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Date:
August 7, 2025

Legend:

Taxpayer =

Operating Partnership =

Country =

State A =

State B =

State C =

Date 1 =

Annual Minimum Amount =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

Dear :

This letter is in reply to a letter dated October 6, 2023, in which Taxpayer requests a ruling that certain payments to be received by Taxpayer for the use of space on and below the surface of the Taxpayer's timberlands constitute qualifying income for purposes of section 856(c)(2) and (3) of the Internal Revenue Code.

Facts

Taxpayer is a State A corporation that elected under section 856(c) to be a real estate investment trust ("REIT") beginning with its taxable year ended Date 1. Taxpayer owns approximately a percent of Operating Partnership, a State B limited partnership that is classified as a partnership for U.S. federal income tax purposes. Operating Partnership owns or controls approximately b acres of timberlands in the United States and Country (the "Timberlands"). Taxpayer has been approached by unrelated[1] third parties who are developing and implementing technologies for the capture of CO_2 emissions from industrial processes and the injection of that CO_2 into deep geological formations for storage. The aforementioned technologies allow the conversion of gaseous CO_2 into a supercritical fluid, the transfer of the CO_2 via pipeline owned by the third party or a common carrier across several miles of land (including land owned by persons unrelated to Taxpayer) to a facility owned and operated by the third party, and the injection of the supercritical CO_2 into underground formations, including saline formations, depleted hydrocarbon reservoirs, and basalt formations. The CO_2 will then move through the subsurface pore space but will be prevented from escaping into the atmosphere by various permanent trapping mechanisms. In some cases, the injected CO_2 will migrate through porous rock until the CO_2 reaches an impermeable layer of "seal rock" or other confining boundary. In other cases, while migrating through porous rock, some droplets of CO_2 will become permanently trapped in the pore space in porous rock. In yet other cases, if the CO_2 encounters brine water within the pore

[1] For purposes of this letter, an unrelated person means a person from which an amount received or accrued directly or indirectly by Taxpayer would not be excluded from rents from real property by operation of section 856(d)(2)(B).

space, a portion of the CO_2 will dissolve in the brine. Brine water containing dissolved CO_2 may react with the minerals in the surrounding rock to form solid mineral deposits.

Operating Partnership has entered into an agreement (the "Agreement") with one such unrelated third party (the "Storage User"). The Agreement permits the Storage User to (i) investigate, survey, locate, construct, maintain, inspect, test, repair, alter, replace, and operate a facility to conduct CO_2 storage operations (the "Carbon Storage Facility"); (ii) inject and store CO_2 in subsurface reservoirs at specified depths beneath a specific area of the Timberlands (such subsurface area, the "Storage Area" and such rights, the "Subsurface Storage Rights"); (iii) use certain surface space of the Timberlands (the "Surface," and together with the Storage Area, the "Premises") as needed to access, develop, and utilize the Storage Area, including the right to construct, maintain, and use pipelines and roads on the Premises to conduct the Storage User's operations on the Premises, as well as rights of ingress and egress necessary to access and operate the Carbon Storage Facility and associated pipelines and injection wells (the "Surface Use Rights"). The Surface is comprised of approximately c acres of Timberlands in State C. Taxpayer represents that the Premises are land and, therefore, real property for purposes of section 1.856-10(b).

The Agreement provides for an "Initial Term" and an "Injection Term." The Initial Term commenced on the effective date of the Agreement and will continue (i) up to d years from the effective date under the terms of the Agreement; or (ii) until the Storage User commences injecting CO_2 into the Storage Area. During the Initial Term, the Storage User only enjoys Surface Use Rights. The Surface Use Rights allow the Storage User to access the Surface as needed to access, develop, and utilize the Storage Area. In particular, the Surface Use Rights allow the Storage User to conduct exploratory activities to determine the suitability of the subsurface for purposes of storing CO_2 and facilitates the construction of a carbon injection facility.

