

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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CC:FIP:B03
PLR-102160-19

Date:
November 04, 2021

LEGEND

Taxpayer 1 =

Taxpayer 2 =

State =

Date 1 =

Date 2 =

Date 3 =

UPREIT LLC =

UPREIT LP =

a =

b =

Master Lease =

Other Leases =

Building Base =
Rent

Facility =

Agreement =

Dear _____ :

On September 28, 2012, the Internal Revenue Service (“Service”) issued PLR 201337007 (PLR-127348-11) to Taxpayer 2. PLR 201337007 includes certain rulings with respect to the Proposed Transaction described in the PLR. The Proposed Transaction involved Taxpayer 1 and Taxpayer 2. (Taxpayer 1 and Taxpayer 2, collectively, “Taxpayers”).

Ruling 47 in PLR 201337007 states: “UPREIT LP’s receipt of Percentage Rent payments under the Master Lease and the specified adjustments to amounts payable

under the Master Lease pursuant to the Escalation and the Other Adjustments will not cause any amounts received under the Master Lease to be treated as other than ‘rents from real property’ under § 856(c)(2)(C) and 856(c)(3)(A).” UPREIT LP is a% owned by UPREIT LLC and b% owned by Taxpayer 1. UPREIT LLC is a single member LLC owned by Taxpayer 1.

On Date 2, the Service notified your authorized representatives that the Service was reconsidering the portion of Ruling 47 that provides that the specified adjustments to amounts payable under the Master Lease pursuant to the Escalation and the Other Adjustments will not cause any amounts received under the Master Lease to be treated as other than rents from real property under section 856(c)(2)(C) and 856(c)(3)(A) of the Internal Revenue Code (“Code”).

The Service has determined that this portion of Ruling 47 is not in accord with the current views of the Service. Section 11.04 of Rev. Proc. 2021-1, 2021-1 I.R.B. 1, provides that a letter ruling found to be in error or not in accordance with the current views of the Service may be revoked or modified. Accordingly, the portion of Ruling 47 in PLR 201337007 that provides that the specified adjustments to amounts payable under the Master Lease pursuant to the Escalation and the Other Adjustments will not cause any amounts received under the Master Lease to be treated as other than rents from real property under section 856(c)(2)(C) and 856(c)(3)(A) is revoked.

Section 11.04 of Rev. Proc. 2021-1 also provides that if a letter ruling is revoked or modified, the revocation or modification applies to all years open under the period of limitation unless the Service uses its discretionary authority under section 7805(b) to limit the retroactive effect of the revocation or modification. Taxpayers requested that the retroactive effect of any revocation or modification of Ruling 47 be limited.

The Service has decided to grant relief, as described below, under section 7805(b) to limit the effect of the partial revocation of Ruling 47.

FACTS

Taxpayer 1 is a State corporation that has elected to be treated as a real estate investment trust (“REIT”) beginning with the taxable year ended Date 1. Taxpayer 2 is a State corporation. Each of the lessors under the Master Lease and the Other Leases (each a “Subject Lease” and together, the “Subject Leases”) is an entity that is disregarded as separate from Taxpayer 1 for Federal income tax purposes, or is a qualified REIT subsidiary (within the meaning of section 856(i)) of Taxpayer 1. Subsidiaries of Taxpayer 2 are the lessees under several of the Subject Leases. Each of the Subject Leases was entered into prior to Date 2. Each of the Subject Leases has options for renewal periods that are solely within the lessee’s discretion.

Each of the Subject Leases provides, in part, for a fixed base rent subject to Escalation and Other Adjustments. Each of the Subject Leases provides for an annual increase to the Building Base Rent that is limited to the lesser of (a) a fixed percentage

of the prior year's Building Base Rent or (b) an amount (but not less than zero) that, when added to Building Base Rent for the prior year, would result in a specified ratio of Adjusted Revenue to the total rent payable for such prior year (each such provision, the "Escalation Provision" and collectively, the "Escalation Provisions"). Each Subject Lease defines "Adjusted Revenue" as the net revenue of the lessee minus expenses other than (i) interest expense, (ii) income tax expense, (iii) depreciation and amortization expense, (iv) rent expense, and (v) certain other expenses.

Under the Master Lease and three of the Other Leases, upon the occurrence of certain contingencies resulting in the removal of a particular property from the properties covered by a Subject Lease, certain rent otherwise payable will be reduced by an amount that is based on the relative Adjusted Revenue generated at the removed property and the Adjusted Revenue at all properties covered by the Subject Lease (each such provision the "Other Adjustments Provision" and collectively, the "Other Adjustments Provisions").

LAW AND ANALYSIS

Section 856(c)(2) requires that at least 95 percent of a REIT's annual gross income (excluding gross income from prohibited transactions) be derived from certain sources, including rents from real property. Section 856(c)(3) requires that at least 75 percent of a REIT's annual gross income (excluding gross income from prohibited transactions) be derived from certain sources, including rents from real property.

Subject to certain exceptions, section 856(d)(2)(A) provides that the term "rents from real property" does 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).

The amounts determined under the Escalation Provisions and the Other Adjustments Provisions in the Subject Leases depend in part on the lessee's Adjusted Revenue. Adjusted Revenue is not equivalent to receipts or sales and is instead a measure of the income or profits derived by the lessee from the operation of the property. Thus, amounts received or accrued under the Subject Leases do not qualify as rents from real property under section 856(d)(2)(A).

Accordingly, Ruling 47 in PLR 201337007 is partially revoked to read as follows:

UPREIT LP's receipt of Percentage Rent payments under the Master Lease will not cause any amounts received under the Master Lease to be treated as other than rents from real property under § 856(c)(2)(A) and 856(c)(3)(A).

Section 7805(b)(8) provides that the Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.

Under section 11.06 of Rev. Proc. 2021-1, if the revocation or modification of a letter ruling is for reasons other than a change in facts as described in section 11.05 of Rev. Proc. 2021-1, the revocation or modification generally will not be applied retroactively to the taxpayer for whom the letter ruling was issued or to a taxpayer whose tax liability was directly involved in the letter ruling provided that (1) there has been no change in the applicable law; (2) the letter ruling was originally issued for a proposed transaction; and (3) the taxpayer directly involved in the letter ruling acted in good faith in relying on the letter ruling, and revoking or modifying the letter ruling retroactively would be to the taxpayer's detriment.

CONCLUSIONS

As discussed above, we conclude that Ruling 47 in PLR 201337007 is partially revoked. The partial revocation of Ruling 47 will apply beginning with Taxpayer 1's first taxable year beginning after Date 3. The partial revocation of Ruling 47, however, will not apply to the Escalation Provision or the Other Adjustments Provision of a Subject Lease (including during any current or remaining renewal periods provided in such Subject Lease, as provided by such Subject Lease on Date 2, that are exercisable at the lessee's sole discretion) as in effect on Date 2, unless and until an amendment or modification to such Subject Lease has the effect of modifying (a) the amount of Building Base Rent set forth in such Subject Lease or (b) the manner in which Building Base Rent is calculated under such Subject Lease, including an amendment or modification to the terms and conditions of the Escalation Provision or the Other Adjustments Provision.

Notwithstanding the above, the following shall not be considered to be an amendment or modification to a Subject Lease contemplated by clause (a) or (b) of the immediately preceding paragraph: (1) an amendment or modification to a Subject Lease that has an indirect effect on Building Base Rent solely by causing an increase or decrease in the amount of Adjusted Revenue; (2) a capital improvement funded by either the lessee or lessor of a Subject Lease, provided that any rent payments attributable to such capital improvement or such funding and added pursuant to any corresponding amendment or modification of such Subject Lease shall not be subject to the Escalation Provision of such Subject Lease; (3) an addition of a Facility to a Subject Lease pursuant to the Agreement and; (4) the removal of one or more Facilities (or a portion of a Facility) (i) from a Subject Lease or (ii) from the Building Base Rent, the Escalation Provision and/or from the calculation of Adjusted Revenue of a Subject Lease (and any correlative or conforming amendments to such Subject Lease necessary to effect a removal described in clause (i) or (ii)). Clauses (1) (in the case of a modification or amendment to the Other Adjustments Provision of a Subject Lease or a modification or amendment to a Subject Lease that implicates the Other Adjustments

Provision thereof) and (4) may be relied on with respect to a particular Subject Lease only if the Other Adjustments Provision of such Subject Lease has been amended either to eliminate the use of Adjusted Revenue or to modify the definition of Adjusted Revenue to conform with applicable law. Any amendment or modification described in this paragraph shall otherwise conform with applicable law. Any other capital improvement or addition of a Facility to a Subject Lease not described in clause (2) or (3) of this paragraph will be considered an amendment or modification to the Subject Lease contemplated by clause (a) or (b) of the immediately preceding paragraph. Notwithstanding the above, the Escalation Provision and the Other Adjustments Provision of a Subject Lease may be amended either to eliminate the use of Adjusted Revenue or to modify the definition of Adjusted Revenue to conform with applicable law.

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 Taxpayer 1 otherwise qualifies as a REIT under Subchapter M, Part II of Chapter 1 of the Code.

In accordance with Forms 8821, *Tax Information Authorization*, submitted by Taxpayer 1 and Taxpayer 2, this ruling is directed only to the Taxpayers. 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,

K. Scott Brown
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Financial Institutions & Products)

Enclosure:
Copy for section 6110 purposes

cc: