Internal Revenue Service

Number: **201143011**
Release Date: 10/28/2011

Index Number: 856.02-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-111324-11

Date:
July 19, 2011

Legend:

Taxpayer =

Partnership =

TRS A =

Dear :

This is in reply to a letter dated March 14, 2011, requesting rulings on behalf of Taxpayer. The requested rulings concern the qualification of amounts received from the rental of certain properties as "rents from real property" for purposes of § 856(d) of the Internal Revenue Code.

Facts:

Taxpayer is a calendar year taxpayer that uses an accrual method of accounting and that elected to be taxed as a real estate investment trust (REIT) under § 856 of the Code. Taxpayer is the managing general partner of Partnership, owning approximately % of the outstanding common units of Partnership. Partnership indirectly owns and operates numerous real properties (the Properties). TRS A is a wholly-owned subsidiary of Partnership that has jointly elected with Taxpayer to be treated as a taxable REIT subsidiary (TRS) of Taxpayer pursuant to § 856(l).

At certain of the Properties, Taxpayer rents space on outdoor steel billboard structures affixed to the Properties (the Steel Billboard Structures). The Steel Billboard Structures range in width from 18 feet to 72 feet and in height from 16 feet to 72 feet. Depending on the Property, the Steel Billboard Structures are mounted either on the

roof of the building or on an exterior wall of the building. They may also be free-standing towers.

Issue 1:

A Steel Billboard Structure mounted on the roof of a building is typically braced back to multiple columns installed in the building's structure, i.e., existing structural support columns of the building are exposed and structural steel column extensions are installed above the roof. A horizontal steel frame of wide flange beams is installed connecting the column extensions above the roof plane and supporting the sign.

A Steel Billboard Structure mounted on the wall of a building is constructed by exposing the building's structural columns and spandrel beams. The exterior of the building is removed locally to expose the structural columns and new extensions of structural steel are attached to the existing structure to extend sign connections beyond the exterior face of the building. The exterior of the building is then reconstructed around the new connection.

A tower Steel Billboard Structure is constructed on concrete foundations which are anchored into the earth, often extending 30 feet or more into the earth. A steel mast or columns then extends up from the foundations. If columns are used, it is typical to truss between them with diagonal members from the foundations to the top of the sign, which provides bracing for wind loads on the sign.

Taxpayer represents that the structural components of the Steel Billboard Structures have never been moved and are designed and constructed to remain in place permanently.

Issue 2:

In certain cases, Taxpayer will rent the Steel Billboard Structures directly to end users for fixed amounts under lease agreements (the Rent). Under some leases, the Rent will include payment for certain noncustomary services, such as services relating to the installation of the vinyl signs and maintaining the sign lighting (the Noncustumary Services). In these cases, Taxpayer will enter into a services agreement with TRS A to provide the Noncustomary Services. In addition, Taxpayer may enter into a brokerage agreement with TRS A to provide brokerage services to Taxpayer in connection with the rental of the Steel Billboard Structures to end users.

In other leases, the Rent will not include payment for the Noncustomary Services. Instead, the end users will contract directly with TRS A or unrelated third parties for any services, and will pay arm's length compensation to TRS A or the third parties.

In either case, Taxpayer represents that it will not perform any services in connection with the renting of the Steel Billboard Structures to occupants, other than usual and customary services and activities permitted by landlords with respect to their property or by trustees with respect to Taxpayer. Any noncustomary services will be performed by TRS A. Taxpayer represents that it will compensate TRS A for the Noncustomary Services and any brokerage services on an arm's length basis. Taxpayer further represents that TRS A will use its own employees and bear all of its own costs relating to the Noncustomary Services and the brokerage services, such as its employees' salaries and the costs of their uniforms, equipment, and supplies. TRS A may contract with unrelated third parties to provide some of the Noncustomary Services and/or brokerage services. TRS A will report amounts received from Taxpayer for the Noncustomary Services and brokerage services as gross income on its income tax return.

Issue 3:

Taxpayer will rent certain Steel Billboard Structures that are potential future sites of electric signs to TRS A under lease agreements for rent based on a percentage of gross receipts. Taxpayer represents that the rent paid by TRS A will include only customary services that can be provided by a REIT and will be at a market rate.

TRS A will construct and install on the leased Steel Billboard Structures (1) an aluminum grid for placement of Light Emitting Diode (LED) screens, (2) LED screens, and (3) structures ancillary to such aluminum grid and LED screens (the Electric Signs). TRS A will be the owner of the Electric Signs installed in the Steel Billboard Structures and will be engaged in the electric sign business. TRS A will use its own employees and bear all of its own costs relating to the electric sign business. TRS A may contract with unrelated third parties to provide services relating to the electric sign business.

Taxpayer represents that the Steel Billboard Structure space to be leased to TRS A is unique space at each Property. The remaining space at each Property will be leased to unrelated tenants and will not be comparable in terms of character or use to the Steel Billboard Structure space rented to TRS A. Taxpayer represents that space comparable to the Steel Billboard Structure space does not exist within each Property, but that rent paid by TRS A will be substantially comparable to rent paid by unrelated tenants for similar spaces in the same geographic area.

Law and Analysis:

Issue 1:

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(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) provides that the term "real estate assets," for purposes of § 856, means 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 that meet the requirements of §§ 856 through 859.

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) 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). In addition, the term "real property" includes interests in real property. Local law definitions will not be controlling for purposes of determining the meaning of "real property" for purposes of § 856 and the regulations thereunder. Under the regulations, "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.

Under section 1.856-3(g), a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of § 856 the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners for all purposes of § 856.

Rev. Rul. 71-220, 1971-1 C.B., considers a REIT that develops a mobile home community on land that it had purchased. The community is situated in a planned site that has a country club, marina, parks, churches and schools. When units are delivered they are set on foundations consisting of pre-engineered blocks. The wheels and axles are removed from the units and the units are affixed to the ground by six or more steel straps. Each unit has a carport or screened porch attached to it. In addition, each unit is connected to water, sewer, gas, electric and telephone facilities. Rev. Rul. 71-220 concludes that the mobile homes are "real property" within the meaning of § 856 and section 1.856-3(d).

Rev. Rul. 75-424, 1975-2 C.B. 269, concerns whether various components of a microwave transmission system are real estate assets for purposes of § 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 further holds 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. 80-151, 1980-1 C.B. 7, provides two examples that illustrate how the Service will apply the criteria set forth in Whiteco Industries, Inc. v. Commission, 65 T.C. 664 (1975) acq., 1980-1 C.B. 1, in determining whether outdoor advertising displays are inherently permanent structures or tangible personal property that qualified for the now-repealed investment tax credit. The criteria, which are in the form of questions, are: (1) is the property capable of being moved, and has it in fact been moved? (2) Is the property designed or constructed to remain permanently in place? (3) Are there circumstances that tend to show the expected or intended length of fixation, that is, are there circumstances that show the property may or will have to be moved? (4) How substantial a job is removal of the property, and how time-consuming is it? (5) How much damage will the property sustain upon its removal? (6) What is the manner of affixation of the property to the land?

The Steel Billboard Structures are substantial structures that are part of the building structures, or separately constructed structures in the case of the tower Steel

Billboard Structures, and are designed and constructed to remain permanently in place. The Steel Billboard Structures range in width from 18 feet to 72 feet and in height from 16 feet to 72 feet (typically several stories high). Each of the structures and structural components has never been moved. Because the construction and permanency of the Steel Billboard Structures are substantially comparable to the transmitting and receiving towers in Rev. Rul. 75-424 and the mobile home units in Rev. Rul. 71-220, they are inherently permanent structures. Further, the Steel Billboard Structures are not assets accessory to the operation of a business.

Based on the facts as represented by Taxpayer, we conclude that the Steel Billboard Structures, are "real estate assets" and "interests in real property" for purposes of §§ 856(c)(5)(B) and (C).

Issue 2:

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 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) provides that, for purposes of §§ 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) 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 section 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 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 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 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 § 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 § 856(d).

In this case, any noncustomary services provided to tenants at the Steel Billboard Structures will be provided by TRS A, and the fees for the services will be either (a) separately stated from the rents received by Taxpayer and collected and retained by TRS A, or (b) included in the rent received by Taxpayer and Taxpayer will compensate TRS A on an arm's-length basis for providing the services. All costs associated with providing the noncustomary services will be paid by TRS A. Accordingly, income from services provided by TRS A to tenants of Taxpayer at each of the Steel Billboard Structures will be excepted from the definition of impermissible tenant service income, and the amounts received by Taxpayer from tenants of the Steel Billboard Structures will not be treated as other than rents from real property under § 856(d).

Issue 3:

Section 856(d)(2)(B) provides that rents from real property does not include any amount received or accrued directly or indirectly from any person if the REIT owns directly or indirectly: (1) in the case of a corporation, stock possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total value of shares of all classes of stock of the corporation; or (2) in the case of any person that is not a corporation, an interest of 10 percent or more in the assets or net profits of the person.

Section 856(d)(8) provides that rent received by a REIT from its TRS will not be excluded from rents from real property under § 856(d)(2) if the terms of the limited rental exception of § 856(d)(8)(A) are met. The requirements of § 856(d)(8)(A) are met with respect to any property if at least 90 percent of the leased space of the property is rented to persons other than TRSs of the REIT and other than persons described in § 856(d)(2)(B), but only to the extent that the amounts paid to the REIT as rents from real property (without regard to § 856(d)(2)(B)) from the property are substantially comparable to the rents paid by the other tenants of the REIT's property for comparable space.

In order to meet the limited rental exception of § 856(d)(8)(A), amounts paid to a REIT as rents from real property must be substantially comparable to rents paid by the other tenants of the REIT's property for comparable space. In the instant case, space leased by TRS A is unmarketable for traditional use and is unique at the property. Remaining leases at the property, although all or substantially all leased to unrelated

tenants, is not comparable in terms of character or use to the space rented to TRS A. In these circumstances, where no comparable leased space exists within a property, § 856(d)(8)(A) may be satisfied by comparing the rent paid by TRS A to rent paid by unrelated tenants for comparable space in the same geographic area.

Accordingly, we conclude that amounts paid to Taxpayer by TRS A for the rental of the Steel Billboard Structures with respect to which there is no comparable space will not fail to qualify for the limited rental exception of § 856(d)(8)(A) if the rent paid by TRS A is substantially comparable to rents paid by unrelated tenants for comparable space in the same geographic area.

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether (1) Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code or (2) whether rents paid to Taxpayer by TRS A satisfy the requirements of § 856(d)(8)(A) concerning comparable rents.

This ruling is directed only to the taxpayer requesting it. Taxpayer 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 the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Jonathan D. Silver
Jonathan D. Silver
Assistant to the Branch Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)