Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.
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Refer Reply To:
CC:FIP:B02
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Date:
June 14, 2010

Legend:

Taxpayer =

Properties =

LLC 1 =

LLC 2 =

LLC 3 =

LLC4 =

TRS 1 =

TRS 2 =

Manager =

LLC5 =

a =

Equipment =

Dear :

This responds to a request for rulings dated January 28, 2010, submitted by your authorized representative. You have requested rulings that the Properties, including their structural components, constitute real estate assets for purposes of sections 856(c) of the Internal Revenue Code; and that the services furnished to tenants of the Properties by Taxpayer through LLC 1 and LLC 2 will not cause any amounts received from tenants of the Properties to be treated as other than "rents from real property" under section 856(d).

FACTS:

Taxpayer has elected to be taxed as a real estate investment trust (REIT) under section 856 of the Code. The Taxpayer wholly-owns two limited liability companies, LLC 1 and LLC 2 (the LLCs), that each own an a percent interest in the capital and profits of a lower-tier limited liability company that is taxed as a partnership for federal income tax purposes. LLC 1 owns an interest in LLC 3 and LLC 2 owns an interest in LLC 4. The LLCs' principal business is to acquire, sell, finance, improve, lease, operate and manage real estate.

Taxpayer also directly or indirectly owns a percent of the common stock of each TRS 1 and TRS 2 (the TRSs). Taxpayer jointly elected with each of the TRSs under section 856(l) for it to be treated as a taxable REIT subsidiary (TRS) of Taxpayer. Taxpayer conducts the management activities for the Properties, provides certain services to tenants, and provides the tenants access to outside service providers through the TRSs. The TRSs contract with the LLC 5, which is represented to be an independent contractor, to provide certain other services to tenants of the Properties.

Tenants of the Properties generally use the Properties to house their Equipment and associated personnel. The Properties contain certain structural components regarding heating, ventilation, and air conditioning ("HVAC") specifically suitable for the tenants' technological requirements. The Properties' components include electrical components designed with redundancy systems to provide uninterruptible power supply beyond that ordinarily found in office buildings. The Properties also possess a structural design with respect to humidification, fire protection and security systems at a level higher than the ordinary average for office buildings. The telecommunication system and infrastructure includes access to third-party providers. Tenant space is generally constructed on raised flooring designed to accommodate the systems necessary for the operation of tenants' Equipment. Taxpayer represents that the Properties are inherently permanent structures and that the structural components of the Properties are designed and constructed specifically for the particular building for which they are a part and are intended to remain permanently in place.

Certain tenant services are currently provided to the tenants through the LLCs, Manager, independent contractors supervised by Manager, or LLC 5, supervised by the TRSs. Customary services performed by the Taxpayer on behalf of the tenants include the provision of utilities (such as HVAC, water, electricity, etc.); humidification services; fire protection; security by means of on-site staff and technology; receiving tenant deliveries during normal business hours in the absence of tenant personnel; unattended and unreserved parking; and maintenance of common areas, telecommunication infrastructure and major structural components and buildings systems. Certain of these customary services may be provided through an independent contractor from whom the Taxpayer neither derives nor receives any income.

Taxpayer represents that any noncustomary services rendered to any tenant are provided by a TRS or through an independent contractor from whom Taxpayer does not derive or receive any income. The TRSs may provide tenants technological services and support specific to the tenants' information technology and telecommunications equipment located at the Properties.

The Taxpayer represents that it has undertaken research regarding services furnished by other similarly situated owners in connection with similar buildings located in the same geographic markets, and it has determined that the services rendered by it to its tenants are customarily rendered in connection with the rental of comparable buildings in the geographic market in which the Properties are located.

LAW AND ANALYSIS

Sections 856(c)(2) and (c)(3) provide that for a corporation to be qualified to be taxable as a REIT for any taxable year at least 95 percent of its gross income must be derived from certain specified sources, including rents from real property, and at least 75 percent of its gross income must be derived from real property interests. 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)(4)(B)(ii) provides that not more than 25 percent of the value of a REIT's total assets is represented by securities of one or more taxable REIT subsidiaries.

Real Property Issue

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 term "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)(1) of the Income Tax Regulations provides that the term "real estate assets" means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or other improvements thereon), and shares in other qualified REITs.

Section 1.856-3(c) provides that the term "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.

Section 1.856-3(d) provides that the term "real property" means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items that are structural components of those buildings or structures). In addition, real property includes interests in real property. Local law definitions do not control for purposes of determining the meaning of the term real property as used in section 856 and the regulations thereunder. The term includes, for example, the wiring of a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in the building, or other items that 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 that 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 those items may be termed fixtures under local law.

Rev. Rul. 75-424, 1975-2 C.B. 270, concerns whether various components of a microwave transmission system are real estate assets for purposes of section 856. The system consists of transmitting and receiving towers built upon pilings or foundations, transmitting and receiving antennae affixed to the towers, a building, equipment within the building, and waveguides. The waveguides are transmission lines from the receivers or transmitters to the antennae, and are metal pipes permanently bolted or welded to the tower and never removed or replaced unless blown off by weather. The transmitting, multiplex, and receiving equipment is housed in the building. Prewired modular racks are installed in the building to support the equipment that is installed upon them. The racks are completely wired in the factory and then bolted to the floor and ceiling. They are self-supporting and do not depend upon the exterior walls for support. The equipment provides for transmission of audio or video signals through the waveguides to the antennae. Also installed in the building is a permanent heating and air conditioning system. The transmission site is surrounded by chain link fencing. The revenue ruling holds that the building, the heating and air conditioning system, the transmitting and receiving towers, and the fence are real estate assets. The ruling holds further that the antennae, waveguides, transmitting, receiving, and multiplex equipment, and the prewired modular racks are assets accessory to the operation of a business and therefore not real estate assets.

Rev. Rul. 73-425, 1973-2 C.B. 222, considers whether a mortgage secured by a shopping center and its total energy system is an obligation secured by real property. A total energy system is a self-contained facility for the production of all the electricity, steam or hot water, and refrigeration needs of associated commercial or industrial buildings, building complexes, shopping centers, apartment complexes, and community developments. The system may be permanently installed in the building, attached to the building, or it may be a separate structure nearby. The principal components consist of electric generators powered by turbines or reciprocating engines, waste heat boilers, heat exchangers, gas-fired boilers, and cooling units. In addition, each facility includes fuel storage tanks, control and sensor equipment, electrical substations, and air handling equipment for heat, hot water, and ventilation. It also includes ducts, pipes, conduits, wiring, and other associated parts, machinery and equipment. The revenue ruling holds, in part, that a mortgage secured by the building and the system is a real estate asset, regardless of whether the system is housed in the building it serves or is housed in a separate structure apart from the building it serves. This is because the interest in a structural component is included with an interest held in a building or inherently permanent structure to which the structural component is functionally related.

Similar to the properties or structural components described in Rev. Rul. 75-424 and Rev. Rul. 73-425 that qualify as real property for purposes of section 856, the Properties and the structural components described above are inherently permanent structures. Although the Properties and structures help to facilitate the technology businesses of tenants that occupy such buildings, the buildings and structural components themselves are not assets accessory to the operation of a business like the examples set forth in section 1.856-3(d). Accordingly, based on the information submitted and representations made, we conclude that the Properties, including their structural components, as described above, constitute real property for purposes of sections 856(c)(2)(C) and 856(c)(3)(A). In addition, because the Properties and their structural components are real property, they constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B).

Tenant Services Issue

Section 856(d)(1) provides that, subject to section 856(d)(2), the term rents from real property includes, inter alia, rents from interests in real property and charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated.

