

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:2
PLR-115781-10

Date:
July 22, 2010

Legend:

Taxpayer =

Property =

Corporation =

Project =

Transport =

Point A =

Point B =

State A =

State B =

Date 1 =

Date 2 =

a =

b =

c =

d =

Dear :

This is in reply to your letter dated April 8, 2010 requesting a ruling that the income received by Taxpayer for certain easements constitutes qualifying income for purposes of sections 856(c)(2) and (3) of the Internal Revenue Code of 1986, as amended (the Code).

Facts

Taxpayer is a State A corporation that has elected to be treated as a real estate investment trust (REIT) under section 856. Taxpayer is a calendar year taxpayer that uses the overall accrual method of accounting.

On Date 1, Taxpayer purchased the Property through a qualified REIT subsidiary (QRS) and has operated the Property as a rental property since the date of acquisition.

Corporation is a public benefit corporation chartered by State B. Corporation is undertaking the Project to connect the services of Transport, another public benefit corporation, from Point A to Point B. Corporation has determined that it needs to construct a support facility (the Support Facility) on a site adjacent to the Property in order to provide adequate support to the Project's new Transport infrastructure. The Support Facility will house mechanical equipment, including emergency backup generators, fans, and exhaust systems.

As part of the Project, Corporation acquired by eminent domain or otherwise certain properties on which to build the Support Facility, including the sites adjacent to the Property as well as certain interests in the Property.

Pursuant to a threat of condemnation, Taxpayer executed an agreement (the Agreement) with Corporation on Date 2. The Agreement grants both permanent and temporary easements in the Property to Corporation. In consideration for the easements, the Agreement provides that Corporation will make cash payments in the aggregate amount of approximately \$a: this amount consists of an upfront cash payment of \$b and two reimbursement payments of \$c and \$d. The upfront payment is in consideration for the easements granted by Taxpayer to Corporation and in lieu of condemnation by Corporation of the easements. The reimbursement payments are for construction work that must be performed on structural components of the Property in order to make the part of the Property to which the easements relate usable for the intended purposes of the easements.

Taxpayer represents that all of the easements run with the land and shall apply and bind successors and assigns of the Taxpayer and the Corporation. Taxpayer also represents that any payments received under the Agreement for reimbursements of lost rents or profits, building administration costs, or any construction advisory and supervisory fees are not considered as amounts received for granting the easements for purposes of this ruling.

Taxpayer intends to defer a significant portion of the gain realized from granting the permanent easements to Corporation under the involuntary conversion rules of section 1033 and to exclude a portion of such gain realized from gross income under section 118. To the extent such gain is recognized for federal income tax purposes, Taxpayer requests a ruling that such recognized gain will constitute qualifying gain from the sale of interests in real property for purposes of the REIT income tests of sections 856(c)(2) and (3). Taxpayer also requests a ruling that any income received from granting the temporary easements to Corporation constitutes qualifying rents from real property for purposes of section 856(c)(2) and (3).

Law and Analysis

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income (excluding gross income from prohibited transactions) must be derived from dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1), and certain other sources.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income (excluding gross income from prohibited transactions) must be derived from rents from real property, interest on obligations secured by mortgages on real property or on interests in real property, gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1), and certain other sources.

Section 856(c)(5)(B) of the Code and section 1.856-3(b) of the Income Tax Regulations (the "Regulations") define 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) of the Code and section 1.856-3(c) of the Regulations define the term "interests in real property" to include 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(c) also includes in the definition of "interests in real property," timeshare

interests that represent an undivided fractional fee interest, or undivided leasehold interest, in real property, and that entitle the holders of the interests to the use and enjoyment of the property for a specified period of time each year.

Section 1.856-3(d) defines the term “real property” to mean land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). In addition, the term “real property” includes interests in real property. Local law definitions are not controlling for purposes of section 856 and the regulations thereunder.

Section 856(d)(1) provides that for purposes of sections 856(c)(2) and (3), 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, whether or not such charges are separately stated, and certain rents attributable to personal property. Section 1.856-4 of the regulations provides that the term “rents from real property” generally means the gross amount received for the use of, or the right to use, real property of the REIT. Section 856(d)(2) of the Code and section 1.856-4(b)(3)-(6) of the Regulations provide certain exclusions to the term “rents from real property,” including in part, amounts received or accrued, directly or indirectly, with respect to any real or personal property, if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property.

Rev. Rul. 71-286, 1971-2 C.B. 263, considers whether air rights over real property are considered “interest in real property” and “real estate assets” within the meaning of section 856(c). The term air rights is defined as the long-term leasehold or fee simple ownership of the space above the ground that a landowner can occupy or use in connection with the land, plus necessary easements on the surface for support of structures erected in such air space. The revenue ruling holds that such air rights, including the necessary surface easements, are considered “interests in real property” and “real estate assets” within the meaning of section 856(c).

Rev. Rul. 68-291, 1968-1 C.B. 351, clarifying, Rev. Rul. 59-121, 1959-1 C.B. 212, provides generally that the consideration received for the granting of an easement constitutes the proceeds from the sale of an interest in real property and should be applied as a reduction of the cost or other basis of the portion of the land subject to the easement. See also, Rev. Rul. 54-575, 1954-2 C.B. 145.

An easement is an interest in real property. Granting such an easement deprives the taxpayer of practically all beneficial interest in the portion of the land covered by the easement, except that Taxpayer retains only the mere legal title to the property. Therefore, the permanent easements will be considered a sale of that portion of the Property and the temporary easements will be akin to a lease of that portion of the Property.

Conclusion

Based on the information submitted and the representations made, we conclude that the income recognized by Taxpayer as a result of the granting of permanent easements to Corporation is income received from the sale of interests in real property and thus constitutes qualifying income for purposes of sections 856(c)(2) and (3). In addition, income recognized by Taxpayer as a result of the granting of temporary easements to Corporation qualifies as rents from real property, and, thus, constitutes qualifying income for purposes of sections 856(c)(2) and (3).

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 regarding whether Taxpayer qualifies as a REIT under Subchapter M of the Code. Additionally, no opinion is expressed regarding the application or tax consequences of sections 1033 and 118.

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,

Thomas M. Preston
Thomas M. Preston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)