Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date: March 13, 2007

Legend:

Taxpayer =

System =

Date 1 =

OP =

Date 2 =

Property Partnership =

Date 3 =

Lessee =

a =

Dear :

This is in reply to a letter dated September 29, 2006, and subsequent submissions, requesting rulings on behalf of Taxpayer. You requested rulings that Taxpayer's System is a "real estate asset" as defined in section 856(c)(5) of the Internal Revenue Code; and that Taxpayer's activities under a lease of its System will not cause amounts received by Taxpayer under the lease to be treated as other than "rents from real property" within the meaning of section 856(d).

Facts:

Taxpayer is a domestic corporation organized on Date 1 that intends to elect to be taxed as a real estate investment trust (REIT) under subchapter M of Chapter 1 of the Internal Revenue Code. OP was organized as a limited liability company under state law on Date 2 and will be classified as a partnership for federal tax purposes. Taxpayer will own as its sole asset an interest in OP and will be the sole managing member in OP. It is anticipated that third parties will own non-managing membership interests in OP.

Property Partnership was organized as a limited partnership under state law on Date 3. OP will own an interest in Property Partnership as its sole asset.

Taxpayer, through OP, intends to acquire one or more Systems. The Systems will be contributed by OP to Property Partnership in exchange for additional interests in Property Partnership. Neither Taxpayer, OP, nor Property Partnership will seek to be licensed by state or federal regulatory authorities to operate a System. Property Partnership will lease a System to Lessee, an entity that will be licensed to operate the System. It is represented that Lessee will not be related to Taxpayer within the meaning of section 856(d)(2)(B) and rent paid to Taxpayer will not be based in whole or in part upon Lessee's net income or profits within the meaning of section 856(d)(2)(A).

The lease arrangement between Taxpayer and Lessee is "triple net". Lessee will be responsible for operating and maintaining the System and is responsible for all expenses associated with the leased property including the payment of insurance, taxes, operating expenses and utilities. Lessee will own or lease all of the vehicles, tools, and equipment and will employ or contract with all of the personnel necessary to operate the System.

Amounts received by Taxpayer under the lease will be for the use of or the right to use the System. Taxpayer will not furnish or render any services to Lessee in connection with the lease. Taxpayer will only conduct activities in connection with the management of its own affairs such as negotiating lease terms and dealing with taxes, interest, and insurance relating to its property. Taxpayer also may undertake limited

activities such as forwarding property tax invoices to Lessee and may make capital expenditures with respect to the System.

A System is a system of physically connected and functionally interdependent assets that serve as a conduit to allow a created by a generation source to flow through the system to end-users. Taxpayer represents that a System is passive and does not include any machinery or equipment that creates or generates any a or any audio, video, electrical signal or other commodity. The System is clearly distinct from the system that generates a.

Law and Analysis:

Issue 1:

Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

Section 856(c)(5)(B) defines the term “real estate assets,” in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 856(c)(5)(C) provides that the terms “interests in real property” includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil or gas royalty interests.

Section 1.856-3(b) of the Income Tax Regulations provides, in part, that the term “real estate assets” means real property. Section 1.856-3(d) provides that “real property” includes land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). Local law definitions will not be controlling for purposes of determining the meaning of “real property" for purposes of section 856 and the regulations thereunder. Under this regulation, “real property” includes, for example, the wiring in a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in a building, or other items which are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment which is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc. even though such items may be termed fixtures under local law.

Rev. Rul. 69-94, 1969-C.B 189, concerns whether properties of a railroad, including land with improvements or other inherently permanent structures situated thereon which may be under, along, or adjacent to certain lines of the railroad, and including the tracks, roadbed, buildings, bridges and tunnels of the railroad, are real property for purposes of section 856. The revenue ruling holds that the railroad properties owned by the trust that are leased to another corporation are not “assets accessory to the operation of a business” within the meaning of section 1.856-3(d), but are “real estate assets” within the meaning of section 856(c).

Rev. Rul. 75-424, 1975-2 C.B. 269, considers whether certain equipment used in connection with the transmission and reception of microwave signals is treated as real property, or assets accessory to a business, for purposes of section 856. The ruling concludes that the building, the heating and air conditioning system, the transmitting and receiving towers, and the chain link fencing are “real estate assets” within the meaning of section 856(c)(5)(B). The antennae, waveguides, transmitting, receiving,

and multiplex equipment, and the prewired modular racks are “assets accessory to the operation of a trade or business” and are not “real estate assets” within the meaning of section 856(c)(5)(B).

The System is designed so that the components are physically and functionally interdependent. It is not feasible to move all or any substantial part of the System. Each component of the System is intended to serve indefinitely and remain in place once affixed to other system parts and to the underlying land.

Similar to the tracks and other railroad components described in Rev. Rul. 69-94, the System is a passive conduit that allows a created by a generation source to flow through the system to end-users. The System itself does not include any machinery or equipment that creates or generates a. Also, like the equipment described in Rev. Rul. 75-424, the passive components that make up the System can be differentiated from the active machinery that generates a that is conducted through the System.

Based upon the information submitted and representations made, we conclude that the System is an inherently permanent structure that is not an accessory to the operation of a business. Accordingly, the System is a real estate asset within the meaning of sections 856(c)(4)(A) and (c)(5)(C).

Issue 2:

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 section 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 such personal property for the taxable year does 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, such lease.

Section 1.856-4(a) defines the term “rents from real property” generally as the gross amounts received for the use of, or the right to use, real property of the REIT.

Section 1.856-4(b)(5)(ii) provides that trustees or directors of the 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 the 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 REIT itself including establishing rental terms, choosing tenants, entering into renewal of leases, and dealing with taxes, interest, and insurance relating to the REIT's property. The trustees may also make capital expenditures with respect to the REIT's property (as defined in section 263).

Section 856(d)(2)(C) excludes from the definition of "rents from real property" any impermissible tenant service income as defined in section 856(d)(7). Section 856(d)(7)(A) provides, in relevant part, that the term impermissible tenant service income means, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for managing or operating such property. Section 856(d)(7)(B) provides that de minimis amounts of impermissible tenant service income, i.e., amounts less than one percent 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) 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 from whom the trust itself does not derive or receive any income. Similarly, subparagraph (C) excludes amounts that would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 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 the tenant's convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only.

Taxpayer represents that they will not be providing any services to Lessee under the lease. The limited activities in which Taxpayer is involved are not services rendered for the convenience of Lessee under section 1.512(b)-1(c)(5). Trustees or directors of Taxpayer also may perform fiduciary functions as provided in section 1.856-4(b)(5)(ii). Accordingly, based on the information submitted and representations made, we

conclude that Taxpayer's activities with respect to the System will not cause amounts received under the lease of the System to be treated as other than "rents from real property" under section 856.

No opinion is expressed or implied with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M. Furthermore, no opinion is expressed or implied concerning the federal income tax treatment of Taxpayer under any section of the Code other than those upon which this ruling is based. 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,

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

Enclosures:
Copy of this letter
Copy for section 6110 purposes