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

Section 1.856-4(b)(1) explains that services furnished to the tenants of a particular building will be considered to be customary if, in the geographic market in which the building is located, tenants in similar buildings are customarily provided with the service. The regulation goes on to provide that furnishing of water, heat, light, air conditioning, the cleaning of windows, public entrances, exits, and lobbies, the performance of general maintenance, janitorial, and cleaning services, the collection of trash and the furnishing of elevator services, telephone answering services, incidental storage space, laundry equipment, watchman or guard services, parking facilities, and swimming pool facilities are examples of services that are customarily furnished to tenants in many geographic marketing areas.

Section 856(d)(2)(C) excludes from the term rents from real property any impermissible tenant service income. Section 857(d)(7)(A) provides that impermissible tenant service income includes, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for (i) services furnished or rendered by the REIT to the tenants of such property, or (ii) managing or operating such property.

Section 856(d)(7)(C)(i) provides that services, management, or operations provided through an independent contractor from whom the REIT itself does not derive or receive any income or through a taxable REIT subsidiary of the REIT will not be treated as provided by the REIT. Section 856(d)(7)(C)(ii) provides that any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2) will not constitute impermissible tenant services income.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income received or accrued directly or indirectly by a REIT 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)(3) provides that an independent contractor is any person (A) who does not own, directly or indirectly, more than 35 percent of the shares or certificates of beneficial interest in the REIT; and (B) if the person is a corporation, not more than 35 percent of the voting power or total number of shares of whose stock; or if the person is not a corporation, not more than 35 percent of the interest in whose assets or net profits, is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the REIT.

Section 1.856-4(b)(5) provides that no amount received or accrued, directly or indirectly, with respect to any real property qualifies as rents from real property if the REIT furnishes or renders services to the tenants of the property or manages or operates the property, other than through an independent contractor from whom the trust itself does not derive or receive any income. This section provides further that the requirement that the trust not receive any income from an independent contractor requires that the relationship between the two be an arm's-length relationship. To the extent that services (other than those customarily furnished or rendered in connection with the rental of real property) are rendered to the tenants of a property by an independent contractor, the cost of the services must be borne by the independent contractor, a separate charge must be made for the services, the amount of the separate charge must be received and retained by the independent contractor, and the independent contractor must be adequately compensated for the services.

Section 512(b)(3) provides, inter alia, 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) explains, however, that payments for the occupancy of rooms and other space where services are also rendered to the occupant, such as payments for the use of a hotel room, are not rents 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 services, 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. Payments for the use or occupancy of entire private residences or living quarters in duplex or multiple housing units, or offices in any office building, are generally treated as rents from real property.

Many of the services described above are usual or customary services that are rendered in connection with the operation or maintenance of the Properties and are not rendered primarily for the convenience of tenants. Other services that may constitute personal services to a tenant will be provided through independent contractors from whom Taxpayer will not receive or derive any income, or through a TRS. Accordingly, the services furnished by Taxpayer in connection with the leasing of the Properties will not cause any amounts received from tenants of the Properties to be treated as other than “rents from real property” under section 856(d).

CONCLUSION

Based on the information submitted and representations made, we conclude that the Properties, including their structural components as represented, constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B). Accordingly, we conclude that income derived from leasing the Properties qualifies as rents from real property under section 856(c)(3).

Also, the customary activities that the Taxpayer undertakes directly with respect to the Taxpayer’s Properties will not cause the gross income received or accrued by the

Taxpayer with respect to those Properties to be treated as something other than rents from real property for purposes of section 856(c)(2) and (3). The activities undertaken by an independent contractor and/or the TRSs described above will not cause any amounts received by the Taxpayer to be treated as other than rents from real property under section 856(d). Further, the customary activities undertaken by the Taxpayer through the LLCs will not cause any amounts received by the Taxpayer to be treated as other than rents from real property under section 856(d).

No opinion is expressed or implied as to the federal tax consequences of this transaction under any provision not specifically addressed herein. Furthermore, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under subchapter M, part II of Chapter 1 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, copies of this letter are being sent to your authorized representatives.

Sincerely,

By: David B. Silber
David B. Silber
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)