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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

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Date:
June 03, 2022

Legend

Taxpayer =

State =

Year 1 =

Year 2 =

Date 1 =

Date 2 =

Date 3 =

OP =

Dear :

This letter responds to a letter dated November 16, 2021, and supplemental correspondence, requesting rulings on behalf of Taxpayer. Taxpayer requests two rulings with respect to inclusions under section 481(a) of the Internal Revenue Code (Code) and earnings and profits (E&P) associated with those inclusions:

1. Pursuant to section 856(c)(5)(J)(i), Taxpayer's share of the OP Section 481(a) Adjustments (defined below), determined in accordance with section 1.856-3(g)

of the Income Tax Regulations, will not be taken into account for purposes of section 856(c)(2) and (3).

2. For purposes other than section 856(c)(2) and (3), if and to the extent that Taxpayer's distributive share, determined in accordance with section 704, of the OP Section 481(a) Adjustments exceeds the correlative E&P adjustments arising from the Method Changes (defined below), any distributions of such excess (that are distributed and treated as dividends by Taxpayer in the year in which such excess arises) will be treated as made from E&P.

FACTS

Taxpayer was organized as a State limited liability company in Year 1 when Taxpayer elected to be taxed as a real estate investment trust (REIT) under sections 856 through 860. Taxpayer's overall method of accounting is an accrual method, and its taxable year is the calendar year. Taxpayer has been a partner in OP, a partnership for federal income tax purposes, during all periods from and after Year 1. Taxpayer's revenue arises almost exclusively from its investment in OP. OP's real estate rental business is described below.

OP is an independent owner of properties (the "Sites") consisting of multi-tenanted communications towers, distributed antenna system networks, and other communications-related real estate such as land parcels and rooftop sites. OP's primary business is the leasing of space on and at the Sites to a diverse group of tenants in different industries.

After a majority of the interests in OP were acquired (including indirectly through the acquisition of Taxpayer) in Year 2, Taxpayer conducted a review of Taxpayer's books and records. Taxpayer concluded that OP had been improperly depreciating or amortizing certain cellular and broadcast towers (and ancillary depreciable property such as site improvements, landscaping, fencing, and roads) placed in service between the tax years ended Date 1 and Date 2 (the "Tower Assets") using cost recovery methods applicable to personal property. As a result of this review, OP submitted Forms 3115, Application for Change in Accounting Method, under the automatic change procedure described in Rev. Proc. 2015-13, 2015-5 I.R.B. 419, to change its methods of accounting for depreciation and amortization for the Tower Assets to methods applicable to land improvements under Asset Class 00.3 of Rev. Proc. 87-56, 1987-2 C.B. 674, beginning with the taxable year of change ended Date 3 (the Method Changes). The Method Changes resulted in positive section 481(a) adjustments (the OP Section 481(a) Adjustments) that Taxpayer will take into account over the appropriate section 481(a) adjustment period. The appropriate section 481(a) adjustment period will generally be the year of change and the next three taxable years unless an acceleration later applies under certain specified circumstances.[1]

[1] See section 7.03 of Rev. Proc. 2015-13.

Accordingly, Taxpayer will take into account its share of the OP Section 481(a)

Adjustments, in accordance with section 1.856-3(g) for purposes of section 856(c)(2) and (3) and section 704 for all other purposes, for a particular taxable year with corresponding changes to Taxpayer's E&P.

Taxpayer makes the following representations:

1. The Sites are comprised of real property or interests in real property within the meaning of section 1.856-10.

2. The OP Section 481(a) Adjustments relate to assets that will be depreciated or amortized pursuant to methods that conform and align more closely with the applicable assets constituting real property and interests in real property for purposes of sections 856 and 1.856-10.

3. Taxpayer will take the correlative adjustments arising from the change in computing depreciation and amortization for E&P purposes into account ratably over the same period as the OP Section 481(a) Adjustments are taken into account, in accordance with Rev. Proc. 79-47, 1979-2 C.B. 528.

4. Taxpayer's share of the OP Section 481(a) Adjustments will not be subject to the section 1374 built-in gains tax, which tax (where applicable) is not eliminated or reduced by the dividends paid deduction per sections 337(d) and 1374 as well as sections 1.337(d)-7 and 1.1374-4(b), (d), and (i), because Taxpayer's share of the OP Section 481(a) Adjustments relates to depreciation and amortization previously taken by Taxpayer as a REIT (and not to depreciation or amortization previously taken as a non-REIT C corporation).

LAW AND ANALYSIS

Ruling Request #1: ***Pursuant to section 856(c)(5)(J)(i), Taxpayer's share of the OP Section 481(a) Adjustments, determined in accordance with section 1.856-3(g), will not be taken into account for purposes of section 856(c)(2) and (3).***

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)); certain dividends or distributions on, and gains from the sale or disposition of, 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 the Code, the Secretary is authorized to determine, solely for purposes of such part, whether any item of income or gain which (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.

Under section 1.856-3(g), a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of section 856 the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners for all purposes of section 856.

The legislative history underlying the tax treatment of REITs indicates that a central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, “[o]ne of the principal purposes of your committee in imposing restrictions on types of income of a qualifying real estate investment trust is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business."

As noted above, OP submitted Forms 3115 to change its methods of accounting for its Tower Assets. The Method Changes resulted in OP Section 481(a) Adjustments that will be includible in OP's gross income and, in accordance with section 1.856-3(g), will be includible proportionately in Taxpayer's gross income in accordance with Taxpayer's capital interest in OP. Section 856(c)(2) and (3) lists the sources of permissible income for a REIT. Income from a section 481(a) adjustment is not specifically enumerated in section 856(c)(2) or (3).

Based on all the facts and circumstances, excluding Taxpayer's share of the OP Section 481(a) Adjustments, determined in accordance with section 1.856-3(g), from Taxpayer's gross income for purposes of sections 856(c)(2) and (3), does not interfere with Congressional policy objectives in enacting the income tests under those provisions. Accordingly, based on the information submitted and representations made, we rule that pursuant to section 856(c)(5)(J)(i), Taxpayer's share of the OP Section 481(a) Adjustments, so determined, will not constitute gross income for purposes of section 856(c)(2) and (3).

Ruling Request #2: ***For purposes other than section 856(c)(2) and (3), if and to the extent that Taxpayer's distributive share, determined in accordance with section 704, of the OP Section 481(a) Adjustments exceeds the correlative E&P adjustments arising from the Method Changes, any distributions of such excess (that are distributed and treated as dividends by Taxpayer in the year in which such excess arises) will be treated as made from E&P.***

Section 561(a) provides that the deduction for dividends paid shall be the sum of the dividends paid during the year and consent dividends for the taxable year.

Section 562(a) provides that the term "dividend" shall include only dividends as described in section 316. Section 316(a) defines the term "dividend" to mean any distribution of property made by a corporation to its shareholders out of either current year or accumulated E&P.

Section 704 generally provides that a partner's distributive share of partnership income, gain, deduction, loss, or credit is determined by the partnership agreement or, in certain cases, in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), with other rules and exceptions not relevant here.

Section 857(a)(1) requires, in part, that a REIT's deduction for dividends paid for a taxable year equals at least 90 percent of its REIT taxable income for the taxable year, determined without regard to the deduction for dividends paid (as defined by section 561) or any net capital gains.

Section 857(b)(2)(B) provides that in determining a REIT's taxable income, the deduction for dividends paid (as defined in section 561) shall be allowed.

Section 857(d)(1)(A) provides that the E&P of a REIT for any taxable year (but not its accumulated earnings) shall not be reduced by any amount that is not allowable in computing the REIT's taxable income for such taxable year.

Section 857(d)(2) provides that a REIT is generally deemed to have sufficient E&P to cover any distribution that it treats as a dividend to the extent the distribution, when combined with other distributions in the same calendar year, does not exceed the distributions required by section 4981.

Section 4981 generally levies an excise tax on REITs that do not make required distributions under that section during the calendar year. In general, a REIT's required distribution equals at least 85 percent of its current year ordinary income and at least 95 percent of its current year capital gain net income. The remaining percentage of the REIT's current year ordinary income (up to 15 percent) and its current year capital gain net income (up to 5 percent) are included in its required distribution in the following year. For purposes of section 4981, "ordinary income" equals the REIT's taxable income as determined under section 857(b)(2) without regard to the section 857(b)(2)(B) dividends-paid deduction.

The House Conference Report for the Tax Reform Act of 1986 states the following in discussing its rejection of a Senate amendment to section 857:

> The conference agreement does not contain the provision from the Senate amendment under which a REIT's [E&P] for a taxable year would not be less than its real estate [investment] trust taxable income for the taxable year (without regard to the dividends paid deduction), since the conferees believe that this provision is a restatement of present law.[2]

H.R. Conf. Rep. No. 99-841, at 218-19 (1986). Therefore, the regime governing the taxation of REITs, which requires distributions of taxable income, is intended to match the REIT's E&P to that income.

As noted above, Taxpayer represents that it will take the correlative adjustments arising from the Method Changes in computing depreciation and amortization for E&P

[2] Prior to enactment of the Tax Reform Act of 1986, a version of the bill amended and passed by the Senate included a provision stating that "the earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings) . . . shall not be less than its real estate investment trust taxable income for such taxable year determined without regard to the deduction for dividends paid (as defined in section 561)." See H.R. 3838, 99th Cong. § 1434(b) (as passed by the Senate, June 24, 1986).

purposes into account ratably over the same period as its distributive share of the OP Section 481(a) Adjustments. Due to differences in computing depreciation and amortization for E&P purposes versus for income tax purposes, Taxpayer's correlative adjustments to its E&P may be lower than its distributive share of the OP Section 481(a) Adjustments.

Taxpayer represents that its share of the OP Section 481(a) Adjustments will not be subject to the section 1374 built-in gains tax, which tax (where applicable) is not eliminated or reduced by the dividends-paid deduction per sections 337(d) and 1374 as well as sections 1.337(d)-7 and 1.1374-4(b) and (d), because Taxpayer’s share of the OP Section 481(a) Adjustments relates to depreciation and amortization previously taken as a REIT (and not to depreciation or amortization previously taken as a non-REIT C corporation).

Based on the information submitted and representations made, we rule that to the extent Taxpayer’s distributive share, determined in accordance with section 704, of the OP Section 481(a) Adjustments exceeds the correlative E&P adjustments arising from the Method Changes, any distributions of such excess (that are distributed and treated as dividends by Taxpayer in the year in which such excess arises) will be treated as made from E&P.

CAVEATS

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 or implied regarding whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of chapter 1 of the Code. Additionally, we express no opinion on whether the Sites are comprised of real property or interests in real property within the meaning of section 1.856-10, the propriety of the amounts of the OP Section 481(a) Adjustments, or the propriety of the Method Changes.

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

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Bernard Audet
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: