

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200831020**
Release Date: 8/1/2008

Index Number: 856.02-00

Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:FIP:1
PLR-147246-07
Date:
April 15, 2008

Legend:

Taxpayer =

Holdings =

Corporation =

Parent =

LLC =

Partner =

State X =

State Y =

Year 1 =

a =

b =

c =

d =

e =

Dear _____ :

This is in reply to a letter in which Taxpayer requests a ruling concerning the proper treatment of Partner's lease rights under § 856 of the Internal Revenue Code. Taxpayer has requested rulings that Partner's lease rights constitute "interests in real property" pursuant to § 856(c)(5)(C) and thus are "real estate assets" under § 856(c)(5). In addition, Taxpayer requests a ruling that the income derived by Taxpayer from Partner's lease rights pursuant to the agreements constitutes "rents from real property" under §§ 856(c)(2) and (3).

Facts:

Taxpayer is a newly formed State X statutory real estate investment trust (REIT), which engages in acquiring, owning, managing, and operating real estate and related investments. Taxpayer intends to engage in a public offering of its securities in Year 1. Concurrently with or immediately prior to this public offering, Taxpayer intends to elect to be treated as a REIT under subchapter M of Chapter 1 of the Code.

Taxpayer is owned a percent by Holdings, a State Y limited liability company treated as a corporation for federal income tax purposes. Holdings is owned a percent by Corporation, a State Y corporation. Corporation is owned a percent by Parent, another State Y corporation. Corporation and Parent are members of an affiliated group of corporations, which file their federal income tax return on a consolidated basis.

Taxpayer owns a b percent interest in LLC, a State Y limited liability company. The remaining c percent interest in LLC is owned by Holdings. Holdings and Taxpayer entered into a joint venture with Partner pursuant to which Taxpayer acquired, indirectly through LLC, an interest in a portfolio of assets. In creating this joint venture, LLC contributed cash in exchange for a d percent interest in the portfolio and Partner transferred, as a part sale, part contribution, the portfolio of assets in exchange for an e percent interest.

The portfolio consists of lease interests acquired by Partner from landlords who have entered into certain leases with tenants. The underlying leases include (i) leases of land on which the tenant has installed communications equipment; and (ii) leases of building rooftops on which the tenant has installed communications equipment. The land and rooftops are collectively referred to as the "Premises".

After the execution of the underlying leases, Partner and the landlord enter into an agreement pursuant to which the landlord sells its rights under the leases to Partner. These lease interests, which are transferred by Partner to the joint venture partnership,

give Partner all the landlord's rights, title and interest to the leases, including the rights to:

- (i) receive and collect rent with respect to the Premises;
- (ii) commence, defend and compromise any action relating to a tenant's obligations;
- (iii) file any claim or proceeding related to the bankruptcy of a tenant;
- (iv) accept or decline the abandonment of the Premises by a tenant;
- (v) waive performance by a tenant of any of its obligations under the lease;
- (vi) terminate or revoke the lease pursuant to its terms;
- (vii) extend or renew the lease term or decline to do so;
- (viii) collect and receive any holdover rent;
- (ix) terminate any holdover tenancy;
- (x) determine the expiration date of the lease;
- (xi) grant or withhold consent to assignment or sublease by a tenant;
- (xii) take any actions permitted under law to be taken by the landlord;
- (xiii) access the Premises for such purposes as Partner deems appropriate; and
- (xiv) assign the foregoing rights without the consent of the landlord.

Each agreement between Partner and a landlord is entered into for valuable and fair consideration following arms length negotiations, and is not contingent on the receipt of any rents from the tenants. There is no affiliation between Partner and any of the landlords. Each agreement runs with the Premises and any subsequent purchaser would take the Premises subject to the agreement between Partner and the landlord. Moreover, for each agreement executed, an accompanying tenant notification letter is delivered to the tenant.

Each agreement provides that if and when a tenant's lease terminates or expires, Partner automatically becomes the ground tenant with the landlord for the Premises pursuant to a successor lease. Each agreement further provides that Partner may freely assign, mortgage, pledge, securitize or encumber some or all of its interest in the agreement and the leases, including its rights under the successor lease, without further notice to or consent of the landlord. Partner does not assume any of the landlord's obligations under the leases.

Taxpayer represents that (i) payments made to Partner pursuant to the leases are "triple-net" rental payments; (ii) Partner does not provide any services to the underlying tenants in connection with the agreements or leases; and (iii) Taxpayer will not own, directly or indirectly, in the case of a corporation, 10 percent or more of the voting power or value of the outstanding securities of any of the tenants or landlords, and in the case of any entity other than a corporation, 10 percent or greater interest in the assets or net profits of any of the tenants or landlords.

Law and Analysis:Issue 1:

Section 856(c)(4)(A) provides that at the close of each quarter of the 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) defines the term "real estate assets" to include real property (including interests in real property and interests in mortgages on real property). 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.

Section 1.856-3(d) of the Income Tax Regulations provides that the term "real property" includes 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 that 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 that 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 those items may be termed fixtures under local law.

Section 1.856-3(c) provides that the term interests in real property includes timeshare interests that represent undivided fractional fee interests or undivided leasehold interests in real property, and that entitle the holders of the interests to the use and enjoyment of the property for a specified period of time each year.

Rev. Rul. 71-286, 1971-2 C.B. 263, considers whether air rights over real property are considered "interests in real property" and thus are "real estate assets" within the meaning of § 856(c). The term air rights is defined as the long-term leasehold or fee simple ownership of the space above the ground that a landowner can occupy or use in connection with the land, plus necessary easements on the surface for support of structures erected in such air space. The revenue ruling concludes that the air rights are considered "interests in real property" and thus are "real estate assets" within the meaning of § 856(c).

Leases of building rooftops, comprised of physical space on the building rooftop together with rights to the use of the air space above the surface of the roof, constitute

“interests in real property” and thus are “real estate assets” within the meaning of § 856(c). In this case, because the underlying leases consist of leases of real property and leases of physical space on rooftops, the leases constitute “interests in real property” and thus are “real estate assets” within the meaning of § 856(c). Pursuant to the agreements between Partner and each landlord, Partner obtains the landlord’s rights under the leases between the landlord and the tenant. This purchase of rights by Partner creates an arrangement that is analogous to Partner holding a leasehold interest in real property. Therefore, the lease rights obtained by Partner under the agreements constitute “interests in real property” and thus are “real estate assets” within the meaning of §§ 856(c)(5)(B) and (C).

Section 1.856-3(g) provides that a REIT that is a partner in a partnership is deemed (1) to own its proportionate share of each of the assets of the partnership and (2) to be entitled to the income of the partnership attributable to that share. For purposes of § 856, the partner’s interest in the partnership’s assets is determined in accordance with the partner’s capital interest in the partnership. Based on this regulation, Taxpayer, through its interest in the joint venture partnership, will be treated as owning its proportionate share of Partner’s lease interests that Partner contributed to the joint venture.

Issue 2:

Section 856(c) of the Code provides that to qualify as a REIT, a corporation must: (i) derive at least 95 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in § 856(c)(2), which includes dividends, interest, rent from real property, and certain other items; and (ii) derive at least 75 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in § 856(c)(3), which include rents from real property and certain other items.

Section 856(d)(1) provides that “rents from real property” include (subject to exclusions provided in § 856(d)(2)) rents from interests in real property, charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated, and 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, the lease.

Under § 856(d)(2), rents will not qualify as “rents from real property” if (i) the rents are based, in whole or in part, on the income or profits of any person (provided, however, that rents based on a fixed percentage or percentages of sales are permissible); (ii) the rents are derived from a “related party tenant” (i.e., entity owned 10% or more by the REIT, actually or through attribution rules) or (iii) the rents constitute “impermissible tenant service income.” Section 856(d)(7) provides that rents

will constitute impermissible tenant service income if: (i) the services are not customarily rendered in connection with the rental of space for occupancy and primarily for the convenience of the tenant (i.e., maid service) or (ii) not performed through an independent contractor who is adequately compensated and from which the REIT derives no income, or a TRS.

As discussed above, Partner's lease rights constitute interests in real property. In addition, the agreements provide for fixed rental payments, not based on the income or cash flow of the underlying tenants. Further, none of the agreements (nor the leases) require Partner or the landlord to provide any services to the tenants which may be construed as giving rise to impermissible tenant service income under § 856(d). Therefore, the income associated with Partner's lease rights constitutes "rents from real property" within the meaning of § 856(d). Pursuant to § 1.856-3(g), Taxpayer, through its interest in the joint venture partnership, will be entitled to an allocable share of Partner's income associated with Partner's lease interests.

No opinion is expressed or implied with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M. 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,

Elizabeth A. Handler
Elizabeth A. Handler
Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)