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Date:
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LEGEND

Taxpayer =

Partnership =

Subsidiary =

Public Agency =

Company A =

Company B =

Company C =

State =

Property =

Date 1 =

Date 2 =

Year 1 =

Year 2 =

a =

b =

c =

d =

e =

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i =

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l =

m =

Dear :

This ruling responds to a letter dated September 16, 2022, and subsequent correspondence, requesting rulings on behalf of Taxpayer. Specifically, you have requested the following rulings:

(1) Amounts received from Airline Users under certain leases, licenses, or other similar agreements are rents from real property under section 856(d) of the Internal Revenue Code ("Code") for purposes of section 856(c)(2) and (3); and

(2) Pursuant to section 856(c)(5)(J), the interest on the deemed loan created by the section 467 rental agreement will be treated as qualifying income for purposes of section 856(c)(3).

FACTS

Taxpayer is a State limited liability company and elected to be taxed as a real estate investment trust ("REIT") beginning with its taxable year ended Date 1. Taxpayer owns a% of Partnership, a State limited liability company, which is treated as a partnership for U.S. federal income tax purposes. Partnership was formed for the purpose of aggregating equity financing for the development of a new, expanded passenger terminal facility at Property for which construction began in Year 1 ("Terminal").

Partnership, through wholly-owned entities that are disregarded from Partnership for U.S. federal income tax purposes, owns b% of the equity interests in Subsidiary, a State limited liability company that has elected to be treated as a corporation for U.S. federal income tax purposes. Taxpayer and Subsidiary have made a joint election for Subsidiary to be treated as a taxable REIT subsidiary ("TRS") with respect to Taxpayer.

a. Lease Agreement with Public Agency

In connection with the Terminal project, Partnership and Public Agency have entered into a lease ("Public Agency Lease") pursuant to which Public Agency leases to Partnership certain areas of land at Property and the buildings and improvements located thereon, including existing structures and the to-be-constructed Terminal (the "Leased Premises"). In addition to access and use of the Leased Premises, Public Agency has granted Partnership certain non-exclusive rights-of-ways and other access rights to cross other parts of Property in which Public Agency holds rights. Taxpayer represents that Public Agency Lease is treated for U.S. federal income tax purposes as a master lease comprised of three separate leases, which sequentially provide to Partnership the use of Leased Premises as certain milestones are met. The first lease began in Year 1 and all three leases will expire on Date 2.

Taxpayer further represents that Public Agency Lease is a true lease for U.S. federal income tax purposes and that the leasehold interest in the Leased Premises is a qualifying real estate asset within the meaning of section 856(c)(5)(B) for purposes of the REIT asset test under section 856(c)(4)(A).

Pursuant to Public Agency Lease, Partnership has agreed to design and construct Terminal on the Leased Premises and will lease Terminal from Public Agency. Taxpayer represents that the land, building, and improvements that will comprise Terminal are and will be real property for purposes of section 856.

Partnership has also agreed to design and construct certain storm drains, electrical duct banks, upgrades to a light rail passenger distribution system at Property, and barriers to prevent large trucks from approaching Terminal, none of which are or will be part of the Leased Premises (collectively the "Off-Premises Facilities"). Partnership will assign its rights and obligations with respect to the Off-Premises Facilities to Subsidiary. Pursuant to an agreement (the "Design Build Agreement"), Partnership and Subsidiary will engage Company A, an unrelated third-party, to design and construct Terminal and the Off-Premises Facilities in exchange for arm's length fees. Under the Design Build Agreement, Company A will acknowledge that Subsidiary is the party under the contract with respect to the provisions related to the Off-Premises Facilities. Taxpayer represents that Company A is an independent contractor with respect to Taxpayer as defined in section 856(d)(3). Taxpayer further represents that it will not derive or receive any income from Company A.

The costs and expenses associated with the design and construction of Terminal will be treated as in-kind rent from Partnership to Public Agency under Public Agency Lease. The amount of the construction costs and the times that they are required to be paid are fixed and determinable under the terms of Public Agency Lease as of the commencement date, and such tenant improvements are in lieu of rent. Additionally, Public Agency Lease allocates all of the fixed rent straight-line over the term of Public Agency Lease.

The terms of Public Agency Lease will cause Public Agency Lease to be treated as a section 467 rental agreement within the meaning of § 1.467-1(c)(1). In addition, the Public Agency Lease includes prepaid rent and a section 467 loan within the meaning of § 1.467-4 made by Partnership to Public Agency ("Prepaid Rent Loan"). As a result, over the term of Public Agency Lease, as the principal of Prepaid Rent Loan amortizes, Partnership will recognize as income section 467 interest ("Prepaid Rent Loan Interest") on the Prepaid Rent Loan and will deduct rental expenses according to the section 467 proportional rental accrual method schedule set forth in Public Agency Lease.

Pursuant to an agreement (the "Assignment Agreement"), Partnership has assigned to Subsidiary, and Subsidiary has assumed, Partnership's rights and obligations under Public Agency Lease and Design Build Agreement with respect to the design and construction of the Off-Premises Facilities in exchange for payments that, in the aggregate, equal an arm's length, fixed amount. Taxpayer represents that Subsidiary will treat these rights and obligations as a long-term contract within the meaning of section 460 and will therefore recognize taxable income under section 460, and that Taxpayer will not recognize any income related to these activities. The fixed amount paid by Partnership to Subsidiary pursuant to the Assignment Agreement will be treated as fixed rent paid by Partnership to Public Agency for purposes of section 467 as costs and expenses incurred by Partnership in connection with the design and construction of Terminal.

b. Management Agreements

Pursuant to a program management agreement, Partnership will engage Company B to provide consulting and management services with respect to the design, development, and construction of Terminal in exchange for arm's length management fees. Company B's services will include overseeing the day-to-day management of the design and construction of Terminal, acting as the principal point of contact with all construction contractors, establishing a working relationship with Public Agency, and, in conjunction with Partnership, developing the manuals, policies, and procedures to be used during the design and construction of Terminal.

Pursuant to a management services agreement, Partnership will engage Company C to provide consultation and management services with respect to the operation of Terminal as part of a modern international airport in exchange for arm's length management fees. Company C's services will include assisting with the development of operational policies, procedures, budgets, schedules, and internal reports, conducting market research and compiling relevant statistics, reviewing and advising on various agreements, and providing experienced management personnel for secondment to Partnership.

Taxpayer represents that both Company B and Company C are independent contractors with respect to Taxpayer as defined in section 856(d)(3). Taxpayer further represents that it will not derive or receive any income from either Company B or Company C.

c. Airline User Agreements

The Use of Space

Each airline whose flights will depart from and/or arrive at Terminal gates (individually an "Airline User") will enter into an agreement with Partnership (individually an "Airline User Agreement"). Taxpayer represents that Airline User Agreements will have a term of multiple years, expected to be between c to d years and generally less than e years in length, and in no event will the term of an Airline User Agreement be less than a days.

Pursuant to each Airline User Agreement, the relevant Airline User will be entitled to use certain common space in Terminal and may also be entitled to use specified exclusive space. Exclusive space leased to an Airline User may consist of exclusive VIP check-in space, office space, support area space, and/or specific lounge space (the "Airline Exclusive Space"). Terminal common space that all Airline Users will have the right to use under each Airline User Agreement will generally include the gates, the ramp area and taxiways; the building structure; the federal inspection service facility (the "FIS facility"); passageways; public areas; retail halls; areas for meeting and

greeting; pedestrian, vehicle, and aircraft access; ingress and egress rights; and rights with respect to utilities and other services for Terminal as reasonably necessary and appropriate for the Airline User's operations and air transportation business, but excluding areas that are Airline Exclusive Space, space leased pursuant to retail leases, and space set aside for certain government agencies (the "Airline Common Space"). Under each Airline User Agreement, the Airline Common Space will be available for use by all Airline Users and their employees, patrons, and guests.

Partnership employs industry knowledge and experience regarding flight forecasts and terminal design parameters in selecting Airline Users with which to enter into Airline User Agreements. However, a flight schedule cannot be specified for the duration of an Airline User Agreement. Precise flight schedules are established in f month blocks (each block, a "Scheduling Season") and, in general, establishing an Airline User's flight schedule into and out of Property for a Scheduling Season (for each such Airline User, its "Flight Schedule") requires negotiation and coordination between the relevant Airline User and a number of agencies and entities, including the Federal Aviation Administration, foreign aviation agencies (for international travel), Public Agency, and other local or regional regulatory or governmental bodies. Due to the complexity of scheduling and limited space at Property to add additional flights, Airline Users rarely modify their Flight Schedule from one Scheduling Season to the next.

Pursuant to the Airline User Agreements, g days before the start of each Scheduling Season, each Airline User is required to provide Partnership such Airline User's Flight Schedule for the upcoming Scheduling Season. Partnership then allocates gate slots at Terminal throughout that Scheduling Season to each Airline User based on the Airline User's Flight Schedule for that Scheduling Season. Once finalized, the gate allocation schedule is a binding contractual obligation of Partnership to each Airline User. An Airline User's allocated gate slots effectively represent its allocated portion of Airline Common Space throughout the Scheduling Season, as the Airline User, and its guests and customers, will use the Airline Common Space in connection with the Airline User's scheduled flights.

Taxpayer represents that it will not oversell capacity of the Airline Common Space. Once Partnership has established the amount of gate capacity (and therefore Airline Common Space) at Property that is committed to existing Airline Users for a given Scheduling Season, it knows how much excess capacity is available for potential new Airline Users.

All Airline Users will also have the right to use certain shared equipment in the Airline Common Space (the "Common Equipment"), including check-in desks and kiosks, computer equipment and related check-in software, baggage scales and baggage tag printers, as well as other physical equipment that will support the Airline Users' operations, such as passenger boarding bridges, certain ramp equipment, flight

and baggage information display systems, and baggage handling systems.[1] Taxpayer represents that Subsidiary or an independent contractor from whom the Taxpayer derives or receives no income will operate, maintain, and repair such personal property.

Amounts Received Under Airline User Agreements

Pursuant to each Airline User Agreement, the relevant Airline User will make payments to Partnership in exchange for the right to use (i) the Airline Exclusive Space (the "Exclusive Space Charge") (if applicable) and (ii) the Airline Common Space and Common Equipment (the "Common Space Charge" and collectively with the Exclusive Space Charge, the "Airline Rents").

Taxpayer represents that with respect to each Airline User Agreement, rent attributable to personal property, including the Common Equipment, which is leased under, or in connection with, the lease of the Airline Exclusive Space and Airline Common Space will not exceed 15% of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such Airline User Agreement. Taxpayer further represents that the amount of the Airline Rents does not depend in whole or in part on the income or profits derived by any person from the Leased Premises within the meaning of section 856(d)(2)(A).

Under each applicable Airline User Agreement, the Exclusive Space Charge will be paid on a monthly basis and calculated as a specified dollar amount (adjusted annually for inflation by reference to the Consumer Price Index ("CPI")) per square foot of leased Airline Exclusive Space. Different rates will apply to different types of space within the Airline Exclusive Space. In addition, the Airline Exclusive Space may include specified space for use as a passenger lounge. If such an Airline User grants a right to a third-party (i.e., an airline passenger flying with another Airline User) to access the lounge space on an hourly, daily, or similar per use basis, the Airline User must pay Partnership h% of the gross revenue from the sale of such right. This revenue sharing provision does not apply to lounge access granted by Airline User based on an individual's travel class of service, loyalty status, or similar criteria.

The Common Space Charge will be paid on a monthly basis and based upon the number of passengers that depart on the Airline User's flights from Terminal ("Enplaned Passengers"). Specifically, the Common Space Charge will be calculated as the product of (i) a specific dollar amount (adjusted annually for inflation by reference to the CPI) and (ii) the number of Enplaned Passengers in a given month. In determining the appropriate dollar amount per Enplaned Passenger to charge an Airline User, Partnership considered both projected Enplaned Passengers and historical cancellation patterns. Taxpayer represents that in the last k years only l percent of scheduled flights

[1] The check-in area of the Airline Common Space will contain numerous computer kiosks that will enable self-service check-in and baggage processing and drop-off for customers of any Airline User. The shared computer equipment and software will be provided by an independent third-party specialist in airport technology.

have been cancelled at Property. Additionally, Taxpayer represents that Partnership anticipates actual Enplaned Passengers for each Airline User each month will be at least m percent of projected Enplaned Passengers for such month. Finally, Taxpayer represents that, other than in situations where an Airline User either discontinued its operations at Property or was prevented from operating by a governmental agency, Taxpayer is unaware of any Airline User that failed to have Enplaned Passengers during any given month. Thus, an Airline User's Common Space Charge each month will be at least m percent of the projected amount based on the Airline User's Flight Schedule for that month.

The Common Space Charge may be discounted in certain circumstances, for example, if the number of Enplaned Passengers exceeds a specified amount for the year or if an Airline User operates at least a specified minimum number of daily flights departing from Terminal. Taxpayer represents that these discounts will be set dollar amounts per passenger or set percentages laid out in the Airline User Agreement and will not be based on the income or profits of any person. Not all Arline User Agreements will provide for a discount.

Certain Airline User Agreements will provide that the relevant Airline User is not permitted to use any other Property terminal unless Terminal is unusable (e.g., due to a natural disaster). If such Airline User uses another terminal despite this provision, Airline User will remain obligated to pay the Common Space Charge as if the Enplaned Passengers departing from such other terminal departed from Terminal. Unless Airline User proves otherwise, airplanes will be deemed to be fully enplaned for this purpose. The Airline User will also remain obligated to pay its monthly Exclusive Space Charge, if applicable.

Activities and Services

Partnership will provide various usual and customary activities and services (whether directly or by engaging Subsidiary or an independent contractor from whom Taxpayer derives no income) necessary for the successful operation of an international airport pursuant to Airline User Agreements (the "Included Services"). Other services will be procured either by Airline Users themselves (the "Excluded Services") or will be performed by governmental authorities (e.g., the processing of arriving international passengers).

Included Services

The following Included Services provided within the Airline Common Space in connection with the Common Space Charge will be provided by Partnership, an independent contractor from whom Taxpayer does not derive or receive any income, or Subsidiary ("Included Services A"):

- Customary utilities (e.g., water, electricity, heating, and cooling)

- Security to ensure certain restricted areas within or adjacent to the Airline Common Space are not accessed by unauthorized individuals as well as the screening of inventory and supplies at the loading docks before such items are delivered to retail tenants to ensure no contraband enters Terminal. Security will not include the provision or supervision of police officers or any other government agents (e.g., TSA agents).
- Janitorial Services for the routine cleaning of the Airline Common Space. Janitorial Services will not include any services specific to tenant requirements.
- Repair and maintenance of the Airline Common Space for routine maintenance performed on a scheduled basis (for example, changing lightbulbs or repainting walls) and routine repairs (for example, fixing cracked sidewalks or floors) within the Airline Common Space. These services will not include any specific upgrades requested by a particular tenant.
- Removal of trash from the Airline Common Space.
- Snow removal from sidewalks and ramps.

Furthermore, the following additional Included Services provided within the Airline Common Space in connection with the Common Space Charge will be provided by either an independent contractor from whom Taxpayer does not derive or receive any income or Subsidiary (“Included Services B"):

- Operation, repair, and maintenance of the Common Equipment.
- Skycap services.
- Services to passengers with disabilities (e.g., wheelchair services) and unaccompanied minors.
- Providing agents to assist passengers within the baggage claim hall (e.g., baggage belt agents)
- Operations management services that involve the Virtual Apron Control Room (the “VACR”) to direct aircraft and vehicle ground traffic within the exterior Airline Common Space and the Integrated Terminal Operational Control Center (the “ITOCC”) to monitor the interior Airline Common Space and coordinating services within that space (e.g., directing that a wheelchair be sent to a particular gate or that a spill be cleaned up in a corridor). The VACR services do not include the movement of traffic on runways or other aircraft movement areas under the control of Public Agency.

Airline Users will be responsible for cleaning, repairing, maintaining, and removing trash from their Airline Exclusive Space and, therefore, such services in Airline Exclusive Space are not Included Services. Airline Users will be provided utilities

in their Airline Exclusive Space and Partnership will charge each Airline User for the cost of utility usage in the Airline Exclusive Space at a rate equal to the actual unit cost paid by Partnership for such utilities, taking into account any other direct costs of Partnership in providing the utilities, but without any mark-up or administrative charge.

Taxpayer represents that consistent with Treas. Reg. § 1.856-4(b)(1), all services furnished to Airline Users are customarily provided to airline tenants of other large international airports in the United States in connection with the rental of real property. In the event Subsidiary provides the operations management services, Subsidiary may lease the VACR and ITOCC space from Partnership and own the equipment therein. In that event, Taxpayer represents that the space leased to Subsidiary plus any other TRS or related party pursuant to section 856(d)(2)(B) will represent less than 10% of the total leased Terminal space on the applicable testing dates set forth in section 856(d)(8)(A).

Excluded Services

Under the Airline User Agreements, the Excluded Services are those that are explicitly excluded from the Included Services and, therefore, must be procured directly by Airline Users. The Excluded Services generally involve services integral to Airline Users' business operations, as opposed to services related to Airline Users' use of space within Terminal. The Excluded Services include:

- Aircraft deicing
- Aircraft fueling
- Aircraft cleaning
- Aircraft security
- Ground handling
- Baggage handling
- Providing passenger service agents, ticket agents, and gate agents
- Fitting out, staffing, cleaning, and maintaining Airline Exclusive Space.

d. Retail User Agreement

Partnership will also lease space in Terminal to retailers, such as restaurants and gift shops (the "Retail Leases"). Taxpayer represents that the term of each Retail Lease will typically be i years or longer (and in no case less than a days). Rent will generally be calculated as a specific dollar amount per square foot of leased space plus the greater of a percentage of gross receipts or a specified minimum amount. Taxpayer represents that amounts received by Partnership pursuant to the Retail Leases will qualify as rents from real property under section 856(c)(2) and (3).

LAW AND ANALYSIS

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from dividends; interest; rents from real property; gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1); 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 at least 75 percent of a REIT's gross income 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)(1)); dividends or other distributions on, and gain from the sale or other 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 1:

Treas. Reg. § 1.856-4(a) provides, in relevant part, that the term "rents from real property" means, generally, the gross amounts received for the use of, or the right to use, real property of the REIT.

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 which is 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% 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) excludes from the definition of rents from real property 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 of any person from such property (except that any amount so received or accrued shall not be excluded from the term "rents from real property" solely by reason of being based on a fixed percentage or percentages of receipts or sales).

Treas. Reg. § 1.856-4(b)(1) provides that, for purposes of section 856(c)(2) and (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 as customary if, in the geographic market in which the building is located, tenants in buildings which are of a similar class are customarily provided with the service. Additionally, where it is customary, in a particular geographic marketing area, 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 856(d)(2)(C) excludes from the definition of rents from real property any impermissible tenant service income as defined in section 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 services furnished or rendered by the REIT to the tenants of such property, or for managing or operating such property. Section 856(d)(7)(C)(i), however, provides that 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 or through a TRS of such REIT shall not be treated as furnished, rendered, or provided by the REIT for purposes of section 856(d)(7)(A). Additionally, 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 ("UBTI") under section 512(b)(3) if received by an organization described in section 511(a)(2).

Treas. Reg. § 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 make decisions as to repairs of the REIT's property, the cost of which may be borne by the REIT.

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of UBTI 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 into service.

Treas. Reg. § 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 the tenant's convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only.

Section 856(d)(3) defines the term "independent contractor" as any person (A) who does not own directly or indirectly, more than 35% of the shares or certificates of beneficial interest in the REIT; and (B) if the person is a corporation, not more than 35% of the total combined voting power of whose stock (or 35% of the total shares of all classes of whose stock), or, if such a person is not a corporation, not more than 35% of the interest in whose assets or net profits is owed, directly or indirectly, by one or more persons owning 35% or more of the shares or certificates of beneficial interest in the REIT.

Section 856(l)(1) defines a TRS as a corporation that is directly or indirectly owned in whole or in part by a REIT, and that makes a joint election with the REIT to treat the corporation as a TRS of such REIT.

In Rev. Rul. 74-198, 1974-1 C.B. 171, a REIT entered into leases with tenants of a shopping center owned by the REIT. The leases provided for fixed annual rental payments to be paid in monthly installments. In addition to the fixed rent, each tenant was required to pay a percentage rental equal to an amount, if any, by which a certain fixed percentage of its gross sales each quarter exceeded that tenant's monthly installments for that quarter. The Service held that the rental payments described in the ruling qualified as rents from real property as defined in section 856(d).

The Airline Rents are comprised of a Common Space Charge and an Exclusive Space Charge. The Common Space Charge is based on a set amount multiplied by the number of Airline User customers that pass through the common space. Some Airline Users may receive a discount for an excessively large volume of passengers or airplanes flying in and out of Terminal, but this discount is still based on a specified, set amount. Additionally, the gate allocation schedule obligates each Airline User to use Terminal for that Scheduling Season. If specified Airline Users do not use Terminal for one or more flights, they are still obligated to pay Partnership for those flights. Taxpayer represents that only l percent of flights at Property have been cancelled in the last j years and that, other than in situations where an Airline User either discontinued its operations at Property or was prevented from operating by a governmental agency, Taxpayer is unaware of any Airline User that failed to have Enplaned Passengers during any given month. Taxpayer further represents that an Airline User's Common Space Charge each month will be at least m percent of the projected amount based on the Airline User's Flight Schedule for that month.

The Exclusive Space Charge is a set amount for each type of space multiplied by the square footage of that space. All set amounts are specified in the Airline User Agreements and are adjusted annually for inflation based on CPI, an inflation tracking index. Taxpayer represents that no portion of the Airline Rents depends in whole or in part on the income or profits of any person from the Leased Premises. Taxpayer also represents that for each Airline User Agreement, the rent attributable to personal property, including the Common Equipment, which is leased under, or in connection with, the lease of the Airline Exclusive Space and Airline Common Space will not exceed 15% of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such Airline User Agreement.

Taxpayer represents that the Included Services furnished to the Airline Users are customarily provided to airline tenants of other large international airports in the United States in connection with the rental of real property.

Taxpayer provides that Included Services A will be performed by either Partnership, Subsidiary (a TRS of Taxpayer), or an independent contractor from whom Taxpayer does not receive or derive any income. Additionally, the Included Services A are usually and customarily rendered in connection with the rental of common space in airport terminals and are not tailored to the needs of any particular Airline User and, thus, would not result in UBTI under section 512(b)(3) if received by an organization described in section 511(a)(2). Taxpayer further provides that Included Services B will be provided by either Subsidiary or an independent contractor from whom Taxpayer does not receive or derive any income. Accordingly, the Included Services should not give rise to impermissible tenant service income and should not cause any portion of the Airline Rents to fail to qualify as rents from real property under section 856(d). Based on the information submitted and representations made, we conclude that the Airline Rents qualify as rents from real property within the meaning of section 856(d) for purposes of section 856(c)(2) and (3).

Ruling 2:

Section 467(a) provides that for a lessor and lessee under a section 467 rental agreement, there shall be taken into account for purposes of the Code for any taxable year the sum of (1) the amount of the rent which accrues during such taxable year as determined under section 467(b), and (2) interest for the year on the amounts which were taken into account under section 467(a) for prior taxable years and which are unpaid.

Under Treas. Reg. § 1.467-1(c), a section 467 rental agreement is, generally, a rental agreement that has increasing or decreasing rents (as described in § 1.467-1(c)(2)), or deferred or prepaid rents (as described in § 1.467-1(e)(3)).

Treas. Reg. § 1.467-1(e)(3) provides that section 467 interest on a section 467 loan is treated as interest for all purposes of the Code.

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, (i) whether any item of income or gain that 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) whether any item of income or gain that otherwise constitutes gross income not qualifying under section 856(c)(2) or (3) may be considered as gross income that qualifies under section 856(c)(2) or (3).

Legislative history indicates that Congress intended part II of subchapter M to apply to certain "organizations specialized in investments in real estate and real estate mortgages." H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960), 1960-2 C.B. 819, 820. Congress intended to restrict the beneficial tax treatment of part II of subchapter M to "what is clearly passive income from real estate investments, as contrasted to income from the active operation of businesses involving real estate." Id.

Taxpayer represents that Public Agency Lease is an interest in real property and, therefore, a real estate asset for purposes of section 856(c)(4)(A). Taxpayer's rental payments to Public Agency under Public Agency Lease consist of the costs to design and construct Terminal, which Taxpayer represents is real property.

Taxpayer's arrangement with Public Agency under Public Agency Lease will cause Public Agency Lease to be subject to section 467 resulting in the Prepaid Rent Loan created by the section 467 rental agreement. As a result, Taxpayer will impute and recognize Prepaid Rent Loan Interest on the deemed Prepaid Rent Loan and will deduct rental expenses according to the section 467 proportional rental accrual method schedule set forth in Public Agency Lease.

The Prepaid Rent Loan Interest is interest that constitutes qualifying income for purposes of section 856(c)(2). The Prepaid Rent Loan Interest, however, does not constitute qualifying income for purposes of section 856(c)(3). The Prepaid Rent Loan is created by the in-kind prepayment of rent for an interest in real property and pursuant to ruling 1, the Airline Rents that Taxpayer receives from the Leased Premises qualify as rents from real property. Thus, treating the Prepaid Rent Loan Interest as qualifying income does not interfere with or impede the objectives of Congress in enacting section 856(c)(3). Accordingly, pursuant to section 856(c)(5)(J)(ii), it is appropriate for the Secretary to determine that income from the Prepaid Rent Loan Interest is treated as qualifying income for purposes of Sections 856(c)(3).

CONCLUSIONS

Based on the information submitted and representations made by Taxpayer, we rule that:

(1) Taxpayer's allocable share of the income from Airline Rents qualifies as rents from real property within the meaning of section 856(d) for purposes of section 856(c)(2) and (3).

(2) Pursuant to section 856(c)(5)(J)(ii), Taxpayer's allocable share of income from the Prepaid Rent Loan Interest will be treated as qualifying income for purposes of section 856(c)(3).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. 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. No opinion is expressed concerning the valuation of personal property for purposes of the section 856(d)(1)(C) 15% personal property limitation. Additionally, except as expressly provided herein, no opinion is expressed or implied concerning whether any income is qualifying income for purpose of section 856(c)(2) and (3). Furthermore, except as expressly provided herein, no opinion is expressed concerning any services performed by Taxpayer, OP, any TRS or any other party. Finally, no opinion is expressed regarding whether Taxpayer otherwise qualifies as a REIT or whether Subsidiary otherwise qualifies as a TRS under subsection M, part II of Chapter 1 of the Code.

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 cite 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
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

CC: