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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

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Date:

JUL - 9 1999

Legend:

Company A =

Company B =

state X =

year 1 =

year 2 =

year 3 =

m =

n =

This replies to a ruling request dated February 26, 1999, your authorized representative filed on Company B's behalf. The ruling requested concerns the treatment under section 856(c) of the Internal Revenue Code of payments Company B may receive under a Tax Allocation Agreement ("Agreement") Company B has entered into with Company A.

Facts:

Company B was incorporated in state X in year 1 and was engaged in the provision of health care services. Company A was formerly a wholly owned subsidiary of Company B. In year 2, in a restructuring transaction, Company A and Company B were separated into two publicly owned companies. Company B was allocated substantially all of the real estate assets and Company A substantially all of the operating assets previously owned by the respective Companies.

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Company B intends to elect to be treated as a real estate investment trust ("REIT") under section 856(c)(1) of the Code commencing on the first day of year 3. Company B intends to operate as a self-administered, self-managed REIT.

Company A and Company B entered into the Agreement as part of the restructuring. The Agreement generally seeks to hold each Company liable for, and entitle each Company to, the taxes or refunds or credits that are attributable to the assets that a Company held prior to the restructuring but which are held by the other Company subsequent to the restructuring. Specifically, the Agreement obligates each Company to pay to the other the amount of any tax a Company pays arising from an item attributable to an asset that the other held before the restructuring. The Agreement also requires a Company to pay over to the other any refund of tax the Company receives arising from an item attributable to an asset the other held prior to the restructuring. A payment owed under the Agreement must be paid within m calendar days after the filing of the tax return if the return is made for a period commencing before, and ending after, the restructuring or n business days after the receipt or crediting of a refund or the receipt of notice of a final determination that a tax is owed.

Law and Analysis:

Section 856(c)(2) of the Code provides that at least 95 percent of a REIT's gross income must be derived from one or more of the passive sources enumerated therein. Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from sources with a real estate nexus. Section 1.856-2(c)(1) of the Income Tax Regulations generally provides that for purposes of sections 856(c)(2) and (c)(3), the term "gross income" has the same meaning as that term has under section 61 and the regulations thereunder. Section 61 generally defines gross income to be income from whatever source derived except as otherwise provided in subtitle A of the Code. The Service has previously ruled that: (1) an expense reimbursement need not be included in a recipient's gross income if the reimbursement is not a payment for services rendered in the course of the recipient's trade or business but rather is payment of an advance in the nature of a loan, see Rev. Rul. 84-138, 1984-2 C.B. 122, and (2) a payment in reimbursement of the proceeds from a tax refund need not be included in gross income by the recipient if the recipient did not derive a prior tax benefit from the item giving rise to the refund. See Rev. Rul. 85-30, 1985-1 C.B. 20.

Assuming that the payments from Company A to Company B under the Agreement are, in fact, reimbursements for taxes Company B paid but for which Company A is liable, we conclude that these payments do not constitute gross income to Company B for purposes of sections 856(c)(2) and (c)(3). We further conclude that a refund of tax received by Company A but which Company A pays to Company B under the Agreement does not constitute gross income to Company B for purposes of sections 856(c)(2) and (c)(3) unless Company B had derived a prior tax benefit from the item giving rise to the reimbursement.

This ruling is directed only to the taxpayer who requested it. No opinion is expressed as to the federal income tax consequences of this transaction under any other provision of the Code.

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In particular, no opinion is expressed whether Company B otherwise qualifies as a REIT under section 856 of the Code. Nor is any opinion expressed on the character or propriety of the payments made under the Agreement. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the power of attorney on file, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions &
Products)

Alice M. Bennett
By: Alice M. Bennett
Chief, Branch 3

Enclosure:
Copy for section 6110 purposes

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