Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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Date:
June 25, 2024

Legend

Taxpayer =

Parent =

Seller =

Firm 1 =

Firm 2 =

Firm 3 =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

State =

Country =

x =

y =

z =

Dear :

This letter responds to a private letter ruling request dated December 11, 2023. Taxpayer requests a ruling that Taxpayer will be treated as if Taxpayer had not made an election to be a real estate investment trust (REIT) on its Form 1120-REIT, *U.S. Income Tax Return for Real Estate Investment Trusts*, filed for Year 1. Taxpayer further requests that, pending an affirmative ruling, its intended filing of Form 1120-X, *Amended U.S. Corporation Income Tax Return* for Year 1 not be treated as a termination or revocation of its REIT status for purposes of section 856(g) of the Internal Revenue Code (Code).

FACTS

Taxpayer was formed on Date 1 as a State corporation. Currently, Taxpayer indirectly owns, through entities treated as partnerships for U.S. federal income tax purposes, multi-family properties. Parent, a Country special limited partnership that is a partnership for U.S. federal income tax purposes, owns x percent of the common interests in Taxpayer. Each of y individual shareholders owns a nonvoting preferred interest in Taxpayer.

In Year 1, Parent sought to issue equity in exchange for cash to allow Taxpayer to acquire a portion of the multi-family properties owned by Seller. Parent intended to complete that offering so that Taxpayer could acquire an interest in those properties before Date 2. Parent completed its equity offering on Date 2 but was not able to obtain

the required approvals from investors and regulatory agencies to transfer the cash proceeds from that equity offering to Taxpayer by the end of Year 1. Parent was able to contribute those cash proceeds to Taxpayer on Date 3. Taxpayer thus had no gross income from any source, and no assets, at any point prior to Year 2, the year following Year 1. On Date 3, Taxpayer acquired from Seller approximately z percent of the membership interests in certain limited liability companies that owned multi-family properties and that were previously treated as disregarded entities of Seller.

On Date 4, Taxpayer engaged Firm 1 to provide a Form 1120-REIT for Taxpayer's Year 1 taxable year. Taxpayer represents that Firm 1 was qualified in REIT related matters. When Taxpayer initially began discussions in Year 1 with Firm 1 regarding the engagement, Taxpayer intended to acquire assets from Seller in Year 1 and to be treated as a REIT by filing a Form 1120-REIT for Year 1. Taxpayer informed Firm 1 that, due to unforeseen circumstances, Taxpayer did not acquire assets until Date 3, and did not begin to earn gross income until its Year 2 taxable year. Firm 1 was aware of no clear Internal Revenue Service guidance indicating that a REIT was required to have gross income or assets to satisfy the tests required for REIT qualification. Accordingly, Firm 1 did not communicate any issue with Taxpayer's ability to satisfy the tests required for REIT qualification. Firm 1 prepared a Form 1120-REIT for Taxpayer for Year 1 showing zero dollars' worth of assets and zero dollars of total income, which was approved and filed by Taxpayer on Date 5. Taxpayer relied on Firm 1, its tax return preparer, when it filed that Form 1120-REIT.

On Date 6, Parent engaged Firm 2 to provide audit services of Parent's financial statements. Firm 2 engaged Firm 3 to provide audit services with respect to the U.S. REIT qualification and taxation of Taxpayer. Taxpayer represents that Firm 3 was qualified in REIT related matters. As part of its audit procedures, Firm 3 requested any formation documents and any prior-year returns. On Date 7, Firm 3 received Taxpayer's Form 1120-REIT for Year 1. After reviewing Taxpayer's Form 1120-REIT for Year 1, Firm 3 advised Taxpayer that there may be uncertainty with respect to Taxpayer's REIT qualification. Firm 3 advised Taxpayer that it was unclear whether a REIT could satisfy the tests required for REIT qualification if the REIT did not have gross income or assets. Firm 3 further advised Taxpayer that if Taxpayer were treated as not qualifying as a REIT for Year 1, section 856(g)(3) would preclude Taxpayer from electing REIT status until its taxable year ending Date 9. To resolve these issues, Taxpayer filed this ruling request. Taxpayer timely filed a Form 1120-REIT for Year 2 on Date 8.

Pending an affirmative ruling, Taxpayer intends to file a Form 1120-X, a non-REIT amended return for Year 1. Taxpayer represents that the Form 1120-X will not alter in its amended return any tax treatment or position on its original Year 1 return, other than the REIT election.

LAW AND ANALYSIS

Section 856(c)(1) of the Code provides that a corporation, trust or association shall not be considered a REIT for any taxable year unless it files with its return for the taxable year an election to be a REIT or has made such election for a previous taxable year, and such election has not been terminated or revoked under section 856(g).

