

Internal Revenue Service

Number: **202520010**

Release Date: 5/16/2025

Index Number: 856.00-00

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-122839-20

Date:

February 18, 2025

Legend:

Taxpayer =

Operating Partnership =

State A =

State B =

Date 1 =

Date 2 =

b =

c =

PLR =

Dear :

This is in reply to a letter dated October 3, 2020, and supplemental correspondence requesting several rulings under section 856 of the Internal Revenue Code ("Code").

Facts

Taxpayer is a publicly traded real estate investment trust (“REIT”) organized under State A law. Taxpayer elected to be taxed as a REIT under sections 856 through 859 beginning with its taxable year ended Date 1. Taxpayer conducts substantially all of its business and holds substantially all of its assets through Operating Partnership, a State B limited partnership taxed as a partnership for federal income tax purposes.

Taxpayer, together with Operating Partnership and its subsidiaries, (“Company Group”) acquires, builds, and leases temperature-controlled warehouses (“Warehouses”). The core business of Company Group is to provide tenants with temperature-controlled storage space and related handling services. Company Group provides space in its Warehouses to unrelated tenants under contracts that Taxpayer represents produce qualifying rents from real property pursuant to section 856(d) for the use of the space.¹ A Warehouse consists of separate rooms or areas that are each set to a specific temperature. Tenants use space in a Warehouse to store their goods at one of the specified temperatures. Included with the use of space, Company Group provides temperature reduction, tempering, blast freezing, rapid tempering, and handling services (as described below) in its Warehouses. Taxpayer’s taxable REIT subsidiaries (each a “TRS”) provide tenants with handling and other warehouse services.²

Temperature reduction and tempering, respectively, involve the lowering and raising of the temperature of goods by placing the tenant’s pallet of goods in a general temperature-controlled storage room or area that is set to a temperature that is lower (temperature reduction) or higher (tempering) than the temperature of the goods when placed in the room or area. The temperature of the room or area will gradually freeze or warm the products until they are at the proper temperature for storage.

Blast freezing involves the rapid freezing of a tenant’s pallet of goods. Company Group will use one of two different methods to provide blast freezing to its tenants: traditional blast cell systems and quick freeze technology systems (collectively, the “Rapid Freezing Systems”). For traditional blast cell systems, a tenant’s pallet is placed in a room where higher velocity air flow lowers the temperature of goods over b to c days. The quick freeze technology systems are integrated into the racking structure in the general cold storage area of a Warehouse and provide blast freezing through high-speed fans and sealing systems located within the racking structure. The sealing system forces high velocity air flow around the goods on the racking structure, freezing goods directly on the storage racks over b to c days. Taxpayer represents that the

¹ Taxpayer previously received PLR, concluding, among other things, that amounts received by the Taxpayer for providing space in its temperature-controlled storage Warehouses constitute rents from real property within the meaning of section 856(d) of the Code.

² In accordance with PLR, income from other warehouse services provided by the TRS is earned directly by the TRS and is not rendered by Taxpayer in connection with the lease of space to tenants in its Warehouses. Taxpayer represents that the provision of these other warehouse services does not generate rents from real property to Taxpayer and are not a part of this ruling request.

racking structures are real property as defined by section 1.856-10(b). After the use of either Rapid Freezing System, the frozen goods are moved to a general temperature-controlled storage room or area within the Warehouse by a TRS of Taxpayer.

Rapid tempering services (together with blast freezing, the “Rapid Services”) are provided by placing goods in a Rapid Freezing System which is set to a temperature that is higher than the current temperature of the goods. Once the goods are tempered over b to c days, the goods are then moved to a general temperature-controlled storage room or area within the Warehouse by a TRS of Taxpayer.

Tempering, temperature reduction, and the Rapid Services, are achieved through the provision of power or electricity to the temperature control systems within Company Group’s Warehouses. Taxpayer represents that the temperature control systems are integrated into Company Group’s Warehouses. Rooms and areas within temperature-controlled Warehouses are set at certain temperatures and are not individually adjusted for each tenant. Charges for tempering, temperature reduction, and the Rapid Services are attributable to Company Group’s equipment costs and the cost of power required to maintain the desired temperature in each room, area, or racking structure. The charges do not depend on which Rapid Freezing System is used; Company Group decides which system to use based on availability and efficiency. However, the Rapid Services include an additional handling charge (discussed below) not required by tempering or temperature reduction. Taxpayer represents that tempering, temperature reduction, and the Rapid Services are customarily provided by temperature-controlled storage facilities in the geographic markets in which Company Group’s Warehouses are located. Taxpayer further represents that temperature control and electricity are usually or customarily rendered in connection with the operation or maintenance of the Warehouses and are not rendered primarily for the convenience of tenants.

For safety and liability reasons, tenants are not granted access to Company Group’s Warehouses. Therefore, Taxpayer’s TRSs provide handling services to all tenants. Handling services include loading, unloading, and moving tenants’ pallets into, out of, and around the Warehouse. As stated above, the Rapid Services require an extra handling charge for moving the pallet out of the Rapid Services area and into the general temperature-controlled area once the goods reach their desired temperature (within b to c days). Charges for handling services are calculated based on an hourly rate that takes into account the costs of labor and equipment used in providing the handling services. Taxpayer represents that handling is customarily provided to tenants of temperature-controlled storage facilities in the geographic market in which each Company Group Warehouse is located.

Taxpayer represents that the fees for the tempering, temperature reduction, blast freezing, and handling services do not include any amount that depends, in whole or in part, on the income or profits derived by any person from the property within the meaning of section 856(d)(2)(A). Taxpayer will receive the fees for the tempering, temperature reduction, blast freezing and handling services. In certain cases, these

amounts may be collected by the TRS on behalf of and be remitted to, Taxpayer and Taxpayer will pay the TRS an arm's length amount for providing the handling services.

Company Group acquires cold storage warehouse businesses through stock acquisitions. Typically, Company Group's target companies depreciate racking as personal property rather than real property. Taxpayer's position is that the racking is more appropriately depreciated as real property. Accordingly, Taxpayer filed Form 3115, *Application for Change in Accounting Method*, under the automatic procedures described in Rev. Proc. 2015-13, 2015-5 IRB 419, to depreciate those assets as real property over longer useful lives beginning with the taxable year ended Date 2. A positive adjustment under section 481(a) ("Section 481(a) Adjustment") resulted from the method change. The Section 481(a) Adjustment was included in Taxpayer's taxable income ratably over a four-year period.

Company Group may lease space in its Warehouses to a TRS of Taxpayer where it is necessary for the TRS to conduct its operations. Taxpayer represents that either (1) at least 90 percent of the total space leased at each Warehouse will be leased to persons other than a TRS and persons who are related tenants with respect to Company Group, or (2) any rents paid by a TRS for space in that Warehouse will be treated as nonqualifying income for purposes of section 856(c)(2) and (3). Payments made by a TRS for the lease of space at a Warehouse will be arm's length and will be substantially comparable to rents paid by unrelated tenants for comparable space at the Warehouse or, where no such comparable space exists at the Warehouse, to rents paid for comparable space leased by unrelated tenants at other, similar warehouses in the same geographic area.

Law & Analysis

Ruling Request 1: Income derived from tenants for providing tempering, temperature reduction, the Rapid Services, and handling services will not constitute impermissible tenant service income under section 856(d)(7)(A) and will qualify as rents from real property under section 856(c)(2) and (3) if furnished or rendered in connection with the rental of real property the income from which otherwise qualifies as rents from real property under section 856(d).

Section 856(c)(2) provides that, 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 dividends; interest; rents from real property; gain from the sale or other disposition of stock, securities, and real property (other than property described in section 1221(a)(1)); abatements and refunds of taxes on real property; income and gain derived from foreclosure property; certain commitment fees; gain from certain sales or other dispositions of real estate assets; and certain mineral royalty income.

Section 856(c)(3) provides that, 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 on interests in real property; gain from the sale or other disposition of real property (other than property in described in section 1221(a)(1)); dividends or distributions on, and gains from the sale or disposition of, shares in other REITs; abatements and refunds of taxes on real property; income and gain derived from foreclosure property; certain commitment fees; gain from certain sales or other disposition of real estate assets; and qualified temporary investment income.

Section 856(d)(1) defines "rents from real property" as (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 which 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 1.856-4(a) of the Income Tax Regulations provides 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.

Section 1.856-4(b)(1) provides that 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 are customarily provided with the service. Examples of services which are customarily furnished to tenants of a particular class of buildings in many geographic marketing areas include water, heat, light, and air-conditioning. 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 tenant, to the guests, customers, or subtenants of the tenant.

Section 856(d)(2)(C), however, excludes impermissible tenant service income from the definition of rents from real property. Section 856(d)(7)(A) defines the term "impermissible tenant service income" to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants of the property, or for managing or operating such property. Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income exceeds a de minimis amount, which is one percent or less of all amounts received or accrued, directly or indirectly, by the REIT with respect to a particular property during the taxable year, the impermissible tenant service income of the REIT with respect to such property shall include all amounts received or accrued, directly or indirectly, by the REIT with respect to such property.

Section 856(d)(7)(C)(i) excludes from the definition of impermissible tenant service income amounts received for 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 a TRS of the REIT. In addition, section 856(d)(7)(C)(ii) excludes from the definition of impermissible tenant service income amounts that would be excluded from unrelated business taxable income (UBTI) under section 512(b)(3) if received by an organization described in section 511(a)(2).

Section 512(b)(3) provides, in relevant part, that rents from real property are excluded from the computation of UBTI. Section 1.512(b)-1(c)(5) provides that payments for the occupancy of space where services are also rendered to the occupant are not rents from real property. Generally, services are considered rendered to the occupant if they are primarily for the occupant's convenience and are other than those usually or customarily rendered in connection with the rental of 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, the collection of trash, etc., are not considered as services rendered to the occupant.

Company Group's Warehouses provide space to tenants in temperature-controlled settings. Heat is an example in a non-exhaustive list of services not considered rendered to the occupant under section 512. Similar to the provision of heat, Company Group provides tempering, temperature reduction, and the Rapid Services by setting a room or area's temperature control system to consistently maintain a specified temperature within a room or specified area. In this instance, tempering, temperature reduction, and the Rapid Services are achieved through the provision of power, or electricity, to operate the temperature control system used to cool or temper the spaces within each Warehouse. Taxpayer represents that the provision of tempering, temperature reduction, and the Rapid Services, including the provision of power or electricity to run the temperature control system, is a service that is usually and customarily rendered in connection with the rental of space in temperature-controlled storage facilities and is not primarily for the convenience of tenants. Taxpayer represents that rooms and specified areas within temperature-controlled Warehouses are set at certain temperatures and are not individually adjusted for each tenant. Additionally, Taxpayer represents that tenants do not choose which Rapid Freezing System is utilized for their pallets, but rather this decision is made by Company Group based on space and availability within the Warehouse. The income from the provision of tempering, temperature reduction, and the Rapid Services are similar to the income from the provision of heat and is also the provision of the utility of power, or electricity, and, therefore, for purposes of determining whether the income is qualifying income for REIT qualification purposes, is 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).

Company Group's tenants do not have direct access to stored pallets, nor do the tenants have exclusive use of defined space. Rather, the pallets must be handled in connection with the temperature reduction, tempering, and the Rapid Services, as well as upon receipt, during storage, and again to make them available to the tenants upon exiting the Warehouses. Taxpayer represents that handling, which will be provided to tenants by a TRS, is customarily provided to tenants of warehouses in the geographic market in which each Company Group Warehouse is located.

Additionally, Taxpayer represents that the fees for the tempering, temperature reduction, blast freezing, and handling services do not include any amount that depend, in whole or in part, on the income or profits derived by any person from the property within the meaning of section 856(d)(2)(A).

Accordingly, based on the information submitted and representations made, we conclude that amounts received by Company Group for the provision of tempering, temperature reduction, and Rapid Services, and for handling services performed by a TRS, do not constitute impermissible tenant service income pursuant to section 856(d)(7)(A) and will qualify as rents from real property under section 856(c)(2) and (3) if furnished or rendered in connection with the rental of real property the income from which otherwise qualifies as rents from real property under section 856(d).

Ruling Request 2: Pursuant to section 856(c)(5)(J), the Section 481(a) Adjustment will not constitute gross income for purposes of section 856(c)(2) and (3).

Section 481(a) provides that a taxpayer that changes its method of accounting takes into account necessary adjustments in computing its taxable income to prevent amounts from being duplicated or omitted.

Section 1.481-1(d) provides that a section 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.

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

As noted above, Taxpayer submitted Form 3115 to change its method of accounting for depreciating some of its assets. The method change resulted in the Section 481(a) Adjustment that is includible in taxable income ratably over a four-year period. Section 856(c)(2) and (3) list the sources of permissible income for a REIT.

Income from a section 481(a) adjustment is not specifically enumerated in section 856(c)(2) or (3).

Legislative history indicates that Congress intended part II of subchapter M to apply to certain “organizations specializing in investments in real estate and real estate mortgages.” H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960), 1960-2 CB 819, at 820. Congress intended to restrict the beneficial tax treatment of part II of subchapter M to “what is clearly passive income from real estate investments, as contrasted to income from the active operation of businesses involving real estate.” *Id.*

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

Excluding the Section 481(a) Adjustment from Taxpayer’s gross income for purposes of section 856(c)(2) and (3) does not interfere with Congressional policy objectives in enacting the income tests under those provisions. Accordingly, pursuant to section 856(c)(5)(J)(i), we conclude that the Section 481(a) Adjustment will not constitute gross income for purposes of section 856(c)(2) and (3).

Ruling Request 3: Payments received by Taxpayer from its TRS will not be treated as related-party rents and will qualify as rents from real property under section 856(d) pursuant to section 856(d)(8)(A).

Section 856(d)(2)(B) provides, in part, that except as provided in section 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 which 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 which is not a corporation, an interest of 10 percent or more in the assets or net profits of such person.

Section 856(d)(8) provides that rent received by a REIT from its TRS will not be excluded from rents from real property under section 856(d)(2)(B) if the terms of the limited rental exception of section 856(d)(8)(A) are met. The requirements of section 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 section 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 section 856(d)(2)(B)) are substantially comparable to such rents paid by the other tenants of the REIT’s property for comparable space.

Taxpayer represents that either at least 90 percent of the leased space of each Warehouse will be leased to persons other than a TRS and other related parties described in section 856(d)(2)(B), or any rents paid by a TRS with respect to that Warehouse will be treated as nonqualifying income for purposes of section 856(c)(2) and (3).

To meet the limited rental exception of section 856(d)(8)(A), amounts paid to a REIT by a TRS must be substantially comparable to rents paid by other tenants. Certain space rented within a Warehouse by a TRS, for example, in the performance of certain other warehouse services, is not fitted for use in the same way as the space that is used by Company Group's tenants in that Warehouse and, thus, the space rented by a TRS may not be comparable to the other leased space within the Warehouse. Taxpayer represents that payments made by a TRS to a member of Company Group for the lease of space in a Warehouse will be arm's length and will be substantially comparable to rents paid by unrelated tenants for comparable space at the Warehouse or, where no such comparable space exists at the Warehouse, to rents paid by unrelated tenants at other, similar warehouses in the same geographic area.

Accordingly, based on Taxpayer's representations, and provided at least 90 percent of the leased space in a Warehouse is leased to persons other than TRSs or related parties described in section 856(d)(2)(B), rents received by Company Group from a TRS for the leasing of space in a Warehouse will not be treated as related party rents and will be treated as rents from real property under section 856(d) through the application of section 856(d)(8)(A).

Conclusion

Based on the information submitted and representations made by Taxpayer, we rule that:

1. Income derived from tenants for providing tempering, temperature reduction, the Rapid Services, and handling services will not constitute impermissible tenant service income under section 856(d)(7)(A) and will qualify as rents from real property under section 856(c)(2) and (3) if furnished or rendered in connection with the rental of real property the income from which otherwise qualifies as rents from real property under section 856(d).
2. Pursuant to section 856(c)(5)(J), the Section 481(a) Adjustment will not constitute gross income for purposes of section 856(c)(2) and (3).
3. Payments received by Taxpayer from its TRS will be treated as rents from real property under section 856(d) through the application of section 856(d)(8)(A).

Caveats

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code. No opinion is expressed concerning whether the Rapid Freezing Systems are real property as defined by section 1.856-10(b). No opinion is expressed whether other warehouse services not mentioned in this letter qualify as rents from real property under section 856(d).

Furthermore, the ruling herein related to whether income from services performed by Company Group is impermissible tenant service income 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 service 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. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) provides that this ruling 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,

Andrea M. Hoffenson
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

CC: