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**Legend:**

Taxpayer =

Partnership =

Date =

State =

Dear :

This is in reply to a letter dated October 20, 2017, and supplemental correspondence, requesting a ruling on behalf of Taxpayer. Taxpayer requests the following rulings: (1) a ruling that the Lease Rights constitute real estate assets under section 856(c) of the Internal Revenue Code, and (2) a ruling that the rent Taxpayer receives for the use of certain ground leases does not depend, in whole or in part, on the income or profits derived by any person from the property subject to each of the ground leases.

FACTS

Taxpayer is a privately held corporation organized under the laws of State. Partnership owns all of the common stock of Taxpayer and unrelated parties own the preferred stock. Taxpayer elected to be taxed as a real estate investment trust (“REIT”) under sections 856 through 859 beginning with its taxable year that ended Date. Taxpayer was formed as part of a restructuring undertaken by Partnership in which Partnership contributed certain wholly-owned special-purpose entities (“SPEs”) that held

Partnership's operating assets, including the Lease Rights, as defined below, to Taxpayer. As a result of the restructuring, Taxpayer now holds the Lease Rights.

Taxpayer earns revenue from leases of land, building rooftops, and other assets that constitute real property under section 1.856-10 of the Income Tax Regulations (collectively, the "Sites"). Typically the fee owner of a Site leases the Site to a third-party tenant (the "Ground Leases"), and the third-party tenant

At some point during the term of the Ground Lease, Partnership acquired (and Taxpayer now holds) or Taxpayer acquired, the fee owner's right, title, and interest in the Ground Leases (the "Lease Rights").

As a result of its acquisition of the Lease Rights, Taxpayer obtained all of the fee owner's rights under the Ground Leases. The agreements conveying the Lease Rights run with the land and any subsequent purchaser of a Site would be subject to the terms of the relevant agreement. Taxpayer may pledge, assign, mortgage, grant a security interest in, or otherwise encumber the Lease Rights. As long as it was economical to do so (based on the value of a Ground Lease) the Partnership took out, and Taxpayer now holds, title policies for the Lease Rights. Either the Partnership has recorded, or Taxpayer will record, the agreements or memoranda of the agreements conveying the Lease Rights with the appropriate office in the county in which each Site is located.

In addition, Taxpayer has a successor lease or an option to enter into a successor lease with respect to each of the Sites. Each successor lease provides that upon termination or expiration of a Ground Lease, Taxpayer automatically becomes the tenant on that Site on terms consistent with those contained in the terminated Ground Lease, except that Taxpayer has no obligation to pay any rent or other consideration to the lessor. Each successor lease runs until a date specified in the Lease Rights purchase agreement and expressly permits Taxpayer to sublease the Site to a substitute third-party tenant until such date. An option to enter into a successor lease is exercisable upon the termination or expiration of the Ground Lease and permits Taxpayer to enter into a successor lease with respect to the Site. Therefore, in the event that a third-party tenant that is subject to a Ground Lease vacates the Site or the underlying Ground Lease expires, Taxpayer's successor lease, or option thereon, permits Taxpayer to establish requisite right, title and interest in such Site to enter into a replacement ground lease with a substitute third-party tenant.

With respect to certain Ground Leases of Sites used for billboards, the third-party tenant pays a percentage rent in addition to, instead of, or insofar as it exceeds, a fixed base rent. Percentage rent is equal to the specified percentage of a third-party tenant's gross revenue or receipts from the billboards reduced by agency fees and continuity discounts.

In certain cases, the third-party tenant pays an agency fee to an advertising agency for locating a billboard customer to advertise on the billboard at the Site. The amount of the fee is added to the rent charged by the third-party tenant in order to reimburse the third-party tenant for the fee it paid to the advertising agency.

In other cases, the third-party tenant receives rent from the billboard customer but pays a portion of the rent received back to the billboard customer in the form of a continuity discount. Continuity discounts are paid to a customer for committing to place their advertisements on multiple billboards owned by a third-party tenant or for using a specific billboard for an extended period of time. Rather than reducing the rent charged, a third-party tenant will reimburse or rebate the continuity discount to the billboard customer once certain thresholds are met.

### 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 856(c)(5)(C) defines the term "interests in real property" to include 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.

Section 1.856-10(f)(1) of the regulations provides that to the extent an intangible asset derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of space, the intangible asset is real property or an interest in real property.

Section 1.856-10(f)(2) provides that a license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold or easement generally is an interest in real property. A license or permit to engage in or operate a business is not real property or an interest in real property if the license or permit produces or contributes to the production of income other than consideration for the use or occupancy of space.

The Lease Rights are intangible assets that derive their value from the underlying Site or lease thereon. Furthermore the Lease Rights are not separable from the underlying Site and lease. The Lease Rights only contribute to the production of rental

income for use of the Site, and thus do not contribute to the production of income other than consideration for the use or occupancy of space.

The Lease Rights are in the nature of a leasehold interest. Unlike a license or permit, the lease rights are not contracts with respect to the property. However the Lease Rights provide an interest in rights under a lease with respect to real property, and the operation of the successor lease, or option thereon, converts the Lease Rights into a traditional lease.

Accordingly, based on the information submitted and representations made, we conclude that the Lease Rights, as described above, constitute real property under section 1.856-10(f) and are real estate assets for purposes of section 856(c)(4).

Ruling 2:

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 such 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 do not include any amount 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 (except that any amount so received or accrued shall not be excluded from the term "rents from real property" solely by reason of being based on a fixed percentage or percentages of receipts or sales).

Section 1.856-4(b)(3) of the regulations provides, in part, that rent may be based on a fixed percentage or percentages of receipts or sales whether or not the receipts or sales are adjusted for returned merchandise, or Federal, state, or local sales taxes. The regulations provide that rents from real property include rents where the lease provides for differing percentages of receipts or sales from different departments or from separate floors of a retail store so long as each percentage is fixed at the time of entering into the lease and a change in such percentage is not renegotiated during the term of the lease. See also, Rev. Rul. 74-134, 1974-1 C.B. 170 (Rents received by a

REIT based on a percentage of a tenant's gross sales, but excluding from gross sales returns of merchandise, exchange of merchandise between stores of the tenant, sales of used fixtures, and sales and excise taxes, qualify as "rents from real property" within the meaning of section 856(d) of the Code.)

The agency fees are transaction fees akin to sales taxes or credit card fees in a retail merchandise business. Unlike general costs of doing business, these types of fees are specific to each transaction. The third-party tenant adds the agency fees to the rent paid by the billboard customer so that the fees are born by the specific customer. Therefore, deducting the agency fees from the rent received by the third-party tenant results in a percentage rental amount that more accurately reflects the third-party tenant's gross receipts from the property. Likewise, the continuity discount paid to the billboard customer effectively reduces the rent paid by the customer to the third-party tenant. If the gross receipts of the third-party tenant were not reduced by the continuity discount, the gross receipts would overstate the amount of rent received by the third-party tenant from its customer. Thus, adjusting a third-party tenant's percentage rent for a billboard Site by agency fees and continuity discounts more accurately reflects the third-party tenant's gross receipts and does not cause the rent received by Taxpayer to be based on the income or profits of any person.

#### CONCLUSION

We hereby rule that (1) the Lease Rights constitute real property under section 1.856-10(f) and are real estate assets for purposes of section 856(c)(4), and (2) the percentage rent paid by Taxpayer's tenants of billboard Sites as adjusted for agency fees and continuity discounts does not depend in whole or in part on the income or profits derived by any person at the billboard Site within the meaning of section 856(d)(2)(A).

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 with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code. Additionally, except for the specific ruling regarding section 856(d)(2)(A), no opinion is expressed as to whether Taxpayer otherwise has qualifying rents from real property with respect to the Lease Rights.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury

statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

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