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Department of the Treasury

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Person to Contact:

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Mall =

State Y =

Trust Co-Tenant =

Third-Party Co-Tenant =

Co-Tenancy Agreement =

This is in response to your letter dated December 28, 1998, as supplemented by subsequent correspondence, submitted on behalf of Trust requesting rulings in connection with Trust's election to be treated as a real estate investment trust (REIT) under § 856 of the Internal Revenue Code.

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FACTS

Trust is a State X corporation that files a consolidated return with affiliated corporations. Trust develops, acquires, owns, and manages commercial, retail, mixed-use, and industrial real estate projects (Projects) throughout the United States. The majority of the retail projects are enclosed regional shopping malls. The mixed-use projects generally consist of a retail project combined with an office building project. A number of mixed-use projects include industrial warehouse type buildings. Trust plans to elect REIT status effective Date 1.

Following its planned REIT election, any affiliated corporation, which is wholly-owned by Trust, directly or indirectly (a "Direct Subsidiary" or an "Indirect Subsidiary"), will be treated as a qualified REIT subsidiary (QRS) under § 856(i)(2) of the Code. Trust, directly or indirectly through one or more Direct or Indirect Subsidiaries, also holds interests in lower tier partnerships.

Management Fees Received by Trust Co-Tenant

A number of Trust's Projects are managed by a Direct Subsidiary or Indirect Subsidiary, which following Trust's REIT election, will be treated as a QRS beginning on Date 1. Management activities and services that are required under management agreements or tenant lease agreements are performed by either the managing QRS or by an unrelated third party from which Trust does not derive any income and which is intended to qualify as an independent contractor within the meaning of § 856(d)(3) of the Code (Independent Contractor). The management activities and services include providing usual and customary utilities and common area maintenance, as well as arranging and supervising installations and improvements in connection with leased space.

In the case of Mall, an enclosed regional shopping mall located in State Y, the real property is held by Trust indirectly as a tenant in common. Mall is jointly owned by Trust Co-Tenant and an unrelated entity, Third-Party Co-Tenant. Trust Co-Tenant, a State X corporation, is an Indirect Subsidiary that will be treated as a QRS following the REIT election. Trust Co-Tenant and Third-Party Co-Tenant hold equal, undivided interests in Mall.

Pursuant to the Co-Tenancy Agreement, all property management services and activities to be provided at Mall are delegated to Trust Co-Tenant as attorney-in-fact for Third-Party Co-Tenant. The property management activities and services to be provided at Mall are generally the same as the management activities and services provided by Manager at Trust's other retail Projects. Trust Co-Tenant receives a separately computed management fee as

compensation for the performance of property management activities and services. The management fee is equal to a percent of the gross revenues from normal operations from Mall. In accordance with Trust Co-Tenant's 50 percent interest in Mall, profits and losses are shared equally, subject to distribution preferences to Trust affiliates of Trust Co-Tenant, as provided under the Co-Tenancy Agreement.

With respect to the management activities and services provided by Trust Co-Tenant at Mall, Trust makes the following representations:

(a) Trust Co-Tenant will perform directly only those activities and services that are usually and customarily furnished or rendered in connection with the rental of a similar class of building located in the geographic market in which Mall is located.

(b) The activities and services performed by the Trust Co-Tenant are not rendered primarily for the occupant's convenience and are those that are customarily rendered in connection with the rental of space for occupancy only within the meaning of § 1.512(b)-1(c)(5) of the Income Tax Regulations.

(c) Any activities and services that are not customarily furnished or rendered in connection with the rental of real property within the meaning of § 1.856-4(b)(1) of the regulations will be performed by an Independent Contractor from whom Trust does not derive any income. See § 1.856-4(b)(5) of the regulations. Any activities and services that are rendered primarily for the occupant's convenience, or are not customarily rendered in connection with the rental of space for occupancy only within the meaning of § 1.512(b)-1(c)(5) of the regulations, will be performed by an unrelated third party from which Trust does not derive any income and which will qualify as an Independent Contractor.

Parking Income

Certain Projects contain parking facilities that are directly or indirectly owned by Trust, or are master-leased directly or indirectly by a city or developmental authority to Trust. The partnership or corporate entity that owns the Project in which the parking facility is located is a "Facility Owner." Trust, directly or indirectly through a lower-tier QRS or partnership, has an interest in the Facility Owner from which it derives parking income. The parking facility in each case is managed and operated by an unrelated third party provider of parking services (Parking Service

Company) under a management agreement with the Facility Owner (Parking Management Agreement).

Pursuant to the Parking Management Agreement, the Facility Owner grants the exclusive right to manage and operate the parking facility to Parking Service Company for a renewable one-year term. Each parking facility is a "self-park" operation, where patrons park their own cars and a Parking Service Company attendant is present only to collect money for the use of the parking spaces.

Parking Service Company, with approval of the Facility Owner, is also permitted to provide ancillary services, such as valet parking, pay telephones, and vending machines. The ancillary services have been represented as being those usually and customarily provided in parking facilities located in or immediately adjacent to properties of a similar class to Project in the relevant geographic market in which the particular Project is located. To the extent these ancillary services are made available at a parking facility, Parking Service Company does so through a third-party contractor unrelated to Trust that will qualify as an Independent Contractor and pursuant to an agreement between Parking Service Company and the particular Independent Contractor. Neither Trust nor the Facility Owner, directly or indirectly, is a party (or an agent of any party) to, or a beneficiary of, any of these contractual arrangements.

With respect to each Project in which there is a parking structure or lot operated by Parking Service Company, tenants and their employees or customers do not have access to alternative parking located within a reasonable distance. The parking facility was built as an integral component of the Project specifically to provide parking for tenants and their employees and customers. Although each parking facility is open to the public, parking spaces are not set aside for the general public; substantially all of the parking spaces at each location are used by tenants and their employees or customers.

The Parking Management Agreement reserves to the Facility Owner the right to allocate parking spaces to tenants, users, or other occupants of the Project. The Facility Owner also has the right to set aside parking spaces for monthly permit users. The number of monthly parking spaces will be determined by the Facility Owner in its sole discretion. Parking Service Company is further obligated to assist the Facility Owner in satisfying the off-site parking needs of its tenants. Tenants of a Project may rent parking spaces on a reserved basis for their employees or customers. Although the employees or customers of a particular tenant are entitled to

the exclusive use of a specified number of spaces, they have no claim to any particular assigned spaces.

Management oversight by the Facility Owner under the Parking Management Agreement is limited to the following rights: (i) right to terminate the arrangement in the event Parking Service Company defaults in the performance of any provision under the Parking Management Agreement; (ii) right to establish rates to be charged by users; (iii) right to designate parking spaces for allocation to tenants and for monthly parking; (iv) right to consult with Parking Service Company concerning the garage operation, including the right to request additional services; and (v) right to approve operating budget which is prepared by Parking Service Company and sets forth estimated revenues and operating expenses. The Parking Management Agreement generally assigns responsibility for structural maintenance and repair to the Facility Owner, and responsibility for cleaning, payment of utilities, repainting stall markings, snow removal, and the ordinary repair of parking equipment and other non-structural items to Parking Service Company.

Parking Service Company handles the administrative paperwork associated with monthly billing and receipt of parking income. Operating expenses are paid from a disbursement account funded by, and pursuant to, a budget pre-approved by the Facility Owner. After payment of operating expenses, Parking Service Company remits the balance to the Facility Owner. As compensation for managing and operating the parking facility, Parking Service Company receives a "Basic Fee" equal to a fixed amount per annum plus an "Incentive Fee" equal to a percentage of net operating surplus in excess of a designated amount.

In connection with each parking facility, Trust makes the following representations:

(a) Substantially all of the parking spaces at each parking facility are used by tenants and their employees or customers.

(b) The "self-park" operation is usual and customary in the geographic area where the parking facility is located.

(c) All services relating to the provision of parking spaces in the parking facilities to tenants, their employees, customers, and guests, as well as to the general public will be performed by Parking Service Company.

(d) Parking Service Company qualifies as an Independent Contractor from whom Trust does not derive or receive any income.

(e) Any and all activities and ancillary services rendered to parking patrons or provided for their benefit by Parking Service Company or any other Independent Contractor are usually and customarily provided in parking facilities located in or immediately adjacent to properties of a similar class to Project in the relevant geographic market in which the particular Project is located.

(f) All parking facility attendants are employed directly or indirectly by Parking Service Company and not by Trust or the Facility Owner.

(g) Parking Service Company compensation under the Parking Management Agreement will be commensurate with the fees charged to manage and operate similar parking facilities in the relevant geographic markets in which the parking facilities are located, and each Parking Management Agreement is negotiated on an arm's length basis.

(h) Income attributable to the performance of management oversight, and structural maintenance and repair by the Facility Owner as described above, will not constitute impermissible tenant service income as defined in § 856(d)(7) of the Code.

Trolley Cart Concession Income

Trust indirectly receives license fees from concessions granted to third party merchants to sell merchandise at kiosks or from trolley or push carts located in retail Projects. These concessions are granted under temporary license agreements in which designated floor space and movable trolley carts (or "mobile retail units"), which belong to the Project owner, are licensed to third-party merchants. Each concession is assigned designated floor space in an identified area of the mall. The designated floor space is identified in a schedule that accompanies the temporary license agreement. The designated floor space typically ranges in area from approximately 108 to 120 square feet.

The license fees under these temporary license agreements consist of (i) a start-up fee; (ii) a minimum license fee; (iii) a mobile retail unit if applicable; (iv) additional license fees based on a fixed percentage of gross sales in

excess of a designated breakpoint (based on the actual sales price of all merchandise sold); and (v) miscellaneous charges.

In connection with the license arrangement, Trust makes the following representations:

(a) The license fees are not based on the "net income" of the licensee.

(b) In accordance with § 856(d)(1) of the Code, the portion of the license fee attributable to the mobile rental unit for the taxable year does not exceed 15 percent of the total license fee for the taxable year attributable to both the real and personal property leased in connection with such license. For this purpose, the license fee attributable to personal property for the taxable year is the amount that bears the same ratio to the total license fee for the taxable year as the average of the adjusted bases of the personal property at the beginning and at the end of the taxable year bears to the average of the aggregate adjusted bases of both the real property (i.e., the designated floor space) and the personal property at the beginning of such taxable year.

LAW AND ANALYSIS

Section 856(c)(2) of the Code 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(d)(1) of the Code provides that "rents from real property" include (subject to the exclusions in § 856(d)(2)): (i) rents from interests in real property, (ii) charges for services customarily furnished or rendered in connection with the rental of real property (whether or not such charges are separately stated), and (iii) 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 year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 1.856-4(a) of the Income Tax Regulations provides that, in general, and subject to certain exceptions, the term "rents from real property" means the gross amounts received

for the use of, or the right to use, real property of the REIT.

Section 1.856-4(b)(1) of the regulations provides that "rents from real property" includes charges for certain services that are customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. A service furnished to tenants will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class are customarily provided with the service. Examples of customary services provided in many geographic market areas include the furnishing of water, heat, light, and air conditioning; the cleaning of windows, public entrances, exits and lobbies; the performance of general maintenance and janitorial and cleaning services; the collection of trash; and the furnishing of laundry equipment, guard services, parking facilities, and swimming pools.

Section 856(d)(2)(C) of the Code excludes from the definition of "rents from real property" any "impermissible tenant service income" as defined in § 856(d)(7). Section 856(d)(7)(A) provides that "impermissible tenant service income" means, with respect to any real or personal property, any amount received or accrued directly or indirectly by a REIT for furnishing or rendering services to the tenants of such property or 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 directly or indirectly by the REIT with respect to such property, the impermissible tenant service income of the REIT with respect to the property shall include all such amounts.

Section 856(d)(7)(C)(i) of the Code excludes from the definition of impermissible tenant service income amounts received for services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT itself does not derive or receive any income. In discussing the relaxing of restrictions on a REIT's ability to furnish services to its tenants without the use of an independent contractor, the Conference Committee Report stated:

> The conferees wish to make certain clarifications regarding those services that a REIT may provide under the conference agreement without using an independent contractor, which services would not cause the rents derived from the property in connection with which the services were rendered

> to fail to qualify as rents from real property (within the meaning of Section 856(d)). The conferees intend, for example, that a REIT may provide customary services in connection with the operation of parking facilities for the convenience of tenants of an office or apartment building, or shopping center, provided that the parking facilities are made available on an unreserved basis without charge to the tenants and their guests or customers. On the other hand, the conferees intend that income derived from the rental of parking spaces on a reserved basis to tenants, or income derived from the rental of parking spaces to the general public, would not be considered to be rents from real property unless all services are performed by an independent contractor. Nevertheless, the conferees intend that income from the rental of parking facilities properly would be considered to be rents from real property (and not merely income from services) in such circumstances if services are performed by an independent contractor.

H.R. Rep. No. 841. 99th Cong., 2d Sess. 1, II-220 (1986), 1986-3 (Vol. 4) C.B. 1, 220.

Additionally, § 856(d)(7)(C)(ii) excludes from the definition of impermissible tenant service income any amount which would be excluded from unrelated business taxable income under § 512(b)(3) if received by an organization described in § 511(a)(2). Section 1.512(b)-1(c)(5) of the regulations 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. Payments for the use or occupancy of entire private residences or living quarters in duplex or multiple housing units, or offices in any office building, are generally treated as rent from real property.

Under § 1.856-3(g) of the regulations, 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 of the Code, 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 § 856.

With respect to the management fees received by Trust Co-Tenant for services performed at Mall, Trust represents that the services performed by Trust Co-Tenant for Mall will be usual and customary services that are ordinarily expected of a lessor in the geographic area in which Mall is located and are not services rendered for the convenience of the tenants under the standard set forth in § 1.512(b)-1(c)(5) of the regulations. Accordingly, the services performed by Trust Co-Tenant will fall within the exception contained in § 856(d)(7)(C)(ii) of the Code and will not prevent Trust's share of amounts derived from Mall from qualifying as "rents from real property" under § 856(d)(1).

