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October 6, 2023

Legend

Taxpayer =

Registry =

Subsidiary =

Intermediary =

Agreement =

State A =

State B =

a =

b =

c =

Date 1 =

Date 2 =

Dear :

This responds to a letter dated April 4, 2023, and subsequent correspondence, submitted on behalf of Taxpayer. For purposes of its status as a real estate investment trust ("REIT") under § 856 of the Internal Revenue Code ("Code"), Taxpayer requests

certain rulings regarding the treatment of income from Registry's issuance of the Offsets (defined below) to Taxpayer in exchange for Taxpayer agreeing to the restrictions in the Agreement:

> (1) Unless § 451(b)(1)(A) requires earlier inclusion, income with respect to the issuance of the Offsets accrues under § 451 upon the earliest of the following events to occur: the Offsets are earned, the Offsets are received, or the Offsets are due; and
>
> (2) Pursuant to § 856(c)(5)(J)(ii), income from the issuance of the Offsets will be considered qualifying income under § 856(c)(2) and (c)(3).

FACTS

Taxpayer is a State A limited liability company that intends to elect to be taxed as a REIT for federal income tax purposes.

Taxpayer wholly owns Subsidiary, a State A limited liability company that is disregarded as separate from Taxpayer for federal income tax purposes. Taxpayer owns approximately a acres of commercial forestland in State B, of which Subsidiary owns approximately b acres (the acreage owned in State B by Subsidiary, the "Site"). The Site qualifies as real property within the meaning of § 856, and substantially all of the Site is land, including unsevered natural products of the land (e.g., trees), within the meaning of § 1.856-10(c) of the Income Tax Regulations.

Taxpayer uses an accrual method of accounting for federal income tax purposes, and its taxable year is the calendar year.

Registry is a greenhouse gas registry and emissions tracking system used by members to transparently register project-based verified emissions reductions and removals as serialized offsets and to record the issuance, retirement, and cancellation of these offsets. Taxpayer (through Subsidiary) participates in a carbon sequestration project involving the development and implementation of forestland management parameters on the Site designed to enhance the Site's long-term capacity to sequester atmospheric carbon (the "Project"). Pursuant to the Agreement between Intermediary and the prior owner of the Site (the "Seller"), Intermediary developed the Project for the Seller in compliance with the requirements of Registry. As of Date 1, Subsidiary had acquired the Site from the Seller and had assumed all rights, title, and interests in the Agreement and succeeded the Seller with respect to the Project. The Project is expected to end no earlier than Date 2.

The Agreement establishes the framework under which Intermediary, as Taxpayer's technical consultant, will develop projects on the Site for Taxpayer and sets forth the respective rights and obligations of the owner of the Site and Intermediary with respect to the Project. Development of the Project involves calculating the estimated

quantity of additional carbon that can be sequestered at the Site through improved forest management (e.g., harvesting at levels below those otherwise allowable under existing law, regulations, and other restrictions) and submitting those calculations and estimates for independent verification in accordance with the standards of Registry. Once the quantity of additional carbon estimated to be sequestered at the Site under the Project is verified, the Project is eligible for carbon emission offsets (the “Offsets”). The quantity of Offsets for which the Project is eligible is directly linked to the sequestration of additional carbon resulting from the improved forest management identified in the Project.

The Site is all of the land currently owned by Subsidiary. The Site is described in detail in the Project documents. The owner of the Site agrees to comply with the Project’s improved forest management requirements associated with the Offsets. The Restrictions are restrictions that could be recorded as easements under local law. Restrictions from the Project include the following land use restrictions (the “Restrictions”):

1. Not to conduct any activities that will result in a reversal of sequestered carbon or the ability of the Site to generate specified Offsets;

2. Not to harvest above a specified volume of timber each year or a volume in excess of a specified amount of growth in a single year;

3. Not to conduct activities on the Site that will result in material reductions of Offsets arising from Taxpayer’s voluntary activities that result in the aggregate harvest levels exceeding the aggregate projected harvest on the project by more than c percent; and

4. To manage the Site in a manner to ensure compliance with the requirements of the program in which the Site is enrolled.

Taxpayer has committed to the Restrictions until at least Date 2, unless Taxpayer sells the Site and the new owner properly assumes Taxpayer’s obligations. The Restrictions apply only to property that is subject to the Project under the Agreement and, upon registration of the Offsets, are binding on the Site for the duration of the Project. Taxpayer may add additional parcels of land under the Agreement that may also generate Offsets if included in future carbon sequestration projects or an expansion of the Project. The Registry requires Taxpayer to assess the risk of reversal of the Offsets and select a risk mitigation mechanism for the Project. Taxpayer has elected to participate in the Registry’s buffer pool. In order to participate in the Registry’s buffer pool, Taxpayer must contribute a risk-adjusted number of Offsets to the Pool. In the event of an unintentional reversal of Offsets (e.g., a forest fire) that exceeds the number of Offsets that Taxpayer has contributed to the Buffer Pool, Taxpayer will be required to contribute Offsets equal to a percentage of the excess of reversed Offsets over the contributed Offsets. In the event of an unintentional reversal of Offsets, Taxpayer is not

otherwise required to replenish its buffer pool contribution. On the other hand, in the event of an intentional reversal of Offsets, Taxpayer will be required to replace all reversed Offsets.

Pursuant to the Agreement, Intermediary analyzes the Site and develops forestland development parameters complying with the Registry's standards to ensure that the Site complies with the Project's requirements to be eligible to generate the Offsets. The Project is filed with the Registry, and the Offsets are issued based on the quantity of additional carbon that can be sequestered at the Site due to the Restrictions. After verification of the quantity and type of Offsets attributable to the Site each reporting period, the Offsets attributable to that reporting period are registered by the Registry. Upon registration of the Offsets by the Registry, the Registry awards Offsets to Taxpayer, Taxpayer transfers the Offsets to Intermediary, and Intermediary markets the Offsets for sale to third parties that are unrelated to Taxpayer (each a "Buyer"). Under the Agreement, Intermediary agrees to aggregate, market, and ultimately sell the Offsets to Buyers under one or more independently operated carbon service credit trading regimes. Taxpayer bears the benefits and burdens of ownership of the Offsets from the issuance of the Offsets to Taxpayer until the sale of the Offsets by Intermediary to Buyers. Neither Taxpayer nor its subsidiaries intend to hold the Offsets for the purposes of speculating on future appreciation.

Taxpayer represents that Taxpayer will include the fair market value of the Offsets upon issuance in gross income. Income from the Offsets is intended to compensate Taxpayer for the loss of revenue from otherwise permissible timber sales and the decrease in value and income resulting from Taxpayer's adherence to the Restrictions. Upon the eventual sale of the Offsets, proceeds are remitted to Taxpayer with Intermediary retaining a portion of the proceeds as commission. Taxpayer will treat any gain from the sale of the Offsets as income not qualifying under § 856(c)(2) and (c)(3).

LAW AND ANALYSIS

Section 61(a) defines gross income as "income from whatever source derived," except as otherwise provided by law. See § 1.61-1(a). Gross income includes income realized in any form, whether in money, property, or services. Id. This definition encompasses all "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).

Section 451 and the regulations thereunder provide rules for determining the taxable year of inclusion for items of gross income.

Under an accrual method of accounting, unless § 451(b)(1)(A) requires earlier inclusion, an item of gross income is generally includible when all the events have occurred which fix the right to receive such income and the amount thereof can be

determined with reasonable accuracy. All the events that fix the right to receive income generally occur upon the earliest of the following: (1) the required performance takes place, (2) payment is due, or (3) payment is made. See Schlude v. Commissioner, 372 U.S. 128 (1963); Rev. Rul. 2003-10, 2003-1 C.B. 288. However, § 451(b)(1)(A) sets forth special rules requiring earlier inclusion in the case of certain accrual-method taxpayers.

Section 856(c)(2) provides that for a corporation to qualify as a REIT for any taxable year, at least 95 percent of its gross income (excluding gross income from prohibited transactions) must be derived from sources that include dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (other than property in which the corporation is a dealer), abatements and refunds of taxes on real property, income and gain derived from foreclosure property, certain commitment fees, and gain from certain sales or other dispositions of real estate assets.

Section 856(c)(3) provides that for a corporation to qualify as a REIT for any taxable year, 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 real property, gain from the sale or other disposition of real property (other than property in which the corporation is a dealer), dividends from REIT stock and gain from the sale of REIT stock, abatements and refunds of taxes on real property, income and gain derived from foreclosure property, certain commitment fees, gain from certain sales or other dispositions of real estate assets, and qualified temporary investment income.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in § 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, the lease.

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 such part, (i) whether any item of income or gain that does not otherwise qualify under § 856(c)(2) or (c)(3) may be considered as not constituting gross income for purposes of § 856(c)(2) or (c)(3), or (ii) whether any item of income or gain that otherwise constitutes gross income not qualifying under § 856(c)(2) or (c)(3) may be considered as gross income that qualifies under § 856(c)(2) or (c)(3).

Section 1.856-4(a)(1) provides that, subject to the exceptions of § 856(d) and § 1.856-4(b), the term “rents from real property” means, generally, the gross amounts received for the use of, or the right to use, real property of the REIT.

Under § 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 § 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 § 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.”

Taxpayer earns the Offsets as a result of agreeing to and complying with Restrictions that satisfy Registry’s standards for carbon sequestration at the Site. The Agreement imposes land-use restrictions by requiring Taxpayer to abstain from certain uses of its land and perform certain actions on its land. Taxpayer has represented that such land-use restrictions are restrictions that could be recorded as easements under local law. Under the Agreement, Taxpayer will incur penalties if it does not abide by the Restrictions to which it has agreed. For these reasons, the Offsets are akin to receiving payment for granting an easement for a term of years with respect to the real property. Cf. Wineberg v. Commissioner, 326 F.2d 157, 169-70 (9th Cir. 1963) (holding amount received for granting 10-year right to use a road was rent rather than sale of an interest in land), aff’g T.C. Memo. 1961-336; Nay v. Commissioner, 19 T.C. 114, 119 (1952) (concluding amount received for granting a “right of way” for a term not to exceed three years is ordinary income because such a “limited easement” does not constitute sale of real property). Under these circumstances, treating Taxpayer’s income with respect to the issuance of the Offsets as qualifying income does not interfere with or impede the objectives of Congress in enacting § 856(c)(2) and (c)(3).

CONCLUSIONS

Based on the information submitted and representations made, we rule as follows:

(1) Unless § 451(b)(1)(A) requires earlier inclusion, income with respect to the issuance of the Offsets will accrue under § 451 upon the earliest of the following events

to take place: the Offsets are earned, the Offsets are received, or the Offsets are due; and

(2) Pursuant to § 856(c)(5)(J)(ii), income from the issuance of the Offsets will be considered qualifying income under § 856(c)(2) and (c)(3).

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. Furthermore, no opinion is expressed with respect to the tax consequences of any dispositions of the Offsets, including whether a sale of the Offsets gives rise to qualifying income under § 856(c)(2) or (c)(3) and whether such a sale constitutes a prohibited transaction as described in § 857(b)(6)(B)(iii). This letter ruling relates only to those Offsets earned by Taxpayer, and no opinion is expressed regarding any Offsets earned by, or issued to, Seller that Taxpayer received after purchasing the Site.

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.

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,

Jason D. Kristall
Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: