IT 20-0001-PLR 01/24/2020 CAPTIVE REAL ESTATE INVESTMENT

REIT More Than 50%-Owned by Publicly Traded Foreign REIT is not Captive REIT (This is a PLR.)

January 24, 2020

Re: Request for Private Letter Ruling

Dear Mr. Xxxx:

This is in response to your letter dated February 15, 2019 in which you request a Private Letter Ruling on behalf of COMPANY and members of its Illinois combined group. Review of your request for a Private Letter Ruling indicates that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code 1200.110 is contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY. and the members of its Illinois combined group. Issuance of this ruling is conditioned upon the understanding that COMPANY. and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented states as follows:

AGENT, as authorized agent for COMPANY. ("COMPANY" "Company" or "taxpayer") requests a Private Letter Ruling as to whether its foreign parents meet the Illinois statutory requirements under Illinois Income Tax Act Section ("IITA") 1501(a)(1.5) and none of its U.S. subsidiaries, for Illinois corporate and replacement tax, would be deemed a "captive Real Estate Investment Trust" ("REIT").

In accordance with 2 Ill. Adm. Code Section 1200.110(b)(3), the subject of this request is not being examined as part of an audit by the Illinois Department of Revenue ("Department").

In accordance with 2 Ill. Adm. Code 1200.110(b)(4), to the best of the taxpayer and the taxpayer's representative's knowledge, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor. In addition, neither the taxpayer nor its representatives have previously submitted the same or a similar issue to the Department and withdrew it before a letter ruling was issued.

The ruling is requested for tax years ended on or after December 31, 20XX. For purposes of this request, COMPANY includes itself and all of its affiliates included in its combined Illinois income tax return. COMPANY is submitting this

Private Letter Ruling request in accordance with 2 Ill. Adm. Code Section 1200.110(a)(3)(A)(ii), which permits one ruling request by a member of a unitary group with reference to issues common to it and other members of the unitary group. COMPANY has a calendar year ending December 31st.

COMPANY is a U.S. REIT as defined in Internal Revenue Code ("IRC") Section 856. COMPANY owns directly or indirectly partnership interests which holds property located in Illinois. Included in the COMPANY Illinois unitary return is a U.S. Incorporated entity ("COMPANY1") that is current not a REIT but intends to elect REIT status for federal income tax purposes sometime in the next few years.

COMPANY is not regularly traded on an established securities market. Currently, COMPANY is owned %% by COMPANY1 which in turn is owned %% by a COMPANY2 ("COMPANY2"). The other %% of COMPANY is directly owned by a COMPANY3 ("COMPANY3."). COMPANY2 and COMPANY3 are stapled securities comprised on COMPANY3 shares and the COMPANY2 Class A Shares, which are traded on non-U.S. established securities markets and COMPANY2's Class B Shares that are owned by COMPANY3. COMPANY1 does not conduct a trade or business and does not own any other assets apart from its ownership interest in COMPANY.

COMPANY1 is not regularly traded on an established securities market. COMPANY1 is owned %% by COMPANY2 which is an entity organized by the laws of the COUNTRY, which has a tax treaty with the United States. COMPANY2 operates a Dutch version of a U.S. REIT.

COMPANY2 assets consist nearly exclusively of its ownership interest in COMPANY1 whose most significant is COMPANY's stock, which is a U.S. REIT. Over %% of COMPANY2's total asset value at the end of its taxable year consist of COMPANY1, which would qualify as a real estate asset under IRC Section 856(c)(5)(B). Further, COMPANY2 is not taxed on amounts distributed to COMPANY2's beneficial owners and COMPANY2 does not pay tax in the COUNTRY. In addition, COMPANY3 calculates taxable income according to Dutch law and distributes over %% of its taxable income to its shareholders.

COMPANY2 has two classes of stock: Class A and Class B. Its Class A stock is regularly traded on established securities markets. Its Class B stock is owned by COMPANY3, which operates the French version of a U.S. REIT. COMPANY3's ownership of COMPANY2's Class B stock represents a 40 percent ownership interest in COMPANYB. Class B shares are substantially identical to the Class A shares held by the public. Class B shares are convertible 1 for 1 for Class A shares. Class B shares have substantially identical voting rights as Class A shares. Class B shares have the same rights to any distribution and liquidation proceeds as the Class A shares.

The purpose of COMPANY2's Class B stock is to meet French banking law requirements so that COMPANY3 can provide guarantees to COMPANY2 and COMPANY2 can be consolidated with COMPANY3 for financial statement purposes.

Although COMPANY3 owns a %% percent ownership interest in COMPANY2 and COMPANY3's articles of formation inhibit a single shareholder from owning more than % percent in the stapled entities. The purpose of this organizational structure was not related to any tax planning or tax avoidance. Rather, it was established as a legitimate structure for good and valid business reasons to allow foreign investors to invest in U.S. real estate.

COMPANY requests the Department to issue a ruling that COMPANY2 and COMPANY3 meet all the statutory requirements under IITA Section 1501(a)(1.5) and for Illinois corporation income and replacement tax purposes, none of its U.S. subsidiaries will be deemed a captive REIT.

While most states conform to IRC Section 856, some states including Illinois have enacted captive REIT legislation. The purpose behind captive REIT state legislation was to prevent corporations from income tax planning which would allow a corporation to avoid paying state income tax from its own real estate holdings. Illinois enacted IITA Section 203(b)(2)(E-15) which requires captive REITs to addback the federal dividends paid deduction for Illinois purposes. Illinois, like many states that have similar provisions, provides for a definition of what constitutes a captive REIT.

IITA Section 1501(a)(1.5)(B)(i)(e)(1)-(5) provides that a captive real estate investment trust does not include a REIT of which more than 50% of the voting power or value of the beneficial interest or shares is owned or controlled, directly, indirectly, or constructively, by an entity that is organized outside the laws of the U.S. provided that such foreign entity satisfies 5 stated criteria. Listed below are the five stated criteria and how the taxpayer maintains that its ultimate foreign parent meets the Illinois statutory requirements and the taxpayer and its U.S. parent should not be classified as captive REITs.

IITA Section 1501(a)(1.5)(B)(i)(e)(1) states that at least 75% of the entity's total asset value at the close of its taxable year is represented by real estate assets (as defined under IRC Section 856(c)(5)(B), thereby including shares or certificates of beneficial interest in any real estate investment trust), cash and cash equivalents and U.S. Government securities.

While Dutch REITs are permitted to invest in passive, portfolio investments which include investing in real estate but are not restricted to real estate, the assets in COMPANY2 consist nearly exclusively of its ownership of COMPANY1 whose only asset is the stock of the taxpayer.

Over %% of COMPANY3's asset value consists of investments in real estate and real estate subsidiaries, including COMPANY2 and COMPANY1.

Taxpayer maintains that COMPANY2 and COMPANY3 meet the first criteria because over %% of their total asset value are represented by real estate assets as defined in Section 856.

IITA Section 1501(a)(1.5)(B)(i)(e)(2) states that the entity is not subject to tax on amounts that are distributed to its beneficial owners or is exempt from entity-level taxation.

The COUNTRY tax rate on Dutch REITs is zero percent. While COUNTRY does not have a formal exemption, the amounts distributed to its beneficial owners are not taxed.

COMPANY3 is not taxed on amounts that it distributes to its beneficial owners and is exempt from entity-level tax on its passive real estate investment income.

Taxpayer maintains that COMPANY2 and COMPANY3 meet the second criteria of the Illinois statute that requires no entity level tax.

IITA Section 1501(a)(1.5)(B)(i)(e)(3) states that the entity distributes at least 85% of its taxable income (as computed in the jurisdiction in which it is organized) to the holders of its shares or certificates of beneficial interest on an annual basis.

Dutch REITs are required to distribute 100% of its taxable income. It is interesting to note that Dutch regulations allow capital gains to be removed from taxable income and added to a reinvestment reserve.

Since the capital gain would not be a part of taxable income, the Dutch REIT regulations which requires a distribution of 100% of taxable income would meet the third criteria as the distribution exceeds the state threshold of 85%.

COMPANY3 distributes at least %% of its taxable income to its public shareholders.

Both COMPANY2 and COMPANY3 meet the third criteria of the Illinois statute.

IITA Section 1501(1.5)(B)(i)(e)(4) states that either (i) the shares or beneficial interests of the entity are regularly traded on an established securities market or (ii) not more than 10% of the voting power or value in the entity is held, directly, indirectly, or constructively, by a single entity or individual.

As previously stated, the French and Dutch REITs are stapled entities with stapled securities comprised of the French REIT's shares and the Class A Shares of the Dutch REIT, which are traded on non-US established securities

market. Taxpayer believes that clause (i) has been met despite the fact that the French REIT owns a class of the Dutch REIT's shares representing approximately a 40% interest in the Dutch REIT (the Class B shares) which are not traded on an established securities market. The purpose of the Class B shares is to meet French banking regulations to allow the French REIT to provide guarantees to the Dutch REIT and to allow the Dutch REIT to consolidate with the French REIT for financial statement purposes. The taxpayer does not believe that this should impact its ability to meet the criteria of 4(i), as the state does not reference whether or not all different classes of shares must be traded on an established securities market.
In addition, taxpayer believes that they meet the condition of 4(ii). The articles of incorporation of the taxpayer's French and Dutch REITs are written to inhibit a single shareholder to own more than 10% in the stapled entities. While the French REIT owns 40% of the stock of the Dutch REIT, the French REIT is ultimately traded on an established securities market as a stapled entity and not one shareholder owns greater than 10% of the stock.

The taxpayer maintains that COMPANY2 and COMPANY3 meet the fourth criteria of the Illinois statute.

IITA Section 1501(1.5)(B)(i)(e)(5) states that the entity is organized in a country that has entered into a tax treaty with the United States.

The U.S. has a tax treaty with the COUNTRY and COUNTRY1. Taxpayer maintains that COMPANY2 and COMPANY3 meet the final statutory requirement that the country of the foreign REIT have a tax treaty with the U.S.

As a result of COMPANY2 and COMPANY2 meeting all the requirements of IITA Section 1501(a)(1.5)(B)(i)(e)(1)-(5), COMPANY1 nor the taxpayer should be classified as captive REITs for Illinois corporation income and replacement tax purposes.

RULING

Section 1501(a)(1.5)(A) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/1501) defines the term "captive real estate investment trust" to mean a real estate investment trust (REIT) as defined under Section 856 of the Internal Revenue Code, the shares or beneficial interests of which are not regularly traded on an established securities market, and which is more than 50% owned (by vote or value) at any time during the last half of the taxable year, directly, indirectly, or constructively, by a single corporation. However, subparagraph (B) of such section provides:

(B) The term "captive real estate investment trust" does not include:

(i) a real estate investment trust of which more than 50% of the voting power or value of the beneficial interest or shares is owned or controlled, directly, indirectly, or constructively, by:

(a) a real estate investment trust, other than a captive real estate investment trust;

…

(e) an entity that is organized outside of the laws of the United States and that satisfies all of the following criteria:

(1) at least 75% of the entity's total asset value at the close of its taxable year is represented by real estate assets (as defined in Section 856(c)(5)(B) of the Internal Revenue Code, thereby including shares or certificates of beneficial interest in any real estate investment trust), cash and cash equivalents, and U.S. Government securities;

(2) the entity is not subject to tax on amounts that are distributed to its beneficial owners or is exempt from entity-level taxation;

(3) the entity distributes at least 85% of its taxable income (as computed in the jurisdiction in which it is organized) to the holders of its shares or certificates of beneficial interest on an annual basis;

(4) either (i) the shares or beneficial interests of the entity are regularly traded on an established securities market or (ii) not more than 10% of the voting power or value in the entity is held, directly, indirectly, or constructively, by a single entity or individual; and

(5) the entity is organized in a country that has entered into a tax treaty with the United States.

Section 318(a)(2)(c) of the Internal Revenue Code, regarding constructive ownership of stock, provides:

If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion

which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

Your letter represents that %% of the outstanding shares of Taxpayer, a REIT, are owned by COMPANY1., and that %% of the outstanding shares of COMPANY1. are owned by COMPANY2. Accordingly, COMPANY2 constructively owns %% of the outstanding shares of Taxpayer.

Regarding COMPANY2, your letter represents as follows:

(1) over %% of COMPANY2's total asset value at the close of its taxable year is represented by real estate assets (as defined in Section 856(c)(5)(B) of the Internal Revenue Code);

(2) COMPANY2 is not subject to tax on amounts that are distributed to its beneficial owners or is exempt from entity-level taxation;

(3) COMPANY2 distributes at least %% of its taxable income. as computed in the jurisdiction in which it is organized (COUNTRY), to the holders of its shares on an annual basis;

(4) the shares of COMPANY2 are regularly traded on an established securities market;

(5) COMPANY2 is organized in a country (COUNTRY) that has entered into a tax treaty with the United States.

Regarding item (4) above, you indicate that COMPANY2 has two classes of stock outstanding. Class A shares, which represent %% of the ownership interest, and Class B shares, which represent %% of the ownership interest. The Class A shares are regularly traded on an established securities market. All of the Class B shares, which are not publicly traded, are owned by COMPANY3. Your letter represents that COMPANY3 also meets items (1)-(5) specified above. In addition, the shares of COMPANY3, which are regularly traded on an established securities market, are stapled securities with the Class A shares of COMPANY2. Accordingly, the shares of COMPANY2 are regularly traded on an established securities market for purposes of IITA Section 1501(a)(1.5)(B)(i)(e)(4). Your letter further represents that this organizational structure was not related to tax planning or tax avoidance purposes.

Based on the representations made in your letter, Taxpayer is not a captive real estate investment trust pursuant to IITA Section 1501(a)(1.5)(B)(i). It follows that members of Taxpayer's combined group which are more than 50% owned or controlled by Taxpayer are not captive real estate investment trusts.

Except as provided herein, this ruling shall bind the Department for the taxable year ending December 31, 20XX and subsequent taxable years. The facts upon which this

ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited and incorporated in this ruling are correct and complete. This ruling shall bind the Department for the taxable years specified above, except as limited pursuant to 2 Ill. Adm. Code 1200.110(d) and (e). In addition, this ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Brian L. Stocker
Chairman, PLR Committee (Income Tax)