For purposes of § 856 of the Code, Trust will be deemed to receive its proportionate share of income from Mall, similar to the accounting for a partnership's allocable share under § 1.856-3(g) of the regulations, based on Trust Co-Tenant's undivided interest in Mall. Subject to certain exceptions, § 1.856-4(a) defines the term "rents from real property" to mean the gross amounts received for the use of, or the right to use, real property of a REIT. Gross amounts are generally not reduced for items such as management fees. The amount of the management fee apportioned to Trust, indirectly through Trust Co-Tenant's 50 percent interest, will already be reflected in Trust's share of "rents from real property." Because Trust, indirectly, will have a significant ownership interest in Mall by reason of Trust Co-Tenant's 50 percent interest, this share of the management fee to Trust will not be treated as a separate item of gross income and will be disregarded for purposes of § 856(c) of the Code. The amount of the management fee that is apportioned to the Third-Party Co-Tenant is considered non-qualifying income under § 856, but does not prevent Trust Co-Tenant's 50 percent share of otherwise qualifying amounts from Mall from qualifying as "rents from real property" under § 856(d)(1) of the Code.

With respect to parking income received directly or indirectly by Trust, Trust has represented that all of the services relating to the provision of parking spaces in the parking facilities to tenants, their employees, customers, and guests, as well as to the general public will be performed by Parking Service Company. Trust

has also represented that Parking Service Company is an Independent Contractor from whom Trust, directly or indirectly, does not derive any income and that a "self-park" operation is usual and customary in the geographic area where the parking facilities are located. Income attributable to the performance of management oversight, and structural maintenance and repair by the Facility Owner as described above, will not constitute impermissible tenant service income as defined in § 856(d)(7) of the Code. In collecting the parking revenues and remitting them to the Facility Owner net of its fees and operating expenses, Parking Service Company as an Independent Contractor is functioning as a conduit for delivering the revenues to the Facility Owner. Under these circumstances, therefore, neither Trust nor Facility Owner will be treated as directly or indirectly deriving or receiving income from Parking Service Company. Accordingly, Trust's allocable share of amounts received by Facility Owner pursuant to the Parking Management Agreement described above will qualify as "rents from real property" for purposes of § 856(d) of the Code.

With respect to the license fees received directly or indirectly by Trust from Trolley Cart Concessions at retail Projects, Trust, directly or indirectly, owns the mobile retail unit that is leased along with the floor space to the third-party tenant. Trust represents that it will treat income from the rental of the designated floor space and personal property leased in connection with the Trolley Cart Concessions as required by § 856(d) of the Code. Accordingly, Trust's allocable portion of otherwise qualifying income derived from the Trolley Cart Concessions under these circumstances constitutes "rents from real property" under § 856(d).

HOLDINGS

Accordingly, based on the facts submitted and representations made, we rule as follows:

(1) Management fees received by Trust Co-Tenant for rendering usual and customary management services in connection with Mall, which is owned by Trust Co-Tenant and Third-Party Co-Tenant as tenants in common, will be disregarded in applying the gross income tests of § 856(c) of the Code to the extent of Trust Co-Tenant's 50 percent undivided interest.

(2) Otherwise qualifying income derived by Trust, directly or indirectly, from the parking facilities at Projects under the described Parking Management Agreement between the Facility Owner and Parking Service Company will qualify as "rents from real property" under § 856(d)(1) of the Code, subject to any allocation under § 1.856-3(g) of the

regulations if the Project is held by a partnership in which Trust has an indirect capital interest.

(3) License fee income derived by Trust, directly or indirectly, from the temporary license agreements described above with respect to Trolley Cart Concessions, if otherwise qualifying, will qualify as "rents from real property" under § 856(d)(1), subject to allocation under § 1.856-3(g) of the regulations if the Project is held by a partnership in which Trust has an indirect capital interest, and provided that the portion of the license fee attributable to the mobile retail unit does not exceed 15 percent of the total license fees attributable to both the real property (the designated floor space) and the mobile retail unit as measured in accordance with § 856(d)(1).

Except as specifically ruled upon above, no opinion is expressed or implied regarding the consequences of this transaction under any other provision of the Code. In particular, no opinion is expressed whether any Direct Subsidiary or Indirect Subsidiary will qualify as a REIT subsidiary, or whether Trust qualifies as a REIT under § 856 of the Code.

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

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions
and Products)

By: Alice M. Bennett
Alice M. Bennett
Chief, Branch 3

Enclosures:
Copy of this letter
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