Internal Revenue Service

Number: **201503010**
Release Date: 1/16/2015

Index Number: 856.02-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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, ID No.

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Refer Reply To:
CC:FIP:B01
PLR-131116-12

Date: July 9, 2014

Legend

Taxpayer	=
State	=
Exchange	=
First REIT Taxable Year	=
A	=
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Dear :

This is in reply to a letter dated July 18, 2012, and subsequent correspondence, requesting several rulings in connection with Taxpayer's intent to elect and to qualify for taxation as a real estate investment trust ("REIT") under §§ 856 through 860 of the Internal Revenue Code of 1986 as amended (the "Code").

Facts

Business operations

Taxpayer is a publicly traded State corporation. Prior to the First REIT Taxable Year, it was the parent of an affiliated group of corporations that filed a consolidated federal income tax return on a calendar year basis (Taxpayer together with its subsidiaries, the "Company"). Taxpayer only has one class of stock outstanding, its voting common stock, which is publicly traded on Exchange. Taxpayer conducts its business operations through directly and indirectly owned and partially owned subsidiaries in the United States and abroad.

Taxpayer is a storage company providing storage for paper, media records, and other items in facilities that are located on real property and include extensive internal physical improvements. Taxpayer provides space to storage customers and the storage fees are generally based on the amount of space used by the storage customer. The storage customers do not generally have direct access to the stored items, nor do they have exclusive use of specific space. Rather, the stored items must be handled by the Company and removed from storage before the stored items are accessible to the storage customer. Under Taxpayer's storage agreements with storage customers, Taxpayer generally may store the stored items at any location within any of its facilities.[1]

The Company performs related services such as: (i) handling of records *(e.g.,* putting cartons into a facility and retrieving cartons for storage customers who need to regain physical custody of the contents of their cartons), (ii) courier operations *(i.e.,* pickup and delivery of cartons upon storage customer request), (iii) secure shredding of sensitive or outdated documents, and (iv) other document and records management services such as scanning and faxing ((i) through (iv) the "Related Services").

Taxpayer intends to elect to be treated as a REIT beginning with the First REIT Taxable Year. As part of the REIT conversion, Taxpayer's structure is adapted to include one or more qualified REIT subsidiaries ("QRSs") within the meaning of § 856(i)(2), and taxable REIT subsidiaries ("TRSs") within the meaning of § 856(l).

As part of the commencement of Taxpayer's First REIT Taxable Year, Related Services will be performed by Taxpayer's TRSs or by third party independent contractors from whom Taxpayer will not derive or receive any income. TRSs will report amounts received from Taxpayer for the Related Services they provide to Taxpayer's storage customers as gross income on their income tax returns. TRSs will use their own employees (including shared personnel) and bear all of their own costs, including salaries and the costs of equipment and supplies (whether incurred directly or pursuant to Cost-Sharing Arrangements (defined below)) related to providing Related Services to Taxpayer's storage customers.

Assets

Taxpayer provides storage at its facilities located throughout the United States (as well as in other countries) that include extensive internal physical improvements. Among these improvements are racking and shelving systems (the "Steel Racking Structures"), which are integrated into the design and layout of Taxpayer's facilities to maximize

[1] As a matter of practice, the stored items are stored at facilities in the geographic area of the storage customer.

storage efficiency. Taxpayer either owns the land, the building, or both or leases the same pursuant to long-term leases.

The time needed to design and install a Steel Racking Structure for a building ranges from a few weeks to a year. This includes time for site review, building measurement, design, pricing, building permits, manufacturing, shipping, delivery to site, and installation. Each Steel Racking Structure requires a building permit and certificate of occupancy from the relevant municipality (or comparable requirement of foreign law). All of the Steel Racking Structures are made from cold rolled steel or heavy-duty structural steel and are custom designed by an engineer or architect to maximize space within a specific building. In addition, all of the Steel Racking Structures have multiple levels (each level up to 24 feet high), aisles, and shelving.

Most of the Steel Racking Structures have all, and almost all of the Steel Racking Structures have several, of the following built-in elements: sprinklers, inert gas, or both fire suppression systems, smoke detection systems, and lighting systems. Depending on the size of the building, the Steel Racking Structure also may include stairways, floors, catwalks, carton elevators, personnel elevators, and other improvements typically found in the interior of a building.

Each "level" of a Steel Racking Structure has approximately A times the load bearing capacity of a floor in a typical commercial building and includes "shelves" between the "levels" of the Steel Racking Structure.[2] To ensure the building's structural integrity in case of seismic activity or other disasters, the Steel Racking Structure is generally not attached to the sides or ceiling of the building. The Steel Racking Structure is, however, anchored to the floor, with floor anchoring systems typically designed by a structural engineer based on load and seismic zone. Likewise, the foundation is designed to accommodate the extreme weight borne by the Steel Racking Structure.

Regardless of whether it owns or leases the land and building in which the Steel Racking Structure is situated, Taxpayer in almost all cases owns the Steel Racking Structure. Once installed, a Steel Racking Structure will last beyond the term of the underlying long term lease, and is designed to likely outlast the useful life of the building in which it is installed. Given that the Steel Racking Structures are sized and designed to fit in specific buildings, Taxpayer has not reused a Steel Racking Structure in another facility (and Taxpayer has no intention of ever reusing any of its Steel Racking Structures) due to prohibitive redesign, teardown, shipping, and reinstallation costs. This is the case even when Taxpayer's lease term expires for a building in which a Steel Racking Structure has been installed; when Taxpayer vacates a building after the lease expires, Taxpayer removes the Steel Racking Structure and sells it as scrap.

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[2] The "shelves" between the "levels" of the Steel Racking Structure provide structural support to the Steel Racking Structure.

Income from Storage Agreements

Taxpayer is in the business of leasing space in its facilities for the storage of cartons and other physical items; although it provides the Related Services through a TRS, there is very little day-to-day activity with respect to most stored items.

Taxpayer's storage revenues consist primarily of recurring periodic charges related to the storage of physical items for storage customers. On average the typical stored item is handled approximately once every B years. Storage fees are based on the amount of space (generally measured in cubic feet, but by item with respect to some magnetic media) used by the storage customer.

Taxpayer provides space in its facilities to a storage customer pursuant to a written agreement. A typical agreement is on a year-to-year basis, whereby Taxpayer provides space at its facilities to a storage customer for the storage of cartons for the year and bills storage charges to the storage customer monthly, in advance. The storage customer is provided space in Taxpayer's facilities but is not generally allocated a dedicated building or dedicated space in a particular building. In practice, a storage customer's cartons will be stored in a Taxpayer facility located in the geographic area where the storage customer provided the cartons to Taxpayer for storage.

In addition to the storage of cartons, the Company provides (generally at the option of the storage customer) the Related Services. Most of the Related Services are charged separately and are billed to the storage customer monthly in arrears. The charges for Related Services are generally not separately negotiated and do not necessarily represent an arm's-length charge for the Related Service on a standalone basis. Although some of the Related Services could be provided by an unaffiliated provider, Taxpayer represents that it would not be economical or practical for anyone except an affiliate of the party providing storage to provide the bulk of the Related Services at the price paid by the storage customers.

After conversion to a REIT, Taxpayer will continue to enter into storage agreements with storage customers on substantially the same terms and conditions as its prior practice. Related Services will be provided by one or more TRSs, either pursuant to a separate agreement between a TRS and the storage customer or under the storage customer's agreement with Taxpayer. In the latter case, Taxpayer will compensate the TRS at the higher of the amount paid by the customer to Taxpayer or an arm's-length amount that satisfies the requirements of § 482.

Rents received by Taxpayer from a TRS for the leasing of space in Taxpayer's facilities

When the TRS's operations are located within Taxpayer's facilities, the TRS will rent space in the facilities. Any space rented by a TRS in a facility will be unique in the facility and not similar to the space rented by Taxpayer to storage customers. Rental payments by a TRS to Taxpayer for the leasing or other occupancy of space in Taxpayer's facilities in connection with the TRS's provision of Related Services will be arm's-length and will be substantially comparable to rents paid by unrelated tenants for comparable space located in the same geographic area, which will generally be determined by means of a third party evaluation.

When a TRS enters into a lease with Taxpayer for space within a Taxpayer facility, Taxpayer represents that in substantially all of its facilities at least 90 percent of the leased space (and rental income) of the property will be leased to (and rent will be received from) persons other than TRSs and other than related persons described in § 856(d)(2)(B). In making this representation, Taxpayer is comparing (i) the square footage of space leased to unrelated storage customers, treating each “level” within the Steel Racking Structures as a floor that contributes to aggregate square footage, to (ii) the square footage of space leased to TRSs and other related persons described in § 856(d)(2)(B).

Contract Intangibles

There are several types of intangibles on Taxpayer's financial statement balance sheet recognized under generally accepted accounting principles ("GAAP"). Taxpayer has requested rulings with respect to two categories of intangibles, (1) the “Leasehold Contract Intangibles” and (2) the “Storage Contract Intangibles.”

The first category of intangibles relates to the acquisition of leaseholds on real property with below-market rent ("Leasehold Contract Intangibles”). When Taxpayer acquires an existing facility leasehold and assumes the corresponding obligation as a tenant under the pre-existing lease, Taxpayer generally engages a third party real estate valuation specialist to determine if the rent due under the lease is at, below, or above fair market value for similar leased property in the applicable area. The Leasehold Contract Intangibles are attributable to the premium paid by Taxpayer to assume a leasehold with below-market rents. For REIT asset testing purposes, only the value of the privilege to pay below-market rents (and not the value of any other assets or businesses) is reflected in the Leasehold Contract Intangibles.

The second category of intangibles relates to the origination or (direct or indirect) acquisition of storage agreements ("Storage Contract Intangibles" and, together with Leasehold Contract Intangibles, "Contract Intangibles"). Storage Contract Intangibles were acquired or created when Taxpayer bought other record storage companies, acquired storage agreements from such companies, or convinced new storage customers to leave competitors (which may include paying charges to end the prior customer and competitor relationships). Storage Contract Intangibles are the GAAP intangibles created by the following items: (i) termination fees paid to new storage customers or competitors on behalf of new storage customers who terminate their existing storage agreements to enter into storage agreements with Taxpayer; (ii) pick-up and move costs and costs related to the acquisition of large volume accounts (*i.e.,* the costs of acquiring storage agreements and moving cartons when Taxpayer acquires large customer accounts or a records storage company business without also acquiring the seller's real estate); and (iii) costs allocated to the acquisition of storage agreements in an acquisition of a records storage company business that includes the real estate. In each case, Storage Contract Intangibles are created in the process of Taxpayer acquiring storage agreements. Taxpayer represents that the Storage Contract Intangibles have no value separate and apart from the value of the storage contracts. Taxpayer further represents that the Storage Contract Intangibles are recognized under GAAP and, if they had capitalized tax basis, would be capitalized or otherwise allocable to the storage contracts or to the underlying real estate under federal income tax principles.

The Company's financial statement balance sheet also includes intangibles related to its service business and to "service only" contracts (which will be transferred to one or more TRSs). In addition, within Taxpayer's storage operations are other separately identifiable intangibles such as information systems, trade names, and workforce in place (the "Other Intangibles"), which are not part of the Contract Intangibles.[3]

As part of its conversion and to comply with the REIT asset tests, Taxpayer will value the Contract Intangibles separately from the Other Intangibles. The Contract Intangibles will be valued based on the discounted cash flows of the below market leases and the rental income associated with the storage agreements. Such valuation will be done to establish the fair market value of the Contract Intangibles as of the effective date of the REIT election and at the end of each calendar quarter thereafter.

When the Company transferred the people, assets, and operations associated with the Related Services to the TRSs, the intangibles associated with the Related Services were transferred to the TRSs. The Leasehold Contract Intangibles, and the Storage Contract Intangibles associated with the storage rental relationship, remained with Taxpayer. Therefore, the Storage Contract Intangibles at issue include only the value of the rental income expected to be generated by the acquired storage contracts.

Shared Personnel and Space

For administrative convenience, certain employees may perform services for Taxpayer and its TRSs. For example, the Company expects that its human resources, legal, accounting, and other administrative departments will remain with either Taxpayer or a TRS while it is a REIT and the personnel in those departments will provide services to both Taxpayer and the TRSs pursuant to an employee sharing agreement. Under the

[3] Taxpayer is not requesting a ruling with respect to the Other Intangibles, and Taxpayer will not treat the Other Intangibles as real property or interests in real property for REIT qualification purposes.

employee sharing agreement, the employer, whether Taxpayer or a TRS, will make available the shared employees to the service recipient to the extent those employees spend time performing services for the service recipient. The service recipient will reimburse the employer for the service recipient's allocable share of the employees' costs including salaries, benefits, and other compensation, costs associated with payroll administration, and allocable overhead costs including, but not limited to, office supplies, furniture and equipment, and office space at the Company's corporate offices. The amount of such reimbursements will be computed periodically and will be determined on the basis of the relative amount of time such employees spend performing services on behalf of the employer versus the service recipient or other reasonable allocation methods. The employer will not deduct or capitalize the costs reimbursed by the service recipient; rather, the service recipient will deduct or capitalize those costs, as appropriate.

Additionally, Taxpayer and one or more TRSs expect to co-occupy the Company's corporate offices.[4] With respect to such shared space, Taxpayer and the applicable TRSs will enter into a space sharing agreement, which will provide that each party pays its allocable share of costs associated with the shared space on a cost reimbursement basis based upon the use of the space and associated costs. Reimbursed costs may include, but are not limited to, utilities, taxes, rent or mortgage payments, and building maintenance and improvement expenses. As with the costs related to shared employees, neither party will deduct or capitalize any costs that are reimbursed by the other party; rather, each party will deduct or capitalize its share of the costs, as appropriate. Taxpayer and the applicable TRS may also enter into equipment sharing agreements employing comparable principles embodied in the space sharing agreements, whereby each party bears allocable costs based on use, and each party will deduct or capitalize its share of the costs, as appropriate, but will not deduct or capitalize reimbursed costs.

The reimbursements under any employee sharing agreement, equipment sharing agreement, or space sharing agreement (collectively "Cost-Sharing Arrangements") will be solely for both direct and indirect costs, with no mark-up. The allocation of general and administrative overhead expenses will be done on an arm's-length and equitable basis. The costs will be deducted or capitalized by the party bearing such costs under the Cost-Sharing Arrangements, and the reimbursed party will not deduct or capitalize reimbursed costs. Finally, neither Taxpayer nor any TRS will be in the business of receiving compensation for services or use of property of the type that will be reimbursed under any Cost-Sharing Arrangement.

Foreign Operations

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[4] There will not be cost sharing of space at any facility other than the corporate offices.

Company's business model and operations outside the United States are substantially the same as its storage business in the United States, including ownership and leasing of space in facilities in foreign countries. Taxpayer operates in foreign countries through one or more foreign subsidiaries and associated intermediate holding companies (each, a "Foreign Sub"). Taxpayer may jointly elect TRS status with Foreign Subs that are corporations for United States federal income tax purposes (each, a "Foreign TRS"). Taxpayer intends to make loans to its domestic TRSs and Foreign TRSs that are secured by "interests in real property" under § 856 held by that domestic TRS or Foreign TRS. Loans between Taxpayer and any domestic TRS or Foreign TRS that are secured by interests in real property owned by that TRS will be adequately secured (based on loan value of the real property under Treas. Reg. § 1.856-5(c)(2)) by such interests in real property; when the TRS real property is located outside the United States, the applicable security interest will be comparable to a mortgage under United States state law, which will provide for traditional rights of foreclosure.

Separately, Taxpayer expects to occasionally (i) pledge shares of one or more Foreign TRSs or (ii) cause one or more Foreign TRSs to pledge assets, in each case as collateral for certain debt of Taxpayer that will be incurred to finance Taxpayer's acquisition, improvement, or development of interests in real property that produce qualifying income under § 856(c)(2). In such cases, the Foreign TRS may be a "controlled foreign corporation" ("CFC") within the meaning of § 957(a), with respect to which Taxpayer may be a United States shareholder within the meaning of § 951(b) (a "United States shareholder").

Taxpayer represents that it is a shareholder of certain subsidiaries that are passive foreign investment companies under § 1297 ("PFIC") and that it has elected to be treated as a qualified electing fund ("QEF") with respect to certain of these PFICs.

Depreciation Method Change

For federal income tax purposes, Taxpayer generally had depreciated the Steel Racking Structures as personal property and amortized Contract Intangibles using a 15-year straight-line method. In the first two Ruling Requests, Taxpayer asks that we conclude that the Steel Racking Structures and the Contract Intangibles are, respectively, real property and interests in real property for purposes of § 856.

Taxpayer has filed separately Forms 3115 to change its method of depreciating the Steel Racking Structures and amortizing Contract Intangibles to methods that have longer recovery periods than the periods that Taxpayer previously used for these assets. These method changes have resulted in positive adjustments under § 481 ("Section 481(a) Adjustments") that will be includible in Taxpayer's taxable income over a period of four taxable years that would include the taxable years before, during, and subsequent to Taxpayer's First REIT Taxable Year.

Stock and Cash Distributions

During its first two taxable years as a REIT, Taxpayer expects to make one or more distributions to its shareholders with respect to its common stock in the form of a combination of cash and common stock, at the election of each shareholder, subject to proration adjustments as described below (a "Stock and Cash Distribution").

For each Stock and Cash Distribution, the total amount of cash available will be limited to a specified percentage (the "Cash Percentage") equal to 20 percent or more (but less than 100 percent) of the aggregate value of the respective Stock and Cash Distribution (the "Cash Limitation"). In no event will the Cash Limitation for any Stock and Cash Distribution be less than 20 percent of the aggregate value of the respective Stock and Cash Distribution. For each Stock and Cash Distribution, each shareholder will have the right to elect to receive their entitlement under the distribution (i) entirely in cash (the "Cash Option"); (ii) entirely in common stock of equivalent value (the "Equity Option"); or, possibly, (iii) a mixture of cash (corresponding to the Cash Percentage) and stock (the "Mixed Option"). In the event Taxpayer does not receive an election from a shareholder, that shareholder will default to the Equity Option or, if the Mixed Option is also available as an election, either the Equity Option or the Mixed Option.

If the cash component of a Stock and Cash Distribution is not oversubscribed, each shareholder electing to receive the Cash Option will receive their entitlement under the distribution entirely in cash. If the cash component of a Stock and Cash Distribution is oversubscribed, then each shareholder electing to receive the Cash Option will receive a pro rata amount of cash corresponding to the shareholder's respective entitlement under the declaration, but in no event will any such shareholder receive cash in an amount less than the Cash Percentage corresponding to the shareholder's entitlement under the distribution. Each shareholder electing to receive the Mixed Option (if available) will, in all events, receive cash corresponding to the Cash Percentage.

Taxpayer anticipates that each Stock and Cash Distribution will be paid as soon as reasonably practicable following the date of the election deadline. Taxpayer also anticipates paying cash in lieu of issuing fractional shares of common stock, though cash paid in lieu of fractional shares will not count against the Cash Percentage.

Taxpayer does not currently have a dividend reinvestment plan (a "DRIP") or similar plan in effect, but it may choose to implement a DRIP in the future.

Taxpayer makes the following representations:

1. Each Stock and Cash Distribution will be made by Taxpayer to its shareholders with respect to the common stock, which is publicly traded on the Exchange, an established U.S. securities market.

2. For each Stock and Cash Distribution, the total amount of cash available will be limited to a specified percentage (the “Cash Percentage”) equal to 20 percent or more (but less than 100 percent) of the aggregate value of the respective Stock and Cash Distribution (the “Cash Limitation”). In no event will the Cash Limitation for any Stock and Cash Distribution be less than 20 percent of the aggregate value of the respective Stock and Cash Distribution.

3. For each Stock and Cash Distribution, each shareholder will have the right to elect to receive their entitlement under the distribution (i) entirely in cash (the “Cash Option”); (ii) entirely in common stock of equivalent value (the “Equity Option”); or, possibly, (iii) a mixture of cash (corresponding to the Cash Percentage) and stock (the “Mixed Option”).

4. The calculation of the number of shares of common stock to be received by any shareholder in each Stock and Cash Distribution will be determined, over a period of up to two weeks ending as close as practicable to the payment date, based upon a formula using market prices, and designed to equate in value the number of shares to be received with the amount of cash that could be received instead.

5. If the cash component of a Stock and Cash Distribution is oversubscribed, then each shareholder electing to receive the Cash Option will receive a pro rata amount of cash corresponding to the shareholder’s respective entitlement under the declaration, but in no event will any such shareholder receive cash in an amount less than the Cash Percentage corresponding to the shareholder’s entitlement under the distribution.

6. For any shareholder participating in a DRIP, the DRIP applies only to the extent of the cash the shareholder would have received in the Stock and Cash Distribution in the absence of the DRIP.

Hedging

As of the commencement of Taxpayer's First REIT Taxable Year, Taxpayer will have had some pre-existing hedges. Taxpayer has been and will be converting one of more of its Foreign TRSs to either disregarded entities (including but not limited to QRSs) or partnerships. Before Taxpayer converts one or more of its Foreign TRSs to either disregarded entities or partnerships, some of these Foreign TRSs will have entered into hedges. Some entities that the Company acquires ("M&A Target Entities") will also have entered into hedges. Such hedges will thus be pre-existing as of the first day that the hedges formerly held by these entities are included as part of Taxpayer’s hedges for REIT income testing purposes.

Some pre-existing hedges will have been clearly and timely identified by Taxpayer, the TRS, or the M&A Target Entity pursuant to § 1221(a)(7). These pre-existing hedges will have met the requirements of § 856(c)(5)(G) but for the fact that these hedges were identified, as applicable, either by Taxpayer prior to its First REIT Taxable Year, by a TRS prior to its converting into a disregarded entity or a partnership, or by an M&A Target Entity prior to its becoming a disregarded entity or a partnership. Taxpayer will identify each pre-existing hedge (including hedges that have previously been identified) for § 856(c)(5)(G) purposes (even though such identification would not be effective for any other purpose) on the first day (starting with the first day of the First REIT Taxable Year) that Taxpayer or one of its disregarded entities or partnerships becomes a party to the hedge for REIT income testing purposes.

Law and Analysis

Ruling Request 1: The Steel Racking Structures will be treated as real property for purposes of § 856.

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.

Treas. Reg. § 1.856-3(b)(1) provides that the term “real estate assets” means:

> [R]eal property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or other improvements thereon), and shares in other qualified real estate investment trusts.

Treas. Reg. § 1.856-3(d) defines the term "real property" as:

> [L]and 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 the term "real property" as used in [S]ection 856 and the regulations thereunder. The term 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 the 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.

Accordingly, real property under § 856 includes, in addition to land and buildings: (1) interests in real property; (2) inherently permanent structures; and (3) structural components of buildings or other inherently permanent structures. The term "interests in real property" also includes leaseholds of land or improvements on land. However, the term "real property" does not include "assets accessory to the operation of a business."

Rev. Rul. 71-220, 1971-1 C.B. 210, 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 Treas. Reg. § 1.856-3(d).

Rev. Rul. 75-424, 1975-2 C.B. 269, considers 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.

In the present case, each Steel Racking Structure is engineered to integrate into a specific building, is constructed to remain in place, cannot be readily moved to another location, is not intended to be moved or removed while Taxpayer occupies the building, and is unlikely to be moved to another location. The Steel Racking Structures are designed to bear A times the weight of the floors of a typical office building, and the concrete floors upon which the Steel Racking Structures are attached are likewise designed to accommodate that weight. Taxpayer has not reused a Steel Racking Structure in any facility, nor does Taxpayer intend to reuse any of its Steel Racking Structures; not only would it be impractical, the costs of doing so are prohibitive.[5]

Further, the degree of integration between a building and its Steel Racking Structure strongly suggests permanence.[6] The time needed to design and install a Steel Racking Structure for a building ranges from a few weeks to a year. This includes time for site review, building measurement, design, pricing, building permits, manufacturing, shipping, delivery to site, and installation. Each Steel Racking Structure requires a building permit and certificate of occupancy from the relevant municipality (or comparable requirement of foreign law). All of the Steel Racking Structures are made from cold rolled steel or heavy-duty structural steel and are custom designed by an engineer or architect to maximize space within a specific building. In addition, all of the Steel Racking Structures have multiple levels (each level up to 24 feet high), aisles, and shelving.

Most of the Steel Racking Structures have all, and almost all of the Steel Racking Structures have several, of the following built-in elements: sprinklers, inert gas, or both fire suppression systems, smoke detection systems, and lighting systems. Depending on the size of the building, the Steel Racking Structure also may include stairways, floors, catwalks, carton elevators, personnel elevators, and other improvements typically found in the interior of a building.

As noted, each “level” of a Steel Racking Structure has approximately A times the load bearing capacity of a floor in a typical commercial building and includes “shelves” between the “levels” of the Steel Racking Structure. To ensure the building’s structural integrity in case of seismic activity or other disasters, the Steel Racking Structure is generally not attached to the sides or ceiling of the building. The Steel Racking Structure is, however, anchored to the floor, with floor anchoring systems typically designed by a structural engineer based on load and seismic zone. Likewise, the foundation is designed to accommodate the extreme weight borne by the Steel Racking Structure.

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[5] Removal of the Steel Racking Structures would require significant renovations and restoration to the building, leaving the pieces of the Steel Racking Structures themselves with little value except as scrap.

[6] Throughout the Steel Racking Structures are fire suppression and lighting systems that are integrated with the building.

The Steel Racking Structures are comparable to the assets described in Rev. Rul. 71-220 and Rev. Rul. 75-424 that qualify as real property for purposes of § 856. Accordingly, we conclude that the Steel Racking Structures qualify as real property for purposes of § 856. Although the Steel Racking Structures are used in Taxpayer's storage business, the Steel Racking Structures themselves are not assets accessory to the operation of a business within the meaning of Treas. Reg. § 1.856-3(d).

Ruling Request 2: The Contract Intangibles will be treated as "interests in real property" for purposes of § 856.

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.

Treas. Reg. § 1.856-2(d)(3) provides that in determining the investment status of a REIT, the term "total assets" means the gross assets of a REIT determined in accordance with GAAP. The Contract Intangibles recognized by GAAP are attributable to the acquisition of leaseholds on real property with below market rent and the acquisition of storage contracts. These intangibles must be analyzed to determine whether they qualify as "real property" for purposes of § 856. To qualify as real property for this purpose, the Contract Intangibles must be inseparable from and inextricably and compulsorily tied to real property.

The Leasehold Contract Intangibles are recognized as an asset by GAAP when Taxpayer pays a premium to acquire a lessee's below-market rent leasehold interest. Taxpayer's Leasehold Contract Intangibles are derived from below-market rent leaseholds and cannot exist without the underlying leaseholds, supporting Taxpayer's representation that the Leasehold Contract Intangibles are inextricably and compulsorily tied to the below-market leaseholds. Accordingly, the Leasehold Contract Intangibles are "interests in real property" under § 856(c)(5)(C) and, therefore, "real estate assets" under § 856(c)(5)(B).

The Storage Contract Intangibles include the GAAP intangibles created by:
(i) termination fees paid to new storage customers or third parties on behalf of new storage customers entering into storage agreements with Taxpayer, (ii) pick-up and move costs and costs related to the acquisition of large volume accounts, and (iii) costs allocated to the acquisition of storage agreements in an acquisition of a records storage company business that includes the real estate. Taxpayer's Storage Contract Intangibles are derived from storage contracts to provide space in storage facilities and cannot exist without the underlying storage contracts, supporting Taxpayer's representation that the Storage Contract Intangibles are inseparable from and

inextricably and compulsorily tied to the storage rental element of the storage contracts, which represent Taxpayer's rights to payment with respect to Taxpayer's real property.

As part of its conversion and in compliance with GAAP and the REIT asset tests, Taxpayer will value the Contract Intangibles separately from the other intangibles. The Contract Intangibles will be valued based on the discounted cash flows of the storage agreements (including expected growth under these agreements) and savings from the below-market leases. Such valuation will be done to establish the fair market value of the Contract Intangibles as of the effective date of Taxpayer's REIT election and at the end of each calendar quarter thereafter.

Although the Storage Contract Intangibles are related to the storage contracts, the storage contracts set the rates both for storage provided by Taxpayer and for the Related Services provided by a TRS. When Taxpayer transferred the workforce, assets, and operations associated with the Related Services to the TRSs, however, the intangibles associated with the Related Services were transferred to the TRSs, and the Storage Contract Intangibles associated with the storage rental element of the storage contract remained with Taxpayer. This transfer separates the Storage Contract Intangibles associated with the storage rental element of the Storage Contracts from the intangibles that are associated with the Related Services element of the storage contracts. Taxpayer represents that the Storage Contract Intangibles held by Taxpayer will only reflect the value of the storage rental element of the storage contracts with which they are associated.

Accordingly, because the Storage Contract Intangibles are associated only with the storage rental element of the storage contracts, are not associated with the Related Services element of the storage contracts, and are inseparable from and inextricably and compulsorily tied to and have no value separate and apart from the storage rental element of the storage contracts, Taxpayer's Storage Contract Intangibles are "interests in real property" under § 856(c)(5)(C) and, therefore, "real estate assets" under § 856(c)(5)(B).

Ruling Request 3: A loan by Taxpayer to a domestic TRS or a Foreign TRS secured by § 856 "interests in real property" of that domestic or Foreign TRS will be treated as an "interest in real property" and will not be treated as a "security" under § 856(c)(4)(B)(ii).

Under § 856(c)(4)(B)(ii), a REIT is permitted to hold the securities of one or more TRSs as long as such securities do not exceed 25% of the value of the REIT's total assets. The question presented in this ruling request is whether, for purposes of the 25% Value Test under § 856(c)(4)(B)(ii), the term "security" includes a loan to a TRS that qualifies as a real estate asset under § 856(c)(5)(B).

Rev. Rul. 74-191, 1974-1 C.B. 170, holds that foreign real estate acquired by a REIT is a "real estate asset" for purposes of § 856(c) and that the term "mortgages on real property" includes a security interest that, under the laws of the jurisdiction in which the property is located, is the legal equivalent of a mortgage or deed of trust in the United States. The ruling describes an unincorporated domestic trust, otherwise qualifying as a REIT under § 856, that made short term construction loans secured by security interests in real property located outside the United States. Such security interests were legally equivalent to those created by mortgages or deeds of trust in the United States. The trust also had direct interests in real estate located abroad. The ruling reasons that neither § 856 nor the regulations thereunder restrict the term "real estate assets" to those located within the United States.

Taxpayer has represented that the loans between Taxpayer and any domestic TRS or Foreign TRS that are secured by interests in real property owned by that TRS will be adequately secured (based on the loan value of the real property under Treas. Reg. § 1.856-5(c)(2)) by such interests in real property. Taxpayer has further represented that the loans create a security interest in real property that, under the laws of the jurisdiction in which the property is located, is the equivalent of a mortgage and in all cases includes a traditional right of foreclosure against the real property.

Treas. Reg. § 1.856-3(e) provides that the term “securities” does not include “interests in real property” or “real estate assets” as those terms are defined in § 856 and under Treas. Reg. § 1.856-3.

There is nothing in the statute or legislative history of § 856 to indicate that Congress intended that the definition of securities in Treas. Reg. § 1.856-3(e) not apply for purposes of the 25% Value Test under § 856(c)(4)(B)(ii). Thus, in applying the 25% Value Test under § 856(c)(4)(B)(ii), “interests in real property” or “real estate assets” as defined in § 856 and Treas. Reg. § 1.856-3 are not “securities” for purposes of § 856(c)(4)(B)(ii).

Based on the information provided and the representations made, a loan by Taxpayer to a domestic TRS or a Foreign TRS secured by a § 856 "interest in real property" of that domestic or Foreign TRS will be treated as an "interest in real property" and will not be treated as a "security" under § 856(c)(4)(B)(ii).

Ruling Request 4: (i) Payments received by Taxpayer from storage customers under the storage agreements described above constitute “rents from real property” within the meaning of § 856(d); and (ii) Customer payments made for Related Services do not give rise to Taxpayer receipt of impermissible tenant services income, and do not cause any portion of the rents received by Taxpayer to fail to qualify as “rents from real property” under § 856(d).

Ruling 4 (i):

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from a broader group of passive sources that also includes "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 passive real estate related sources, "rents from real property." The 75 percent and 95 percent tests are collectively referred to as the "Income Tests."

Treas. Reg. § 1.856-4(a) provides, in relevant part, 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.

Treas. Reg. § 1.856-4(b)(1) provides that 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. The regulation further provides that services furnished to tenants 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. To qualify as a service customarily furnished, the service must be furnished or rendered to the tenants of the REIT or primarily for the convenience or benefit of the tenants, to the guests, customers, or subtenants of the tenants.

Taxpayer’s storage customers generally do not have direct access to stored items, nor do the storage customers have exclusive use of defined space. Rather, the stored items must be handled and removed from storage before the stored items are available to the storage customer. Under Taxpayer’s storage agreements with storage customers, Taxpayer generally may store the stored items at any of its facilities and at any location within a facility. Nevertheless, the Storage Agreement represents an obligation by Taxpayer to provide a specified amount of space within a facility to store the stored items, and the fees charged under the storage contacts are primarily based on the amount of space that the customer seeks to occupy. Moreover, on average, the stored items are handled only once every B years; thus, the customers’ items, once placed at a specific part of Taxpayer’s space, generally remain there as long as the storage contract is in effect.[7] Accordingly, based on the information submitted, the representations made, and our conclusion that the Steel Racking Structures are real property, we conclude that payments received by Taxpayer from storage customers under the storage agreements under the arrangements described above constitute “rents from real property” within the meaning of § 856(d).

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[7] Storage contracts are typically on a year to year basis with storage payments charged monthly in advance.

<u>Ruling 4 (ii)</u>:

Section 856(d)(1) defines, in relevant part, "rents from real property" to include charges for services customarily furnished or rendered in connection with the rental of real property (whether or not such charges are separately stated). Section 856(d)(2)(C) excludes from the definition of "rents from real property" any "impermissible tenant service income" as defined under § 856(d)(7).

Section 856(d)(7)(A) provides that "impermissible tenant service income" means, with respect to any real or personal property, any amount received or accrued directly or indirectly by a REIT for "services furnished or rendered" by the REIT to tenants of the property, or for managing or operating the property. Section 856(d)(7)(B) provides that if "impermissible tenant service income" exceeds one percent of all the income from the property during the tax year, then none of the income from the property qualifies as "rents from real property." Section 856(d)(7)(C)(i) provides that services furnished or rendered through an "independent contractor" (defined under § 856(d)(3)) from whom the REIT does not derive or receive any income, or through a TRS of such REIT, will not be treated as furnished, rendered, or provided by the REIT for purposes of § 856(d)(7)(A).

In Rev. Rul. 2002-38, 2002-2 C.B. 4, a REIT pays its TRS to provide non-customary 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 REIT's 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(d)(7)(C)(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).

The income derived from a TRS owned by Taxpayer from the Related Services the TRS provides may constitute "impermissible tenant services income" if the Related Services are considered "furnished or rendered" by Taxpayer for purposes of § 856(d)(2)(C) and (d)(7)(A). However, if the Related Services are considered rendered by a TRS, then the Related Services are not considered rendered by its REIT, by reason of § 856(d)(7)(C)(i), and thus would not give rise to "impermissible tenant service income" under § 856(d)(7)(A).

In a typical storage agreement, Taxpayer provides to its storage customers both the space at Taxpayer's facilities and certain services. After Taxpayer becomes a REIT, substantially all of the Related Services will be performed by a TRS and none of the Related Services will be performed by Taxpayer. When the Related Services are provided under the storage customer's agreement with Taxpayer, the TRS will receive from Taxpayer the higher of the fee paid by the storage customer or the § 482 arm's-length fees for these Related Services.[8] Many Related Services, such as shredding or transportation of storage boxes, will be charged separately to customers under the storage agreement. Certain customary services, such as building security, that generally do not involve the movement of cartons, may be provided by Taxpayer either directly or through independent contractors from whom Taxpayer does not derive or receive any income.

The TRS will (i) perform (and pay all the costs of providing) the Related Services; (ii) either rent space from Taxpayer or share space under a cost sharing arrangement; (iii) make no payment to Taxpayer other than its rental or reimbursement payments for shared space and costs; and (iv) receive the higher of the fee paid by the storage customer or the § 482 arm's-length fee for providing these services. Accordingly, based upon the information submitted and the representations made, we conclude that the storage customer payments for Related Services do not give rise to Taxpayer's receipt of impermissible tenant services income, and do not cause any portion of the rents received by Taxpayer to fail to qualify as "rents from real property" under § 856(d).

<u>Ruling Request 5:</u> **Rents received by Taxpayer from a TRS for the leasing of space in a facility (where at least 90 percent of the leased space at a facility (as determined under this ruling) is leased to persons other than the TRS or a related person described in §856(d)(2)(B)) in connection with the TRS's provision of services to Taxpayer's storage customers and to others will be treated as rents from real property under § 856(d) through the application of § 856(d)(8)(A).**

Section 856(d)(1) defines "rents from real property" (subject to exclusions provided in § 856(d)(2)) to include rents from interests in real property, charges for services customarily rendered in connection with the rental of real property, and rent attributable to certain personal property leased in connection with the lease of real property.

Section 856(d)(2)(B) provides, in part, that except as provided in § 856(d)(8), the term "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: (i) in the case of any person that is a corporation, stock of such person 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 such person; or (ii) 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 such person.

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[8] The separate charges the storage customers pay for Related Services may be at a discount or premium compared to prices that would have been charged had the Related Services not been provided under an accompanying storage agreement.

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)(B) 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 such REIT and other than related parties described in § 856(d)(2)(B), but only to the extent that the amounts paid to the REIT by the TRS as rents from real property (without regard to § 856(d)(2)(B)) are substantially comparable to such rents paid by the other tenants of the REIT's property for comparable space.

Taxpayer has represented that at least 90 percent of the leased space of substantially all its facilities will be leased to persons other than TRSs and other related persons described in § 856(d)(2)(B). In making this representation, Taxpayer is comparing (i) the square footage of space leased to unrelated customers, treating each "level" within the Steel Racking Structures as a floor that contributes to aggregate square footage, to (ii) the square footage of space leased to TRSs and other related persons described in § 856(d)(2)(B).

To meet the limited rental exception of § 856(d)(8)(A), amounts paid to a REIT by the TRS must be substantially comparable to rents paid by other tenants. The space rented within Taxpayer's facilities by a TRS is not fitted for use in the same way as the space that is used by Taxpayer's storage customers, and thus the space rented by a TRS is not comparable to the other leased space within the facilities. Taxpayer has represented that rental payments made by a TRS to Taxpayer for the leasing or other occupancy of space in Taxpayer's facilities in connection with the TRS's provision of services will be arm's-length and will be substantially comparable to rents paid by unrelated tenants for comparable space located in the same geographic area.

Accordingly, rents received by Taxpayer from a TRS for the leasing of space in a facility (where at least 90 percent of the leased space at a facility (as determined under this ruling) is leased to persons other than the TRS or a related person described in §856(d)(2)(B)) in connection with the TRS's provision of services to Taxpayer's storage customers and to others will be treated as rents from real property under § 856(d) through the application of § 856(d)(8)(A).

<u>Ruling Request 6:</u> Any amounts received by Taxpayer as reimbursements under a Cost-Sharing Arrangement will not be included in Taxpayer's gross income for purposes of § 856(c)(2) and (3).

To qualify as a REIT, an entity must derive at least 95 percent of its gross income from sources listed in § 856(c)(2) and at least 75 percent of its gross income from sources listed in § 856(c)(3).

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. Commissioner, 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).

In the present case, the reimbursement arrangement between Taxpayer and its TRS is analogous to the situation in Rev. Rul. 84-138. Neither Taxpayer nor the TRS will be in the trade or business of providing to third parties any service, equipment, or property of the type reimbursed under any Cost-Sharing Arrangement. Accordingly, based on the information provided and representations made, reimbursement payments received under Cost-Sharing Arrangements will not be treated as gross income received by Taxpayer for purposes of § 856(c)(2) and (3). Also, Taxpayer will not be entitled to a deduction for the expenses that are reimbursed.

Ruling Request 7: Taxpayer's Subpart F inclusions under § 951(a) will be treated as qualifying income under § 856(c)(2) to the extent that such inclusions result either (i) from § 954(c) foreign personal holding company income of Taxpayer's Foreign TRSs, or (ii) from the pledge of the stock or the assets of a Foreign TRS that is a CFC with respect to which Taxpayer is a United States shareholder to secure the debt of Taxpayer that will be incurred to finance Taxpayer's acquisition, improvement, or development of interests in real property that produce qualifying income under § 856(c)(2). In addition, (iii) Taxpayer's income under §§ 1291(a) and 1293(a) will be treated as qualifying income under § 856(c)(2).

Section 856(c)(2) requires that at least 95 percent of a REIT's gross income (excluding gross income from prohibited transactions) 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) that is not property described in § 1221(a)(1), and certain other sources.

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 that otherwise constitutes gross income not qualifying under § 856(c)(2) or (3) may be considered as gross income which qualifies under § 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. 86-2020, at 6 (1960), 1960-2 C.B. 819, 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."

Ruling 7(i):

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 § 951(b) 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 § 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 § 954. Under § 954(a)(1), foreign base company income includes foreign personal holding company income ("FPHCI"), as determined under § 954(c). Section 954(c)(1)(A) defines FPHCI 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 that (among other things) gives rise to income described in § 954(c)(1)(A) (after application of paragraph (2)(A)) other than property that gives rise to income not treated as foreign personal holding company income by reason of § 954(h) or (i) for the taxable year.

Taxpayer has represented that it is a United States shareholder within the meaning of § 951(b) with respect to certain of its subsidiaries that are 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 ("Subpart F Inclusions"), treatment of the § 951(a)(1)(A)(i) inclusion attributable to such income as qualifying income for purposes of § 856(c)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under § 856(c)(2). Accordingly, we rule that Taxpayer's Subpart F Inclusion income inclusions attributable to the FPHCI earned by Taxpayer's CFCs are qualifying income for purposes of § 856(c)(2), pursuant to the authority provided in § 856(c)(5)(J)(ii).

Ruling 7(ii):

Section 951(a)(1)(B) 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 gross income the amount determined under § 956 with respect to the shareholder for such year (but only to the extent not excluded from gross income under § 959(a)(2)).

Section 956(a) provides that in the case of a CFC, the amount determined under § 956 with respect to any United States shareholder for any taxable year is the lesser of — (1) the excess (if any) of— (A) such shareholder's pro rata share of the average of the amounts of United States property held (directly or indirectly) by the CFC as of the close of each quarter of such taxable year, over (B) the amount of earnings and profits ("E&P") described in § 959(c)(1)(A) with respect to such shareholder, or (2) such shareholder's pro rata share of the applicable earnings of such CFC. The amount taken into account in the preceding sentence under (1) with respect to any property shall be its adjusted basis as determined for purposes of computing E&P, reduced by any liability to which the property is subject.

Treas. Reg. § 1.956-2(c)(1) provides that except as provided in Treas. Reg. § 1.956-2(c)(4), any obligation (as defined in Treas. Reg. § 1.956-2(d)(2)) of a United States person (as defined in § 957) with respect to which a CFC is a pledgor or guarantor shall be considered for purposes of § 956(a) to be United States property held by such CFC. Treas. Reg. § 1.956-2(c)(2) provides that if the assets of a CFC serve at any time, even though indirectly, as security for the performance of an obligation of a United States person, then, the CFC will be considered a pledgor or guarantor of that obligation.

Taxpayer expects to pledge the stock or the assets of one or more Foreign TRSs that is a CFC with respect to which Taxpayer is a United States shareholder to secure the debt of Taxpayer that will be incurred to finance Taxpayer's acquisition, improvement, or development of interests in real property that produce qualifying income under § 856(c)(2). This pledge may cause Taxpayer to recognize income under § 951(a)(1)(B) that arises in connection with the pledge of the CFC's assets against the debt of Taxpayer ("Section 956 Inclusion"). The facts and representations in this case indicate that a Section 956 Inclusion would occur as a result of a debt of Taxpayer's that arises in connection with the acquisition of real estate assets. This has a close nexus to Taxpayer's business of owning and renting real property. The Section 956 Inclusion recognized in connection with the production of otherwise qualifying income is treated as qualifying income for purposes of § 856(c)(2) to the extent that the underlying income so qualifies. Accordingly, we rule that to the extent Taxpayer recognizes a Section 956 Inclusion on the pledge of the assets or stock of a CFC to secure a debt of Taxpayer that is used to finance the acquisition of real estate assets from which income is derived that qualifies under § 856(c)(2), there is a sufficient nexus to treat the Section 956 Inclusion as qualifying income for purposes of § 856(c)(2), pursuant to the authority provided in § 856(c)(5)(J)(ii).

Ruling 7(iii):

Section 1297(a) defines a PFIC as a foreign corporation when 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 § 1297(e)) held by such corporation during the taxable year that produce passive income or 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 § 954(c), subject to certain exceptions.

Section 1291(a)(1) provides that if a United States person receives an excess distribution (as defined in § 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 § 1291(a)(1)(A) to — (i) the current year, or (ii) any period in the shareholder's holding period before the first day of the first taxable year of the company that 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 § 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 § 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 § 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 are PFICs and that it has made QEF elections with respect to certain of these PFICs. Because Taxpayer's PFICs earn income that is FPHCI and such income is generally passive income, whether included under § 1293(a)(1) or § 1291(a) (“PFIC Inclusions”), treatment of such PFIC Inclusion income as qualifying income for purposes of § 856(c)(2) does not interfere with or impede the policy objectives of Congress in enacting the income test under § 856(c)(2). Accordingly, we rule Taxpayer's PFIC

Inclusion income will be treated as qualifying income under § 856(c)(2), pursuant to the authority provided in § 856(c)(5)(J)(ii).

<u>Ruling Request 8:</u> **Foreign currency gain with respect to distributions of previously taxed E&P as described in § 986(c)(1) will not be taken into account for purposes of § 856(c)(2).**

Sections 959(a), 1291(b)(3)(F), and 1293(c) provide that, when a United States shareholder is taxed on undistributed corporate earnings under the subpart F or QEF inclusion rules, subsequent distributions of the previously taxed earnings are tax-free to the shareholder.

Section 986(c)(1) provides that foreign currency gain or loss with respect to distributions of previously taxed E&P (as described in § 959 or §1293(c)) attributable to movements in exchange rates between the times of the deemed inclusion and the actual distributions ("Section 986(c) Gain") will be recognized and treated as ordinary income or loss from the same source as the associated income inclusion.

Section 856(n)(1)(A) provides that "passive foreign exchange gain" for any taxable year will not constitute gross income for purposes of § 856(c)(2).

Section 856(n)(3) defines passive foreign exchange gain as: (A) real estate foreign exchange gain (as defined in § 856(n)(2)); (B) foreign currency gain (as defined in § 988(b)(1)) that is not described in subparagraph A and is attributable to (i) any item of income or gain described in § 856(c)(2), (ii) the acquisition or ownership of obligations (other than foreign currency gains attributable to any item described in clause (i)), or (iii) becoming or being the obligor under obligations (other than foreign currency gain attributable to any item of income or gain described in clause (i)); and (C) any other foreign currency gains determined by the Secretary.

Although Section 986(c) Gain is not a foreign currency gain defined in § 988(b)(1), Section 986(c) Gain is attributable to items of income that are qualifying income for purposes of § 856(c)(2). Section 986(c) Gain is substantially similar to passive foreign exchange gain described in § 856(n)(3)(B)(i). Therefore, pursuant to the authority granted under § 856(n)(3)(C), the foreign currency gain with respect to distributions of previously taxed E&P as described in § 986(c)(1) will not constitute gross income for purposes of § 856(c)(2).

<u>Ruling Request 9:</u> **To the extent that the Section 481(a) Adjustments exceed the correlative E&P adjustments arising from the change in computing depreciation and amortization, any distributions of such excess (that are distributed and treated as dividends by Taxpayer) shall be treated as made from E&P.**

Taxpayer has filed Forms 3115 to change its method of accounting for the Steel Racking Structures and the Contract Intangibles retained by Taxpayer. As a result of these method changes, Taxpayer has positive Section 481(a) Adjustments that have been and will be includible in Taxpayer's taxable income ratably over four taxable years, including Taxpayer's First REIT Taxable Year and taxable years thereafter. See Rev. Proc. 97-27, sec. 5.02(3)(a), 1997-1 C.B. 680, 684.

Taxpayer received a ruling allowing it to take correlative adjustments arising from the change in computing depreciation for E&P purposes ratably over the same period as the Section 481(a) Adjustments. Due to differences in computing depreciation for E&P purposes versus income tax purposes, Taxpayer's correlative adjustments to its E&P are lower than its Section 481(a) Adjustments.

The Section 481(a) Adjustments are subject to the §1374 built in gains tax, which is not eliminated or reduced by the dividends paid deduction. Under § 337(d), Treas. Reg. § 1.337(d)-7, § 1374, and the regulations thereunder, the Section 481(a) Adjustments are subject to corporate level taxation pursuant to Treas. Reg. § 1.1374-4(b) and (d). The net amount after the application of corporate level taxation is REIT taxable income ("REITTI") subject to the distribution requirements of § 857(a).

Section 561(a) provides that the deduction for dividends paid shall be the sum of the dividends paid during the year and consent dividends for the taxable year.

Section 562(a) provides that the term "dividend" shall include only dividends as described in § 316. Section 316(a) defines the term "dividend" to mean any distribution of property made by a corporation to its shareholders out of either current year or accumulated E&P.

Section 857(a)(1) requires, in part, that a REIT's deduction for dividends paid for a taxable year equals at least 90 percent of its REITTI for the taxable year, determined without regard to the deduction for dividends paid (as defined by § 561) or any net capital gains.

Section 857(a)(2) generally requires that, as of the close of a taxable year, a REIT has no E&P accumulated in any non-REIT year.

Section 857(b)(2)(B) provides that in determining a REIT's taxable income, the deduction for dividends paid (as defined in § 561) shall be allowed.

Section 857(d)(1) provides that the E&P of a REIT for any taxable year (but not its accumulated earnings) shall not be reduced by any amount that is not allowable in computing the REIT's taxable income for such taxable year.

Section 857(d)(2) provides that a REIT is generally deemed to have sufficient E&P to cover any distribution that it treats as a dividend to the extent the distribution, when combined with other distributions in the same calendar year, does not exceed the distributions required by § 4981.

Section 4981 generally levies an excise tax on REITs that do not make required distributions under that section during the calendar year. In general, a REIT's required distribution equals at least 85 percent of its current year ordinary income and at least 95 percent of its current year capital gain net income. The remaining percentage of the REIT's current year ordinary income (up to 15 percent) and its current year capital gain net income (up to 5 percent) are included in its required distribution in the following year. For purposes of § 4981, "ordinary income" equals the REIT's taxable income as determined under § 857(b)(2) without regard to the § 857(b)(2)(B) dividends-paid deduction.

The House Conference Report for the Tax Reform Act of 1986 states the following in discussing its rejection of a Senate amendment to § 857:

> The conference agreement does not contain a provision from the Senate amendment under which a REIT's earnings and profits for a taxable year would not be less than its real estate [investment] trust taxable income for the taxable year (without regard to dividends paid deduction), since the conferees believe that this provision is a restatement of law.[9]

H.R. Conf. Rep. No. 99-841, at 218 (1986). Therefore, the regime governing the taxation of REITs, which requires distributions of taxable income, is intended to match the REIT's E&P to that income.

Based on the above, to the extent that the Section 481(a) Adjustments exceed the correlative E&P adjustments arising from the change in computing depreciation, any distributions of such excess (that are distributed and treated as dividends by Taxpayer in the year in which such excess arises) shall be treated as made from E&P.

Ruling Request 10: Positive Section 481(a) Adjustments will not be taken into account in determining whether Taxpayer satisfies the gross income tests of § 856(c)(2) and (3).

As referenced above, Taxpayer filed Forms 3115 to change its method of depreciating certain assets. The changes have resulted in positive Section 481(a) Adjustments that

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[9] Section 1434(b) of H.R. 3838 as amended and passed by the Senate included a provision stating that "the earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings and profits) . . . shall not be less than its real estate investment trust taxable income for such taxable year determined without regard to the deduction for dividends paid (as defined by section 561)."

will be includible in taxable income over a period of four years. Section 856(c) lists the sources of permissible income under the Income Tests. Income from a § 481(a) adjustment is not specifically enumerated in § 856(c)(2) or (3).

Section 856(c)(5)(J) provides 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 that – (i) does not otherwise qualify under § 856(c)(2) or (3) may be considered as not constituting gross income for purposes of § 856(c)(2) or (3), or (ii) otherwise constitutes gross income not qualifying under § 856(c)(2) or (3) may be considered as gross income that qualifies under § 856(c)(2) or (3).

Section 481(a) provides that a taxpayer that changes its method of accounting takes into account necessary adjustments in computing its taxable income.

Treas. Reg. § 1.481-1(d) provides that a § 481(a) adjustment must be properly taken into account for purposes of computing gross income, adjusted gross income, or taxable income in determining the amount of any item of gain, loss, deduction, or credit that depends on gross income, adjusted gross income, or taxable income.

The legislative history underlying the tax treatment of REITs indicates that the central concern behind the gross income restrictions is that 95% of a REIT's gross income should be passive income and 75% of a REIT's gross income should be passive real estate income. See H.R. Rep. No. 86-2020, supra, at 6.

Any income resulting from a § 481(a) adjustment constitutes gross income. Pursuant to the authority under § 856(c)(5)(J), that income may either be considered as not constituting gross income under § 856(c)(2) or (c)(3) or as qualifying gross income under those provisions.

Excluding Taxpayer's positive Section 481(a) Adjustments from Taxpayer's gross income for purposes of § 856(c)(2) and (c)(3) does not interfere with Congressional policy objectives in enacting the Income Tests. Accordingly, pursuant to § 856(c)(5)(J)(i), Taxpayer's positive Section 481(a) Adjustments will not constitute gross income for purposes of § 856(c)(2) and (c)(3).

Ruling Request 11: All of the cash and the common stock distributed in any Stock and Cash Distribution made during Taxpayer's first two taxable years as a REIT will be treated as a distribution of property on the common stock to which § 301 applies. If during Taxpayer's first two taxable years as a REIT, some shareholders receive a distribution of all cash, all common stock, or a combination of cash and common stock that differs from the distribution received by other shareholders in the same Stock and Cash Distribution, or if the fair market value of the common stock on the date of the Stock and Cash Distribution

differs from the amount of cash that could have been received, those differences will not cause any such Stock and Cash Distribution to be treated as a preferential dividend under § 562(c).

Based solely on the information provided and the representations made, we rule as follows with respect to any Stock and Cash Distribution made during Taxpayer's first two taxable years as a REIT: Any and all of the cash and common stock distributed in a Stock and Cash Distribution (as described above) by Taxpayer will be treated as a distribution of property with respect to its stock to which § 301 applies. §§ 301, 305(b).

Section 857(a)(1) of the Code requires, in part, that a REIT's deduction for dividends paid for a tax year (as defined in § 561, but determined without regard to capital gains dividends) equal or exceed 90 percent of its REIT taxable income for the tax year (determined without regard to the deduction for dividends paid and by excluding any net capital gain).

Section 561(a) defines the deduction for dividends paid, for purposes of § 857, to include dividends paid during the taxable year.

Section 561(b) applies the rules of § 562 for determining which dividends are eligible for the deduction for dividends paid under § 561(a).

Section 562(c) provides that the amount of any distribution will not be considered as a dividend for purposes of computing the dividends paid deduction under § 561 unless the distribution is pro rata. The distribution must not prefer any shares of stock of a class over other shares of stock of that same class.

Treas. Reg. § 1.562-2 provides that a corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class. Nor will a corporation be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock. A preference exists if any rights to preference inherent in any class of stock are violated. The disallowance, when any preference in fact exists, extends to the entire amount of the distribution and not merely to a part of such distribution.

Accordingly, based on the above facts and circumstances, we conclude that if during Taxpayer's first two taxable years as a REIT, some shareholders receive a distribution of all cash, all common stock, or a combination of cash and common stock that differs from the distribution received by other shareholders in the same Stock and Cash Distribution, or if the fair market value of the common stock on the date of the Stock and

Cash Distribution differs from the amount of cash that could have been received, those differences will not cause any such Stock and Cash Distribution to be treated as a preferential dividend under § 562(c).

Ruling Request 12: The income from a pre-existing hedge will be considered as not constituting gross income under § 856(c)(2) or (c)(3), provided that such pre-existing hedging transaction was properly identified by the entity that acquired, originated or entered into the hedge. Similarly, the income from a pre-existing hedge that was not previously identified will be considered as not constituting gross income under § 856(c)(2) and (c)(3), provided that Taxpayer clearly identifies such pre-existing hedge (i) on the first day that Taxpayer or one of its disregarded entities or partnerships becomes a party to the hedge (including through conversion of a TRS to a disregarded entity or a partnership of Taxpayer or through acquisition of an M&A Target Entity that becomes a disregarded entity or a partnership of Taxpayer), or (ii) on the first day of the First REIT Taxable Year.

Section 61(a) of the Code provides that, except as otherwise provided, gross income includes all income from whatever source derived.

Section 856(c)(5)(G)(i) provides that, except to the extent determined by the Secretary, income of a REIT from a hedging transaction (as defined in § 1221(b)(2)(A)(ii) or (iii)) that is clearly identified pursuant to § 1221(a)(7), including gain from the sale or disposition of such transaction, does not constitute gross income under § 856(c)(2) or (3) to the extent the transaction hedges indebtedness incurred or to be incurred by the REIT to acquire or carry real estate assets.

Section 856(c)(5)(G)(ii) provides that, except to the extent determined by the Secretary, income of a REIT from a transaction entered into by the REIT primarily to manage risk of currency fluctuations with respect to any item of income or gain described in § 856(c)(2) or (3) (or any property that generates such income), including gain from the termination of such a transaction, does not constitute gross income under § 856(c)(2) or (3), provided that the transaction is clearly identified as such before the close of the day on which it was acquired, originated, or entered into.

Section 856(c)(5)(J)(i) authorizes the Secretary to determine, to the extent necessary to carry out the purposes of part II of subchapter M and solely for the purposes of such part, whether any item of income or gain that does not otherwise qualify under § 856(c)(2) or (3) may be considered as not constituting gross income for purposes of § 856(c)(2) or (3).

Section 1221(b)(2)(A)(ii) and the regulations thereunder provide that a "hedging transaction" includes any transaction entered into by the taxpayer in the normal course of the taxpayer's trade or business primarily to manage risk of interest rate or price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, by the taxpayer.

Section 1221(a)(7) and Treas. Reg. § 1.1221-2(f)(1) require a hedging transaction to be clearly identified as such before the close of the day on which it was acquired, originated, or entered into. Treas. Reg. § 1.1221-2(f)(2) requires a taxpayer that enters into a hedging transaction to make a substantially contemporaneous identification of the item, items, or aggregate risk being hedged, and provides that an identification is not substantially contemporaneous if it is made more than 35 days after entering into the hedging transaction.

Taxpayer will have entered into hedges prior to the commencement of Taxpayer's First REIT Taxable Year. In addition, prior to the time that Taxpayer converts one or more of its TRSs that do business in foreign countries to either disregarded entities or partnerships, some of these TRSs will have entered into hedges. Finally, some M&A Target Entities will have entered into hedges prior to the acquisition of these M&A Target Entities by the Company. Such hedges will thus be pre-existing as of the first day that Taxpayer is treated as a REIT or when pre-existing hedges entered into by these entities are included as part of Taxpayer's hedges for REIT income testing purposes.

Some pre-existing hedges will have been clearly and timely identified by Taxpayer, the TRS, or the M&A Target Entity pursuant to § 1221(a)(7). These pre-existing hedges will have met the requirements of § 856(c)(5)(G) but for the fact that these hedges were identified by, as applicable, Taxpayer prior to its becoming a REIT, a TRS prior to its becoming a disregarded entity or a partnership of Taxpayer, or the M&A Target Entity prior to its becoming a disregarded entity or a partnership of Taxpayer.

With respect to any pre-existing hedge that has not been clearly identified prior to the time Taxpayer becomes a REIT or the hedge is included by Taxpayer, Taxpayer intends to identify each such hedge for § 856(c)(5)(G) purposes (i) on the first day that Taxpayer or one its disregarded entities or partnerships becomes a party to the hedge (including through conversion of a TRS to a disregarded entity or a partnership of Taxpayer or through acquisition of an M&A Target Entity that becomes a disregarded entity or a partnership of Taxpayer), or (ii) on the first day of the First REIT Taxable Year.

Based on the facts above and the representations of Taxpayer, pre-existing hedges that were properly identified by, as applicable, Taxpayer prior to its becoming a REIT, a TRS prior to its becoming a disregarded entity or a partnership of Taxpayer, or the M&A Target Entity prior to its becoming a disregarded entity or a partnership of Taxpayer will be treated as properly identified for purposes of § 856(c)(5)(G).

Based on the facts above and the representations of Taxpayer, excluding the income with respect to any pre-existing hedge that has not been clearly identified prior to the time Taxpayer becomes a REIT (or a TRS prior to its becoming a disregarded entity or a partnership of Taxpayer, or the M&A Target Entity prior to its becoming a disregarded entity or a partnership of Taxpayer) from Taxpayer's gross income for purposes of § 856(c)(2) and (c)(3) does not interfere with Congressional policy objectives in enacting the income tests under those provisions. Therefore, pursuant to the authority under § 856(c)(5)(J)(i), we rule that the income from a pre-existing hedge will be considered as not constituting gross income under § 856(c)(2) or (c)(3), provided that such pre-existing hedging transaction was properly identified by the entity that acquired, originated or entered into the hedge. Similarly, the income from a pre-existing hedge that was not previously identified will be considered as not constituting gross income under § 856(c)(2) and (c)(3), provided that Taxpayer clearly identifies such pre-existing hedge (i) on the first day that Taxpayer or one of its disregarded entities or partnerships becomes a party to the hedge (including through conversion of a TRS to a disregarded entity or a partnership of Taxpayer or through acquisition of an M&A Target Entity that becomes a disregarded entity or a partnership of Taxpayer), or (ii) on the first day of the First REIT Taxable Year.

Caveats:

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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. Specifically, no opinion is expressed or implied on whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code. We further express no opinion on (a) the propriety of the amount of Taxpayer's net Section 481(a) Adjustment; (b) the propriety of Taxpayer's proposed method of depreciating the Steel Racking Structures under § 168; (c) whether the Steel Racking Structures are § 1245 property or § 1250 property for depreciation purposes; (d) whether the Steel Racking Structures constitute real property for depreciation purposes; or (e) the propriety of Taxpayer's proposed methods of amortizing the Contract Intangibles. We also express no opinion regarding whether the value that Taxpayer allocated to the Contract Intangibles was properly determined or whether some of the value that Taxpayer ascribes to the Contract Intangibles is properly attributable to some other intangible that would not qualify as real property for the purposes of § 856.

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 representative.

Sincerely,

Robert A. Martin
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)