Project will be redeveloped as a single integrated project. A single architect has served as the site plan architect for the Project and has created designs and drawings of all three buildings as one development.

Building A will be renovated for use as commercial and residential space. Construction work for the renovation of Building A will commence on a, with a projected completion date of b, and placed-in-service date of c. The d floor of Building A will be a general lobby and retail space. The e and f floors will have Executive Office space for lease. The g through h floors will be leased or operated for Partnership by a hotel company as an extended-stay hotel with u units. The i through j floors will be residential apartments. The k floor will have l two-level penthouse residential units and a private amenity center for use by tenants and their guests. There will be m residential rental units in Building A.

Building B also will be renovated for use as commercial and residential space. Construction work for the renovation of Building B will commence on a, with a projected completion date of n, and placed-in-service date of o. The d floor of Building B will be a residential lobby and retail space. The e through p floors will be residential apartment units. There will be q residential units in Building B.

Garage is attached to the west side of Building B. It has approximately r parking spaces. Taxpayer plans extensive renovations to Garage. Construction work for the renovation of Garage will commence on a, with a projected completion date of s. During these renovations, some of the parking access ramps will be rendered inoperative. Moreover, during the renovations, Garage will be used for construction staging, such as contractor offices, secure storage of equipment and materials, and other construction personnel support facilities. As a result, Garage will need to be taken out of service. All parking agreements and third-party use will be terminated (e.g., Garage will be closed to the public). Once the renovations are completed, Garage will be placed back in service with the Project.

Upon completion of the renovations to Garage, Garage will be connected to Building B by interior pathways and to Building A by an enclosed skywalk that crosses Street. Employees and customers of the retail and commercial space and residents of Building A and Building B will access Garage by means of these interior pathways, including the enclosed skywalk. Moreover, the newly-renovated Garage will contain an emergency generator for the entire Project, which will be connected with Building A by electrical lines that run across the skywalk, the Project's storage space, and the Project's maintenance facilities.

In addition to its parking spaces, Garage will have t square feet of retail/office space.

The commercial and residential tenants of the Project will be given priority in leasing parking spaces in Garage at a slight discount from market rent. Garage will also be available to the general public on a daily and monthly basis. Of the r parking spaces, m will be dedicated to the residential rental units in Building A, q will be dedicated to the residential rental units in Building B, u will be available for hotel guests, and the remaining v spaces will be available to retail, office, and general public parking. Parking will be provided to residents and commercial tenants of the Project as part of their rent. Parking for residential and commercial tenants will not be separately invoiced.

The Project has been designed to provide for the seamless movement of the residents and commercial tenants of the Project among the three buildings composing the Project (Building A, Building B, and Garage). After the renovations, the enclosed skywalk that crosses Street will connect Building A to Building B and Garage. This skywalk will allow residents and commercial tenants of the Project to move among the three buildings composing the Project. For example, tenants in Building B will need to walk to Building A to visit the management office and business center, to use the exercise facilities, or to access the lobby for vehicle pick up and drop off. In addition, the skywalk will provide a conduit for mechanical supplies among the three buildings composing the Project.

There is one overall plan of finance for the development of the Project. Financing for the Project will come from Gulf Opportunity Zone Bonds (w%), historical rehabilitation credits (x%), and equity investment (y%). Building A, Building B, and Garage will all be included in the Gulf Opportunity Zone Bond package.

The financing for the Project is interdependent. The purchasers of the bonds that will finance the Project, the investors who will receive the new markets tax credit ("NMTC Investors"), the financial institution that will provide credit enhancement for the bonds (e.g., a letter of credit), and any additional lenders will each analyze all aspects of the financing of the Project and make its commitment on reliance of each aspect of the financing being in place. That is, the Project will not move forward unless all the financing is in place, and the financing will be done on a complete Project basis and not on particular components of the Project.

Taxpayer represents that the financing will be done on the basis of the Project. There will be no financing with respect to any specific property or individual component of the Project's real estate. Further, the trustee for the bond holders, the financial institution providing the letter of credit, the NMTC Investors, and any lenders (financing separate from the new markets tax credit) will look to the revenue and assets of the Project (i.e., the properties as a single property), and not to a particular property to

secure the financing. Moreover, any lender would hold a mortgage on all the real estate of the Project.

The Project will be marketed to the public as a single, mixed-use development. Each building of the Project will be owned by the same person (i.e., Partnership) for Federal income tax purposes and that person will be primarily responsible for managing and maintaining the property. The operations and management office of the Project will be located in one of the three buildings. All tenants and other users of the facilities will correspond, make rent payments, or request services from this office.

Partnership will enter into a contract with Management Company. A single entity of Management Company will manage all aspects of the Project. It will operate an onsite management office that will serve as a single point of contact, and will oversee all leasing, tenant relations, preventative or other maintenance, and daily management for the entire Project. The entity of Management Company also will directly manage all commercial operations (i.e., office, retail, parking garage, etc.), and will subcontract the hotel and residential functions to related companies. The functions that will be subcontracted relate to various activities within the buildings; that is, the subcontracts are not done on a building-by-building basis.

Taxpayer provided the following representation by Management Company: "[Management Company] will manage [Building A], [Building B], and [Garage] as one building/property for all purposes (including the Comprehensive Management Plan, accounting system, annual budget, monthly accounting package, and program of preventive maintenance procedures)."

The accounting function for the Project will be administered at the corporate level of Management Company in Location 2. Given the distinct operating requirements for each of the uses of the Project, initially the accounting will be done on the basis of use, such as apartments, hotels, and commercial spaces, enabling the Project to meet the individual reporting requirements to the City and State 2 for each Project component. These individual accountings will subsequently be consolidated for Partnership's use for lenders, investors, and tax purposes. The books for tax purposes will be prepared and kept by an independent CPA firm.

Taxpayer represents that neither it nor Partnership will have gross income derived from: (a) any trade or business consisting predominantly of the development or holding of intangibles for sale or license; or (b) any trade or business consisting of the operation of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises. Taxpayer also represents that no commercial (nonresidential) space in each of the three buildings (Building A, Building B, and Garage) will be leased or used as a massage parlor, hot tub facility, suntan facility, facility used for gambling, or store the

principal business of which is the sale of alcoholic beverages for consumption off premises.

Moreover, Taxpayer represents that the Project is considered a substantial improvement to the property, and that Partnership will be engaged in a trade or business. Finally, with respect to the extended stay hotel in Building A, Taxpayer represents that for more than one-half of the days in which a dwelling unit in the extended stay hotel will be occupied on a rental basis during Taxpayer's taxable year, such unit will be occupied by a tenant or series of tenants each of whom occupies the unit for less than 30 calendar days.

RULINGS REQUESTED

Taxpayer requests the Internal Revenue Service issue the following rulings:

1) Building A, Building B, and Garage may be treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2).

2) If Building A, Building B, and Garage are treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2), then Partnership qualifies as a qualified business under § 45D(d)(3) to the extent this single building (and its structural components) is nonresidential real property under § 168(e)(2)(B).

LAW AND ANALYSIS

Ruling 1

Section 168(e)(2) defines the terms "residential rental property" and "nonresidential real property" for purposes of determining depreciation under § 168. Section 168(e)(2)(A)(i) provides that the term "residential rental property" means any building or structure if 80 percent or more of the gross rental income from such building or structure for the taxable year is rental income from dwelling units. For this purpose, § 168(e)(2)(A)(ii) provides that the term "dwelling unit" means a house or apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, or other establishment more than one-half of the units in which are used on a transient basis.

Section 168(e)(2)(B) provides that the term "nonresidential real property" means section 1250 property which is not (i) residential rental property, or (ii) property with a class life of less than 27.5 years.

Section 168(i)(12) provides that the term "section 1250 property" has the meaning given such term by § 1250(c). Section 1250(c) provides that the term "section 1250 property" means any real property (other than section 1245 property, as defined in § 1245(a)(3)) that is or has been property of a character subject to the allowance for depreciation provided in § 167. See also § 1250-1(e) of the Income Tax Regulations.

Section 1.1250-1(a)(2)(ii) provides that, for purposes of applying depreciation recapture rules of § 1250, the facts and circumstances of each disposition is considered in determining what is the appropriate item of section 1250 property. In general, a building is an item of section 1250 property, but in an appropriate case more than one building may be treated as a single item. For example, if two or more buildings or structures on a single tract or parcel (or contiguous tracts or parcels) of land are operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting), they may be treated as a single item of section 1250 property.

Section 168(e)(2)(A) was amended by § 11812(b)(2)(A) of the Revenue Reconciliation Act of 1990, Pub. L. 101-508, 1991-2 C.B. 484, 543 (the "1990 Act"). Prior to this amendment, § 168(e)(2)(A) provided that the term "residential rental property" has the meaning given such term by § 167(j)(2)(B).

Prior to the enactment of the 1990 Act, § 167(j)(2)(B) provided in pertinent part that a building or structure shall be considered to be residential rental property for any taxable year only if 80 percent or more of the gross rental income from such building or structure for such year is rental income from dwelling units (within the meaning of former § 167(k)(3)(C)).

Former § 1.167(j)-3(b)(1)(ii) provided that in any case where two or more buildings or structures on a single tract or parcel (or contiguous tracts or parcels) of land are operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting), they may be treated as a single building for purposes of determining whether the building or structure is residential rental property.

Thus, for purposes of determining if Building A, Building B, and Garage are residential rental property or nonresidential real property under § 168(e)(2), these buildings may be treated as a single building when they are on a single tract of land or parcel (or contiguous tracts or parcels) and they are operated as a single integrated unit. For making the latter determination, the relevant factors are the actual operation, management, financing, and accounting for the buildings. See § 1.1250-1(a)(2)(ii); see also former § 1.167(j)-3(b)(1)(ii).

While Building B and Garage are contiguous, Building A is separated from Building B and Garage by only one public street, Street. Further, after the renovations, Building A will be connected to Building B and Garage by an enclosed skywalk that

crosses Street. These facts support treating Building A, Building B, and Garage as being on contiguous tracts of land for purposes of determining whether these buildings may be treated as a single building under § 168(e)(2).

With regard to operation of the Project, Taxpayer represents that, once renovated, Garage will be connected to Building B by interior pathways and to Building A by an enclosed skywalk that crosses Street. The enclosed skywalk that crosses Street will connect Building A to Building B and Garage. The skywalk and interior pathways will be used by employees, customers, and tenants to travel among the buildings, and will allow the movement of mechanical supplies among the buildings. Thus, the Project will provide for the seamless movement of the residents and commercial tenants of the Project among the three buildings of the Project.

Taxpayer also represents that residential and commercial tenants of the Project will be given priority in leasing parking spaces at a slight discount from market rent and parking will be provided as part of their rent. Further, of the r parking spaces in Garage, Taxpayer will dedicate one parking space to each residential rental unit in Building A and Building B.

Further, Taxpayer represents that Garage will contain an emergency generator that supports the entire Project, as well as the Project's storage space and the Project's maintenance facilities. Moreover, Building A, Building B, and Garage will be renovated and placed in service within the same one-year period.

With regard to management of the Project, Taxpayer represents that the three buildings comprising the Project will be owned by Partnership and marketed as a single, mixed-use development. All aspects of the Project will be managed by a single entity of Management Company. It will operate an onsite management office that will serve as a single point of contact, and will oversee all leasing, tenant relations, preventative or other maintenance, and daily management for the entire Project. All tenants and other users of the facilities will correspond, make rent payments, or request services from this office. The entity of Management Company also will directly manage all commercial operations (i.e., office, retail, parking garage, etc.), and will subcontract the hotel and residential functions to related companies. The functions that will be subcontracted will not be done on a building-by-building basis. Moreover, Taxpayer has provided Management Company's representation that it will manage the three buildings as one building/property for all purposes (including the Comprehensive Management Plan, accounting system, annual budget, monthly accounting package, and program of preventive maintenance procedures).

With regard to financing of the Project, Taxpayer represents that there is one overall plan of finance for the development of the Project. Financing will be done on the basis of the Project. There will be no financing with respect to any specific property or individual component of the Project's real estate. Further the trustee for the bond

holders, the financial institution providing the letter of credit, the NMTC Investors, and any lenders (financing separate from the new markets tax credit) will look to the revenue and assets of the Project (i.e., the properties as a single property), and not to a particular property to secure the financing. Moreover, any lender would hold a mortgage on all the real estate of the Project.

Finally, with regard to the accounting for the Project, Taxpayer represents that the accounting function for the Project will be administered at the corporate level of Management Company in Location 2. Ultimately, the individual accountings required for Taxpayer to meet its City and State reporting requirements for each Project component will be consolidated for Partnership's use for lenders, investors, and tax purposes.

Taxpayer's facts and representations about the operation, management, financing, and accounting of the Project show that the three buildings composing the Project (Building A, Building B, and Garage) are to be operated as a single integrated unit. As previously discussed, Taxpayer's facts also support treating these three buildings as being on contiguous tracts of land. Accordingly, Taxpayer's facts and representations support treating the three buildings composing the Project as a single building for purposes of determining whether Building A, Building B, and Garage are residential rental property or nonresidential real property under § 168(e)(2).

Ruling 2

Section 45D(a) provides that, for purposes of the § 38 general business credit, in the case of a taxpayer who holds a qualified equity investment on a credit allowance date of this investment, which date occurs during the taxable year, the new markets tax credit determined under § 45D for the taxable year is an amount equal to the applicable percentage of the amount paid to the qualified community development entity for this investment at its original issue. The credit allowance date for any qualified equity investment is the date on which the investment is initially made and each of the 6 anniversary dates thereafter. The applicable percentage is 5 percent for the first 3 credit allowance dates and 6 percent for the remaining credit allowance dates.

The new markets tax credit may be claimed only for a qualified equity investment in a qualified CDE. Under § 45D(b), a qualified equity investment is any equity investment in a qualified CDE for which the CDE has received an allocation from the Secretary of the Treasury if, among other things, the CDE uses substantially all of the cash from the investment to make qualified low-income community investments.

Section 45D(d)(1)(A) provides that a "qualified low-income community investment" includes any capital or equity investment in, or loan to, any QALICB. Under § 45D(d)(2)(A)(i), a QALICB means, with respect to any taxable year, any corporation (including a nonprofit corporation) or partnership if for this taxable year, amongst other

requirements, at least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business within any low-income community.

Section 45D(d)(3) provides that for purposes of § 45D(d), the term “qualified business” has the same meaning given to such term by § 1397C(d), except that (A) in lieu of applying § 1397C(d)(2)(B), the rental to others of real property located in any low-income community is treated as a qualified business if there are substantial improvements located on the property, and (B) § 1397C(d)(3) does not apply.

Section 1.45D-1(d)(4)(i) provides that the term QALICB means, with respect to a taxable year, a corporation (including a nonprofit corporation) or a partnership engaged in the active conduct of a qualified business (as defined in § 45D-1(d)(5)), if the requirements in § 1.45D-1(d)(4)(i)(A), (B), (C), (D), and (E) are met.

Except as otherwise provided in § 1397C(d), § 1397C(d)(1) provides that the term "qualified business" means any trade or business.

Section 1397C(d)(2)(A) provides that the rental to others of real property located in an empowerment zone is treated as a qualified business if and only if the property is not residential rental property (as defined in § 168(e)(2)).

Section 1397C(d)(4) provides that the term “qualified business” does not include any trade or business consisting predominantly of the development or holding of intangibles for sale or license.

Section 1397C(d)(5)(A) provides that the term “qualified business” does not include any trade or business consisting of the operation of any facility described in § 144(c)(6)(B). These facilities are any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

Section 1397C(d)(5)(B) provides that the term “qualified business” also does not include any trade or business the principal activity of which is farming (within the meaning of § 2032A(e)(5)(A) or (B)), but only if, as of the close of the taxable year, the sum of (i) the aggregate unadjusted bases (or, if greater, the fair market value) of the assets owned by the taxpayer which are used in such a trade or business, and (ii) the aggregate value of assets leased by the taxpayer which are used in such a trade or business, exceeds $ 500,000. For purposes of § 1397C(d)(5)(B), rules similar to the rules of § 1397(b) (regarding controlled groups) apply.

Taxpayer represents that it will develop the Project at Location 1, which is located in a low-income community. Taxpayer also represents that Partnership will be

engaged in a trade or business and that the Project is considered a substantial improvement to the property.

Further, Taxpayer represents that neither it nor Partnership will have gross income derived from: (a) any trade or business consisting predominantly of the development or holding of intangibles for sale or license; or (b) any trade or business consisting of the operation of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises. Moreover, Taxpayer represented that no commercial space in each of the three buildings composing the Project will be leased or used as a massage parlor, hot tub facility, suntan facility, facility used for gambling, or store the principal business of which is the sale of alcoholic beverages for consumption off premises.

CONCLUSIONS

Based solely on the facts and representations submitted and the relevant law and analysis as set forth above, we conclude that:

1) Building A, Building B, and Garage may be treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2).

2) If Building A, Building B, and Garage are treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2), then Partnership qualifies as a qualified business under § 45D(d)(3) to the extent this single building (and its structural components) is nonresidential real property.

We also note that if Building A, Building B, and Garage are treated as a single building for purposes of determining whether the building (and its structural components) is residential rental property or nonresidential real property under § 168(e)(2), then Building A, Building B, and Garage also are treated as a single item of section 1250 property for purposes of § 1250.

Except as specifically set forth above, we express no opinion concerning the tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed or implied on (i) whether the buildings composing the Project are nonresidential real property or residential rental property for any taxable year under § 168(e)(2), (ii) what components of such buildings are section 1245 property (as defined in § 1245(a)(3)), and (iii) whether any of the buildings composing the Project qualify for the rehabilitation credit under § 47 (including whether such buildings may be treated as a single building under § 47).

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

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representative. We are also sending a copy of this letter to the appropriate Industry Director, LMSB.

Sincerely,

Kathleen Reed

KATHLEEN REED
Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax and Accounting)

Enclosures (2):
copy of this letter
copy for section 6110 purposes

cc: