

Internal Revenue Service

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Person To Contact:
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Date:
December 11, 2009

LEGEND:

Trust =

Operating Partnership =

Contractor =

State =

Building =

x =

y =

Dear :

This is in reply to your letter dated July 9, 2009, requesting a ruling that a third-party contractor be qualified as an independent contractor from whom Trust does not derive or receive any income for purposes of section 856(d)(7) of the Internal Revenue Code (Code).

FACTS

Trust is a State domestic corporation that has elected to be treated as a real estate investment trust (REIT). Trust is the managing general partner of Operating Partnership, owning approximately x percent of the outstanding common units of the Operating Partnership. The Operating Partnership, through business entities classified as taxable REIT subsidiaries, partnerships, and entities disregarded as separate from the Operating Partnership for Federal income tax purposes (Property-Owning Entities), owns and operates a diversified portfolio of numerous real properties throughout the United States (Properties). (Hereafter, Trust, the Operating Partnership, and the Property-Owning Entities will be referred to collectively as Taxpayer.)

Contractor is an independent construction services company that has provided various construction services (Services) to Taxpayer at certain of Taxpayer's Properties periodically. The Services generally involve the construction of various improvements to the Properties, including work in tenant space that would be considered non-customary services if performed by Taxpayer. All Services have been performed by Contractor for arm's-length amounts.

Taxpayer does not own any stock or any other interest in Contractor, either directly or indirectly, or through constructive ownership under section 318. To the best of Taxpayer's knowledge, Contractor does not own any stock or any other interest in Taxpayer, either directly or indirectly, or through constructive ownership under section 318. There is no overlapping ownership of Taxpayer and Contractor.

Taxpayer intends to continue to utilize Contractor to render Services at the Properties. Taxpayer intends to lease office space to Contractor at Building, an office building owned by Taxpayer, to serve as Contractor's office. The lease will be negotiated at arm's length, will be for a term of y years, and will contain a fixed rental amount. The lease terms will represent the fair market value of the office space. Other than rental income, Taxpayer will not derive or receive any income from Contractor or from the operation of Contractor's business.

Taxpayer believes that the lease of the office space at Building to Contractor will be conducive to Contractor's better provision of the Services to Taxpayer at both the Building and at other Properties owned by Taxpayer. Further, Taxpayer believes that such lease of office space at Building will allow Contractor to be more efficient in providing Services to Taxpayer.

LAW AND ANALYSIS

To qualify as a REIT, an entity must derive at least 95 percent of its gross income from sources listed in section 856(c)(2) and at least 75 percent of its gross income from sources listed in section 856(c)(3). Rents from real property are among the sources listed in sections 856(c)(2) and (3).

Section 856(d)(1) defines the term rents from real property as including (i) rents from interests in real property, (ii) charges for services customarily rendered in connection with the rental of real property, and (iii) rent attributable to certain leased personal property. Similarly, section 1.856-4(a) of the Income Tax Regulations provides that rents from real property generally means the gross amounts received for the use of, or the right to use, real property of the REIT.

Section 856(d)(2), in part, excludes from the term rents from real property any amount received or accrued directly or indirectly from (i) any corporation in which the REIT owns, directly or indirectly, 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 the corporation; (ii) in the case of a person that is not a corporation, any interest in 10 percent or more in the assets or net profits of such person; and (iii) any impermissible tenant service income, as defined in section 856(d)(7). Section 856(d)(5) provides (with certain modifications as to percentage) that for purposes of section 856(d), the rules prescribed in section 318(a) apply for determining ownership of stock, assets, or net profits of any person.

Section 856(d)(7)(A) defines the term impermissible tenant service income as any amount received or accrued, directly or indirectly by the REIT for (i) services furnished or rendered by the trust to the tenants of such property, or (ii) managing or operating such property. Section 856(d)(7)(C) provides an exception to that definition for services furnished or rendered, or management or operation provided, through an independent contractor from whom the trust itself does not derive or receive any income.

Section 856(d)(3) defines an independent contractor as any person who does not own directly or indirectly, more than 35 percent of the shares or certificates of beneficial interest in the REIT, and if such a person is a corporation, not more than 35 percent of the total combined voting power of whose stock, or if such person is not a corporation, not more than 35 percent of the interest in whose assets or net profits is owned, directly or indirectly, by one or more persons owning 35 percent or more of the shares or certificates of beneficial interest in the trust.

Section 1.856-4(b)(5)(i) of the Income Tax Regulations provides, in effect, that for purposes of determining whether a trust qualifies as a REIT, amounts received by the trust either directly or indirectly, shall not qualify as rents from real property if the trust furnishes services to the tenants of the real property or manages or operates the real property, other than through an independent contractor from whom the trust does not receive or derive any income. The relationship between such independent contractor and the trust must be arm's-length, and the independent contractor must be adequately compensated for any services rendered to the trust. The prohibition against the trust deriving or receiving any income from the independent contractor applies regardless of the source from which the income was derived by the independent contractor.

In Rev. Rul. 66-188, 1966-2 C.B. 276, the Service addressed whether amounts received by an unincorporated trust from tenants of property managed or operated by an independent contractor were rents from real property as defined in section 856(d)(3) of the 1954 Code, if the trust received any income from the independent contractor with respect to the property serviced, managed or operated by the independent contractor. The ruling stated that pursuant to section 1.856-4(b)(3) of the then current Income Tax Regulations, the income received by the trust did not constitute rents from real property as defined in section 856(d) because the trust also received rental income from the independent contractor. The Service concluded, however, that the provisions in section 1.856-4(b)(3) were not intended to apply to a REIT renting office space to an independent contractor for the independent contractor's own occupancy where the independent contractor's presence in an office on the REIT's premises is conducive to better management of the trust's property.

CONCLUSION

In this case, Taxpayer represents that Contractor is an independent contractor within the meaning of section 856(d)(3). The facts indicate that Contractor's lease at Building will be negotiated at arm's-length, will be for a fixed term, and will be for a fixed rental amount that reflects the fair market rental value for the office space. Furthermore, Contractor will be adequately compensated for any Services provided to Taxpayer. On the basis of the information submitted and the representations of Taxpayer, the facts and circumstances indicate that the leasing of office space at Building will be conducive to Contractor's better provision of Services to Taxpayer. We conclude, therefore, that the leasing of space to Contractor at Building will not cause Contractor to fail to qualify as an independent contractor from whom Taxpayer does not derive or receive any income for purposes of sections 856(d)(3) and 856(d)(7)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the Federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter under any other provision of the Code. Specifically, we do not rule whether Contractor qualifies as an independent contractor under section 856(d)(3) or whether Taxpayer qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

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 representative.

Sincerely,

Thomas M. Preston
Thomas M. Preston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)