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Date:
March 25, 2004

LEGEND:

Trust =

Company =

State X =

Date 1 =

Dear

This responds to a letter dated October 17, 2003, submitted on behalf of Trust, requesting rulings under § 856(d) of the Internal Revenue Code.

FACTS

Trust, a State X corporation, elected to be taxed as a real estate investment trust (REIT) beginning with its tax year that ended Date 1. Trust owns temperature-controlled storage facilities. Currently, Trust leases these facilities to Company, an unrelated limited liability company that is disregarded as an entity separate from its owner for federal income tax purposes.

Company provides food manufacturers, distributors, and retailers with temperature-controlled storage space as well as handling, transportation, and other

supply chain services. Additionally, Company manages temperature-controlled storage facilities on a cost-plus basis for other companies pursuant to management contracts.

In most cases, Company's invoices to its customers indicate separate charges. The invoices show a fee for the storage space being used as well as separate fees for product handling, such as loading and unloading customers' goods from trucks into and out of the facilities as well as other optional handling services provided at the request of the customer. Storage fees are based on the amount of space used by the customer. For safety and liability reasons, customers generally do not have unrestricted access to the inside of the storage facilities with the exception of some facilities that are dedicated to a single customer. Customers typically do not have reserved storage locations within a particular storage facility.

Charges for handling services are generally calculated to include a profit component and are computed according to the type of service required, the type and quantity of product, and in some cases, product weight. In certain cases, the fee negotiated with a customer for handling services may be equal to Company's cost of rendering the services. Trust represents that these methods of charging customers are usual and customary in the commercial temperature-controlled logistics industry. Company also offers transportation services with third party carriers and other supply chain services to its customers for additional fees.

Trust desires to restructure its current operations by forming a taxable REIT subsidiary or TRS (the TRS) under § 856(l) of the Code. Trust will rent space in its temperature-controlled storage facilities directly to customers. The TRS will perform all of the product handling and other services currently being performed by Company.

Trust plans to cancel its leases with Company, and the TRS will purchase the assets of Company by acquiring 100 percent of the membership interests in Company from Company's owner. Trust and the TRS will notify customers that Trust will thereafter provide the storage space directly to customers and that employees of the TRS will provide product handling services to the customers. Trust will receive separately stated amounts for providing storage space and the TRS will receive separately stated amounts for providing product handling services. In certain cases, the TRS may collect both amounts from the customers and will remit to Trust the amounts received for providing storage space.

Generally, the TRS will separately contract with and bill customers for providing product transportation and other supply chain services. In cases where the services for transportation, supply chain, and other services are covered in the same contract as the provision of storage space and product handling services, the charges for transportation, supply chain, and other services will be separately stated and retained by the TRS.

Other than usual and customary services, Trust will not provide any services in connection with the lease of space in its temperature-controlled storage facilities. In providing usual and customary services, certain employees of Trust and the TRS may perform activities for both Trust and the TRS, and thus may be treated as shared employees. Activities that may be engaged in by these shared employees include negotiating contracts with customers, account maintenance, and general administration duties. For example, the shared employees may solicit prospective tenants and customers, perform background and credit checks of prospective tenants and customers, and negotiate lease, storage, handling, and other service agreements. Account maintenance and general administrative activities may include accounting (including preparing financial statements), billing, and bookkeeping activities, and collecting rent, handling, and other service fee income.

Trust and the TRS plan to enter into a cost-sharing arrangement whereby the TRS will generally advance funds for Trust's share of the shared employees' expenses as well as Trust's allocable share of general and administrative overhead expenses. General and administrative expenses may include property taxes, utilities, and firm management and administrative expenses (including human resources, finance, legal, accounting, administrative support, and marketing). Occasionally, however, Trust may advance funds to the TRS for the TRS's allocable share of expenses. In each of these cases, the entity advancing funds will be reimbursed by the other entity for its fair allocation of expenses. Trust represents that the expenses of the shared employees will be determined on an arm's-length basis based on the amount of time spent carrying out the various activities. Likewise, the allocation of general and administrative overhead expenses will be on an arm's-length basis and will be equitable. Trust also represents that neither Trust nor the TRS is in the business of providing the services for which the TRS may reimburse Trust.

LAW AND ANALYSIS

Section 856(c) of the Code provides that to qualify as a REIT, a corporation must: (1) derive at least 95 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in § 856(c)(2), which include dividends, interest, rents from real property, and certain other items; and (2) derive at least 75 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in § 856(c)(3), which include rents from real property and certain other items.

Section 856(d)(1) of the Code defines the term "rents from real property" to include (A) rents from interests in real property, (B) charges for services customarily rendered in connection with the rental of real property, whether or not such charges are separately stated, and (C) 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 the

personal property for the taxable year does not exceed 15 percent of the total rent for the taxable year for both the real and personal property under the lease.

Section 1.856-4(b)(1) of the Income Tax Regulations provides that services furnished to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings that are of a similar class are customarily provided with the service.

Section 856(d)(2)(C) of the Code, however, excludes "impermissible tenant service income" from the definition of rents from real property. Section 856(d)(7)(A) defines impermissible tenant service income to include, with respect to any real or personal property, any amount received or accrued directly or indirectly by a REIT for services furnished or rendered by the REIT to tenants of the property. Section 856(d)(7)(B) provides that *de minimis* amounts of impermissible tenant service income, i.e., amounts that are one percent or less of all amounts received or accrued by the REIT with respect to a particular property during the taxable year, will not cause otherwise qualifying amounts to not be treated as rents from real property.

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 through an independent contractor from whom the REIT does not derive or receive any income. Additionally, services furnished or rendered through a TRS shall not be treated as furnished, rendered, or provided by the REIT which has the ownership interest in that TRS. Thus, services rendered by a TRS do not give rise to impermissible tenant service income. Similarly, § 856(d)(7)(C)(ii) excludes from the definition of impermissible tenant service income amounts that would be excluded from unrelated business taxable income (UBTI) under § 512(b)(3) if received by an organization described in § 511(a)(2).

Section 512(b)(3) of the Code provides, in relevant part, that rents from real property are excluded from the computation of UBTI. Section 1.512(b)-1(c)(5) provides that payments for the occupancy of space where services are also rendered to the occupant are not rents from real property. Generally, services are considered rendered to the occupant if they are primarily for the occupant's convenience and are other than those usually or customarily rendered in connection with the rental of space for occupancy only.

Section 1.856-4(b)(5)(ii) of the regulations provides that the trustees or directors of a REIT are not required to delegate or contract out their fiduciary duty to manage the trust itself, as distinguished from rendering or furnishing services to the tenants of its property or managing or operating the property. Thus, the trustees or directors may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the trust itself. The trustees or directors may also make capital expenditures with respect to the REIT's property and may make decisions as to repairs of the

property the cost of which may be borne by the REIT. *See also* Rev. Rul. 67-353, 1967-2 C.B. 252.

Section 856(l) of the Code provides that a REIT and a corporation (other than a REIT) may jointly elect to treat such corporation as a TRS. To be eligible for treatment as a TRS, § 856(l)(1) provides that the REIT must directly or indirectly own stock in the corporation, and the REIT and the corporation must jointly elect such treatment. The election is irrevocable once made, unless both the REIT and the subsidiary consent to its revocation. In addition, § 856(l) specifically provides that the election, and any revocation thereof, may be made without the consent of the Secretary.

Section 857(b)(7)(A) of the Code imposes for each taxable year of a REIT a tax equal to 100 percent of "redetermined rents.'' Section 857(b)(7)(B))(i) provides that redetermined rents means rents from real property (as defined in § 856(d) to the extent the amount of the rents would (but for § 857(b)(7)(E)) be reduced on distribution, apportionment, or allocation under § 482 to clearly reflect income as a result of services rendered by a TRS to a tenant of the REIT. Section 482 provides that when two or more organizations are owned or controlled directly or indirectly by the same interests, the Secretary may allocate gross income between or among those controlled organizations if the Secretary determines that such allocation is necessary to clearly reflect the income of any of those controlled organizations. Pursuant to § 1.482-1(b)(1), the standard applied in determining the true taxable income of a controlled organization is that of an organization dealing at arm's length with an uncontrolled organization. Section 1.482-2(b)(3) defines an arm's length charge for services provided between controlled organizations. Section 857(b)(7)(E) provides that the imposition of tax under § 857(b)(7)(A) is in lieu of allocation under § 482. Section 857(b)(7)(B)(ii) through (vii) contain certain exceptions from the imposition of 100 percent tax on redetermined rents.

The activities listed above that will be carried out directly by Trust are either services that are not considered "rendered to the occupant" or are among the fiduciary duties described in § 1.856-4(b)(5)(ii). Accordingly, any income derived from these activities will not be treated as impermissible tenant service income under § 856(d)(2)(C) and (d)(7)(A) of the Code. Moreover, the fees for product handling and other services provided by the TRS as described above will be excluded from the definition of impermissible tenant service income under § 856(d)(7)(C)(i).

Accordingly, based on the information submitted and representations made, we conclude that amounts received by Trust for providing space in its temperature-controlled storage facilities under the arrangements described above constitute "rents from real property" within the meaning of § 856(d) of the Code. Additionally, the fees for product handling and other services provided by the TRS as described above will not be attributed to Trust and the provision of such services will not cause otherwise qualifying amounts received by Trust for providing space in its temperature-controlled storage facilities as described above to fail to qualify as rents from real property.

Section 1.856-2(c)(1) of the regulations defines gross income for purposes of § 856 to have the same meaning as that term under § 61 and the regulations thereunder. In Rev. Rul. 84-138, 1984-2 C.B. 123, a regulated investment company (RIC) owned all of the stock of a subsidiary corporation that was also a RIC. The parent and the subsidiary shared the same facilities and some of the same personnel. Pursuant to an agreement, the parent RIC paid all of the overhead expenses, including personnel costs. The subsidiary then would reimburse the parent for its *pro rata* share of the expenses determined on an arm's length basis. Neither the parent nor the subsidiary RIC was in the business of providing services of the type that were reimbursed. The issue considered in the revenue ruling was whether reimbursements received by the parent were gross income for purposes of the gross income test of § 851(b)(2) of the Code. If the reimbursements were considered gross income to the parent, the parent would not have satisfied the § 851(b)(2) gross income test. The revenue ruling held that the reimbursement payments paid by the subsidiary to the parent represented funds advanced by the parent RIC on behalf of the subsidiary. Accordingly, the advanced funds were not includible in the parent RIC's gross income and were therefore excluded from the application of § 851(b)(2).

In a situation similar to that described in Rev. Rul. 84-138, Trust will incur shared employees' expenses as well as the TRS's allocable share of general and administrative overhead expenses on behalf of the TRS, and the TRS will incur shared employees' expenses as well as Trust's allocable share of general and administrative overhead expenses on behalf of Trust. Trust and the TRS will reimburse each other for their *pro rata* shares of these expenses as determined on an arm's length basis. Trust has represented that neither Trust nor the TRS is now in or will be in the business of providing services of the type that will be covered by these reimbursement arrangements. Based on the holding in Rev. Rul. 84-138, the reimbursement of expenses by the TRS is a repayment of amounts advanced by Trust. Accordingly, we conclude that the reimbursement payments to be made by the TRS to Trust for shared employees' expenses and shared general and administrative overhead expenses will not constitute gross income to Trust for purposes of § 856(c) of the Code.

CONCLUSIONS

Based on the information submitted and representations made, we conclude that amounts received by Trust for providing space in its temperature-controlled storage facilities under the arrangements described above constitute "rents from real property" within the meaning of § 856(d) of the Code. Additionally, the fees for product handling and other services provided by the TRS as described above will not be attributed to Trust and the provision of such services will not cause otherwise qualifying amounts received by Trust for providing space in its temperature-controlled storage facilities as described above to fail to qualify as "rents from real property" within the meaning of § 856(d). The arrangements between Trust and the TRS, however, remain subject to

the provisions of § 857(b)(7) regarding “redetermined rents” and, if applicable, the possible imposition of a tax equal to 100 percent of “redetermined rents.”

Moreover, amounts paid by the TRS to Trust as reimbursements for shared employees’ expenses and other shared general and administrative overhead expenses under the cost sharing arrangements described above will not be treated as gross income to Trust for purposes of § 856(c) of the Code. Consistent with this treatment, Trust is not entitled to a deduction for the reimbursed expenses.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed with regard to whether Trust qualifies as a REIT under subchapter M of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Alice M. Bennett
Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:
Copy of this letter
Copy for section 6110 purposes