

**Internal Revenue Service**

Department of the Treasury  
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**Legend:**

Taxpayer =

JV =

State A =

State B =

City =

Portfolio A =

Portfolio B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

a =

b =

c =

d =

e =

Dear :

This letter responds to your letter dated February 2, 2018, and supplemental correspondence, in which Taxpayer requests a ruling that the sales of Taxpayer's assets pursuant to a plan of liquidation will not be considered prohibited transactions for purposes of section 857(b)(6) of the Internal Revenue Code (the "Code").

### Facts

Taxpayer elected to be treated as a real estate investment trust ("REIT") beginning with its taxable year ended Date 1. JV, a partnership for federal income tax purposes, holds a percent of the issued common stock of Taxpayer. JV formed Taxpayer as a State A limited liability company on Date 2 for the purpose of purchasing and managing multifamily real estate complexes located in the United States.

Pursuant to a joint venture agreement effective Date 3 (the "Agreement"), direct or indirect partners in JV transferred interests in Portfolio A to Taxpayer. Portfolio A consists of multifamily residential real property located in City. Pursuant to the Agreement, Taxpayer targeted an initial public offering ("IPO") within b years of Date 3. In the absence of an IPO, the Agreement provides that Taxpayer shall be liquidated after c years. Prior to its acquisition of interests of Portfolio A, Taxpayer owned no real property and held no material assets.

Effective Date 4, Taxpayer purchased an indirect interest in Portfolio B. Portfolio B also consists of multifamily residential real property located in City. Portfolio A and Portfolio B are collectively referred to as the "Properties." For the taxable years ended Date 1 and Date 5, the majority of the income Taxpayer received from the Properties was passthrough rental income that Taxpayer represents is qualifying gross income for purposes of section 856(c)(2) and (3).

Taxpayer represents that, at all times, it has intended to hold the Properties for a period of at least c years, and to realize rental income and capital appreciation therefrom. However, Taxpayer believes that current market conditions represent the beginning of a long decline in the value of real property in City. Accordingly, Taxpayer now believes its investors will be best served through a disposition of its assets and Taxpayer's full liquidation. Taxpayer has not previously disposed of any real estate assets.

Taxpayer anticipates that the time to fully liquidate the Properties will take between d and e months. However, Taxpayer has been negotiating with potential purchasers, and this time period could be accelerated if a letter of intent and/or a purchase agreement is signed and due diligence can be completed quickly. Taxpayer represents that substantially all marketing expenditures with respect to sales of the Properties will be made through a taxable REIT subsidiary of Taxpayer or an independent contractor (as defined in section 856(d)(3)) from whom Taxpayer does not derive or receive any income.

Before Taxpayer pursues a plan of complete liquidation, Taxpayer intends to take several steps following receipt of this ruling. First, Taxpayer's board of directors will perform an updated assessment of the state of Taxpayer's business including a review of the current state of Taxpayer's strategic plan and an updated review of strategic alternatives. Second, Taxpayer's board will initiate a portfolio liquidation following the updated review. Third, Taxpayer's board will formally adopt a plan of liquidation. The adoption of the plan will be publicly disclosed, and the sale of Taxpayer's assets will be performed subject to any shareholder or other necessary approvals of the liquidation plan.

### **Law and Analysis**

Section 857(b)(6)(A) imposes a 100 percent tax on a REIT's net income from prohibited transactions. Section 857(b)(6)(B)(iii) defines the term "prohibited transaction" as the sale or other disposition of property described in section 1221(a)(1) that is not foreclosure property. Section 1221(a)(1) property, in turn, consists of property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Section 857(b)(6)(B)(ii) provides that losses attributable to prohibited transactions are not taken into account in determining the amount of net income derived from prohibited transactions.

Section 857(b)(6)(C) excludes certain sales from the definition of a prohibited transaction. Under section 857(b)(6)(C), the term "prohibited transaction" does not include the sale of property which is a real estate asset (as defined in section 856(c)(5)(B)) if –

- (i) the REIT has held the property for not less than 2 years;
- (ii) the aggregate expenditures made by the REIT, or any partner of the REIT, during the 2-year period preceding the date of sale which are includible in the basis of the property do not exceed 30 percent of the net selling price of the property;
- (iii) (I) during the taxable year the REIT does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033

applies), or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all the assets of the REIT as of the beginning of the taxable year, or (III) the fair market value of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the fair market value of all the assets of the REIT as of the beginning of the taxable year, or (IV) the REIT satisfies the requirements of subclause (II) applied by substituting "20 percent" for "10 percent" and the 3-year average adjusted bases percentage for the taxable year (as defined in section 857(b)(6)(G)) does not exceed 10 percent, or (V) the REIT satisfies the requirements of subclause (III) applied by substituting "20 percent" for "10 percent" and the 3-year average fair market value percentage for the taxable year (as defined in section 857(b)(6)(H)) does not exceed 10 percent;

(iv) in the case of property, which consists of land or improvements, not acquired through foreclosure (or deed in lieu of foreclosure), or lease termination, the REIT has held the property for not less than 2 years for production of rental income; or

(v) if the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the REIT itself does not derive or receive any income or a taxable REIT subsidiary.

The legislative history underlying section 857(b)(6), which was added to the Code by the Tax Reform Act of 1976, indicates that the purpose of that section was to "prevent a REIT from retaining any profit from ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project." S. Rep. No. 84-938, at 470 (1976), 1976-3 (Vol. 4) C.B. 508.

To determine whether a taxpayer holds property "primarily for sale to customers in the ordinary course of its trade or business," the Tax Court has held that several factors must be considered, none of which is dispositive. Among those factors are: (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity, and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; and (5) the time and effort the taxpayer habitually devoted to the sales. Generally, it is the purpose for which property is held at the time of the sale that is determinative, although earlier events may be considered to decide the taxpayer's purpose at the time of the sale. See Cottle v. Commissioner, 89 T.C. 467, 487 (1987).

Taxpayer has made the following representations that address its purposes with respect to the Properties. Taxpayer represents that its intention has always been to hold the Properties over the long-term to generate rental income and appreciated value. Taxpayer's disposition of the Properties will be due to a plan of liquidation, and Taxpayer will adopt the plan only after exploring alternatives that would allow Taxpayer to continue holding the Properties. Since its formation in Year 1, Taxpayer has not sold any real property. Taxpayer acquired the Properties prior to any consideration of a plan of liquidation. Moreover, Taxpayer represents that substantially all marketing expenditures with respect to sales of the Properties will be made through a taxable REIT subsidiary of Taxpayer or an independent contractor (as defined in section 856(d)(3)) from whom Taxpayer does not derive or receive any income.

### **Conclusion**

Based on the facts presented and representations made, we conclude that sales of Taxpayer's Properties pursuant to a plan of liquidation under the above circumstances will not constitute prohibited transactions within the meaning of section 857(b)(6).<sup>1</sup>

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequence relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer qualifies as a REIT under Part II of Subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code 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 penalty of perjury statements 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.

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<sup>1</sup> Section 4 of Rev. Proc. 2018-3 sets forth those areas in which rulings or determination letters will not ordinarily be issued by the Service. "Not ordinarily" means that unique and compelling reasons must be demonstrated to justify the issuance of a ruling or determination letter. See Rev. Proc. 2018-3, sec. 2.01. Section 4.02(5) of Rev. Proc. 2018-3 provides that one of the areas in which rulings or determination letters will not ordinarily be issued is any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of a trade or business. In this case, Taxpayer has demonstrated unique and compelling reasons to justify issuance of the ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Andrea M. Hoffenson  
Andrea M. Hoffenson  
Branch Chief (Branch 2)  
Office of Associate Chief Counsel  
(Financial Institutions & Products)