

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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PLR-123585-21

Date:
February 22, 2022

Legend

Taxpayer =
State =
Assets =
Date 1 =
Date 2 =

Dear :

This ruling responds to a letter dated November 11, 2021, submitted on behalf of Taxpayer. Taxpayer requests a ruling that a section 481(a) adjustment required to be included in gross income by Taxpayer will not be treated as gross income for purposes of section 856(c)(2) or (3) of the Internal Revenue Code (the "Code").

FACTS

Taxpayer is a State corporation that intends to elect to be taxed as a real estate investment trust ("REIT") under sections 856 through 860 beginning with its taxable year ending on Date 1. Taxpayer and its subsidiaries design, build, and own Assets.

Taxpayer filed a Form 3115, Application for Change in Accounting Method, under the automatic change procedures described in Rev. Proc. 2015-13, 2015-5 I.R.B. 419, to change its method of accounting for certain interest expense with respect to its designated property (as defined in section 1.263A-8(b) of the Income Tax Regulations) beginning with its taxable year ended Date 2. See section 12.14 of Rev. Proc. 2019-43, 2019-48 I.R.B. 1107, 1160. Taxpayer thereby secured consent to change its method of accounting from not capitalizing to capitalizing interest with respect to its designated property. This method change resulted in a positive adjustment under section 481(a)

(the "Section 481(a) Adjustment") that is includible in Taxpayer's taxable income over a four-year period that includes Taxpayer's taxable year ending Date 1.

LAW AND ANALYSIS

Section 856(c)(2) provides that in order for a corporation to qualify as a REIT, at least 95 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from dividends; interest; rents from real property; gain from the sale or other disposition of stock, securities, and real property (other than property described in section 1221(a)); abatements and refunds of taxes on real property; income and gain derived from foreclosure property; commitment fees to make loans secured by mortgages on real property or on interests in real property or to purchase or lease real property; gain from certain sales or other dispositions of real estate assets; and certain mineral royalty income.

Section 856(c)(3) provides that in order for a corporation to qualify as a REIT, at least 75 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from rents from real property; interest on obligations secured by mortgages on real property or on interests in real property; gain from the sale or other disposition of real property (other than property described in section 1221(a)); dividends or other distributions on, and gain from the sale or disposition of, transferable shares in other REITs; abatements and refunds of taxes on real property; income and gain derived from foreclosure property; commitment fees to make loans secured by mortgages on real property or on interests in real property or to purchase or lease real property; gain from certain sales or other dispositions of real estate assets; and qualified temporary investment income.

Section 856(c)(5)(J) provides that, to the extent necessary to carry out the purposes of part II of subchapter M of chapter 1 of the Code, the Secretary is authorized to determine, solely for purposes of that part, whether any item of income or gain that (i) does not otherwise qualify under section 856(c)(2) or (3) may be considered as not constituting gross income for purposes of section 856(c)(2) or (3), or (ii) otherwise constitutes gross income not qualifying under section 856(c)(2) or (3) may be considered as gross income which qualifies under section 856(c)(2) or (3).

Section 481(a) provides that a taxpayer that changes its method of accounting takes into account necessary adjustments in computing its taxable income to prevent amounts from being duplicated or omitted.

Section 1.481-1(d) provides that a section 481(a) adjustment must be properly taken into account for purposes of computing gross income, adjusted gross income, or taxable income in determining the amount of any item of gain, loss, deduction, or credit that depends on gross income, adjusted gross income, or taxable income.

The Section 481(a) Adjustment constitutes gross income of a type not listed in section 856(c)(2) or (3). Based on all of the facts and circumstances, however, exclusion of the Section 481(a) Adjustment from Taxpayer's gross income for purposes of sections 856(c)(2) and (3) is consistent with the purposes of part II of subchapter M of chapter 1 of the Code.

CONCLUSION

Based on the information submitted and the representations made, we rule that, under section 856(c)(5)(J)(i), the Section 481(a) Adjustment will not be treated as gross income for purposes of section 856(c)(2) or (3).

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 regarding whether Taxpayer otherwise qualifies (or will qualify) as a REIT under part II of subchapter M of chapter 1 of the Code. Additionally, no opinion is expressed regarding the propriety of Taxpayer's method change or the amount of the Section 481(a) Adjustment.

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,

Steven Harrison
Branch Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: