Internal Revenue Service

Number: **201907001**
Release Date: 2/15/2019

Index Number: 856.01-00, 856.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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CC:FIP:B02
PLR-109705-18

Date:
November 16, 2018

Legend

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Dear :

This letter responds to a letter dated March 19, 2018, and subsequent submissions, requesting a ruling on behalf of Taxpayer. Taxpayer requests a ruling that amounts received by Taxpayer from unrelated third parties for the use of certain real property assets described below qualify as rents from real property under section 856(d) of the Internal Revenue Code for purposes of sections 856(c)(2) and (3).

FACTS

Taxpayer is a corporation that has elected to be taxed and has operated as a real estate investment trust (REIT) under sections 856 through 859 of the Code

beginning with its taxable year that ended on Date. Taxpayer principally invests in U.S. energy infrastructure assets and intends to acquire an offshore oil and gas platform, storage tank facilities, and pipelines, as described below.

A. Offshore Oil and Gas Platform

Taxpayer is negotiating to construct and lease an offshore oil and gas platform (the Platform) to an unrelated partnership (the Platform Lessee). Taxpayer represents that the Platform is real property for purposes of section 856.

The Platform will include equipment that is affixed to the Platform (the Equipment) that will (i) control the extraction of crude oil and gas produced by the Platform Lessee from existing or future undersea wells owned by the Platform Lessee or its partners and located within proximity to the Platform; (ii) separate oil, gas, and water from the fluid extracted from those wells; and (iii) condition the oil and gas for export in undersea oil and gas pipelines. Taxpayer represents that the Equipment is personal property for federal income tax purposes.

Taxpayer will enter into a multi-year lease with the Platform Lessee providing the Platform Lessee with the exclusive right to use the Platform and the Equipment (the Platform Lease). Taxpayer represents that the fair market value of any personal property, including the Equipment, leased to the Platform Lessee is less than 15 percent of the total fair market value of the real and personal property leased to the Platform Lessee.

The Platform Lessee will be solely responsible for operating, maintaining, and repairing the Platform, the Equipment, and any other property associated with the Platform. Taxpayer will not perform any activities, and no services will be furnished, in connection with the lease of the Platform or Equipment.

The rent paid by the Platform Lessee (the Platform Rent) will be computed based upon a fixed dollar amount per volumetric measure of product flowing through the Platform. The fixed dollar amount may change after a specified volume of product flows through the Platform. The fixed dollar amount may also change periodically pursuant to a formula set forth in the Platform Lease to reflect changes in crude oil or gas prices. Taxpayer also expects that the Platform Rent will include a specified minimum amount that will provide for a return of Taxpayer's invested capital associated with the construction of the Platform plus a market-based return thereon. Taxpayer represents that the Platform Rent will not depend, in whole or in part, on the income or profits of any person.

The Platform Lessee may sublease the Platform to one or more third parties during the term of the Platform Lease (the Platform Sublease). In this case, the sublessee will pay to the Platform Lessee a fixed amount of rent plus additional

payments based on volume. The Platform Lessee will be required to pay a negotiated percentage of approximately a percent of the gross revenue it receives from a sublease to Taxpayer as part of the Platform Rent under the terms of the Platform Lease. The Platform Lessee will be separately compensated for operating the Platform on behalf of the sublessee and will not pay any portion of that amount to Taxpayer. Taxpayer represents that the rent paid by the sublessee will not depend, in whole or in part, on the income or profits of any person.

B. Storage Tank Facilities

Taxpayer intends to purchase several storage tank facilities (the Storage Tank Facilities) from unrelated third parties. The Storage Tank Facilities include various interests in or rights to occupy land, driveways, roadways, docks, rail spurs, dikes, fencing, loading/unloading facilities, and storage tanks. The Storage Tank Facilities also include other types of real property, including pipes and inherently permanent steel structures such as racks or docks. Taxpayer represents that the Storage Tank Facilities are real property or interests in real property for purposes of section 856.

Taxpayer will enter into agreements with unrelated third-party users (each, a Storage User) with respect to the Storage Tank Facilities for a term that will generally be between b and c years, and in no event will be less than d (each, a Storage Agreement). Taxpayer represents that the fair market value of any personal property leased to a Storage User is less than 15 percent of the total fair market value of the real and personal property leased to the Storage User.

In some cases, a Storage Agreement will specify the particular tank or tanks in which the Storage User's product will be stored, and in other cases a Storage Agreement will provide the Storage User with a right to a fixed portion of the storage capacity at the respective Storage Tank Facility, but will not specify the specific tank or tanks. Taxpayer will not oversell storage capacity and will be obligated to ensure that the capacity specified in a Storage Agreement is reserved for the Storage User. A Storage Agreement may provide for the lease of a portion of the capacity of a tank when the stored content is fungible and may be stored on a comingled basis.

Taxpayer represents that it will only undertake activities with respect to the Storage Tank Facilities that are consistent with its fiduciary duty to manage the trust itself. Taxpayer will inspect, maintain, repair, and construct storage tanks and other real property assets located at the Storage Tank Facilities. These activities will include painting and repairing the storage tanks to prevent atmospheric corrosion or excessive wear and tear, testing product in the storage tanks to verify it is the product specified in the Storage Agreement solely to ensure the safety and integrity of the storage tanks and the safety of the environment, and providing security at the Storage Tank Facilities.

A taxable REIT subsidiary (TRS) will perform all services. These services will include loading, unloading, and moving product; adding agents or additives to product in a storage tank for the benefit of a Storage User; taking samples of product in a storage tank for the benefit of a Storage User; measuring or weighing product for the benefit of a Storage User; heating and circulating product as necessary to ensure the stored product retains the appropriate physical characteristics; and blending different products and maintaining the blended state of the products. The TRS will operate, maintain, and repair all equipment used to heat, circulate, and blend the products. The TRS will receive arm's length compensation from Taxpayer for the performance of all services. Taxpayer represents that, consistent with §1.856-4(b)(1), all services furnished to the Storage Users in connection with a Storage Agreement are customarily provided to tenants of similar properties in the geographic market in which the respective Storage Tank Facility is located.

The fee paid by a Storage User (the Storage Fee) will be calculated on a monthly basis and will be a fixed monthly amount for a prescribed amount of reserved storage capacity. The Storage User will pay the fixed monthly amount regardless of whether it uses the capacity reserved for it. In some cases, a Storage User will have the right to exceed the capacity reserved for it. In these cases, the Storage Fee will include an additional amount for the excess capacity computed based upon a fixed dollar amount set forth in the Storage Agreement multiplied by the volume of product stored. Fixed dollar amounts may change after a specified volume of product is stored. Fixed dollar amounts may also increase over time by an agreed upon amount, change periodically to reflect changes in the consumer price index or other public index commonly used as a benchmark for inflation, or both.

The Storage Fee will also include amounts paid for the services performed by the TRS, described above. Taxpayer represents that the Storage Fee will not depend, in whole or in part, on the income or profits of any person.

C. Pipelines

Taxpayer intends to purchase oil and gas pipelines (the Pipelines) from unrelated third parties. Taxpayer represents that the Pipelines are real property for purposes of section 856.

Taxpayer will enter into agreements with one or more unrelated third-party users (each, a Pipeline User) with respect to each Pipeline for a term that will generally be between b and e years, and in no event will be less than d (each, a Pipeline Use Agreement). Taxpayer represents that the fair market value of any personal property leased to a Pipeline User is less than 15 percent of the total fair market value of the real and personal property leased to the Pipeline User. Taxpayer will not oversell capacity in the Pipelines and will be obligated to ensure that the capacity specified in a Pipeline Use Agreement is reserved for the Pipeline User.

Taxpayer represents that it will only undertake activities with respect to the Pipelines that are consistent with its fiduciary duty to manage the trust itself. Taxpayer will inspect and monitor the physical condition of the Pipelines; mark the location of buried Pipelines to minimize the possibility of damage due to digging by unrelated parties; make decisions with respect to and supervise the maintenance, repair, and construction of the Pipelines; and test product as it enters the Pipelines to verify that it is the product specified in the Pipeline Use Agreement solely to ensure the safety and integrity of the Pipeline and the environment.

A TRS will perform all services. These services will include scheduling the use of the Pipelines with the Pipeline Users pursuant to the Pipeline Use Agreements, loading product on the Pipelines, and unloading product off the Pipelines. Some Pipelines will include compressors or pumps. A TRS will own, monitor, maintain, and operate all compressors or pumps. The TRS will receive arm's length compensation from Taxpayer for the performance of these services. Taxpayer represents that all services furnished to the Pipeline Users in connection with a Pipeline Use Agreement are customarily provided to tenants of similar properties in the geographic market in which the respective Pipeline is located within the meaning of §1.856-4(b)(1).

The fee paid by a Pipeline User (the Pipeline Use Fee) will be calculated on a monthly basis. In some cases, the Pipeline Use Fee will be a fixed monthly amount for a prescribed amount of reserved pipeline capacity. The Pipeline User will pay the fixed monthly amount regardless of whether it uses the capacity reserved for it. In some of these cases, a Pipeline User will have the right to exceed the capacity reserved for it. In these cases, the Pipeline Use Fee will include an additional amount for the excess capacity computed based upon a fixed dollar amount set forth in the Pipeline Use Agreement multiplied by the volume of product that exits the Pipeline. In other cases, the Pipeline Use Fee will be computed solely based upon a fixed dollar amount set forth in the Pipeline Use Agreement multiplied by the volume of product that exits the Pipeline. In these cases, the Pipeline User will agree to use the Pipeline for all of the product it extracts from a particular area or field, and Taxpayer will agree to accept and reserve capacity for that product. Fixed dollar amounts may change after a specified volume of product exits the Pipeline. Fixed dollar amounts may also increase over time by an agreed upon amount, change periodically to reflect changes in the consumer price index or other public index commonly used as a benchmark for inflation, or both.

The Pipeline Use Fee will also include amounts paid for the services performed by the TRS, described above. Taxpayer represents that the Pipeline Use Fee will not depend, in whole or in part, on the income or profits of any person.

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” includes (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 that is leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property for the taxable year 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.

Section 856(d)(2)(A) provides that, subject to certain exceptions, rents from real property does not include any amount received or accrued, directly or indirectly, with respect to any real or personal property, if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property (except that any amount so received or accrued will not be excluded from rents from real property solely by reason of being based on a fixed percentage or percentages of receipts or sales).

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from 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 the property, or for managing or operating the property.

Section 856(d)(7)(C) provides as an exception from impermissible tenant service income services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income or through a TRS of the REIT.

Section 1.856-4(a) defines “rents from real property” generally as the gross amounts received for the use of, or the right to use, real property of the REIT.

Section 1.856-4(b)(1) provides that, for purposes of sections 856(c)(2) and (c)(3), “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 the tenants of a particular building will be considered as 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)(3) provides in relevant part that, except as provided in §1.856-4(b)(6)(ii), no amount received or accrued, directly or indirectly, with respect to any real property (or personal property leased under, or in connection with, real property) qualifies as rents from real property if the determination of the amount depends in whole or in part on the income or profits derived by any person from the property. However, any amount so accrued or received will not be excluded from rents from real property solely by reason of being based on a fixed percentage or percentages of receipts or sales (whether or not receipts or sales are adjusted for returned merchandise, or Federal, State, or local sales taxes). An amount will not qualify as rents from real property if, considering the lease and all the surrounding circumstances, the arrangement does not conform with normal business practice but is in reality used as a means of basing the rent on income or profits.

Section 1.856-4(b)(6)(i) provides that, except as provided in §1.856-4(b)(6)(ii), if a REIT leases real property to a tenant under terms other than solely on a fixed sum rental (for example, a percentage of the tenant's gross receipts), and the tenant subleases all or a part of the property under an agreement that provides for a rental based in whole or in part on the income or profits of the sublessee, the entire amount of the rent received by the REIT from the prime tenant with respect to the property is disqualified as rents from real property.

Section 1.856-4(b)(5)(ii) provides that the trustees or directors of the REIT are not required to delegate or contract out their fiduciary duty to manage the REIT 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 REIT 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.

Taxpayer represents that the Platform, the Storage Tank Facilities, and the Pipelines are real property for purposes of section 856. The Platform Lease will be a multi-year lease that provides the Platform Lessee with the exclusive right to use the Platform. The Storage Agreements will typically have a term of b to c years, and the Pipeline Use Agreements will typically have a term of b to e years. No Storage Agreement or Pipeline Use Agreement will have a term of less than d. Each of the Storage Agreements and Pipeline Use Agreements will provide the user with the exclusive right to use a fixed portion of the capacity of the Storage Tank Facilities or the

Pipelines throughout the term of the lease. Taxpayer represents that the Platform Rent, the Storage Fee, and the Pipeline Use Fee will not depend, in whole or in part, on the income or profits of any person. With respect to the Platform Sublease, Taxpayer further represents that the rent paid by the sublessee will not depend, in whole or in part, on the income or profits of any person. The Pipeline Use Fees received by Taxpayer that are solely based upon the volume of product that exits the Pipeline are comparable to amounts received that are based upon a percentage of gross receipts. Accordingly, each of the Platform Rent, Storage Fee, and Pipeline Use Fee are an amount received for the use of, or the right to use, real property of Taxpayer and qualify as rents from interests in real property under section 856(d)(1)(A).

Taxpayer represents that it will not perform any activities, and no services will be furnished, in connection with the Platform. With respect to the Storage Tank Facilities and the Pipelines, Taxpayer represents that it will only undertake activities that are consistent with its fiduciary duty to manage the trust itself. A TRS will perform all services in connection with the Storage Tank Facilities and the Pipelines. Therefore, the activities performed by Taxpayer and the services furnished to the users detailed in the Facts section of this letter do not give rise to impermissible tenant service income. Taxpayer represents that all services furnished to the Storage Users in connection with a Storage Agreement are customarily provided to tenants of similar properties in the geographic market in which the respective Storage Tank Facility is located, and that all services furnished to the Pipeline Users in connection with a Pipeline Use Agreement are customarily provided to tenants of similar properties in the geographic market in which the respective Pipeline is located.

Taxpayer represents that the fair market value of any personal property leased to the Platform Lessee, a Storage User, or a Pipeline User is less than 15 percent of the total fair market value of the real and personal property leased to the respective tenant.

CONCLUSION

Based on the facts submitted and representations made by Taxpayer, we rule that the Platform Rent, Storage Fee, and Pipeline Use Fee received by Taxpayer qualify as rents from real property under section 856(d) of the Code for purposes of sections 856(c)(2) and (3).

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, we express no opinion regarding whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of chapter 1 of the Code.

Furthermore, we express no opinion regarding whether any assets are real property for purposes of section 856, any amount received by Taxpayer will depend on

the income or profits of any person, any activities are fiduciary duties to manage the REIT itself, any services are customarily provided to tenants of similar properties in the same geographic market, or any income attributable to personal property leased in connection with real property does not exceed 15 percent of the total rent under section 856(d)(1)(C).

This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) 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 ruling is being sent to your authorized representatives.

Sincerely,

_____

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

cc: