

- (1) for purposes of determining Taxpayer's gross income under section 856(c)(2) and (3) (the "Income Tests"), Taxpayer's proportionate share, within the meaning of section 1.856-3(g), of Colocation Prime Rents (defined below) received by each JV (defined below) is excluded; and
- (2) for purposes of determining Taxpayer's gross income under the Income Tests, a portion of the Facilities Prime Rents (defined below) received from a

JV in an amount corresponding to Taxpayer's capital interest in that JV (expressed as a proportion) is excluded.

FACTS

Taxpayer, a State corporation, represents that it made an election to be treated as a real estate investment trust ("REIT") effective beginning the taxable year ended Date. Taxpayer owns, acquires, leases from others, develops, and builds carrier-neutral colocation data center buildings throughout the United States and in several foreign countries. Taxpayer's recurring revenue streams stem primarily from the licensing of space to tenants and related activities.

Taxpayer has formed and intends to form a series of joint ventures ("JVs") with various capital partners (the "Other Partners") to invest in, develop, own, and lease out a type of data center known as a Facility. Each Facility will provide space, power, climate control, and other conventional data center offerings to single or multiple tenants at lower pricing than conventional data centers. As compared to a typical colocation data center, the construction of each Facility will require a larger up-front capital commitment and a longer period to recover the capital investment. Taxpayer expects to own, directly or indirectly, between an a and b percent interest in each JV. Taxpayer will be the general partner for each JV, and one or more Other Partners will own the remainder of each JV. Each JV will engage a taxable REIT subsidiary ("TRS") of Taxpayer to provide all construction, asset management, and other services pursuant to contracts between the JV and TRS. Taxpayer represents that each JV will be treated as a partnership for federal tax purposes.

If a data center property has both colocation space and space to develop a Facility, then the property will be split between Taxpayer and one or more JVs. Taxpayer, wherever possible, will own the portion of each data center property used for colocation tenants, and one or more JVs will own the portion of the data center property used as a Facility. However, splitting the ownership of a data center property might not be possible because of local real estate law, property-specific financing constraints, or restrictions imposed by ground landlords. If ownership of a data center property cannot be split, Taxpayer and one or more JVs will invest in a data center property using one of the following two approaches.

Under the first approach, one or more JVs will acquire ownership of a property in its entirety and will lease a portion of the property to Taxpayer (the "Tenant Approach"). Under the Tenant Approach, Taxpayer will pay rent to the JVs owning the property (the "Colocation Prime Rents"). Taxpayer intends to sublease its space to colocation tenants with the intent that its income from the subleases (the "Colocation Sub-Rents") will yield qualifying rents from real property.

Under the second approach, Taxpayer will own a property in its entirety and will lease a portion of the property to one or more JVs (the "Landlord Approach"). Under the

Landlord Approach, each JV will pay rent to Taxpayer (the “Facilities Prime Rents”). Each JV will sublease a portion of the property to third parties for use as a Facility and Taxpayer represents each JV intends to receive qualifying rents from real property under these subleases (the “Facilities Sub-Rents”). Taxpayer will lease the retained space to colocation tenants.

Taxpayer represents that each of the Other Partners will be unrelated to Taxpayer for purposes of section 856(d)(2)(B) and (d)(5). Additionally, Taxpayer represents that all rental and service charges under both the Tenant Approach and the Landlord Approach will be at arm’s length. Each JV is expected to have gross assets that satisfy section 856(c)(4)(A) and gross income that satisfies the Income Tests. Taxpayer expects that any services provided to JV tenants that would generate income described in section 856(d)(7)(A) if received or accrued directly or indirectly by Taxpayer will be performed by a TRS of Taxpayer and will be customary within the meaning of section 856(d)(1)(B). Taxpayer further represents that no amount of rent under either the Tenant Approach or the Landlord Approach will be disqualified under section 856(d)(2)(A) as based in whole or in part on the income or profits derived by any person from the leased property.

LAW AND ANALYSIS

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, for purposes of the Income Tests, the term “rents from real property” includes (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 which is 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) generally excludes from rents from real property any amount received or accrued, directly or indirectly, with respect to 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 856(d)(2)(B) generally excludes from rents from real property any amount received or accrued, directly or indirectly, from any person if the REIT owns, directly or indirectly, (i) in the case of any person which is a corporation, stock of such person possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total value of shares of all classes of stock of such person; or (ii) in the case of any person that is not a corporation, an interest of 10 percent or more in the assets or net profits of such person.

Section 856(d)(2)(C) generally excludes from rents from real property any impermissible tenant service income (as defined in section 856(d)(7)).

Section 1.856-3(g) provides that a REIT which is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and is deemed to be entitled to the income of the partnership attributable to such share. For purposes of section 856, the interest of a partner in the partnership's assets shall be 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 shall 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 Congress's central concern behind the gross income restrictions is that a REIT's gross income should largely be derived from passive income sources. For example, H.R. REP. NO. 86-2020, at 6 (1960), 1960-2 C.B. 819, 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.”

Ruling 1: The Tenant Approach; Taxpayer's Proportionate Share of The Colocation Prime Rents

For properties subject to the Tenant Approach, tenants will pay Taxpayer the Colocation Sub-Rents and Taxpayer will pay each relevant JV the Colocation Prime Rents. Under section 1.856-3(g), Taxpayer will include a proportionate share of the Colocation Prime Rents in an amount corresponding to Taxpayer's capital interest in each relevant JV in Taxpayer's gross income. Because Taxpayer's gross income as a partner of a JV includes a proportionate share of the Colocation Prime Rents paid by Taxpayer to that JV, including an amount of the Colocation Prime Rents attributable to its proportionate share in the JV would cause the amounts to be counted twice for purposes of the Income Tests.

Ruling 2: The Landlord Approach; The Facilities Prime Rents Attributable to Taxpayer's Capital Interest

For properties subject to the Landlord Approach, each JV will collect the Facilities Sub-Rents from tenants and each JV will pay Taxpayer the Facilities Prime Rents. Under section 1.856-3(g), Taxpayer will receive a proportionate share of each JV's income, including the Facilities Sub-Rents, in an amount corresponding to Taxpayer's capital interest in each relevant JV. Thus, Taxpayer's gross income will include both Taxpayer's proportionate share of each JV's income and the Facilities Prime Rents from each JV. Because the Facilities Prime Rents are derived from income already included in Taxpayer's gross income, including the full amount of the Facilities Prime Rents in Taxpayer's gross income would cause amounts to be counted twice for purposes of the Income Tests.

CONCLUSIONS

Based on the information submitted and representations made, we conclude that:

- (1) for purposes of determining Taxpayer's gross income under the Income Tests, Taxpayer's proportionate share, within the meaning of section 1.856-3(g), of the Colocation Prime Rents received by each JV are excluded; and
- (2) for purposes of determining Taxpayer's gross income under the Income Tests, a portion of the Facilities Prime Rents received from a JV in an amount corresponding to Taxpayer's capital interest in that JV (expressed as a proportion) are excluded.

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, we do not rule whether Taxpayer qualifies as a REIT under Part II of Subchapter M of Chapter 1 of the Code. Further, we do not rule on whether Taxpayer is related to any of the Other Partners or any other tenant or sub-tenant for purposes of section 856(d)(2)(B) and (d)(5), or whether any amount is based on the income or profits from any person from any property for purposes of section 856(d)(2)(A). Additionally, we do not rule on whether Taxpayer's recurring revenue streams are qualifying income under the Income Tests. Finally, we do not rule on whether any income derived from a service provided in connection with the use of Taxpayer's colocation data centers or a Facility constitutes impermissible tenant service income under section 856(d)(7).

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalties 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.

These rulings are directed only to the taxpayer that requested them. Section 6110(k)(3) provides that these rulings 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.

Sincerely,

Matthew P. Howard
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Financial Institutions and Products)

Enclosures:

Copy of this letter

Copy for 6110 purposes

cc: