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Person To Contact:

ID No.

Telephone Number:

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Date:
July 5, 2017

LEGEND:

Taxpayer =

State =

Pipeline Transmission System A =

Pipeline Transmission System B =

Product A =

Product B =

User =

a =

b =

c =

d =

e =

f =

Dear _____ :

This ruling responds to a letter dated July 22, 2013, and subsequent submissions, requesting rulings on behalf of Taxpayer. Specifically, you have requested the following rulings:

1. The Dehydrator (as defined below) constitutes real property under section 1.856-10(b) of the Income Tax Regulations and is a “real estate asset” for purposes of sections 856(c)(4) and (c)(5) of the Internal Revenue Code (“Code”).
2. Amounts received under the User Agreement (as defined below), solely for the use of, or right to use, the real property in Pipeline Transmission System B constitute “rents from interests in real property” within the meaning of section 856(d)(1)(A).
3. The Activities (as defined below) undertaken by Taxpayer with respect to Pipeline Transmission System B, are among those activities that are allowed under section 1.856-4(b)(5)(ii) of the Income Tax Regulations for trustees or directors of a real estate investment trust (“REIT”) to undertake directly pursuant to their fiduciary duty to manage the Taxpayer itself, are not services rendered to the tenant in connection with the rental of real property, and accordingly, will not cause any rents received under the agreement described below to be excluded from “rents from real property” under section 856(d).

FACTS

Taxpayer is a publicly traded corporation incorporated in State. Taxpayer represents that it elected under section 856(c) to be treated as a REIT under part II of subchapter M of the Code. Taxpayer invests in assets of certain pipeline transmission systems (“Pipeline Transmission Systems”) by either owning such assets or making loans secured by such assets.

Each of Pipeline Transmission System A and Pipeline Transmission System B is a Pipeline Transmission System and is composed of the following: fee ownership, leases, and rights-of-way with respect to land; Pipelines (as defined below); and certain other assets.

The pipeline (“Pipeline”) in each Pipeline Transmission System provides a conduit for the delivery of a product. Taxpayer represents that each of the Pipelines is

designed, constructed, maintained, and intended to remain permanently in place and will be abandoned in place when it is no longer used.

Pipeline Transmission System A

Taxpayer owns Pipeline Transmission System A. Pipeline Transmission System A consists of two Pipelines, one approximately a miles long and the other approximately b miles long, as well as the leased rights-of-way for the use of land on which the Pipelines are located. These Pipelines are constructed of steel and high density polyethylene and are buried underground. Pipeline Transmission System A's Pipeline, which begins at certain production plants owned by third parties, provides a conduit for the delivery of Product A to wells that are owned by third parties who are unrelated to Taxpayer. These wells are used in the production of c. In addition to other assets, Pipeline Transmission System A contains a Dehydrator, as described below.

As Product A enters Pipeline Transmission System A, a dehydrator ("Dehydrator") removes moisture from Product A to protect the integrity of the Pipeline. Taxpayer represents that if the Dehydrator were removed from Pipeline Transmission System A, the Pipeline would corrode and its integrity would be compromised within a matter of days or weeks, and that the Pipeline would cease to provide a conduit for the delivery of Product A. Taxpayer further represents that the utility of Product A to the unrelated third parties using Product A in their wells is not improved by the removal of moisture because at the junction point between Pipeline Transmission System A and the wells, the mechanism owned and used by the third party producers of c injects Product A with water.

Taxpayer represents that the Dehydrator was installed during the construction of the Pipeline and is either bolted or fused to the Pipeline. Taxpayer represents that removing the Dehydrator would cause the Dehydrator to sustain damage, and would also damage the Pipeline because the Pipeline would corrode as a result of the removal of the Dehydrator. Taxpayer represents that the damage the Dehydrator would sustain during the removal process would not be so extensive as to preclude reusing it at a different location. Moreover, Taxpayer represents that the Dehydrator is designed to remain in place indefinitely because the Dehydrator is expensive to install and removing the Dehydrator is a complicated and expensive process. Furthermore, Taxpayer represents that the Dehydrator functions like a dehumidifier by removing moisture from the Pipeline. Taxpayer represents that the Dehydrator will remain in place when the tenant vacates the property.

Pipeline Transmission System B

Pipeline Transmission System B is currently owned by one of Taxpayer's taxable REIT subsidiaries ("TRS"). Taxpayer represents that upon the issuance of this letter, the TRS will distribute, either directly or by converting the TRS to a single member

limited liability company that will be treated as a disregarded entity for federal income tax purposes, Pipeline Transmission System B to Taxpayer (“Transaction”). Pipeline Transmission System B consists of approximately d miles of Pipeline and other related assets. Pipeline Transmission System B begins at User’s property line and extends through User’s property to various usage points. Pipeline Transmission System B’s Pipeline is constructed of carbon steel and high density polyethylene, is buried underground, and occupies space pursuant to a license granted by User. Pipeline Transmission System B includes regulators (“Regulators”), which are devices that are built into the Pipeline to regulate the pressure to ensure that the proper amount of pressure is maintained in the Pipeline. If the pressure is too great, the Pipeline might explode. Pipeline Transmission System B’s Pipeline provides a conduit for the transportation of Product B and e.

User has exclusive use of the entirety of Pipeline Transmission System B under an agreement with a term of f years (“User Agreement”). Taxpayer represents that currently the TRS receives a fixed monthly fee (“Base Fee”) from User for the use of Pipeline Transmission System B. The Base Fee is based on the length of Pipeline Transmission System B’s Pipeline and is subject to adjustment when the Pipeline is extended. Additionally, the Base Fee is increased by a fixed amount each year to reflect inflation.

After the Transaction, Taxpayer’s employees will perform only the following activities (“Activities”) with respect to Pipeline Transmission System B:

- (i) make decisions and supervise independent contractors in connection with the repair of Pipeline Transmission System B;
- (ii) make decisions and supervise independent contractors in connection with the maintenance of Pipeline Transmission System B;
- (iii) make decisions and supervise independent contractors in connection with the construction of additions to Pipeline Transmission System B;
- (iv) inspect the Regulators to ensure that they are in good repair, to ensure the safety of Pipeline Transmission System B;
- (v) mark the location of Pipeline Transmission System B if User or an unrelated person digs on User’s property to ensure that their activities do not result in damage to Pipeline Transmission System B; and
- (vi) walk the length of Pipeline Transmission System B every six months with a sniffer to ensure that Pipeline Transmission System B is sound and is not leaking.

Taxpayer will not have any relationship with or obligation to any retail customer of User, will not connect or disconnect any such retail customer of User from Pipeline Transmission System B, and will not render any services to any retail customer of User. Taxpayer represents that it is not related to User within the meaning of section 856(d)(2)(B), and that the Base Fee is a flat fee that is not based, in whole or in part, on the income or profits of any person within the meaning of section 856(d)(2)(A).

LAW AND ANALYSIS

Ruling 1:

Section 856(c)(4)(A) of the Code provides that, at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash, cash items (including receivables), and Government securities.

Section 856(c)(5)(B) of the Code defines the term "real estate assets," in part, to mean real property (including interests in real property and interests in mortgages on real property). Section 1.856-3(b)(1) provides that the term "real estate assets" means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or other improvements thereon), and shares in other qualified REITs.

Section 1.856-10(b) provides that the term "real property" means land and improvements to land. Local law definitions are not controlling for purposes of determining the meaning of the term real property. Section 1.856-10(d)(1) provides that the term "improvements to land" generally means inherently permanent structures and their structural components. Section 1.856-10(d)(2)(i) provides that the term "inherently permanent structure" means any permanently affixed building or other permanently affixed structure. Affixation may be to land or to another inherently permanent structure and may be by weight alone. If the affixation is reasonably expected to last indefinitely based on all the facts and circumstances, the affixation is considered permanent. A distinct asset that serves an active function, such as an item of machinery or equipment, is not a building or other inherently permanent structure.

Section 1.856-10(d)(2)(iii)(A) provides that, in general, other inherently permanent structures serve a passive function, such as to contain, support, shelter, cover, protect, or provide a conduit or a route, and do not serve an active function, such as to manufacture, create, produce, convert, or transport. Section 1.856-10(d)(2)(iii)(B) provides a list of distinct assets that may qualify as other inherently permanent structures if they are permanently affixed. Permanently affixed pipelines are included in the list of inherently permanent structures found in section 1.856-10(d)(2)(iii)(B).

Section 1.856-10(d)(3)(i) defines the term “structural component” to mean any distinct asset that is a constituent part of and integrated into an inherently permanent structure, serves the inherently permanent structure in its passive function, and, even if capable of producing income other than consideration for the use or occupancy of space, does not produce or contribute to the production of such income. In addition, among other requirements, a structural component may qualify as real property only if the REIT holds its interest in the structural component together with a real property interest in the space in the inherently permanent structure served by the structural component. Section 1.856-10(d)(3)(ii) provides a list of distinct assets and systems that may qualify as structural components if integrated into the inherently permanent structure and held together with a real property interest in the space in the inherently permanent structure served by that distinct asset or system. Dehydrators are not included in the list of structural components found in section 1.856-10(d)(3)(ii).

Section 1.856-10(d)(3)(iii) provides that if an interest in a distinct asset (within the meaning of section 1.856-10(e)) is held together with a real property interest in the space in the inherently permanent structure served by that distinct asset and that asset is not otherwise listed in section 1.856-10(d)(3)(ii) or in guidance published in the Internal Revenue Bulletin, the determination of whether that asset is a structural component is based on all the facts and circumstances. In particular, the following factors must be taken into account: (A) the manner, time, and expense of installing and removing the distinct asset; (B) whether the distinct asset is designed to be moved; (C) the damage that removal of the distinct asset would cause to the item itself or to the inherently permanent structure to which it is affixed; (D) whether the distinct asset serves a utility-like function with respect to the inherently permanent structure; (E) whether the distinct asset serves the inherently permanent structure in its passive function; (F) whether the distinct asset produces income from consideration for the use or occupancy of space in or upon the inherently permanent structure; (G) whether the distinct asset is installed during construction of the inherently permanent structure; and (H) whether the distinct asset will remain if the tenant vacates the premises.

Taxpayer represents that it owns both the Pipeline and the Dehydrator in Pipeline Transmission System A, and that the Dehydrator alters the contents of Pipeline Transmission System A’s Pipeline because it removes moisture from Product A. Taxpayer represents that the unrelated third parties using Product A in their wells do not benefit from the removal of moisture from Product A. Taxpayer further represents that the Dehydrator’s sole purpose is to keep the Pipeline from corroding and to protect the integrity of the Pipeline as a conduit for Product A. Taxpayer also represents that the Dehydrator is either bolted or fused to Pipeline Transmission System A’s Pipeline. By removing the moisture from Product A, the Dehydrator facilitates the use of Pipeline A as a conduit for Product A, and therefore serves the Pipeline in its passive function of providing a conduit for the delivery of Product A, which is a passive function under section 1.856-10(d)(2)(iii).

In addition, the Dehydrator: (A) is time consuming and expensive to install and remove from the Pipeline; (B) is designed to remain in place indefinitely; (C) if removed, would sustain damage and would also damage the Pipeline; (D) functions like a dehumidifier, which performs a utility-like function by removing moisture from the Pipeline; (E) serves the Pipeline in its passive function of providing a conduit for Product A; (F) has the sole purpose of protecting the integrity of the Pipeline and is not required by or is useful to the end user, and accordingly, does not produce or contribute to the production of income other than from consideration for the use or occupancy of space within the Pipeline; (G) was installed during construction of the Pipeline; and (H) will remain in place when the tenant vacates the property. Notwithstanding that the Dehydrator alters the contents of Pipeline Transmission System A's Pipeline because it removes moisture from Product A and that upon removal the Dehydrator would not sustain damage as to render it unusable at another location, the factors described above support the conclusion that the Dehydrator is a structural component of Pipeline Transmission System A's Pipeline.

Accordingly, based on the information submitted and representations made, we conclude that the Dehydrator, as described above, is a structural component of Pipeline Transmission System A's Pipeline and, therefore, constitutes real property under section 1.856-10(b) and is a real estate asset for purposes of sections 856(c)(4) and (c)(5).

Ruling 2:

Section 856(c)(2) of the Code provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property" and interest. 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" and "interest on obligations secured by mortgages on real property or on interests in 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 tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 1.856-4(a) defines the term "rents from real property" generally as the gross amounts received for the use of, or the right to use, real property of the REIT. Permanently affixed pipelines are included in the list of inherently permanent structures found in section 1.856-10(d)(2)(iii)(B).

With respect to Pipeline Transmission System B, Taxpayer represents that pursuant to the User Agreement it will receive a fixed amount based on the length of Pipeline B and the User will be the sole user of Pipeline Transmission System B for a term of f years. This arrangement is similar to a lease arrangement because it is for the use of space in or upon real property. Accordingly, amounts received under the User Agreement, solely for the use of, or right to use, the real property in Pipeline Transmission System B will constitute “rents from interests in real property” within the meaning of section 856(d)(1)(A).

Ruling 3:

Section 1.856-4(b)(5)(ii) provides that trustees or directors of the REIT are not required to delegate or contract out their fiduciary duty to manage the trust 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 trust 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 it will only undertake the Activities with respect to Pipeline Transmission System B. Trustees or directors of Taxpayer may undertake fiduciary functions as provided in §1.856-4(b)(5)(ii). The Activities are fiduciary duties that the Taxpayer is permitted to undertake pursuant to section 1.856-4(b)(5)(ii). Accordingly, the Activities undertaken by Taxpayer with respect to Pipeline Transmission System B, are among those activities that are allowed under section 1.856-4(b)(5)(ii) for trustees or directors of Taxpayer. Therefore, the Activities undertaken by the trustees or directors of Taxpayer pursuant to their fiduciary duty to manage Taxpayer will not cause any rents received under the agreement described above to be excluded from “rents from real property” under section 856(d).

CONCLUSIONS

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

1. The Dehydrator described above constitutes real property under section 1.856-10(b) and is a “real estate asset” for purposes of sections 856(c)(4) and (c)(5).

2. Amounts received under the User Agreement, solely for the use of, or right to use, the real property in Pipeline Transmission System B will constitute “rents from interests in real property” within the meaning of section 856(d)(1)(A).
3. The Activities undertaken by Taxpayer with respect to Pipeline Transmission System B are among those activities that are allowed under section 1.856-4(b)(5)(ii) for trustees or directors of Taxpayer to undertake pursuant to their fiduciary duty to manage Taxpayer, are not services rendered to the tenant in connection with the rental of real property, and will not cause any rents received under the agreement described above to be excluded from “rents from real property” under section 856(d).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. 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, no opinion is expressed concerning whether the Dehydrator or any other asset described herein constitutes real property for purposes of any section of the Code other than section 856. Furthermore, no opinion is expressed concerning any services performed by Taxpayer or the TRS. Finally, no opinion is expressed whether Taxpayer otherwise qualifies as a REIT under subchapter M, part II 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 representatives.

Sincerely,

Julanne Allen
Assistant to the Branch Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosure:
Copy of this for section 6110 purposes