

St. Louis
C. M. ...

[REDACTED]

September 6, 1990

Premerger Notification Office
Bureau of Competition
Room 303

ATTENTION: MS. Nancy Ovuka

Re: Section 802.63 Exemption

Dear Ms. Ovuka:

As you may recall, I had several telephone conversations last month with Dick Smith and you regarding the applicability of the Section 802.63 exemption to certain types of sale-leaseback transactions routinely consummated by our client, a corporation that qualifies as a "real estate investment trust" or "REIT" under the Internal Revenue Code ("Code"). The purpose of this letter is to provide you with additional detail regarding our client and the specifics of a pending sale-leaseback transaction and to confirm your concurrence in our view that such a transaction is exempt from the reporting requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act").

[REDACTED]

Premeger Notification Office
September 6, 1990
Page 2

I. The Section 802.63 Exemption

Section 802.63(a) provides in pertinent part:

An acquisition . . . in connection with the establishment of a lease financing . . . shall be exempt from the requirements of the act if made by a creditor in a bona fide credit transaction entered into in the ordinary course of the creditor's business.


1989 that the Premeger Notification Office has concluded that Section 802.63 exempts sale-leaseback transactions as long as the acquiring person (1) takes title to the property and then leases the property back to the seller in a bona fide transaction, (2) engages in such sale-leaseback transactions in the ordinary course of its business, and (3) does not compete with the person

II. [REDACTED]
Business

Our client, [REDACTED], is a corporation engaged in the business of making passive investments in health care facilities and qualifies as a REIT under the Code. When considering the applicability of the [REDACTED] provisions, it is important to understand the significance and implications of what it means to be a qualifying

[REDACTED] paragraph release of this special tax treatment is the absence of

The purpose of this special tax treatment is to encourage and facilitate long-term passive investments in real estate by small investors. In order to ensure that this broad purpose is achieved, Sections 856 through 860 of the Code and the


Premerger Notification Office
September 6, 1990
Page 3

As set forth below, these rules greatly restrict the business activities in which a qualifying REIT may engage.

In order to qualify as a REIT for a taxable year the Code requires generally that (1) at least 75 percent of the total

including rents from real property and interest on mortgage obligations; (3) at least 95 percent of the REIT's gross income


and (4) gross income from the sale or other disposition of real property held for less than four years or from the sale of certain securities must comprise less than 30 percent of the gross income of the REIT.

In order for a REIT's income to qualify as "rents from real property," (1) the REIT may not own, directly or indirectly, ten percent or more of any entity that is its lessee; and (2) amounts received with respect to the leased property may not depend on the income or profits of the lessee. These requirements are intended to ensure that the REIT will not have a

The Code also discourages a REIT from buying and selling property as a dealer by imposing a 100 percent tax on the net income (not reduced by losses) from such sales with some limited exceptions and, in addition, extensive dealer activities could jeopardize the company's ability to maintain its status as

The practical consequence of all of these provisions is that the business activities of a REIT are limited to investing on a long-term basis in mortgages or investing in real estate for the purpose of renting such real estate on an arm's length basis to unrelated entities.

The REIT provisions in the Code also prohibit a REIT from actively managing or operating its property, either directly or indirectly through a property manager. Income from the operation or management of its property would not be qualifying income to a REIT under the 95 percent gross income test discussed above. Thus, even a small amount of such activity could


Premerger Notification Office
September 6, 1990
Page 4

jeopardize its status as a REIT under the Code.^{1/} In addition, with respect to property that a REIT leases to another entity, the REIT is restricted to providing only those services to its tenants that a tax-exempt organization may provide to its tenants without causing its rental income to be "unrelated business income." Generally, the services under this standard are those

the business of the lessee. As a result, a REIT generally must

property manager or provide such services.

The failure to qualify as a REIT during any taxable year would have a material adverse effect on the REIT and its shareholders. The REIT would be subject to federal income tax at

shareholders. REITs would also be subject to the regular tax

1. There is one exception to this 95 percent gross income test limitation. Income derived by a REIT from the operation of "foreclosure property" will be treated as qualifying income under the 95 percent gross income test. A REIT may elect to treat as foreclosure property, property it acquires as a result of a foreclosure on a lease of the property or on a loan which was secured by the property. Property may qualify as foreclosure

of the Internal Revenue Service. A REIT may directly operate

purpose of the foreclosure property provision is to allow a REIT to operate property it acquires through foreclosure while the REIT is attempting to re-lease or sell the property. REITs are discouraged from electing foreclosure property treatment because, while qualifying REITs generally are not subject to corporate

property as the highest corporate tax rate. Most currently, and operates, through independent property managers, two properties which qualify as foreclosure property. All of the

and REIT is attempting to re-lease these two foreclosure properties.

[REDACTED]

Premier Notification Office
September 6, 1990
Page 5

rules applicable to dividends received by shareholders of corporations.

The Code also requires that the shares of a REIT be held by at least 100 shareholders and that five or fewer individuals may not own more than 50 percent, in value, of the

and a qualifying REIT is always its own ultimate parent entity.

investments are made in various forms, with each transaction


arrangements in which [REDACTED] acquires a health care facility from the owner of the facility and [REDACTED] then leases the facility back to the owner who will operate the facility. As a result of such

general income from the lease. From the operator's perspective, the sale-leaseback arrangement serves, in many respects, as a financing mechanism.




Once it acquires a health care facility, [REDACTED] does not (and could not without placing its REIT status in jeopardy)

may not [REDACTED] greatly limit [REDACTED]'s ability to provide services to its lessee. In fact, all of the properties currently leased by HCPI have been leased on a triple net basis whereby [REDACTED] provides no services to the lessees.

In sum, [REDACTED] routinely enters into sale-leaseback arrangements with operators of health care facilities. In these transactions, [REDACTED] acquires title to the real property and leases the property back to the operators in a bona fide lease. [REDACTED] is not in the business of operating or managing the health care



Premerger Notification Office
September 6, 1990
Page 7

We would greatly appreciate your concurrence in our
transaction between . If you have any questions
about  or this transaction, please do not hesitate to contact
me at .

We look forward to hearing from you at your earliest
convenience.

Sincerely

