

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Legend

- Taxpayer =
- State A =
- Date 1 =
- Property =
- Agreement =
- Provider A =
- Provider B =
- Systems =
- Equipment =
- Program =

Dear :

This is in reply to a letter dated October 18, 2016, requesting a ruling on behalf of Taxpayer. Taxpayer requests a ruling that certain amounts paid to Taxpayer by tenants, as described below, do not depend in whole or in part on the income or profits derived by any person from Property within the meaning of section 856(d)(2)(A) of the Internal Revenue Code.

Taxpayer is a State A corporation that will elect to be taxed as a real estate investment trust (“REIT”) under section 856 of the Code beginning with its taxable year ended Date 1. Taxpayer is a calendar-year, accrual-basis taxpayer that owns, and leases to tenants space within, Property. Taxpayer represents that Property is real property for purposes of section 856.

Prior to Taxpayer’s acquisition of Property, the prior owner of Property entered into Agreement with Provider A. Provider A assigned Agreement to its affiliate, Provider

B (Provider A and Provider B collectively referred to as “Provider”). In connection with its acquisition of Property, Taxpayer accepted and assumed Agreement. Pursuant to Agreement, Provider installed five Systems at Property.

Systems primarily consist of large Equipment that store electricity to be used at Property at a later time. Each System uses electricity from the grid utility to charge the Equipment during off-peak hours when the cost of electricity is cheaper. Taxpayer and tenants of Property then use the electricity stored in the Equipment during peak hours instead of purchasing electricity at the more expensive peak prices from the grid utility.

Taxpayer represents that Systems are and will continue to be owned by Provider, and Provider (or its subcontractors) has installed and maintained, and will continue to maintain, Systems at Provider’s expense. Provider has access rights at Property necessary to enable Provider to fulfill its obligations under Agreement. Taxpayer further represents that Provider is entitled to the benefit of any incentives, grants, reduced rate financing, or other assistance or benefits available for Systems or for the use of Systems at Property from any federal, state, or local government authority, utility, or other entity, including all Program financial incentives.

Under Agreement, Taxpayer is required to pay Provider a monthly fee (“the Charge”) for its and its tenants’ use of electricity from Systems. Taxpayer itself uses electricity at Property (including from Equipment) for one or more of the following reasons: (1) to supply power to common areas (e.g., hallway and lobby lighting, parking lot lighting, elevators, escalators); (2) to power landlord-controlled areas and personal property that landlord uses to provide tenants with services (e.g., security desk monitors, cleaning supply closets and janitor locker rooms); and (3) to power components of Property that serve tenants and common areas (e.g., HVAC systems, security systems, fire detection and suppression systems). Electricity at Property (including from Equipment) is also used by tenants with respect to their occupancy of space within Property.

The Charge is calculated based on Taxpayer’s energy cost savings from Provider’s operation of Systems at Property. Systems use and collect electricity from the grid utility during off peak (cheaper) hours and provide electricity to Taxpayer and tenants of Property during peak hours in lieu of Taxpayer purchasing electricity from the grid utility during peak hours. Therefore, the use of Equipment results in a net reduction in electricity costs at Property. Except for termination fees payable pursuant to a fixed schedule in the event Agreement is terminated early, Taxpayer represents that it does not and will not pay any other consideration to Provider. Taxpayer further represents that Provider does not pay Taxpayer for services or space under Agreement or otherwise. Taxpayer represents that Systems discharge electricity only for use at the Property or back to the grid utility.

In order to calculate the Charge, Provider processes historical energy usage data and current real time usage data through a proprietary algorithm that is designed to predict the future energy usage by Taxpayer and tenants of Property and their energy costs at Property. The algorithm then controls when Equipment charges from the grid utility to store energy and when Equipment discharges to provide electricity at Property. Based on actual energy usage from the grid utility at Property (including electricity used to charge Equipment) and from Equipment, Provider and a third party energy data company then calculate the energy cost savings for Property from Provider's operation of Equipment. The Charge equals 50 percent of these energy costs savings.

Under Taxpayer's leases to tenants at Property, utility charges are submetered. Taxpayer passes submetered utility usage costs through to tenants without any markup. Taxpayer represents the Charge is a cost incurred by Taxpayer for electricity used at Property. Taxpayer includes the allocable portion of the Charge with the allocable portion of the utility grid electricity costs in the separately stated electricity charges due under each tenant's lease.

LAW & 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 taxable year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(A) provides that rents from real property does not include amounts 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.

Section 1.856-4(b)(1) of the Income Tax Regulations provides that in particular geographic areas where it is customary to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of those utilities to tenants in the buildings will be considered a customary service.

Charges for electricity at Property include those from the grid utility and the Charge from Provider. The Charge from Provider is a fee for the use of electricity, just as the charges from the grid utility are fees for the use of electricity. The Charge is based on the cost savings provided by Systems, which results from using electricity from the grid utility during off-peak hours rather than peak hours. Neither the charges for electricity from the grid utility nor the Charge depend on the income or profits derived by any person from Property.

Therefore, the amounts paid to Taxpayer by tenants for the allocable portions of the Charge from Provider do not depend in whole or in part on the income or profits derived by any person from Property within the meaning of section 856(d)(2)(A).

CAVEAT

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. Additionally, no opinion is provided regarding whether the amounts paid by tenants of Property to Taxpayer otherwise qualify as rents from real property for purposes of section 856.

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,

Susan Thompson Baker
Susan Thompson Baker
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)