Internal Revenue Service

Number: **201742013**
Release Date: 10/20/2017

Index Number: 856.01-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B03
PLR-106605-17
Date:
July 20, 2017

LEGEND:

REIT 1	=
REIT 2	=
REIT 3	=
Partnership	=
Retail Center	=
State A	=
State B	=
City	=
City Utility	=
State Initiative	=
A	=
B	=
C	=

Dear :

This letter responds to your letter dated February 23, 2017 and a subsequent submission, requesting a ruling on behalf of REIT 1 ("Taxpayer"), that, pursuant to section 856(c)(5)(J)(ii) of the Internal Revenue Code ("Code"), Taxpayer's income from the Base Solar Incentive Amount (as defined below) will be considered qualifying income for purposes of sections 856(c)(2) and (c)(3).

FACTS

Taxpayer is a State A limited liability company that has elected to be taxed as a real estate investment trust ("REIT") under sections 856 through 859 of the Code.

Collectively, Taxpayer, REIT 2, and REIT 3 wholly own Partnership, a State B limited liability company treated as a partnership for U.S. federal income tax purposes. Partnership, directly and through a disregarded entity, owns an A square foot, mixed-use shopping center ("Retail Center"). Partnership leases space at Retail Center to tenants for use as retail outlets. Retail Center features an anchor store and ancillary fueling station, upscale retail, boutique specialty shops, personal services, restaurants, a community center, and other retail outlets typically found in a mixed-use regional shopping center, along with associated common spaces, parking, and landscaping. Taxpayer represents that Retail Center is a building within the meaning of § 1.856-10(d)(2)(ii) of the Income Tax Regulations and is therefore real property within the meaning of § 1.856-10(b). Taxpayer also represents that the rental income that is generated from leasing space at Retail Center is qualifying income for purposes of sections 856(c)(2) and (c)(3).

The State Initiative mandates that all State B electric utilities implement a solar incentive program. In accordance with the State Initiative, the City Utility has established a solar incentive program ("Solar Incentive Program") that offers an estimated performance-based incentive ("Solar Incentive") to City Utility customers who purchase or lease and install solar PV systems and who meet certain other eligibility requirements, including a requirement that the solar PV system must be owned or leased by the building owner who is also the owner of the roof space or a City Utility customer who demonstrates their rights to the roof space for the duration of the incentivized period. The Solar Incentive consists of a one-time, lump sum, upfront payment that is the lesser of (1) the amount calculated by a formula that estimates the expected performance of the customer's solar PV system ("Incentive Formula") or (2) the net installed cost of the system, after any tax benefits or other outside funding sources are subtracted from the gross cost of the system. Thus, in no case will the amount of the Solar Incentive exceed the net installed cost of the solar PV system.

The Incentive Formula is based on the capacity of the solar PV system, adjusted to consider inverter and module losses, and a design factor that compares the estimated output of the solar PV system to the simulated output of an optimal reference system. These factors are multiplied by one of two incentive rates, depending on whether or not a participant in the Solar Incentive Program retains ownership of renewable energy credits ("RECs") or transfers the RECs to City Utility. The incentive rate for a City Utility customer that transfers its RECs to City Utility is $B per watt ("REC Incentive Rate"). The incentive rate for a customer that retains ownership of its RECs is $C per watt ("Base Incentive Rate").

Taxpayer represents that Partnership intends to purchase or lease and permanently install a solar PV system on the roof of Retail Center. Taxpayer represents that the solar PV system will be designed and intended to produce electricity only to serve Retail Center and that Partnership will not sell any electricity generated by the solar PV system to third parties. Taxpayer also represents that the solar PV system will be a structural component within the meaning of § 1.856-10(d)(3). Taxpayer intends for the solar PV system to comply with the terms of the Solar Incentive Program and allow Partnership to apply for and receive a Solar Incentive from City Utility. Taxpayer represents that Partnership intends to transfer any RECs that it receives in connection with the solar PV system and would therefore qualify for the REC Incentive Rate. Taxpayer is not seeking a ruling with respect to its receipt of any portion of the Solar Incentive that is attributable to the transfer of RECs to City Utility ("Solar Incentive REC Component"), and Taxpayer intends to treat such an amount as non-qualifying income for purposes of sections 856(c)(2) and (c)(3). The portion of the Solar Incentive that is not attributable to the transfer of RECs to City Utility is the "Base Solar Incentive Amount." Thus, Taxpayer intends to treat the difference between the Solar Incentive calculated using the REC Incentive Rate and the Solar Incentive calculated using the Base Incentive Rate as non-qualifying income for purposes of sections 856(c)(2) and (c)(3). Taxpayer is seeking a ruling under section 856(c)(5)(J)(ii) that the Base Solar Incentive Amount will be considered qualifying income for purposes of sections 856(c)(2) and (c)(3).

LAW AND ANALYSIS

Section 856(c)(2) provides that in order for a corporation to qualify as a REIT, at least 95 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from sources that include dividends; interest; rents from real property; gain from the sale or other disposition of stock, securities, and real property (other than section 1221(a)(1) property); abatements and refunds of taxes on real property; income and gain derived from foreclosure property; commitment fees; and gain from certain sales or other dispositions of real estate assets.

Section 856(c)(3) provides that in order for a corporation to qualify as a REIT, at least 75 percent of the corporation's gross income (excluding gross income from

prohibited transactions) must be derived from rents from real property, interest on obligations secured by mortgages on real property or interests in real property, gain from the sale or other disposition of real property (other than section 1221(a)(1) property), dividends from REIT stock and gain from the sale of REIT stock, abatements and refunds of taxes on real property, income and gain derived from foreclosure property, commitment fees to make loans secured by mortgages on real property or to purchase or lease real property, gain from certain sales or other dispositions of real estate assets, and qualified temporary investment income.

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 which (i) does not otherwise qualify under sections 856(c)(2) or (c)(3) may be considered as not constituting gross income for purposes of sections 856(c)(2) or (c)(3), or (ii) otherwise constitutes gross income not qualifying under sections 856(c)(2) or (c)(3) may be considered as gross income which qualifies under sections 856(c)(2) or (c)(3).

The legislative history underlying the tax treatment of REITs indicates that a central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, “[o]ne of the principal purposes of your committee in imposing restrictions on types of income of a qualifying real estate investment trust is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business.”

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

Income attributable to the receipt of the Base Solar Incentive Amount constitutes gross income not listed as qualifying income under sections 856(c)(2) or (c)(3). Taxpayer will earn the Base Solar Incentive Amount for purchasing or leasing and installing a solar PV system on the roof of Retail Center in accordance with the State Solar Initiative. In order to be eligible for the Solar Incentive Program, a solar PV system must be owned or leased by the building owner who is also the owner of the roof space or a party who demonstrates its rights to the roof space for the duration of the incentivized period. Taxpayer represents that Partnership intends to permanently install a solar PV system on the roof of Retail Center. Taxpayer also represents that the solar PV system, once completed, will be a structural component within the meaning of § 1.856-10(d)(3), that it will therefore be real property within the meaning of

§ 1.856-10(b), and that substantially all of the other income Taxpayer derives from Retail Center will be qualifying income for purposes of sections 856(c)(2) and (c)(3). Under these circumstances, treating income from the Base Solar Incentive Amount as qualifying income does not interfere with or impede the objectives of Congress in enacting sections 856(c)(2) and (c)(3). Accordingly, pursuant to section 856(c)(5)(J)(ii), the Base Solar Incentive Amount is treated as qualifying income for purposes of sections 856(c)(2) and (c)(3).

CONCLUSION

Based on the fact submitted and representations made by Taxpayer, we hereby rule that pursuant to section 856(c)(5)(J)(ii), Taxpayer's income from the Base Solar Incentive Amount is considered qualifying income for purposes of sections 856(c)(2) and (c)(3).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code. Additionally, no opinion is expressed regarding whether any credits or offsets earned in connection with the Solar Incentive Program constitute gross income, whether such income is qualifying income for purposes of section 856(c)(2) and (c)(3), and whether any credit or offset qualifies as real property for purposes of section 856.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a power of attorney on file, we are sending a copy of this ruling letter to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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.

Sincerely,

_____

Julanne Allen
Assistant Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Financial Institutions & Products)

Enclosure:
Copy for section 6110 purposes