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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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Date:
October 09, 2012

Legend:

Company =

State =

Parent =

Date 1 =

Country A =

Country B =

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Dear

This is in reply to a letter dated May 23, 2012, requesting a ruling on behalf of Taxpayer. Taxpayer has requested rulings in connection with its intent to be taxed as a real estate investment trust ("REIT") under section 856 of the Internal Revenue Code of 1986, as amended (the "Code").

Facts:

Company, a State corporation, is indirectly owned by Parent and owns and leases several data centers throughout the United States and abroad. Taxpayer will be a newly-formed entity that intends to elect to be taxed as a REIT under section 856 commencing with its taxable year ending Date 1. One or more affiliates of Parent will be limited partners in an operating partnership ("OP") along with Taxpayer as a general partner. Taxpayer will be a fully integrated, self-managed REIT that conducts substantially all of its business as general partner through the OP, in which it will be the sole general partner and a substantial limited partner. The OP intends to acquire, lease, purchase, develop, and build data center buildings and to lease such properties to unrelated tenants and certain related tenants. The initial data center buildings (the "Initial Properties") are currently owned or leased by affiliates of Parent and will be acquired by the OP through contributions of such buildings and/or interests in the buildings. Following the contributions of the Initial Properties, the OP will own or lease properties in several states within the United States and will lease data centers in Country A and Country B.

The space leased to tenants in the Initial Properties ranges in size from a single rack to an entire floor comprised of several thousand feet. The leases have terms ranging from a to b years, with the majority between c and d years. The tenant space is generally prepared in accordance with the lease terms including the installation of cages made of wire similar in appearance to a chain link fence, that are placed around the perimeter of the tenants' leased space. Some tenants may lease land adjacent to, and rooftop space on, the data center building for placement of their satellite communication equipment. The tenants may have access to common area space used for staging and storage as well as loading dock space for receipt and storage of equipment.

Tenant space is generally constructed on raised flooring, which is necessary to accommodate electrical, telecommunications and HVAC infrastructure. Some existing properties do not have raised flooring and must be cooled through a series of forced air pipes and fans. Similar to office buildings, the Initial Properties furnish tenants with electrical power, central air conditioning systems and access to telecommunications. Data center buildings are different than ordinary office buildings in the magnitude and quality of the electrical power and air conditioning that are furnished to tenants and the redundancies built into those systems.

The major components of the data center buildings include the (1) electrical distribution and redundancy system (the "Electrical Components"), (2) HVAC components (the "HVAC Components"), (3) security system (the "Security Components"), (4) fire protection system (the "Fire Protection Components") and (5) telecommunications infrastructure (the "Telecommunication Components"). Each of

these components (collectively, the “Structural Components”) is designed and constructed to remain permanently in place and is unlikely and not intended to be moved or removed. The Electrical Components are designed to (1) deliver between 50 and 250 watts of electric power per square foot, (2) convert the high voltage power received from the public utility to low voltage power for use in the tenant space, (3) ensure uninterrupted power through the use of redundant electric systems and (4) provide stable power through an energy conditioning process. The HVAC Components are designed to maintain a room temperature between 64-72 degrees Fahrenheit. The Security Components are designed to meet heightened security requirements of data center tenants. The Fire Protection Components include both detection and suppression systems. The Telecommunication Components provide tenants with access to third-party telecommunications and internet providers.

After its IPO, Taxpayer, through the OP, will have certain identifiable intangible assets recorded on its books resulting from purchase price allocations made under Generally Accepted Accounting Principles (“GAAP”) when accounting for acquisitions. Generally, identifiable intangible assets are recorded under GAAP if they arise from contractual or legal rights, regardless of whether those rights are transferable or separable from the underlying physical business assets. In this case, identifiable intangibles acquired through these transactions include tenant relationships, trademarks, and favorable land leases. The remaining amount of the purchase price, after allocation to tangible and intangible assets, is allocated to goodwill.

Tenant relationships are assets that arise from the expected future cash flows associated with an enterprise’s existing tenant base, who are tenants because of the high quality of the data centers. A trademark is generally defined as any word, name, symbol, or other devise used by a business enterprise to distinguish its offering from those of its competitors. In this case, the trademark is directly associated with the quality of these data centers as well as their location. Favorable land leases are assets that relate to the below market land lease obligations associated with the data centers that have been developed on the land and which will be owned or leased by the OP. In this case, goodwill represents the premium above the amounts allocated to the physical structures of the data centers and the other identifiable intangible assets that affiliates of Parent are willing to pay for the future anticipated cash flow it expects to generate from its data centers. This amount is based upon a GAAP principle and relates solely to the real estate assets that will be acquired by the OP. These assets will constitute the OP’s trade or business of leasing real property and will directly produce income for the OP. Taxpayer represents that the goodwill is directly related to, and is generated by, the OP’s trade or business as a lessor of real property.

Taxpayer represents that services that OP will provide to tenants consist of ordinary, necessary, usual, and customary services in connection with the operation and maintenance of the Initial Properties. These services do not constitute services rendered for the convenience of a particular tenant. Some of these services will include

controlled humidity, security, fire protection, utilities, common area maintenance including cleaning and maintenance of public areas, shipping and receiving, landscaping, maintenance and repair of the major building systems and components, parking, telecommunications infrastructure to allow tenants to connect to telecommunication carriers, and interconnection using wires, cables and other transmission equipment to provide tenants connectivity to carriers, their own servers, and directly with each other. Tenants may engage the OP to provide remote hands services to execute basic server services and to ensure basic power is being delivered to the tenants' spaces and equipment. Remote hands services that do not require logical access to the tenants' equipment include such tasks as re-seating, relabeling or replacing external cables, rebooting servers and changing backup tapes. Any remote hands services that do require logical access (i.e. tenant log-in access and information) will be provided by third-party providers or a taxable REIT subsidiary ("TRS"). Any other noncustomary services will be provided by an independent contractor from whom Taxpayer derives no income, or through a TRS.

Neither the OP nor its employees will repair, replace, or operate the tenant's equipment, nor will they provide network or IT management services ("Smart Hands"). Smart Hands services generally entail providing technical and content support for the tenant's information technology and telecommunications equipment that is located in the Initial Properties. The OP intends that Smart Hands services, other than those Smart Hands services requiring physical access to the tenants' equipment, will be provided by third party providers or through a taxable REIT subsidiary ("TRS").

Parent and its affiliates may provide certain services to many customers, including data center tenants ("Parent Services"). These services will be provided by each corporation separately through its own employees or by its contractors. These services will not be provided by employees of Taxpayer or the OP. Tenants of the data centers will contract directly with each service provider without any involvement by Taxpayer or the OP. All of the Parent Services offered to tenants of the properties, with one exception, are currently offered to the general public. Parent Services include backup services, monitoring and management, hardware sales, hosting services, staff augmentation, telephone, internet access, circuits, land-based voice, wireless, VOIP/long distance, audio conferencing, alert services, data center collocation and third-party managed services. These services are not provided by the OP or at the OP's request, and are not provided by Parent and its affiliates in connection with the OP's lease of space to these tenants. Rather, Parent and its affiliates operate separate and independent businesses and it is represented that they will not be agents of the OP.

Taxpayer, through the OP, intends to have certain employees who will perform Smart Hands or other noncustomary services for the TRS and remain employees of the OP solely for administrative purposes. In addition, the OP and TRS intend to enter into an employee sharing agreement under which these employees will be shared and the TRS will reimburse the OP for the TRS's allocable share of the employee costs. The

reimbursement will be solely for costs, both direct and indirect. The OP will not profit from the reimbursement. Neither the OP nor Taxpayer will be in the business of providing services that are otherwise provided by the TRS to third parties.

In addition to the Initial Properties, Taxpayer, through the OP, is in negotiations to expand its business outside the United States and intends to own entities treated as controlled foreign corporations within the meaning of section 957(a) ("CFCs") with respect to which the OP is a United States shareholder within the meaning of section 951(b). Taxpayer would make a TRS election with the CFCs to satisfy the REIT asset test requirements set forth in section 856(c)(4).

Additionally, Taxpayer, through the OP, intends to own entities treated as passive foreign investment companies under section 1297(a) ("PFICs") with respect to which itself or the OP is a shareholder. To the extent Taxpayer or the OP creates or acquires a PFIC, Taxpayer intends to make an election under section 1295(a) to treat the PFIC as a qualified electing fund ("QEF").

Law and Analysis:

Issue #1: Interests in Real Property

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) 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) 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 Initial Properties and the structural components described above are inherently permanent structures. Although the Initial 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 Initial Properties including the 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 Initial Properties and the structural components are real property, they constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B).

Issue #2: Real Estate Intangibles

Section 1.856-2(d)(3) provides that in determining the investment status of a REIT, the term “total assets” means the gross assets of the REIT determined in accordance with GAAP.

Section 1060 generally provides the method that is required to be used by a transferor to allocate the consideration received on the sale of assets that constitute a trade or business. Under section 1.1060-1(b)(2)(i), assets will be considered a trade or business if either (A) the use of such assets would constitute an active trade or business within the meaning of section 355 or (2) goodwill or going concern value could attach to the assets under any circumstance. Section 1.1060-1(b)(2)(ii) further provides that goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor. *See also* Newark Morning Ledger Co. v. United States, 507 U.S. 546, 556 (1993).

Although the income and asset tests under section 856(c) require a REIT primarily to hold assets that generate passive income for purposes of subchapter M, a REIT may be considered an active trade or business for other areas of the Code. For example, Rev. Rul. 2001-29, 2001-1 C.B. 1348, provides that a self-managed REIT will be considered to be engaged in an active trade or business within the meaning of section 355. The revenue ruling concludes that a REIT's rental activity that produces income that qualifies as rents from real property under section 856(d) satisfies the active trade or business requirement of section 355(b) although that activity is considered "passive" for purposes of subchapter M.

It follows therefore, that a REIT such as Taxpayer that is engaged in the trade or business of owning and leasing data centers (within the scope of subchapter M) will generate goodwill that increases the value of the REIT. Goodwill is inseparable from the business from which it arose. *See* Hatch's Estate v. Commissioner, 198 F.2d 26 (9th Cir. 1952); Pfleghar Hardware Specialty Company v. Blair, 30 F.2d 614 (2d Cir. 1929).

In this case, the existence of the real estate intangibles is a function of a GAAP rule and section 1060 that require an allocation of the excess purchase price over the value of the tangible assets to goodwill or other intangible assets. Although the real estate intangibles are separate assets for those purposes, they may be characterized for purposes of the REIT income and asset tests based upon the characterization of the OP's activities in its underlying trade or business. Since the real estate intangibles relate solely to the OP's business of leasing and providing customary services to tenants in their data centers, they qualify as real estate assets and interests in real property for purposes of section 856. Therefore, gain from the disposition of the real estate intangibles produces qualifying income for purposes of sections 856(c)(2) and 856(c)(3).

Issue #3: Services furnished by Taxpayer

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 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 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.

The services that OP will provide to tenants described above are either usual or customary services that are rendered in connection with the operation or maintenance of the data centers and are not rendered primarily for the convenience of tenants, or they will be provided by an independent contractor or through a TRS. Accordingly, the services furnished by Taxpayer through OP in connection with the leasing of the Initial Properties will not cause any amounts received from tenants of the Initial Properties to be treated as other than "rents from real property" under section 856(d).

Issue #4: Services furnished by Parent and its Affiliates

The Parent Services should not be treated as services rendered by Taxpayer to the tenants of the data centers since these services are not made in connection with Taxpayer's rental of space to those tenants in the data centers. The Parent Services are currently offered to the general public as well as to the tenants of the Initial Properties. The Parent Services are not dependent upon any customers they might draw from Taxpayer's business. The Parent Services provided to the tenants of the data centers may be invoiced separately or invoiced at the same time as the rent payment with a specific identification of the amount attributable to the Parent Services. Parent and its affiliates will account for their own revenue and costs operated independently from Taxpayer. Parent and its affiliates have their own employees, books, records and equipment. Parent and its affiliates will separately negotiate and contract with tenants for the Parent Services and Taxpayer will not participate or profit from those services. Accordingly, the Parent Services do not cause Taxpayer's share of income from the data centers to be treated as other than "rents from real property" under section 856(d).

Issue #5: Reimbursement Arrangement or Employee Sharing Agreement

In Rev. Rul. 84-138, 1984-2 C.B. 123, a regulated investment company (RIC) and its wholly-owned subsidiary shared facilities and some personnel. It was agreed that the RIC would pay all the expenses for general and administrative overhead, including personnel costs and the subsidiary would reimburse the RIC for its pro rata share of the expenses on an arm's length basis. The ruling, in distinguishing *Jergens Co. v. Comm'r*, 40 B.T.A. 868 (1939), states that the RIC was not engaged in the

business of receiving compensation for services of the type that were reimbursed. Instead, reimbursements to the RIC from the subsidiary were merely repayments of advances made on behalf of the subsidiary. Accordingly, the ruling holds that the reimbursements were not included in the RIC's gross income under § 61, and, therefore, were not subject to the gross income requirement of § 851(b)(2).

Rev. Rul. 57-104, 1957-1 C.B. 166, considers whether the amount paid by a taxpayer to an independent contractor as reimbursement for the costs of a union negotiated qualified pension plan for the contractor's employees will be deductible to the taxpayer and included in the income of the contractor. The taxpayer, a ship owner, contracted with a stevedore contractor to handle its cargoes. Pursuant to their contract, the taxpayer reimbursed the contractor for the amount required to be contributed by the contractor to the pension trust. The ruling holds that the amount paid by the taxpayer as a reimbursement is part of the cost of the services rendered by the independent contractor to the taxpayer, and, as such, is a deductible expense to the taxpayer under section 162. The ruling also holds that the reimbursement of amounts contributed to the trust on behalf of its employees is includible in gross income by the contractor under section 61.

In the present case, the reimbursement and cost sharing arrangements to be executed between Taxpayer, through the OP, and its TRS is analogous to the situation in Rev. Rul. 84-138. The OP and the TRS intend to enter into an employee sharing agreement under which certain employees of the OP will be treated as loaned or advanced to the TRS. Under the terms of the employee sharing agreement, the TRS will reimburse the OP for the TRS's share of the employee costs including salaries, benefits and other compensation, costs associated with payroll administration, and allocable overhead costs. The amount of such reimbursements will be computed quarterly and will be determined on the basis of the relative amount of time such employees spend performing leasing or property management services on behalf of the TRS. These reimbursements will be solely for costs and the OP will not profit from these arrangements. Neither Taxpayer nor the OP will engage in the business of providing services that are otherwise provided by the TRS under these arrangements. Accordingly, the amounts paid to the OP by the TRS as reimbursement for the TRS's allocable share of employee costs and other shared expenses will not be treated as gross income received by either the OP or Taxpayer under section 856. Also, neither the OP nor Taxpayer will be entitled to a deduction for the reimbursed expenses.

Issue #6: Subpart F and PFIC Inclusions

As noted earlier, Taxpayer intends to own, either partially or wholly, Foreign Subs for which TRS elections will be made. Such Foreign Subs are either CFCs within the meaning of section 957(a) with respect to which Taxpayer is a United States Shareholder within the meaning of section 951(a), or PFICS for which Taxpayer intends to make elections under section 1295(a) to treat as QEFs.

Taxpayer expects that CFCs will earn the following types of income: (a) interest income on working capital; (b) rental income from leasing space on towers if the employees who perform the leasing activity belong not to the relevant CFC but instead to an affiliate or to an independent contractor; and (c) interest, dividend, or rental income from an affiliate that is not excepted from foreign personal holding company income within the meaning of section 954(c) ("FPHCI") under sections 954(c)(3) or (c)(6).

Taxpayer represents that the income it expects to receive from the PFICs will be passive within the meaning of section 1297(b).

As a result of being a United States shareholder with respect to CFCs, Taxpayer is required by section 951(a)(1)(A)(i) to include in its gross income its pro rata share of the subpart F income, as defined in section 952(a), of any such CFCs. Therefore, Taxpayer expects to report section 951(a)(1)(A) inclusion attributable to one or more CFC's FPHCI, net of allocable expenses, which is passive rental income, interest, dividends and gain from the sale of property that gives rise to income such as dividends, interest and rental income (the "Subpart F Inclusions").

As a result of being a shareholder in PFICs for which Taxpayer makes QEF elections, Taxpayer is required under section 1293(a) to include in its gross income its pro rata share of the ordinary earnings and net capital gain income of each such QEF. As a result of being a shareholder in PFICs for which Taxpayer has not made QEF elections, Taxpayer is required to include amounts in its gross income (as ordinary income) pursuant to section 1291(a)(1)(B). Therefore, Taxpayer expects to report section 1293(a)(1) ordinary income inclusions attributable to passive income from numerous PFICs for which QEF elections have been made (the "QEF Inclusions") and section 1291(a) ordinary income inclusions attributable to passive income for PFICs for which QEF elections have not been made (together with QEF Inclusions, the "PFIC Inclusions").

Section 856(c)(5)(J) provides, in relevant part, that to the extent necessary to carry out the purposes of Part II of subchapter M of the Code, the Secretary is authorized to determine, solely for purposes of such part, whether any item of income or gain which otherwise constitutes gross income not qualifying under section 856(c)(2) or (3) may be considered as gross income which qualifies under section 856(c)(2) or (3).

The legislative history underlying the tax treatment of REITs indicates that a central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, "[o]ne of the principal purposes of your committee in imposing restrictions on types of income of a qualifying

real estate investment trust is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business."

Subpart F Inclusions

Section 957 defines a CFC as a foreign corporation in which more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or the total value of the stock is owned by United States Shareholders on any day during the corporation's taxable year. A United States Shareholder is defined in section 951(a) as a United States person who owns 10 percent or more of the total voting power of the foreign corporation. Taxpayer represents that it is a United States shareholder within the meaning of section 951(b) with respect to certain subsidiaries that are CFCs.

Section 951(a)(1)(A)(i) generally provides that, if a foreign corporation is a CFC for an uninterrupted period of 30 days or more during a taxable year, every person who is a United States Shareholder of the corporation and who owns stock in the corporation on the last day of the taxable year in which the corporation is a CFC shall include in income the shareholder's pro rata share of the CFC's subpart F income for the taxable year.

Section 952 defines subpart F income to include foreign base company income, as determined under section 954. Under section 954(a)(1), foreign base company income includes FPHCI. Section 954(c)(1)(A) defines FPHCI income to include (among other things) dividends, interest, royalties, rents, and annuities. Section 954(c)(1)(B) also includes gain from the sale or exchange of property which (among other things) gives rise to income described in section 954(c)(1)(A) (after application of paragraph (2)(A)) other than property which gives rise to income not treated as FPHCI by reason of section 954(h) or (i) for the taxable year.

Taxpayer has represented that it is a United States Shareholder within the meaning of section 951(b) with respect to certain of its subsidiaries that it expects to be CFCs. As Taxpayer's CFCs earn subpart F income attributable to foreign base company income that is FPHCI and such income is generally passive income, treatment of the section 951(a)(1)(A)(i) inclusion attributable to such passive income as qualifying income for purposes of section 856(b)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under section 856(c)(2). Accordingly, we rule that Subpart F Inclusions attributable to the FPHCI expected to be earned by Taxpayer's CFCs are qualifying income for purposes of section 856(c)(2), as provided in section 856(c)(5)(J)(ii).

PFIC Inclusions

Section 1297(a) defines a PFIC as a foreign corporation where either (1) 75 percent or more of the gross income of such corporation for the taxable year is passive

income, or (2) the average percentage of assets (as determined in accordance with section 1297(e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent. Section 1297(b) defines the term "passive income" as income of a kind that would be FPHCI under section 954(c), subject to certain exceptions.

Section 1291(a)(1) provides that if a United States person receives an excess distribution (as defined in section 1291(b)) in respect of stock in a PFIC, then – (A) the amount of the excess distribution shall be allocated ratably to each day in the shareholder's holding period for the stock, (B) with respect to such excess distribution, the shareholder's gross income for the current year shall include (as ordinary income) only the amounts allocated under section 1291(a)(1)(A) to – (i) the current year, or (ii) any period in the shareholder's holding period before the 1st day of the 1st taxable year of the company which begins after December 31, 1986, and for which it was a PFIC, and (C) the tax imposed by this chapter for the current year shall be increased by the deferred tax amount (determined under section 1291(c)).

Section 1295(a) provides that a PFIC will be treated as a QEF with respect to a shareholder if (1) an election by the shareholder under section 1295(b) applies to such PFIC for the taxable year; and (2) the PFIC complies with such requirements as the Secretary may prescribe for purposes of determining the ordinary earnings and net capital gains of such company. Section 1293(a) provides that every United States person who owns (or is treated under section 1298(a) as owning) stock of a QEF at any time during the taxable year of such fund shall include in gross income – (A) as ordinary income, such shareholder's pro rata share of the ordinary earnings of such fund for such year, and (B) as long-term capital gain, such shareholder's pro rata share of the net capital gain of such fund for such year.

Taxpayer has represented that it is a shareholder of certain subsidiaries that it expects to be PFICs and that it intends to make QEF elections with respect to certain of these PFICs. As Taxpayer's PFICs earn income that is FPHCI and such income is generally passive income, treatment of such PFIC Inclusions as qualifying income for purposes of section 856(c)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under section 856(c)(2). Accordingly, we rule Taxpayer's PFIC Inclusions expected to be earned by Taxpayer are qualifying income for purposes of section 856(c)(2), as provided in section 856(c)(5)(J)(ii).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. No opinion is expressed with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M 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, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Diana Imholtz
Diana Imholtz
Branch Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions and Products)

Enclosures:
Copy of this letter
Copy for § 6110 purposes

cc: