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Legend

Taxpayer =

State =

a =

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Dear :

This responds to a letter dated November 18, 2019, and supplemental correspondence, requesting rulings on behalf of Taxpayer. Taxpayer requests rulings that (1) amounts paid by unrelated third parties for the use of certain telecommunications infrastructure assets under leases, licenses, or other similar agreements constitute "rents from real property" under section 856(c)(2) and (c)(3) of the Internal Revenue Code; and (2) 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 (c)(3).

FACTS

Taxpayer is a State Corporation that intends to elect to be taxed as a real estate investment trust ("REIT") under sections 856 through 859. Taxpayer constructs and/or acquires telecommunication infrastructure assets (the "Systems") and then leases,

licenses and/or otherwise grants the use of the Systems to unrelated third party wireless carriers (the "Users"). Taxpayer owns the Systems through one or more entities that will be disregarded for federal income tax purposes. Taxpayer also owns or will acquire interests, such as leasehold or license interests, easements, rights-of-way, rights of use, attachment rights or other similar rights or interests, with respect to land, buildings and/or other inherently permanent structures to support each System (the "Real Estate Rights"). The primary component of each System (other than the Real Estate Rights) is fiber optic cable. Each System also includes optical converters, amplifiers, antennae and other personal property associated with the Systems that perform an active function (the "Equipment"). In some cases the optical converters, amplifiers and antennae are owned by Taxpayer and in other cases they are owned by the User. Taxpayer represents that the Systems (excluding the Equipment and the Real Estate Rights) constitute inherently permanent structures within the meaning of section 1.856-10(d)(2)(i) of the Income Tax Regulations.

Ruling Request 1- Rents from the Use of the Systems

The Use Agreements

Taxpayer enters into an agreement with a User granting the User the use of the Systems (the "Use Agreements"). The Use Agreements typically have an initial term of a to b years with multiple a-year renewal options. A Use Agreement requires a User to pay Taxpayer a recurring monthly or quarterly charge for the use of the Systems that may escalate annually based upon a fixed amount or an index that tracks inflation, such as the Consumer Price Index. Taxpayer represents that no amount received under a Use Agreement will be based, in whole or in part, on a percentage of any person's income or profits. In some cases, a Use Agreement may also require a nonrecurring payment at the inception of the Use Agreement, and Taxpayer represents that this nonrecurring payment is for the use of the Systems over time.

Taxpayer reserves capacity for a User under a Use Agreement and does not oversell capacity. In addition, the User pays for such reserved capacity regardless of whether it uses that capacity. Each Use Agreement specifies a particular System and each User will have dedicated fiber optic strands and coaxial cable or dedicated wavelengths and frequencies on fiber optic strands and coaxial cables in that System, such that the Users' signals will not be combined. Where a User has a right to a portion of the capacity of a fiber optic cable (rather than an entire strand), the User will have an exclusive right to use a dedicated wavelength within the specified fiber optic pathway, but may not have a right with respect to a specifically identified strand or specific wavelength within a specifically identified strand in a fiber optic cable. In other words, although the User may not be guaranteed a specific wavelength in a specific strand in the fiber optic cable, it is guaranteed a wavelength in a strand within the fiber optic cable in the System.

Activities and Services Provided under the Use Agreements

Taxpayer is obligated to perform certain activities with respect to the Systems. These activities include designing the Systems, constructing the Systems, installing the components of the Systems, and providing limited maintenance and ongoing monitoring of the Systems (other than monitoring and maintaining the Equipment or any assets owned by a User) (the “Activities”). Taxpayer will also undertake Activities when a portion of the System needs to be demolished and replaced due to construction in a building, the relocation of utility poles, or other similar events.

Maintaining and monitoring the Systems means responding to alarm conditions, inspecting a System periodically to ensure it is working properly, repairing broken components of a System (other than the Equipment or any assets owned by a User), and making adjustments to a System to ensure that a System is operational, safe and secure (as opposed to maximizing the quality of a System’s performance as to a particular User). For example, when an unrelated third party intends to dig at a particular location, that party is required to call 811 to ensure that there are no utilities (including fiber optic cable) in the area. In such a case, Taxpayer will locate its fiber optic cable and mark its presence with flags or semi-permanent paint. Taxpayer will also relocate fiber optic cable when necessary due to construction activity (a road next to the fiber optic cable is widened, the poles upon which the fiber optic cable hangs are relocated, etc.). In addition, Taxpayer will repair the fiber optic cable if it is cut or otherwise damaged. Taxpayer represents that the Activities are in furtherance of the Taxpayer’s fiduciary capacity to manage the affairs of the REIT itself within the scope of section 1.856-4(b)(5)(ii).

