

Internal Revenue Service

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Legend

Taxpayer	=
State A	=
Operating Partnership	=
Facilities	=
Systems	=
Fixtures	=
<u>X</u>	=
<u>Y</u>	=

Dear :

This is in reply to a letter dated April 3, 2018, requesting a ruling on behalf of Taxpayer. Taxpayer requests a ruling that certain amounts paid to Operating Partnership by tenants, as described below, do not depend in whole or in part on the income or profits derived by any person from Facilities leased by Operating Partnership within the meaning of section 856(d)(2)(A) of the Internal Revenue Code.

FACTS

Taxpayer is a State A corporation that has elected to be taxed as a real estate investment trust (“REIT”) under sections 856 through 859. Taxpayer’s activities primarily occur through Operating Partnership. Operating Partnership leases Facilities to tenants.

As part of a new program, Operating Partnership is offering to enter into agreements with its existing tenants of Facilities to install Systems in place of Fixtures in

Facilities (“the Agreements”). For the typical project, the installation of Systems is expected to take x to y weeks, depending on the size of the tenant’s space. Metering devices will also be installed to track energy usage. Taxpayer represents that costs related to the installation of Systems and the metering devices will be borne by Operating Partnership. Taxpayer expects Operating Partnership to enter into similar arrangements with any new tenants that lease Facilities. However, the arrangements are expected to be integrated in the new tenant’s lease, rather than a separate agreement.

Currently, Operating Partnership offers two types of leases to its tenants of Facilities. Tenants pay a monthly base amount plus either: (1) the tenant’s share of actual operating expenses; or (2) a fixed amount for operating expenses. In addition, tenants are directly responsible for amounts paid to the utilities provider for electricity. Under the Agreements, tenants will be required to pay Operating Partnership a monthly fee (“the Charge”) for tenant’s use of Systems. The Charge is in addition to the payments tenants must make under the tenant’s existing lease agreements.

The Charge is calculated based on the tenant’s energy cost savings from using Systems. Systems use less kilowatt hours (“kWh”) than Fixtures. Therefore, the use of Systems results in a net reduction in electricity costs at Facilities. The Charge is calculated by multiplying a fixed rate per kWh by the amount of kWh saved by using Systems. The amount of kWh saved is the difference between the actual kWh used as determined by the metering device and either the amount of kWh that was historically used under the old system or a stipulated amount. Taxpayer represents that costs related to the monitoring of energy savings will be borne by Operating Partnership.

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, such 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.

The Charge is a fee for the use of Systems. The Charge is based on the electricity cost savings provided by Systems, which results from the fact that Systems use less electricity than Fixtures. The Charge does not depend on the income or profits derived by any person from Facilities.

CONCLUSION

Based on the facts and representations submitted, we rule that the Charge paid by tenants does not depend in whole or in part on the income or profits derived by any person from Facilities within the meaning of section 856(d)(2)(A).

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 Facilities 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,

Andrea M. Hoffenson
Andrea M. Hoffenson
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)