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Department of the Treasury
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Date:
May 06, 2005

Legend:

Trust =

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LP =

Cities =

State =

Sub 1 =

Dear :

This is in reply to a letter dated February 4, 2005, and a subsequent submission, requesting a ruling on behalf of Trust that amounts received by Trust from tenants at certain properties will not be treated as other than "rents from real property" under section 856(d) of the Internal Revenue Code.

Facts:

Trust, which has elected under section 856 to be treated as a real estate investment trust (REIT), owns approximately a percent of the outstanding common units and is the general partner of LP. LP, through separate limited liability companies or

partnerships, owns and operates real properties throughout the United States. One division of LP (Division) is comprised of properties in Cities and State (the Properties).

Trust owns all of the stock of Sub 1, a taxable REIT subsidiary (TRS) of Trust. Sub 1 acts as the property manager for the Properties, and operates trade shows at the Properties and at properties owned by third-parties. As property manager, Sub 1 leases, markets, and handles day-to-day operations for the Properties, and is compensated by Trust, directly or indirectly, on an arm's-length basis for its services.

Trust, through Division, rents commercial space, retail space, and showroom space at the Properties to tenants. The showroom space, which is the subject of this ruling, consists of space rented to third-party occupants and to Sub 1, for periods of from one to ten years. The showroom space is used by manufacturers and wholesalers to display products for buyers, specifiers (such as architects and designers), and end-users.

Currently, the showroom space leased by Sub 1 from Trust is subleased by Sub 1 to occupants in connection with trade shows. Sub 1 provides certain furniture and equipment and various services to the occupants, including security, drayage, cleaning, and promotions (the "Basic services"). The rent that Sub 1 collects from the occupants includes payment for the Basic services. Sub 1 offers additional services (beyond the Basic services) such as additional drayage, painting, carpentry, and additional furniture and equipment rentals to showroom space occupants. Occupants using the additional services are separately charged by Sub 1 for those services.

Trust and Sub 1 wish to restructure the current arrangement. Trust desires to rent all showroom space directly to tenants. Sub 1 will continue to provide the Basic services to tenants and will continue to manage the Properties. Trust will receive rental income from the occupants and will compensate Sub 1 on an arm's length basis for the Basic services provided by Sub 1 to the occupants. Sub 1 will continue to be compensated directly by the occupants for the additional services. The restructuring is intended to enable Sub 1 to function purely as a service company.

Trust represents that it will not perform any services in connection with its renting space in the Properties to occupants, other than usual and customary services and activities permitted to be rendered by REITs as landlords with respect to their property, or by trustees with respect to the Trust. Any services which are rendered to the occupant primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only will be performed by Sub 1 or a qualified independent contractor. The costs of any services provided by Sub 1 will be paid by Sub 1, including employees' salaries and the costs of uniforms, equipment, and supplies. To provide the various services, Sub 1 will rent space in Trust's Properties in compliance with section 856(d)(8)(A).

Trust represents that the rent attributable to personal property that is leased under, or in connection with, the lease of any showroom space will not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, the leases of any showroom space.

Law and Analysis:

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(d)(1) provides that "rents from real property" include (subject to exclusions provided in § 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property 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 tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 1.856-4(b)(1) of the Income Tax Regulations provides that, for purposes of sections 856(c)(2) and (c)(3), the term "rents from real property" includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services rendered to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class are customarily provided with the service. In particular geographic areas where it is customary to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of those utilities to tenants in the buildings will be considered a customary service. 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.

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of "rents from real property". Section 856(d)(7)(A) defines "impermissible tenant service income" to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants at the property, or for managing or operating the property.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income exceeds one percent of all amounts received or accrued during the tax year directly or indirectly by the REIT with respect to the property, the impermissible tenant service income of the REIT will include all of the amounts received or accrued with respect to the property. Section 856(d)(7)(D) provides that the amounts treated as received by a REIT for any impermissible tenant service shall not be less than 150 percent of the direct cost of the REIT in furnishing or rendering the service.

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C) provides that for purposes of § 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income, or through a TRS of the REIT shall not be treated as furnished, rendered, or provided by the REIT, and there shall not be taken into account 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).

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, and the collection of trash are not considered as services rendered to the occupant.

In Rev. Rul. 2002-38, 2002-2 C.B. 4, a REIT pays its TRS to provide noncustomary services to tenants. The REIT does not separately state charges to tenants for the services. Thus, a portion of the amounts received by the REIT from tenants represents an amount received for services provided by the TRS. TRS employees perform all of the services and TRS pays all of the costs of providing the services. The TRS also rents space from the REIT for carrying out its services to tenants. The revenue ruling concludes that the services provided to the REIT's tenants are considered to be rendered by the TRS, rather than the REIT, for purposes of section 856(c)(7)(i). Accordingly, the services do not give rise to impermissible tenant service income and do

not cause any portion of the rents received by the REIT to fail to qualify as rents from real property under section 856(d).

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.

In this case, following the restructuring, it is represented that any services or activities to be performed by Trust in connection with the rental of the showrooms will be usual and customary for landlords to provide for their property or for trustees to provide on behalf of a trust, and will not be primarily for the convenience of the tenant. Accordingly, such services will not cause rents received from tenants of the showrooms to be treated as other than rents from real property under section 856(d).

Any noncustomary services provided to tenants at any showroom property will be provided by Sub 1, and the fees for such services will be either (a) separately stated from the rents received by Trust and collected and retained by Sub 1, or (b) included in the rent received by Trust and Trust will compensate Sub 1 on an arm's-length basis for providing the services. All costs associated with providing the noncustomary services will be paid by Sub 1. Accordingly, income from services provided by Sub 1 to tenants of Trust at each of the Properties will be excepted from the definition of impermissible tenant service income, and the amounts received by Trust from tenants of the Properties will not be treated as other than rents from real property under section 856(d).

Other Information:

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provisions of the Code. Specifically, we do not rule whether Trust will otherwise qualify as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Trust should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent. In accordance with a

Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)