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Department of the Treasury
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Date:
May 14, 2021

Legend

Taxpayer =

State =

Date =

Facility A =

Facility B =

Pipeline A =

Pipeline B =

Port =

Port Authority =

Product =

a =

b =

c =

d =

e =

f =

Dear :

This letter responds to a letter dated November 12, 2020, and subsequent submissions, requesting a ruling on behalf of Taxpayer. Taxpayer requests a ruling that amounts received by Taxpayer from unrelated third parties for the use of certain real property assets described below qualify as rents from real property under section 856(d) of the Internal Revenue Code (the Code) for purposes of sections 856(c)(2) and (3).

FACTS

Taxpayer was formed as a State limited liability company on Date, and is currently disregarded for U.S. federal income tax purposes. Taxpayer intends to elect to be taxed as a real estate investment trust (REIT) under sections 856 through 859 of the Code. Taxpayer principally invests in U.S. energy infrastructure assets, including storage terminal facilities and pipelines, as described below. Taxpayer currently holds its assets through entities that are disregarded for U.S. federal income tax purposes. Taxpayer intends to make a joint election with a subsidiary to treat it as a taxable REIT subsidiary (TRS).

A. Storage Terminal Facilities

Taxpayer owns two storage terminal facilities, Facility A and Facility B (each, a Storage Terminal Facility). The Storage Terminal Facilities include various interests in or rights to occupy land, driveways, roadways, docks, rail spurs, dikes, fencing, loading/unloading facilities, and storage tanks. The Storage Terminal Facilities also include other types of real property, including pipes, pipelines, and other inherently permanent steel structures (for example, racks or docks) and structural components of inherently permanent structures (for example, vents or fire suppression systems). Facility A includes waterfront located in the Port with stationary wharves and docks for tankers. Taxpayer represents that all of the assets described above are either land, interests in land, inherently permanent structures, or structural components of an inherently permanent structure within the meaning of section 1.856-10 of the Income Tax Regulations.

Taxpayer enters into agreements with unrelated third-party users of the Storage Terminal Facility (Storage Terminal Users) permitting Storage Terminal Users to store their products at, and move their products through, the Storage Terminal Facility for a term that is generally between a and b years, and in no event less than c (Terminal Usage Agreements). Taxpayer represents that, with respect to each Terminal Usage Agreement, rent attributable to pumps, compressors, meters, or other personal property that is leased under, or in connection with, the lease of the Storage Terminal Facility 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 agreement.

A Terminal Usage Agreement may or may not specify the tank in which the Storage Terminal User's product will be stored. In some cases, a specified tank or tanks is identified and dedicated to a Storage Terminal User. In other cases, the Storage Terminal User has a right to a fixed portion of the storage capacity at the Storage Terminal Facility but does not have a particular tank or tanks dedicated to it. Taxpayer does not oversell storage capacity and is obligated at all times to ensure that the capacity specified in a Terminal Usage Agreement is reserved for and available to the Storage Terminal User. A Terminal Usage Agreement may provide for the lease of a portion of the capacity of a storage tank, as opposed to a lease of the entire storage tank, when the stored content is fungible and may be stored on a comingled basis. At all times, the Storage Terminal Users retain title to the product stored at the Storage Terminal Facility.

Taxpayer will only undertake activities with respect to the Storage Terminal Facilities that are consistent with its fiduciary duty to manage itself. Taxpayer will design, construct, inspect, maintain, and repair storage tanks and other real property assets located at each Storage Terminal Facility. Taxpayer will also paint and repair the storage tanks to prevent atmospheric corrosion or excessive wear and tear, and test product in the storage tanks to verify that it is the product specified in the Terminal Usage Agreement solely to ensure the safety and integrity of the storage tanks and the environment.

Taxpayer will also provide electricity to light the Storage Terminal Facilities and provide security, including monitoring through security cameras and the provision of security guards, at the Storage Terminal Facilities. Additionally, Taxpayer may heat, cool, or pressurize the storage tanks located at a Storage Terminal Facility and may circulate product stored in a storage tank. Such heating, cooling, pressurization, or circulation[1] is performed only when it is necessary to avoid damage to the storage tanks, pipes, and stored product (for example, so the stored product does not congeal in the storage tanks) and to make storing a product more efficient (for example, to keep a product like Product in a liquid state). Taxpayer represents that it is customary for storage tanks to be designed with the foregoing systems and that the heating, cooling,

[1] Circulation is separate and apart from the blending of two products as requested by a Storage Terminal User. Circulation is performed to minimize the accumulation of sediment deposits on the storage tank floor in order to protect the storage tanks from the build-up of sediment.

pressurization, or circulation will be applied, as necessary, at standard industry settings depending on the product stored therein, will not be customized for an individual Storage Terminal User, and that the systems are not provided primarily for the convenience of a particular Storage Terminal User. Further, Taxpayer represents that these services are necessary for the passive storage of the relevant products.

A TRS will perform all other activities and services. These services will include connecting and disconnecting loading lines and moving product, capturing and burning off vapors that are displaced when product is loaded into vessel storage tanks, adding agents or additives to product in a storage tank for the benefit of a Storage Terminal User, taking samples of product in a storage tank for the benefit of a Storage Terminal User, and measuring or weighing product for the benefit of a Storage Terminal User. On rare occasions, the TRS may also move different types of products owned by a Storage Terminal User into a single tank, which effects a blending of the different products. The TRS will monitor, operate, manage, and repair pumps, compressors, meters, and other personal property. The TRS will receive arm's length compensation from Taxpayer for the performance of these services.

Taxpayer represents that, consistent with section 1.856-4(b)(1), all services furnished to the Storage Terminal Users are customarily provided to tenants of similar properties in the geographic market in which the Storage Terminal Facility is located.

A Terminal Usage Agreement provides that storage tank capacity for a specified minimum volume of product will be reserved for the Storage Terminal User. Under the Terminal Usage Agreement, the fee paid by a Storage Terminal User (the Storage Fee) is paid on a monthly basis, is based on volume, and is generally calculated as a fixed dollar amount multiplied by the amount of product stored and handled at the Storage Terminal Facility. The fixed dollar amount per barrel may decrease if and when product stored for a particular Storage Terminal User exceeds an agreed upon minimum volume commitment for the month. The Storage Terminal User pays for the minimum volume of product each month regardless of whether it uses the capacity reserved for it. Taxpayer represents that the Storage Fee does not depend, in whole or in part, on the income or profits of any person.

Taxpayer entered into an easement (the Easement) with respect to submerged land owned by the Port Authority allowing Taxpayer to construct, maintain, repair, and operate a wharf, dock, or similar structure on the submerged land. In consideration for the Easement, Taxpayer is required to pay the Port Authority a wharfage fee (the Wharfage Fee) based on the amount of product loaded or unloaded at its facility. Pursuant to the Terminal Usage Agreements, Taxpayer collects the Wharfage Fee from the Storage Terminal Users and passes it on to the Port Authority without a mark-up. For tax purposes, Taxpayer includes the amounts it collects as Wharfage Fees in its gross income and deducts the Wharfage Fees it pays to the Port Authority.

B. Pipelines

Taxpayer owns a d percent equity interest in a long-haul pipeline (Pipeline A) and a e percent equity interest in a short-haul pipeline (Pipeline B) (each, a Pipeline). Taxpayer represents that the Pipelines are inherently permanent structures under section 1.856-10.

Taxpayer enters into agreements for the use of the Pipelines with unrelated third-parties (Pipeline Users). Each agreement to use a Pipeline is for a term that is generally between a and b years, and in no event less than c (Pipeline Use Agreements). Taxpayer represents that, with respect to each Pipeline Use Agreement, rent attributable to pumps, compressors, meters, or other personal property that is leased under, or in connection with, the lease of the Pipeline 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 agreement. Taxpayer does not oversell capacity on the Pipeline and is obligated at all times to ensure that the capacity specified in a Pipeline Use Agreement will be available for use by the Pipeline User.

The capacity of Pipeline B is currently substantially committed to a particular Pipeline User under a b year Pipeline Use Agreement, and it is possible that the remaining capacity of Pipeline B may be used by other Pipeline Users from time to time. To date, the remaining Pipeline B capacity has been reserved by only one other Pipeline User under a Pipeline Use Agreement with a duration of f months. Upon the expiration of the current b year Pipeline Use Agreement, Taxpayer intends to enter into another long-term Pipeline Use Agreement or Agreements with the same and/or other Pipeline Users. Taxpayer will treat as rents from real property only those Pipeline Use Fees (defined below) earned under Pipeline Use Agreements with a term of at least c.

Taxpayer will only undertake activities with respect to the Pipelines that are consistent with its fiduciary duty to manage itself. Taxpayer will design, construct, inspect, monitor, maintain, and repair the Pipelines. Taxpayer will mark the location of the Pipelines to minimize the possibility of damage due to digging by unrelated third parties. Taxpayer may also test product as it enters a Pipeline to verify that it is the product specified in the Pipeline Use Agreement solely to ensure the safety and integrity of the Pipeline and the environment.

A TRS will perform all other activities and services, including scheduling use of the Pipeline by the Pipeline Users. The TRS will monitor, operate, manage, maintain, and repair pumps, compressors, meters, and other personal property. The TRS will receive arm's length compensation from Taxpayer for the performance of these services.

Taxpayer represents that, consistent with section 1.856-4(b)(1), all services furnished to the Pipeline Users are customarily provided to tenants of similar properties in the geographic market in which the Pipeline is located.

The fee paid by a Pipeline User (the Pipeline Use Fee) is paid on a monthly basis, is based on the volume of product placed on the Pipeline, and is generally calculated as a fixed dollar amount multiplied by the amount of product placed on the Pipeline. The fixed dollar amount per volumetric measure (i) may change depending upon the volume of the Pipeline User's product flowing through the Pipeline and/or the origin point where the product is placed on the Pipeline and (ii) may increase periodically under the terms of the Pipeline Use Agreement by an agreed upon amount and/or based on the consumer price index or some other benchmark that measures inflation. The Pipeline User pays for the minimum volume of product each month that is specified in its Pipeline Use Agreement regardless of whether it uses the capacity reserved for it. Taxpayer represents that the Pipeline Use Fee does not depend, in whole or in part, on the income or profits of any person.

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 “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 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, such lease.

Section 856(d)(2)(A) provides that, subject to certain exceptions, 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 will not be excluded from rents from real property solely by reason of being based on a fixed percentage or percentages of receipts or sales).

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from 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 the REIT for services furnished or rendered by the REIT to the tenants of the property, or for managing or operating such property.

Section 856(d)(7)(C) provides certain exceptions from impermissible tenant service income. Section 856(d)(7)(C)(i) provides that for purposes of section 856(d)(7)(A), 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 shall not be treated as furnished, rendered, or provided by the REIT.

Section 856(d)(7)(C)(ii) provides that impermissible tenant service income does not include any amount 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 1.856-4(a) defines “rents from real property” generally as the gross amounts received for the use of, or the right to use, real property of the REIT.

Section 1.856-4(b)(1) provides that, for purposes of sections 856(c)(2) and (3), 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 as 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. 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 tenants, to the guests, customers, or subtenants of the tenants.

Section 1.856-4(b)(5)(ii) provides that the trustees or directors of the 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, including establishing rental terms, choosing tenants, entering into renewal of leases, and dealing with taxes, interest, and insurance relating to the REIT’s property. The trustees may also make capital expenditures with respect to the REIT’s property (as defined in section 263) and may make decisions as to repairs of the REIT’s property (of the type that would be deductible under section 162), the cost of which may be borne by the REIT. See also Rev. Rul. 67-353, 1967-2 C.B. 252.

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 rents 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.

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).

Taxpayer represents that the Storage Terminal Facilities and the Pipelines are real property for purposes of section 856. The Terminal Usage Agreements and the Pipeline Use Agreements will typically have a term of a to b years. No Terminal Usage Agreement or Pipeline Use Agreement will have a term of less than c. Each of the Terminal Usage Agreements and the Pipeline Use Agreements will provide the user with the exclusive right to use a fixed portion of the capacity of the Storage Terminal Facilities or the Pipelines throughout the term of the lease. Taxpayer represents that the Storage Fee and the Pipeline Use Fee do not depend, in whole or in part, on the income or profits of any person. Further, the Wharfage Fee is an amount received by Taxpayer for the use of Taxpayer's wharves and docks that Taxpayer must pay the Port Authority and is analogous to the state and local real property taxes in Revenue Ruling 73-426. Accordingly, each of the Storage Fee, Wharfage Fee, and Pipeline Use Fee is an amount received for the use of, or the right to use, real property of Taxpayer and qualifies as rents from interests in real property under section 856(d)(1)(A).

With respect to the Pipelines, Taxpayer represents that it will only undertake activities that are consistent with its fiduciary duty to manage itself and that a TRS will perform all other activities and services. With respect to the Storage Terminal Facilities, Taxpayer will only undertake activities that are consistent with its fiduciary duty to manage itself or that would produce 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), and a TRS will perform all other activities and services. In connection with the Storage Terminal Facilities, the heating, cooling, or pressurization of the storage tanks and the circulation of product stored in a storage tank is performed only when it is necessary to avoid damage to the storage tanks and pipes, to make storing a product more efficient; and is necessary for the passive storage of the relevant

products. Such heating, cooling, pressurization, or circulation is applied at standard industry settings depending on the product stored and is not tailored to the needs of individual Storage Terminal Users. Such heating, cooling, pressurization, or circulation is not provided primarily for the convenience of a particular Storage Terminal User. Therefore, the activities and services performed by Taxpayer and by a TRS detailed in the Facts section of this letter do not give rise to impermissible tenant service income. Taxpayer represents that all services furnished to the Storage Terminal Users are customarily provided to tenants of similar properties in the geographic market in which the Storage Terminal Facility is located, and that all services furnished to the Pipeline Users are customarily provided to tenants of similar properties in the geographic market in which the Pipeline is located.

Taxpayer represents that, with respect to each Terminal Usage Agreement and each Pipeline Use Agreement, rent attributable to personal property that is leased under, or in connection with, the lease of the Storage Terminal Facility or the Pipeline 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 agreement.

CONCLUSION

Based on the facts submitted and representations made, we conclude that the Storage Fee, Wharfage Fee, and Pipeline Use Fee received by Taxpayer qualify as rents from real property under section 856(d) for purposes of sections 856(c)(2) and (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. In particular, we express no opinion regarding whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of chapter 1 of the Code. Additionally, no opinion is expressed regarding whether any assets are real property for purposes of section 856, any amount received by Taxpayer depends on the income or profits of any person, any activities are fiduciary duties to manage the REIT itself, any services are customarily provided to tenants of similar properties in the same geographic market, or any income attributable to personal property leased in connection with real and personal property does not exceed 15 percent of the total rent under section 856(d)(1)(C).

Furthermore, the ruling herein related to whether income from services performed by Taxpayer is impermissible tenant service income 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 service may have unrelated business taxable income because the income may not be excluded under section 512(b)(3) as rents from real property.

This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) 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 ruling is being sent to your authorized representatives.

Sincerely,

_____

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

cc: