Internal Revenue Service

Number: **201812009**
Release Date: 3/23/2018

Index Number: 856.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-136399-16

Date:
December 14, 2017

Legend:

Taxpayer =

State A =

Area =

Property A =

Property B =

Property C =

Dear :

This is in reply to a letter dated November 14, 2016, requesting a ruling on behalf of Taxpayer. Taxpayer requests a ruling that the provision of services described below does not give rise to impermissible tenant service income and will not cause rent received from tenants to be treated as other than rents from real property under section 856(d) of the Internal Revenue Code.

FACTS

Taxpayer is a State A corporation that has elected to be taxed as a real estate investment trust (REIT) under section 856 of the Code. Through disregarded entities,

Taxpayer wholly owns three separate residential properties in Area: Property A, Property B, and Property C (each a "Property" and collectively, the "Properties").

Description of the Properties

Each Property includes some or all of the following amenities that are available to all tenants of that Property at no additional cost: a swimming pool; an exercise room with exercise equipment, televisions, and water; sports courts and related equipment; a tennis court; a fire pit; a roof deck; a lounge with a television, a movie screen, and games; a kitchen; a picnic area with grills; a playground; a dog playground; a jogging path; laundry rooms; and a business center (collectively, the "Facilities").

Taxpayer represents that rent attributable to personal property that is leased under, or in connection with, any lease of the Properties does not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such lease.

Services provided at the Properties

Taxpayer provides the following services at each Property: leasing functions; wireless internet in common areas of the Property; ordinary and necessary maintenance functions such as service to HVAC, plumbing, and electrical systems, and repair of basic kitchen appliances and light fixtures in tenants' units; landscaping of the Property's grounds; security services; routine doorman services as described below; and routine maintenance, cleaning, and activities to ensure the safety and security of tenants and Taxpayer's property in the common areas, including the Facilities described above (collectively, the "Taxpayer Provided Services"). The doorman services provided at each Property include managing the flow of residents and non-residents into and out of the Property, monitoring security cameras and other security systems, admitting guests, receiving packages, assisting locked-out tenants, and acting as the first point of contact for an apartment emergency.

Taxpayer will also engage in occasional marketing activities (hereinafter, the "Marketing Services") to enhance its ability to attract new tenants and keep existing tenants. The Marketing Services are seasonal holiday parties and social events[1] to help bolster a positive atmosphere and feeling of community at the Properties, which will attract new tenants and induce current tenants to renew their leases. The Marketing Services will be available to all tenants, and not specifically to any particular tenant.

Taxpayer represents that the Taxpayer Provided Services and Marketing Services are customarily furnished or rendered in connection with the rental of real property in luxury apartment buildings located in the geographic area where the

[1] Social events may include a tasting event (for which a local merchant may donate products), a breakfast, a happy hour, an ice cream party, an outing, a bingo night, a raffle, or a pool party.

Properties are located. Taxpayer further represents that the Taxpayer Provided Services and Marketing Services are provided to all tenants and do not constitute personal services rendered to any particular tenant.

Services provided by a third party:

In addition to the services provided by Taxpayer, Taxpayer has hired independent contractors from whom it does not derive or receive any income to provide lifeguards at the pools, extermination services, and cable and internet.

LAW AND ANALYSIS

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, such lease.

Section 1.856-4(b)(1) provides that, for purposes of §§ 856(c)(2) and (c)(3), the term “rents from real property” includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services furnished to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class (such as luxury apartment buildings) are customarily provided with the service.

Section 1.856-4(b)(5)(ii) provides that trustees or directors of the REIT are not required to delegate or contract out their fiduciary duty to manage the trust itself, as distinguished from rendering or furnishing services to the tenants of the property or managing or operating the property. Thus, the trustees or directors may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the trust itself, including establishing rental terms, choosing tenants, entering into renewal of leases, and dealing with taxes, interest, and insurance relating to the trust’s property. The trustees may also make capital expenditures with respect to the trust’s property (as defined in section 263) and may make decisions as to repairs of the trust’s property (of

the type that would be deductible under section 162), the cost of which may be borne by the trust. See also Rev. Rul. 67-353, 1967-2 C.B. 252.

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of rents from real property. Section 856(d)(7)(A) defines impermissible tenant service income to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to the tenants of such property, or for managing or operating such property.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income exceeds one percent of all amounts received or accrued during any taxable year directly or indirectly by the REIT with respect to such property, the impermissible tenant service income of the REIT will include all of the amounts received or accrued with respect to the property. Section 856(d)(7)(D) provides that the amounts treated as received by a REIT for any impermissible tenant service shall not be less than 150 percent of the direct cost of the REIT in furnishing or rendering the service (or providing the management or operation).

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. For purposes of section 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income shall not be treated as furnished, rendered, or provided by the REIT, and there shall not be taken into account any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public

entrances, exits, stairways, and lobbies, and the collection of trash are not considered as services rendered to the occupant.

In determining whether a taxpayer has income that is impermissible tenant service income, only the income that is attributable to a provision of a service is analyzed. Although services may be provided in the Facilities, the Facilities themselves are not services. Income that is attributable to making available to all tenants at no additional cost a space such as one of the Facilities is not income from the provision of a service and is therefore not impermissible tenant service income. Any services (e.g., the Taxpayer Provided Services) that are provided in or with respect to the Facilities are analyzed as any other service provided to tenants.

Taxpayer has represented that the Taxpayer Provided Services and Marketing Services are customarily furnished or rendered in connection with the rental of real property in luxury apartment buildings located in the geographic area where the Properties are located. Taxpayer further represents that the Taxpayer Provided Services and Marketing Services are provided to all tenants and do not constitute personal services rendered to any particular tenant.

The income from the Taxpayer Provided Services and Marketing Services is, for purposes of determining whether the income is qualifying income for REIT qualification purposes, income that would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2) or is an activity that is a fiduciary duty to manage the trust itself. Taxpayer represents that any additional services are provided through independent contractors from whom Taxpayer does not derive or receive any income.

Accordingly, income from the Taxpayer Provided Services and Marketing Services is not impermissible tenant service income and, therefore, will not cause any portion of the rents received by Taxpayer from the tenants of each Property to fail to qualify as rents from real property under section 856(d).

CONCLUSION

Based on the facts and representations submitted, we rule that income from the Taxpayer Provided Services and Marketing Services is not impermissible tenant service income and, therefore, will not cause any portion of the rents received by Taxpayer from the tenants of each Property to fail to qualify as rents from real property under section 856(d).

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.

Furthermore, the ruling herein relates to whether income from services performed by Taxpayer is impermissible tenant service income and is specifically limited to whether the income is qualifying income for REIT qualification purposes. The definition of rents from real property under section 856(d) differs in scope and structure from the definition of rents from real property under section 512(b)(3), which applies to exempt organizations described in section 511(a)(2). Therefore, an exempt organization providing the same services may have unrelated business taxable income because the income may not be excluded under section 512(b)(3) as rents from real property.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

_____

Andrea M. Hoffenson
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)