Per the Use Agreements, Taxpayer is obligated to make electricity available to each User to operate its equipment. Thus, Taxpayer may arrange for electrical service to be provided to the Users by the local utility, an independent contractor as defined in section 856(d)(3) (“IK”). The local utility company will perform any work necessary to provide power to a particular location. The installation of separate meters or disconnect boxes for power connection at specific locations along the Systems will be performed by a taxable REIT subsidiary (“TRS”) or an IK. Each User typically pays Taxpayer a one-time charge for the installation of meters or other necessary equipment for the provision of electricity and then pays recurring charges for the electricity through the term of the Use Agreement. The recurring charge for the electricity will either be paid by the User as part of its recurring monthly or quarterly charge under its Use Agreement or directly to the utility company.

Also per the Use Agreements, space is given to Users for the Users to place their communications equipment that connects to the Systems. This space is within a secure room or other restricted access area where the System is located that holds multiple Users’ equipment. Taxpayer is obligated to provide physical security for these restricted access areas. Physical access to these restricted access areas is controlled through a tightly managed, controlled process via Taxpayer’s network operations center. Any site

access by any visitor must be scheduled in advance. Individuals visiting these sites must check-in and check-out through the network operations center using a keypad. The restricted access areas are also monitored remotely at the network operations center through video cameras. While on site, the visitors are monitored by security cameras to ensure service continuity, asset protection, and the safety of the personnel working in these facilities. Access to the network operations center offices is controlled by key card.

Additionally, because Taxpayer owns the Real Estate Rights, it is responsible for maintaining and repairing the Equipment. Either a TRS or an IK will monitor, operate, manage, maintain and repair the Equipment. The Equipment owned by one User is often located in close proximity to the Equipment owned by another User. In order to limit those who have access to space containing the Users' equipment, a TRS or IK will also be responsible for maintaining and repairing the Equipment owned by a User that is connected to a System. The Use Agreement may or may not contain a separately stated charge for the cost of installing, monitoring, operating, managing, maintaining, moving, repairing, and replacing Equipment or any assets owned by a User. Taxpayer represents that all of these activities will be undertaken by a TRS or an IK, regardless of who owns the Equipment.

Taxpayer represents that all services provided to Users in connection with the lease of its Systems are customarily provided by lessors of telecommunication infrastructure assets in the geographic area in which Systems are located. Taxpayer further represents that the TRS or IK will receive a fair market value, arm's-length fee from Taxpayer for any services provided to the Users for purposes of section 857(c)(7).

In addition, Taxpayer represents that the rent attributable to the Equipment and other personal property which is leased under, or in connection with the lease of a System 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.

Ruling Request 2- Section 481(a) adjustment

Taxpayer will file a Form 3115, Application for Change in Accounting Method, under the automatic change procedures described in Rev. Proc. 2015-13, 2105-5 I.R.B. 419, to change its method of accounting for the depreciation of certain assets beginning with the year in which Taxpayer elects to be treated as a REIT. This automatic change will result in a positive adjustment under section 481(a) that will be includible in Taxpayer's taxable income over a period of four years (the "Section 481(a) Adjustment"). The Section 481(a) Adjustment relates to a change in the depreciable useful life of real property being changed from a class of real property with a shorter useful life to a different class of real property with a longer useful life.

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.

Ruling Request 1

Section 856(d)(1) provides that “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 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 1.856-4(b)(1) provides that, for purposes of sections 856(c)(2) and (c)(3), the term rents from real property includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services furnished to the tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class (such as luxury apartment buildings) are customarily provided with the service. In particular geographic areas where it is customary to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of such utilities to tenants in such buildings will be considered a customary service. To qualify as a service customarily furnished, the service must be

furnished or rendered to the tenants of the REIT or, primarily for the convenience or benefit of the tenant, to the guests, customers, or subtenants of the tenant.

Section 1.856-4(b)(5)(ii) provides that the trustees or directors of a REIT are not required to delegate or contract out their fiduciary duty to manage the REIT itself, as distinguished from rendering or furnishing services to the tenants of its property or managing or operating the property. Thus, the trustees or directors may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the REIT itself. For example, the trustees or directors may deal with taxes, interest, and insurance relating to the REIT's property. The trustees or directors may also make capital expenditures with respect to the REIT's property and may make decisions as to repairs of the REIT's property, the cost of which may be borne by the REIT.

Section 856(d)(2)(C) excludes impermissible tenant service income from the definition of rents from real property. Section 856(d)(7)(A) defines "impermissible tenant service income" to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by a REIT for (i) services furnished or rendered by the REIT to tenants of such property, or (ii) for managing or operating such property.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income with respect to a property for any taxable year exceeds one percent of all amounts received or accrued during such taxable year directly or indirectly by the REIT with respect to such property, the impermissible tenant service income of the REIT will include all of the amounts received or accrued with respect to the property. Section 856(d)(7)(D) provides that the amounts treated as received by a REIT for any impermissible tenant service shall not be less than 150 percent of the direct cost of the REIT in furnishing or rendering the service (or providing the management or operation).

Section 856(d)(7)(C) excludes from the definition of impermissible tenant service income (i) amounts received for services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income or through a TRS of the REIT, and (ii) amounts which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor

courts, or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, and the collection of trash are not considered as services rendered to the occupant.

In Rev. Rul. 2002-38, 2002-2 C.B. 4, a REIT pays its TRS an arm's length rate to provide noncustomary services to tenants. The REIT does not separately state charges to tenants for the services. Thus, a portion of the amounts received by the REIT from tenants represents an amount received for services provided by the TRS. The TRS employees perform all of the services and the TRS pays all of the costs of providing the services. The revenue ruling concludes that the services provided to the REIT's tenants are considered to be rendered by the TRS, rather than the REIT, for purposes of section 856(d)(7)(C)(i).

Taxpayer represents that the Systems (excluding the Equipment and the Real Estate Rights) are inherently permanent structures within the meaning of section 1.856-10(d)(2)(i) and are therefore real property for purposes of section 856. Under the Use Agreements, each User has a right to use or to occupy space on a System. The Use Agreements have an initial term of a to b years with multiple a-year renewal options. Each Use Agreement requires a fixed, recurring amount to be paid by a User during the term of the Use Agreement that may escalate annually based upon a fixed amount or an inflation tracking index. In addition, the User generally pays an upfront amount for the use of the System in addition to a recurring amount. The User is required to pay for the contracted usage and Taxpayer does not oversell capacity in its Systems so that Users always have access to their contracted usage, regardless of the User's actual usage. Taxpayer represents that no amount received under a Use Agreement will be based, in whole or in part, on a percentage of any person's income or profits. Accordingly, amounts received by Taxpayer for the right to use or to occupy space on a System qualifies as rents from interests in real property under section 856(d)(1)(A).

Taxpayer represents that any service that will be furnished or rendered to a User under a Use Agreement is a service that is customarily furnished to tenants of Systems of a similar class to that of Taxpayer in the same geographic area and, except for arranging for the provision of electricity and providing physical security of the restricted areas, are performed by either a TRS or an IK. Arranging for the provision of electricity and providing physical security, as described above, are services usually or customarily rendered in connection with the rental of telecommunication infrastructure assets similar to the Systems and which are necessary to maintain Taxpayer's property. Thus, for purposes of determining whether the income is qualifying income for REIT qualification purposes, income from arranging for the provisions of electricity and providing physical security, as described above, would be excluded from unrelated business taxable

income under section 512(b)(3) if received by an organization described in section 511(a)(2). In addition, Taxpayer represents that the performance of the Activities described above are an exercise of the fiduciary duties of the Taxpayer's directors in accordance with section 1.856-4(b)(5)(ii) and are not services rendered to a User in connection with the rental of real property. Therefore, the furnishing of services to Users and the provision of Activities described above by Taxpayer under a Use Agreement detailed above does not give rise to impermissible tenant service income, and will not cause any portion of the rents received by Taxpayer from Users for use of the Systems to fail to qualify as rents from real property under section 856(d).

Taxpayer further represents that the rent attributable to the Equipment and other personal property which is leased under, or in connection with the lease of a System 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.

Ruling Request 2:

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.

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.

As noted above, Taxpayer submitted a Form 3115 to change its method of accounting for depreciation of certain real estate assets. The method changes will result in a positive Section 481(a) Adjustment that will be includible in taxable income over a four-year period beginning with the taxable year in which Taxpayer makes its REIT election. Sections 856(c)(2) and (3) list 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).

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."

Any income resulting from a section 481(a) adjustment constitutes gross income. Pursuant to the authority under section 856(c)(5)(J), that income may be considered either as not constituting gross income under section 856(c)(2) or (3), or as gross income which qualifies under those provisions.

Exclusion of the Section 481(a) Adjustment 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, pursuant to section 856(c)(5)(J)(i), we conclude that Taxpayer's Section 481(a) Adjustment will not constitute gross income for purposes of sections 856(c)(2) and (3).

CONCLUSION

Accordingly, based on the facts as represented, we rule that amounts paid by Users under the Use Agreements for the use of a System constitute rents from real property under section 856(c)(2) and (c)(3); and (2) the 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 (c)(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 whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of chapter 1 of the Code. Furthermore, no opinion is expressed as to whether the Systems constitute inherently permanent structures within the meaning of section 1.856-10(d)(2)(i). Additionally, no opinion is expressed regarding the propriety of Taxpayer's method change or the amounts of the Section 481(a) Adjustment.

Furthermore, the ruling herein relates to whether income from services performed by Taxpayer is impermissible tenant service income and is specifically limited to whether the income is qualifying income for REIT qualification purposes. The definition of rents from real property under section 856(d) differs in scope and structure from the definition of rents from real property under section 512(b)(3), which applies to exempt organizations described in section 511(a)(2). Therefore, an exempt organization providing the same services may have unrelated business taxable income because the income may not be excluded under section 512(b)(3) as rents from real property.

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,

Andrea M. Hoffenson_________________
Andrea M. Hoffenson
Chief, Branch 2
Office of Chief Counsel
(Financial Institutions & Products)

cc: