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PLR: Taxable REIT subsidiary found not operating a disqualifying healthcare facility

The IRS publicly released a private letter ruling* that addresses a real estate investment trust (REIT) and its taxable REIT subsidiary (TRS) and concluded the TRS would not be considered to be operating or managing a healthcare facility which would otherwise disqualified its TRS status.

The IRS found that this would be so even when: (1) the TRS is an indirect limited partner in partnerships, each of which owns a healthcare facility and at the same time employs individuals working at such facility; and (2) these facilities are managed by an operator that qualifies as an independent contractor but not likely an eligible independent contractor—as required for a *REIT Investment Diversification and Empowerment Act of 2007* (RIDEA) structure.

Read [PLR 202029002](#) [PDF 91 KB] (released July 17, 2020, and dated January 28, 2020)

*Private letter rulings are taxpayer-specific rulings furnished by the IRS Office of Chief Counsel in response to requests made by taxpayers and can only be relied upon by the taxpayer to whom issued. Pursuant to section 6110(k)(3), written determinations such as private letter rulings are not intended to be relied upon by third parties and may not be cited as precedent. These written determinations may, however, offer an indication of the IRS's position on the issues addressed.

KPMG observation

The letter ruling is consistent with less known positions shared among tax professionals who regularly address RIDEA-related issues and may provide flexibility for structuring the ownership and operation of foreign investments by global healthcare and hotel REITs.

Background

A REIT is permitted to form a TRS to engage in activities that would otherwise raise REIT qualification concerns, such as deriving too much nonqualifying income. For example, a REIT can lease a qualified lodging facility or a qualified healthcare property to its related TRS and treat rents from such lease as qualifying income if the property is operated by an eligible independent contractor (commonly referred to as the "RIDEA structure"). For this purpose, an eligible independent contractor means any

independent contractor (or its related person) that is actively engaged in the trade or business of operating similar properties for persons not related to the REIT or TRS.

Further, for purposes of a REIT's income tests, Rev. Proc. 2018-48 treats any amounts required to be included in gross income by a REIT under sections 951(a)(1) (except by reason of section 965), 951A(a), 1291(a), 1293(a)(1) or 1296(a) as income qualifying for the 95% income test. Thus, for foreign assets that require significant restructuring in order to generate qualifying income, the use of a foreign TRS (which is generally not subject to U.S. taxation) may be more efficient. However, by statute, a TRS cannot undertake certain activities including, among other things, directly or indirectly operating or managing a lodging facility or a healthcare facility. To this end, for the RIDEA structure, the statute provides that a TRS is not considered to be operating or managing a qualified healthcare property or qualified lodging facility solely because it "employs individuals working at such facility or property located outside the United States, but only if an eligible independent contractor is responsible for the daily supervision and direction of such individuals on behalf of the taxable REIT subsidiary pursuant to a management agreement or similar service contract."

Private letter ruling

In the letter ruling:

- A REIT's TRS is acquiring a limited partner interest in a foreign partnership that owns qualified healthcare properties through lower-tier property partnerships (Sub LPs).
- After the acquisition, each of Sub LPs will enter into a management contract with an operator that will have the exclusive right to manage the day-to-day operation of the property and to provide daily supervision and direction of the employees at the property.
- Sub LP directly employs employees working at its property, and this employment structure has been in place prior to the acquisition and is more efficient for Sub LPs in Region A.
- The TRS will not be involved in any component of the day-to-day operations of, or services provided at, the properties and will have no employees who perform any services relating to the properties.
- All employees with supervisory roles over property employees will be employed by the operator, which is represented to be an independent contractor to the REIT but will have no customers other than Sub LPs. In other words, as understood by the IRS, the operator qualifies as an independent contractor but not an eligible independent contractor.

The IRS acknowledged that a TRS is not precluded from owning a healthcare facility. The IRS then reasoned that the TRS has no legal or contractual rights to participate in the daily operation of the properties and that pursuant to the statute "mere legal employment of an individual working in a qualified health care property is not, per se, operation of the qualified health care property." Accordingly, the IRS ruled the TRS would not be considered to be directly or indirectly operating or managing a healthcare facility as a result of its indirect majority ownership interests in the Sub LPs, each of which will own a qualified healthcare property and employ employees working in such property under the control of the operator as described.

KPMG observation

The ruling is viewed by tax professionals as sensible, but the conclusion may not be apparent to those professionals who deal less frequently with healthcare or hotel REIT issues. To start, the use of an eligible independent contractor (that must have other customers) is required in connection with the RIDEA structure, i.e., when the TRS is leasing qualified property from its REIT parent. However, the

arrangement described in the letter ruling does not involve that situation; thus, the operator just needs to qualify as an independent contractor so that the TRS is not tainted by operator's "daily supervision" activities.

Also, as similar to the rulings in PLRs 201041034, 201208014, and 201139005, the fact that the TRS will indirectly through Sub LPs have employees working at the properties does not by itself disqualify the TRS as long as these employees are under the daily supervision of the independent contractor.

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