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from certain specifically enumerated sources.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from certain specifically enumerated sources (together with section 856(c)(2), the "Gross Income Tests").

Section 856(c)(4)(A) provides that, at the close of each quarter of its taxable year, at least 75 percent of the value of a REIT's total assets must be represented by certain specifically enumerated items (the "Asset Test").

Section 1.856-2(c) of the Income Tax Regulations provides that a corporation, trust, or association is not a REIT for a taxable year unless it meets certain requirements with respect to the sources of its gross income for the taxable year.

Section 1.856-2(c)(1) provides that in determining whether the gross income of a REIT satisfies the percentage requirements of section 856(c)(2) and (3), for purposes of both the numerator and denominator in the computation of the specified percentages, the term "gross income" has the same meaning as that term has under section 61 and the regulations thereunder.

Section 61(a) of the Code provides that, except as otherwise provided, gross income includes all income from whatever source derived.

Section 856(g)(1) provides that an election under section 856(c)(1) made by a corporation shall terminate if the corporation is not a REIT to which the provisions of part II of subchapter M of chapter 1 of the Code apply for the taxable year with respect to which the election is made, or for any succeeding taxable year. Such termination shall be effective for the taxable year for which the corporation is not a REIT to which the provisions of part II of subchapter M of chapter 1 of the Code apply, and for all succeeding taxable years.

Section 856(g)(2) provides that an election under section 856(c)(1) made by a corporation may be revoked by it for any taxable year after the first taxable year for which the election is effective. Such revocation shall be effective for the taxable year in which made and for all succeeding taxable years.

Section 856(g)(3) provides, in general, that if a corporation has made a REIT election and such election has been terminated or revoked, such corporation or any successor corporation, shall not be eligible to make an election under section 856(c)(1) for any taxable year prior to the fifth taxable year which begins after the first taxable year for which such termination or revocation is effective.

Legislative history indicates that Congress enacted part II of subchapter M of the Code to provide for a type of conduit treatment for income of certain "organizations specializing in investments in real estate and real estate mortgages." H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960), 1960-2 C.B. 819, 820. The legislative history further indicates that the central concern behind the Gross Income Tests is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 86-2020, 2d Sess. 4 (1960), 1960-2 C.B. 819, at 822-823 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." The legislative history similarly indicates that the Asset Test "is designed to give assurance that the bulk of the [REIT's] investments are in real estate . . . ." See H.R. Rep. No. 86-2020, 2d Sess. 4 (1960), 1960-2 C.B. 819, at 822.

The Gross Income Tests provide that at least a percentage of the REIT's gross income is derived from enumerated sources. Taxpayer's gross income in Year 1 was $0. The percentage is 95% under section 856(c)(2), and 95% of $0 equals $0. The percentage is 75% under section 856(c)(3), and 75% of $0 equals $0. Thus, in Year 1, at least $0 of Taxpayer's gross income was derived from the enumerated sources under the Gross Income Tests. Section 1.856-2(c) interprets the Gross Income Tests as being concerned with the sources of a REIT's gross income and not with whether the REIT has gross income in the first instance. Section 1.856-2(c)(1) does not prevent qualification as a REIT on account of having $0 of gross income. Similarly, the above legislative history demonstrates that Congress was primarily concerned with the source of a REIT's income. Accordingly, Taxpayer did not fail the Gross Income Tests in Year 1.

The Asset Test provides that at least 75% of the value of the REIT's total assets is represented by enumerated items. The value of Taxpayer's total assets in Year 1 was $0, and 75% of $0 equals $0. Thus, in Year 1, at least $0 of Taxpayer's assets was represented by the enumerated items under the Asset Test. To state that the Asset Test is not failed in the absence of any assets is consistent with the above legislative history, which demonstrates that in enacting the Asset Test, Congress was concerned with the nature of a REIT's assets and not whether the REIT had assets in the first instance. Accordingly, Taxpayer did not fail the Asset Test in Year 1.

CONCLUSION

Based upon the facts and representations submitted, we conclude that Taxpayer's lack of assets and income in Year 1 did not cause Taxpayer to fail the Gross Income Tests or Asset Test in Year 1. Accordingly, Taxpayer's request to be treated as if it had not made an election to be a REIT for Year 1 is denied, and it is unnecessary to address Taxpayer's further request regarding the effect of the intended filing of Form 1120-X for Year 1.

CAVEATS

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. Except as specifically provided otherwise, no opinion is expressed on the federal income tax consequences of the transactions described above. In particular, and except as expressly provided, no opinion is expressed or implied regarding 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 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 terms of a power of attorney on file in this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

_____

K. Scott Brown
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: