

Year 3 =

Dear

This letter responds to your letter dated March 6, 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 corporation that has elected to be treated as a real estate investment trust ("REIT") under sections 856 through 859. Taxpayer owns a% of the interests in Operating Partnership. Operating Partnership owns b% of the member interests in Subsidiary, a limited liability company that is disregarded for federal income tax purposes. Taxpayer uses an accrual method of accounting and a calendar tax year.

In Year 1, Subsidiary acquired Center through three separate purchases. The neighborhood in which Center is located has been revitalized. Center, however, still suffers from a high vacancy rate with buildings in derelict condition. Taxpayer now intends to redevelop Center by modernizing the site's buildings and infrastructure, and by providing the surrounding neighborhoods with state-of-the-art retail, residential and other amenities, all of which is intended to produce jobs and other economic benefits to the area (the "Redevelopment"). Taxpayer represents that Center, 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 Center will be qualifying income for purposes of sections 856(c)(2) and (c)(3).

In order to fund the Redevelopment, Taxpayer has applied for a \$c grant through Program (the "Grant"). Program is authorized by Act and is for projects that are primarily economic development projects. The projects must have a regional or multi-jurisdictional impact and generate substantial increases or maintain current levels of employment, tax revenue or other measures of economic activity. A developer must go through an application process in order to be approved and awarded a Program grant. Once the application process is complete, and the developer has been approved, Budget Office enters into a Program grant between State and the developer.

Program operates on a proportional reimbursement basis. As the developer incurs and pays construction expenses, State will reimburse the developer, provided State receives sufficient documentation regarding reimbursable expenditures with the request for reimbursement. The primary intent and use of Program funds should be towards reimbursement of construction costs. Secondary reimbursable costs that are

allowed include interest paid during construction, permit costs, land acquisition costs, and other costs related to the abatement of hazardous materials. Ineligible costs include future physical maintenance and operation costs, administrative costs, legal fees, financing and accounting costs, and architectural and engineering fees.

In the event that Taxpayer is awarded the Grant, Taxpayer will use the Grant proceeds to reimburse certain construction costs incurred by Taxpayer. Assuming Subsidiary is successful with the Redevelopment, Taxpayer believes the Grant proceeds will be received in late Year 2 or early Year 3, when the phase of construction the Grant is meant to fund is completed. Taxpayer represents that the Grant proceeds will be recognized as income by Operating Partnership for federal income tax purposes, and Taxpayer expects its share of the gross income from the Grant proceeds to exceed d% of Taxpayer's gross income.

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 Income Tax 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 Center, 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 Center will be qualifying income for purposes of sections 856(c)(2) and (c)(3). Taxpayer will earn the Grant for developing real property in State 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 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 representatives.

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

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Chief, Branch 2

Office of Associate Chief Counsel

(Financial Institutions & Products)