

Taxpayer is a domestic corporation that initially elected to be treated as a real estate investment trust (REIT) for its tax year that ended in Year 1. Partnership owns and leases industrial facilities. As of Date 1, Taxpayer owned a% of the interest in Partnership. Subsidiary is owned by Partnership and is a taxable REIT subsidiary ("TRS") of Taxpayer that develops, acquires, and sells industrial properties. Partnership owns b% of the outstanding stock of Subsidiary.

Subsidiary's business activities are financed through an unsecured line of credit from Partnership to Subsidiary. Partnership intends to convert the unsecured line of credit into a secured line of credit ("Loan"). Loan will have an initial term of three years with two one-year extensions, if requested by Subsidiary, and will be secured by first priority mortgages and deeds of trust on certain of the real estate assets of Subsidiary. At all times, the principal and any accrued interest on Loan will not exceed c% of the gross book value of the real estate securing Loan. In determining the gross book value of the real estate securing Loan, only security interests with respect to real estate will be taken into account if they are senior in priority to any other lien, mortgage, or other encumbrance on such real estate. Taxpayer represents that the gross book value of the real estate owned by Subsidiary is expected to be at all times at least equal to its fair market value. Taxpayer also represents that Loan constitutes a "real estate asset" under section 856(c)(5)(B).

Law and Analysis:

Section 856(c)(4)(A) provides that at the close of each quarter of the taxable year at least 75 percent of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities. Section 856(c)(4)(B) provides, in relevant part, that at the end of each quarter of a taxable year, (i) not more than 25 percent of the value of a REIT's total assets may be represented by securities; (ii) not more than 20% of the value of its total assets may consist of securities of TRSs (the "20% Value Test"); (iii) not more than 5% percent of the REIT's total assets may be represented by securities of any one issuer; and (iv) a REIT may not hold securities possessing more than 10 percent of the total voting power or value of the outstanding securities of a single issuer.

Section 856(c)(5)(B) defines the term "real estate assets," in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 1.856-3(d) of the Income Tax regulations provides that local law definitions are not controlling for purposes of determining the meaning of the term "real property" as used in section 856 and the regulations thereunder. Section 1.856-3(e) provides that the term "securities" does not include "real estate assets" as defined in sections 856 and 1.856-3.

Under section 856(c)(4)(B)(ii), a REIT is permitted to hold the securities of one or more TRSs as long as such securities do not exceed 20% of the value of the REIT's total assets. The question presented in this ruling request is whether, for purposes of the 20% Value Test under section 856(c)(4)(B)(ii), the term "security" includes a loan to a TRS that qualifies as a real estate asset under section 856(c)(5)(B).

There is nothing in the statute or legislative history to indicate that Congress intended that the definition of securities in § 1.856-3(e) not apply for purposes of the 20% Value Test under section 856(c)(4)(B)(ii). Thus, in applying the 20% Value Test under section 856(c)(4)(B)(ii), the term "securities" does not include real estate assets as defined in sections 856 and 1.856-3. Accordingly, based on the information submitted and representations made, we conclude that if Loan is a real estate asset within the meaning of section 856(c)(5)(B), it will not be treated as a security for purposes of the REIT 20% Value Test under section 856(c)(4)(B)(ii).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer will otherwise qualify as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Alice M. Bennett
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:

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