Internal Revenue Service

Department of the Treasury

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Date:
July 5, 2001

LEGEND

Company =

Operating Partnership =

Project Partnership =

Subsidiary A =

Corporation A =

Corporation B =

Project =

State X =

City Z =

Date 1 =

Year 1 =

Year 2 =

Year 3 =

a =

b =

c =

d =

e =

f =

g =

h =

Dear

This is in reply to a letter dated February 19, 2001, as supplemented by subsequent submissions, requesting two rulings on behalf of Company concerning the treatment of certain income for purposes of § 856(d) of the Internal Revenue Code. This letter addresses only the first ruling requested. The second ruling requested will be addressed in a separate private letter ruling pursuant to § 8.02(1) of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 27.

FACTS

Company, a State X corporation, has made an election under § 856 of the Code to be treated as a real estate investment trust (REIT). Company is engaged primarily in the business of owning, operating, managing, leasing, acquiring, expanding, and developing regional malls and community shopping centers. Company owns interests in these properties through Operating Partnership, a State X limited partnership. Company and Subsidiary A, of which Company holds more than a percent of the outstanding stock, are the sole general partners of Operating Partnership. Company directly and indirectly holds a b percent beneficial ownership in Operating Partnership.

Operating Partnership is the sole limited partner of Project Partnership, a State X limited partnership that was formed to construct, develop, own, and manage the Project, a regional mall located in City Z. Company has represented that Corporation A, a subsidiary of Company, is a qualified REIT subsidiary of Company. Corporation A is the sole general partner of Project Partnership.

Operating Partnership is negotiating a Naming Rights Agreement (the "Naming Agreement") with Corporation B, which is in the cable television business and in the business of producing programs for broadcast on cable television. The Naming Agreement will become effective on the date it is executed and will expire on Date 1. The Naming Agreement provides that the full name of the Project will include the name of Corporation B. To protect Corporation B’s financial investment in acquiring the

Naming Rights to the Project, the Naming Agreement requires Operating Partnership to do the following:

(i) Refrain from sponsoring events within the Project with competitors of Corporation B, advertising the products of any competitors of Corporation B within the Project, or leasing space in the Project to any competitors of Corporation B. However, the Naming Agreement does not restrict the activities of any tenants of the Project or prohibit them from obtaining telecommunication services from a competitor of Corporation B.

(ii) Include the full Project name on all signs that identify the Project and on all directories within the Project. The full Project name must also be included in all promotional materials and brochures and referred to in all advertisements sponsored by Project Partnership. This requirement is consistent with the manner in which Operating Partnership promotes its other properties.

(iii) Use commercially reasonable efforts to require tenants to use the full Project name when referring to the Project in writing.

(iv) Grant Corporation B a right of first offer on promotional events within the Project that are sponsored by Company.

(v) Advertise by direct mail or on the Corporation B cable system for a minimum of c years at amounts to be specified in a schedule to the Naming Agreement.

(vi) Cooperate with Corporation B to establish and develop a joint marketing effort, which may include links on web sites controlled by either Company or Corporation B, joint promotion within publications controlled by either Company or Corporation B and the inclusion of promotional material relating to the Project in Corporation B's customer bills and other agreed upon promotions. Following the execution of the Naming Agreement, the parties are obligated to use their best efforts to establish an initial marketing plan which sets forth their respective obligations.

The most significant financial obligation imposed on Operating Partnership pursuant to the Naming Agreement is the requirement that Operating Partnership and its affiliates advertise on the Corporation B cable television system for a minimum of c years. Company anticipates that the amount it and its affiliates will be required to spend will range from $ d to $ e annually except that they will be required to spend $ f on such advertisements during each of the first g years of the Naming Agreement. Corporation B is required to charge Operating Partnership and its affiliates no more than the lowest rates afforded to other advertisers of similar scope and scale. The

advertisements will promote the Project and other Company malls and are not intended to promote Corporation B's sales or business at the Project except to the extent that all tenants may benefit from general promotions of the Project. The obligation of Operating Partnership and its affiliates to purchase advertising on Corporation B's cable television system and the minimum expenditures for advertising required of Operating Partnership and its affiliates are not subject to any schedule or time requirements, and expenditures in any year which exceeds amounts specified in the Naming Agreement for such year reduce the amounts required to be expended in subsequent years. Likewise, the other requirements under the Naming Agreement, including the requirement that Project Partnership and Operating Partnership develop and implement a marketing plan with Corporation B, are not subject to any schedule or time requirements.

Corporation B's obligations under the Naming Agreement consist primarily of cooperating with Operating Partnership and Project Partnership in the development of the promotional materials described above and making a payment of $ h (the "Payment"). Under the Naming Agreement, the Payment will be paid into an escrow account from which amounts will be released to Operating Partnership as certain specified phases of construction of the Project are completed. The final installment of the Payment is to be made when the Project opens.

Company anticipates that most of the Payment will be released from the escrow account to Operating Partnership in Year 1 and Year 2, the year prior to the year in which Company will begin receiving rents from tenants of the Project. However, Company anticipates that at least some portion of the Payment will be released in the year in which the Project opens, which Company anticipates will be Year 3.

Company anticipates that any services required of the managers and employees of the Project under the Naming Agreement will not be significant. These services will relate primarily to making sure that Project Partnership complies with the requirements that the advertising materials refer to the full name of the Project and that Corporation B be provided with a right of first offer for Project promotions. Since Operating Partnership's advertisements typically include the full names of its malls and since the promotions will be planned and developed without regard to the Naming Agreement, the services performed by managers and employees of Project Partnership will be substantially the same as if the Naming Agreement did not exist, and the time devoted to complying with the other terms of the Naming Agreement will not be substantial. Furthermore, these services will be required regardless of whether Corporation B is a tenant of the Project, and the nature and extent of these services will not change if Corporation B does become a tenant. Services related to the development of joint marketing materials, such as mutual web site links, will be performed primarily by personnel of Operating Partnership who have no involvement with the management or operation of the Project.