During the Initial Term, with respect to the Surface Use Rights, the Storage User will pay (i) annual payments consisting of an initial upfront payment and a fixed annual payment for each year of the Initial Term ("Annual Payments"); and (ii) may pay one or more payments ("Surface Payments"), described in more detail below.[2] Taxpayer will treat the Annual Payments as rents from real property within the meaning of section 856(d) for purposes of the section 856(c)(2) and (3) and is not seeking a ruling to that effect.

If the Storage User commences injecting CO_2 into the Storage Area, the Initial Term will terminate and the Injection Term will begin. The Injection Term will continue as long as the Storage User continues to inject CO_2 into the Storage Area without a

[2] Storage User may also pay one or more payments during both the Initial Term and the Injection Term with respect to cut timber. Taxpayer is not seeking a ruling with respect to those payments.

lapse of more than e consecutive years, or f years in the aggregate.[3] Taxpayer anticipates that the Injection Term will last between h and i years.

During the Injection Term, the Storage User will continue to use the Surface Use Rights but will also utilize Subsurface Storage Rights. Once the Injection Term begins, the Storage User will no longer make the Annual Payments and will instead make monthly payments for the Subsurface Storage Rights based on the volume of the CO_2 injected into the Storage Area during the month (the "Injection Payments"). Specifically, an Injection Payment will be calculated as the product of (a) the metric tons of CO_2 injected into the Storage Area during the month and (ii) a specified dollar amount (the "Injection Payment Rate") per metric ton of CO_2. The Injection Payment Rate will be adjusted annually for inflation and will be increased proportionally based on any future increase in federal tax credit benefits for CO_2 sequestration above a specified, fixed base rate (with such increase equal to a percentage of the gross additional benefit to the Storage User). To the extent the Injection Payments for a year are less than an Annual Minimum Amount, the Storage User is required to pay the shortfall to Operating Partnership annually. Any such shortfall is included as an Injection Payment. In addition to the Injection Payments subject to the Annual Minimum Amount, the Storage User may pay the Operating Partnership one or more Surface Payments.

Surface Payments are made each time the Storage User expands its activities. Pursuant to the Agreement, a single Surface Payment is required when Storage User first occupies an area of the Surface. There are two types of Surface Payments. General Surface Payments are the first type of Surface Payments and consist of one or more payments calculated as $j per acre of the Surface occupied and utilized in connection with storage wells and associated equipment. The second type of Surface Payments are Specific Surface Payments. Each separate Specific Surface Payment is calculated based on (i) the length and type of pipelines and flowlines installed by Storage User; and (ii) the length and type of roads constructed, expanded, or upgraded by the Storage User.

The Storage User will be responsible for payment of any and all taxes or government charges that may be imposed on Operating Partnership in connection with the Storage User's property located on the Premises and the injection and storage of CO_2 in the Storage Area (such taxes and charges, the "Government Charges;" together with the Surface Payments and the Injection Payments, the "Storage User Payments"). Taxpayer represents that the Storage User Payments include amounts that are fixed, amounts that are determined by reference to volumes of CO_2, amounts that are determined by reference to Government Charges, and amounts that are determined by reference to the intensity of use of the Premises by the Storage User, but no amounts are determined by reference to the income or profits of any person. Taxpayer also represents that no Storage User Payment is for services or personal property.

[3] Any cessation of injection lasting less than g consecutive days will not be counted for this purpose.

The payment of the Surface Payments will not relieve the Storage User of its obligations (i) to indemnify Operating Partnership against all other damages caused by operations or activities under the Agreement or environmental damages and (ii) to restore the Premises as provided in the Agreement. Upon termination of the Agreement, the Storage User will be required to perform site remediation, including removing all structures (other than as described below) and restoring the Surface as nearly as practicable to its pre-Agreement condition. If the Storage User has constructed any pipelines on the Premises, Operating Partnership may decide to purchase them for salvage value. If Operating Partnership does not decide to purchase the pipelines, the Storage User will, at Operating Partnership's election, remove the pipelines and restore the associated parts of the Premises or abandon the pipelines in place. Taxpayer represents that it is common as a commercial matter for pipelines to be abandoned in place upon the expiration of an easement agreement with respect to the placement of such pipelines. The Storage User will also be required to remove all roads that it constructed on the Premises and restore the associated parts of the Premises unless Operating Partnership elects otherwise.

At all times during and after the termination of the Agreement, the Storage User will have the right to permanently store previously injected CO_2 in the Storage Area; will bear exclusive risk of loss with respect to CO_2 transported through the Carbon Storage Facility and stored in the Storage Area; will hold all right, title, interest, and ownership of CO_2 transported through the Carbon Storage Facility and/or injected into the Storage Area pursuant to the Agreement; and will indemnify Operating Partnership for any claims, damages, or losses resulting from a release, spill, emission, leak or discharge of CO_2.[4]

The rights granted to the Storage User run with and burden the Premises. As a result, any sale by Operating Partnership of all or a portion of the Premises will be subject to the terms of the Agreement. Further, under the terms of the Agreement, Operating Partnership has expressly not conveyed to the Storage User certain rights with respect to the Timberlands, including the right to continue managing the Timberlands as a working forest through the term of the Agreement and thereafter, as well as all rights with respect to timber, coal, oil, gas, water (except water needed for the Storage User's drilling operations), wind and solar resources, minerals, sand, gravel, and aggregates located in, on, over, or under the Premises.

Operating Partnership will not capture the CO_2 that will be stored, nor will it own or operate the equipment that converts captured CO_2 into a supercritical fluid state. Operating Partnership will not own or operate the pipeline used to transport the CO_2 or the equipment that injects the CO_2 into the Storage Area. Operating Partnership's sole role with respect to the CO_2 storage activities performed pursuant to the Agreement will

[4] Taxpayer anticipates that, in some cases, the State in which the CO_2 storage area is located may take title to the CO_2 after the term of the storage agreement. However, it is unlikely that any party would be able to extract the CO_2 after the expiration of the term of the relevant storage agreement because, once injected, the CO_2 is effectively unrecoverable due to the trapping mechanisms.

be the granting of rights to the Storage User to use and occupy Operating Partnership's real property.[5]

Law and Analysis

Section 856(c)(2) provides that, for a corporation to qualify as a REIT for a taxable year, at least 95 percent of the corporation's gross income for the year (excluding gross income from prohibited transactions) must be derived from certain enumerated sources, which 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, and certain commitment fees.

Section 856(c)(3) provides that, for a corporation to qualify as a REIT for a taxable year, at least 75 percent of the corporation's gross income for the year (excluding gross income from prohibited transactions) must be derived from certain enumerated sources, which include 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), distributions on 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, and qualified temporary investment income.

Section 856(c)(5)(C) and section 1.856-3(c) of the Income Tax Regulations define the term "interests in real property" to include fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, and options to acquire such interests in land or improvements thereon.

Section 1.856-10(b) defines the term "real property" to mean land or improvements to land. Section 1.856-10(c) defines "land" to include water and air space superjacent to land and natural products and deposits that are unsevered from the land. Natural products and deposits, such as crops, water, ores, and minerals, cease to be real property when they are severed, extracted, or removed from the land. The storage of severed or extracted natural products or deposits, such as crops, water, ores, and minerals, in or upon real property does not cause the stored property to be recharacterized as real property.

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[5] Taxpayer does not intend to provide, directly or indirectly, any services to the Storage User. To the extent that any services are provided to the Storage User, Taxpayer represents that consistent with section 1.856-4(b)(1), all such services will be services that are customarily provided to other third parties who store CO_2 in subsurface reservoirs like the Storage Area. Taxpayer represents that any impermissible tenant service income for any taxable year will not exceed 1% of all amounts received or accrued during such taxable year directly or indirectly by Taxpayer with respect to the Premises within the meaning of section 856(d)(7)(B). No ruling was requested and, therefore, no opinion is expressed as to any services provided by Taxpayer.

Section 856(d)(1) provides that rents from real property include (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 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.

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 of sales).

Section 1.856-4(a)(1) provides that the term "rents from real property" generally means the gross amounts received for the use of, or the right to use, real property of the REIT.

Revenue Ruling 73-426, 1973-2 C.B. 223, provides that if a REIT obligates a lessee under the terms of the lease agreement to pay the amount of state and local real property taxes imposed on the REIT's property, such amount is for the use of, or right to use the property, and therefore, constitutes additional rental income to the REIT and qualifies as rents from real property within the meaning of section 856(d).

Revenue Ruling 68-291, 1968-1 C.B. 351, clarifying Revenue Ruling 59-121, 1959-1 C.B. 212, provides generally that the consideration received for the granting of a permanent easement constitutes the proceeds from the sale of an interest in real property and should be applied as a reduction of the cost or other basis of the portion of the land subject to the easement, with any excess treated as gain.

In *Vest v. Commissioner,* 481 F.2d 238 (5th Cir. 1973), the Fifth Circuit, affirming the Tax Court, held that certain payments for the grant of various surface rights incident to a mineral lease were in the nature of rent. The Vests received surface payments under an agreement with Standard Oil for certain surface activities (well locations, flowlines, roads, etc.) which were necessary to the exploration of the subsurface mineral rights also acquired under the agreement. The agreement further required Standard to pay the Vests for all actual damage to the surface of the property independent of its obligation to pay for the aforementioned surface activities. The Fifth Circuit reasoned that the Vests could not logically be compensated for damages twice and, therefore, concluded that the surface payments were in the nature of rental income. *See*, *Vest* at 245-246. Similarly, the Specific Surface Payments received by Taxpayer do not relieve the Storage User from restoring the Premises as provided in the Agreement. Therefore,

the Specific Surface Payments described above can be considered to be in exchange for the use of the Premises and not a duplication of the obligation to remediate damage to the Surface.

The Storage User Payments are payments for the use of the Premises during the term of the Agreement, payments for a permanent interest in the Premises, or a combination of both. Taxpayer represents that the surface and subsurface of the Premises are land and, therefore, real property for purposes of section 1.856-10(b). The Storage User Payments include amounts that are fixed, amounts that are determined by reference to volumes of CO_2, amounts that are determined by reference to Government Charges, and amounts that are determined by reference to the intensity of use of the Premises by the Storage User, but no amounts are determined by reference to the income or profits of any person. No Storage User Payments are for services or personal property. Thus, to the extent a Storage User Payment is for a permanent interest in the Premises, akin to a permanent easement, the Storage User Payment is a payment for the sale of an interest in real property. To the extent the Storage User Payment is for the use of the Premises during the term of the Agreement, the payment meets the general definition of rents from real property in section 1.856-4(a)(1).

Conclusion

Based on the facts submitted and representations made by Taxpayer, we conclude that (a) Taxpayer's gross income attributable to any Storage User Payment that is for a permanent interest in the Premises is gain from the sale or other disposition of an interest in real property for purposes of section 856(c)(2)(D) and (3)(C), and (b) Taxpayer's gross income attributable to any Storage User Payment that is not for a permanent interest in the Premises is rents from real property described in section 856(c)(2)(C) and (3)(A).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. Except as specifically ruled upon above, no opinion is expressed concerning any Federal income tax consequences related to the facts herein under any other provisions of the Code. Specifically, we express no opinion whether Taxpayer qualifies as a REIT under part II of subchapter M of chapter 1 of the Code. Additionally, no opinion is expressed regarding whether any sale or disposition of property is a prohibited transaction for purposes of section 857(b)(6).

This ruling is directed only at the taxpayer that requested it. Section 6110(k)(3) provides that it 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 letter ruling to your authorized representatives.

The rulings in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed

by an appropriate party. Although this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

_____
Matthew Howard
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:

Copy of this letter
Copy for section 6110 purposes

cc: