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PLR: REIT's distributive share of management fee income disregarded under gross income tests

The IRS publicly released a private letter ruling* in which the IRS exercised its authority under section 856(c)(5)(J) to rule that a REIT's distributive share of management fee income (that would have been treated as nonqualifying) paid by it to a partnership in which it would hold an interest is to be disregarded for purposes of the REIT gross income tests.

The IRS followed prior rulings—the IRS ruled similarly in PLR 201620001—and applied the "self-charged" or "no double-counting" concept to allow a REIT to disregard its share of nonqualifying income that is effectively paid by the REIT itself.

Read **PLR 202102002** [PDF 95 KB] (released January 15, 2021, and dated October 16, 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.

Summary

In this recent letter ruling, a REIT—through a disregarded entity and two lower-tier partnerships—owns real estate and realizes interest and rental income, substantially all of which is represented to be income qualifying for purposes of the REIT gross income tests. Currently, the REIT indirectly owns an interest in another regarded partnership through its taxable REIT subsidiary. This partnership provides asset-management services to the REIT, and receives fees from the REIT in exchange for those services.

The REIT represented that the asset management services are activities that a REIT could perform in managing the assets of the REIT as well as managing the REIT itself without adverse tax consequences. The manager-partnership receives a base management fee based on REIT's consolidated stockholder's equity and an incentive fee based on returns in excess of specified hurdles.

The REIT proposed to acquire the interest in the manager-partnership held by the taxable REIT subsidiary. As a partner in the manager-partnership, the REIT would have gross income attributable to its share of management fee income earned by the partnership. The manager-partnership currently does not, but may provide similar asset management services to existing and future joint ventures in which the REIT owns an interest and, thus, may be compensated by those joint ventures. The REIT represented that it would treat its gross income attributable to any fees earned by the manager-partnership that would be attributable to third parties as non-qualifying income.

After the acquisition, the REIT would have gross income for tax purposes as a partner in partnerships that own commercial real estate and as a partner in the manager-partnership.

The IRS reasoned that:

> *Because the Management Fees are derived from the same Investments that generate the Investment Income, including Taxpayer's share of the Management Fees in Taxpayer's gross income would cause the amounts to be counted twice for purposes of the gross income tests under section 856(c).*

The IRS continued:

> *Taxpayer's gross income attributable to Manager's Management Fee income represents an amount that Taxpayer, as a partner in Manager, is charging itself to perform functions that, based on Taxpayer's representations, Taxpayer could perform directly without adverse tax consequences.*

In effect, the taxpayer was paying itself. Accordingly, the IRS exercised its authority under section 856(c)(5)(J) and ruled that REIT's gross income attributable to its allocable share of the management fees will be disregarded for purposes of the income tests.

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