Project Partnership anticipates entering into a lease (the "Corporation B Lease") with Corporation B pursuant to which Corporation B will be a tenant in the Project operating a kiosk in the common area and a production studio in an area designated for single tenant occupancy. Currently, however, there are no active negotiations with respect to the Corporation B Lease, and the parties anticipate that the Naming Agreement will be executed prior to the time that the negotiations for the Corporation B Lease are resumed. It is possible that Corporation B will not ultimately become a tenant of the Project. Company represents that the Corporation B Lease and the Naming Agreement are being separately negotiated, are each on arm's-length terms, and that the terms of each will be unaffected by the terms of the other. The decision by Operating Partnership of whether to enter into the Naming Agreement is unrelated to the decision of whether to enter into the Corporation B Lease. Neither the Corporation B Lease nor the Naming Agreement will contain cross-default provisions. Although the term of the Corporation B Lease will not begin until Year 3, the term of the Naming Agreement will commence in Year 1 and will continue until Date 1.

LAW AND ANALYSIS

Section 856(c)(2) of the Code requires at least 95 percent of a REIT's gross income to be derived from passive sources, including dividends, interest, "rents from real property" and certain other items. Section 856(c)(3) requires at least 75 percent of a REIT's gross income to be derived from real property interests, including rents from real property and certain other sources specified in that section.

Section 1.856-2(c)(1) of the Income Tax Regulations provides, in part, that for purposes of determining the gross income requirements of § 856(c)(2), (3) and (4) of the Code, the term "gross income" has the same meaning as that term has under § 61 of the Code and the regulations thereunder. For purposes of the items of gross income listed in § 61, except as specifically provided or otherwise permitted to be elected, § 451(a) requires that such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period. Section 446(b) requires that a taxpayer's accounting method must clearly reflect income.

Section 856(d)(1) of the Code provides that the term "rents from real property" includes rents from interests in real property, charges for services customarily furnished or rendered in connection with the rental of real property, and rent attributable to personal property which is leased under or in connection with a lease of real property, but only if the rent attributable to such personal property for the taxable year does not exceed 15 percent of the total rent for the year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(C) of the Code excludes from the definition of “rents from real property” any “impermissible tenant service income” as defined in § 856(d)(7). Section 856(d)(7)(A) provides that “impermissible tenant service income” means, with respect to any real or personal property, any amount received or accrued directly or indirectly by a REIT for furnishing or rendering services to the tenants of such property or managing or operating such property. Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income with respect to a property for any taxable year exceeds one percent of all amounts received or accrued directly or indirectly by the REIT with respect to such property, the impermissible tenant service income of the REIT with respect to the property shall include all such amounts.

Section 856(d)(7)(C)(i) of the Code excludes from the definition of impermissible tenant service income amounts received for services furnished or rendered, or management or operation provided, through an independent contractor within the meaning of § 856(d)(3) from whom the REIT itself does not derive or receive any income (Independent Contractor). Additionally, § 856(d)(7)(C)(ii) excludes from the definition of impermissible tenant service income any amount which would be excluded from unrelated business taxable income under § 512(b)(3) if received by an organization described in § 511(a)(2).

Rev. Rul. 98-60, 1998-2 C.B. 749, holds that the determination of whether impermissible tenant service income received by a REIT exceeds the one percent limitation is computed separately with respect to each property owned by the REIT rather than with respect to any particular tenant.

The amounts of the Payment received by Operating Partnership under the Naming Agreement are not received for services rendered to a tenant by Operating Partnership or Project Partnership with respect to the Project. Thus, such amounts are not impermissible tenant service income. The Naming Agreement and Corporation B Lease were separately negotiated on arm's-length terms, and Company's obligations, including its advertising obligations and the services provided by Project Partnership under the Naming Agreement, do not relate to and do not depend on Corporation B's occupancy of the Project. Moreover, Operating Partnership and Project Partnership will be subject to the Naming Agreement during periods that Corporation B is not a tenant of the Project. Furthermore, any services performed by management or employees of Project Partnership pursuant to the Naming Agreement will be required regardless of whether Corporation B is a tenant of the Project, and the services required under the Naming Agreement will not change if Corporation B becomes a tenant of the Project. Thus, the requirements under the Naming Agreement, including any obligations of Operating Partnership, and any services performed by Project Partnership pursuant to the Naming Agreement, are unrelated to Corporation B's occupancy of the Project. Accordingly, Company’s allocable share of any amounts received or accrued by Operating Partnership as part of the Payment under the Naming Agreement are not for services rendered by Company to Corporation B as a tenant.

CONCLUSION

Based on the facts as represented by Company, we conclude that the performance by Operating Partnership or Company of the obligations required under the Naming Agreement will not be considered services furnished or rendered by Company to Corporation B as a tenant under section 856(d)(7)(A)(i) of the Code. Company's allocable share of any amounts received or accrued by Operating Partnership as part of the Payment under the Naming Agreement, however, does not qualify as "rents from real property" within the meaning of section 856(d).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provision of the Code. Specifically, we do not rule whether Company qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code or whether Corporation A is a qualified REIT subsidiary of Company.

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.

Sincerely yours,
Acting Associate Chief Counsel
(Financial Institutions and Products)
By: Alice M. Bennett
Chief, Branch 3

Enclosures:
Copy of this letter
Section 6110 Copy

cc: Internal Revenue Service