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Date:
December 13, 2023

Legend:

Taxpayer =

Subsidiary =

Commission =

State A =

State B =

State C =

Date =

Pipelines =

a =

b =

c =

d =

Dear :

This letter responds to a letter dated June 23, 2023, and subsequent correspondence, requesting a ruling on behalf of Taxpayer. Taxpayer requests a ruling that its allocable share of income from unrelated third parties for the use of certain pipelines, qualify as rents from real property under section 856(d) of the Internal Revenue Code (the "Code") for purposes of section 856(c)(2) and (c)(3).

FACTS

Taxpayer is a State A corporation that elected to be taxed as a real estate investment trust ("REIT") beginning with its taxable year ended Date. Taxpayer invests in energy infrastructure assets, such as pipelines, storage terminals, and gas distribution assets.

Subsidiary is a State B limited liability company that is classified as a partnership for U.S. federal income tax purposes. Taxpayer currently owns an approximately a percent voting interest in Subsidiary and intends to acquire a controlling interest upon receiving Commission approval. Subsidiary owns the Pipelines, oil and gas pipelines located in State C, through two disregarded entities (the "Pipeline Companies").

The Pipelines were constructed to connect certain oil fields to certain refineries. Taxpayer represents that the Pipelines are inherently permanent structures under section 1.856-10 of the Income Tax Regulations and, thus, are real estate assets for purposes of section 856 of the Code. The Pipelines are regulated by Commission.

Subsidiary enters into arrangements with one or more unrelated third-party users (each, a "Pipeline User") with respect to each Pipeline pursuant to the nomination process described below (each, a "Pipeline Use Agreement"). The Pipeline Use Agreements generally have a term of b, and Pipeline Users generally utilize the Pipelines on a continuous and consistent basis for extended periods, often years. Taxpayer represents that Subsidiary does not oversell capacity on a Pipeline and is obligated at all times to ensure that the capacity confirmed each month for each Pipeline User is available for use by the relevant Pipeline User.

Pipeline Users use a monthly nomination process governed by the Commission rules and regulations to confirm the capacity to be reserved for each Pipeline User during the following month. Pursuant to the nomination process, the Subsidiary establishes certain minimum aggregate monthly throughput amounts necessary to maintain optimal operations of each Pipeline. Each Pipeline User informs Subsidiary as to the kind and quantity of product the Pipeline User intends to place on a particular Pipeline in the coming month (a "nominated amount"). Provided that the nominated amounts for each Pipeline User in the aggregate meet the minimum aggregate monthly throughput requirement, each nominated amount becomes a confirmed amount. Once a Pipeline User's nominated amount becomes a confirmed amount, Subsidiary reserves

a portion of the monthly capacity on the relevant Pipeline for that Pipeline User's confirmed amount. Subsidiary does not confirm nominated amounts in excess of the total monthly capacity of any Pipeline. Taxpayer represents that to its knowledge, a Pipeline User has never placed c product on a Pipeline in a month in which they have a nominated and confirmed amount. Taxpayer represents that each Pipeline User who reserves capacity on a Pipeline for a given month uses at least d percent of such reserved capacity during that month.

Pipeline Users pay a fee for the use of a Pipeline that is based on the volume of product placed on the Pipeline by the Pipeline User ("Pipeline Use Fee"). Pipeline Use Fees are calculated as the product of the barrels of oil placed on a Pipeline in a given month and the tariff rate approved by the Commission for each barrel of oil that is received at a specified origin point on the Pipeline and that exits the Pipeline at a specified destination point. Taxpayer represents that each Pipeline User is contractually obligated to deliver product extracted from a particular field or area to a point connected to a Pipeline and is economically compelled to exclusively use the Pipeline to satisfy that legal obligation. Each Pipeline User will exclusively use the Pipeline for the applicable monthly nomination period to deliver such product extracted from a particular field or area to a point connected to the Pipeline. Subsidiary will agree to accept and reserve capacity for that product, but will not oversell capacity on a Pipeline. Taxpayer represents that the Pipeline Use Fee does not depend, in whole in or in part, on the income or profits of any person.

The Pipelines include a de minimis amount of personal property (e.g., pumps, compressors, and meters). Taxpayer represents that, with respect to each Pipeline, the Pipeline Use Fees attributable to the pumps, compressors, meters, and other personal property used in connection with the reserved use of the Pipeline does not exceed 15 percent of the total Pipeline Use Fees attributable to both the real and personal property reserved for use by Pipeline Users for the taxable year.

Taxpayer represents that Subsidiary will only undertake activities with respect to the Pipelines that are consistent with its fiduciary duty to manage its assets or that would not result in unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2). Subsidiary will inspect and monitor the physical condition of the Pipelines and will mark the location of underground Pipelines to minimize the possibility of damage due to digging. Subsidiary may test product as it enters a Pipeline to verify that the product in that Pipeline is, in fact, the product specified in the Pipeline Use Agreement. Such testing is performed solely to ensure the safety and integrity of the Pipeline and the environment. Subsidiary will also make decisions with respect to, and will supervise, the maintenance, repair, and construction of, the Pipelines in accordance with the requirements of all applicable governmental authorities, including Commission.[1] Such maintenance, repair, and

[1] The Pipelines are subject to the regulatory authority of the Commission. Accordingly, Taxpayer, Subsidiary, and the Pipeline Companies are required to comply with all rules and regulations, and orders of the Commission in order to continue operating the Pipelines.

construction will be performed by an independent contractor from whom Taxpayer does not derive or receive any income ("IK").

All other activities and services with respect to the Pipelines will be undertaken by a TRS or an IK, including scheduling use of the Pipeline by the Pipeline Users. Additionally, a TRS or IK will operate, monitor, maintain, manage, and repair any pumps, compressors, meters, and other personal property associated with the Pipelines. The TRS or IK will receive arm's length compensation from Subsidiary for performing these activities and services.

Taxpayer represents that all services furnished to the Pipeline Users are customarily provided to tenants of similar properties in the geographic market in which the relevant Pipeline is located.

## 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" 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 that 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 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 such 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 1.856-3(g) provides that, in the case of a REIT which is a partner in a partnership, as defined in section 7701(a)(2) and the regulations thereunder, the REIT will be deemed to own its proportionate share of each of the assets of the partnership and will be deemed to be entitled to the income of the partnership attributable to such share. For purposes of section 856, the interest of a partner in the partnership's assets shall be determined in accordance with his 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 section 856. Thus, for example, if the REIT owns a 30 percent capital interest in a partnership which owns a piece of rental property the REIT will be treated as owning 30 percent of such property and as being entitled to 30 percent of the rent derived from the property by the partnership. Similarly, if the partnership holds any property primarily for sale to customers in the ordinary course of its trade or business, the REIT will be treated as holding its proportionate share of such property primarily for such purpose. Also, for example, where a partnership sells real property or a REIT sells its interest in a partnership which owns real property, any gross income realized from such sale, to the extent that it is attributable to the real property, shall be deemed gross income from the sale or disposition of real property held for either the period that the partnership has held the real property or the period that the REIT was a member of the partnership, whichever is the shorter.

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 (c)(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.

Section 1.856-4(b)(2)(ii) provides that the 15 percent test in section 856(d)(1)(C) is applied separately to each lease of real property. However, where the REIT rents all (or a portion of all) the units in a multiple unit project under substantially similar leases (such as the leasing of apartments in an apartment building or complex to individual tenants), the 15 percent test may be applied with respect to the aggregate rent received or accrued for the taxable year under the similar leases of the property, by using the average of the REIT's aggregate adjusted bases of all of the personal property subject to such leases, and the average of the REIT's aggregate adjusted bases of all real and personal property subject to such leases. A lease of a furnished apartment is not considered to be substantially similar to a lease of an unfurnished apartment (including an apartment where the REIT provides only personal property, such as major appliances, that is commonly provided by a landlord in connection with the rental of unfurnished living quarters).

Section 1.856-4(b)(3) provides in relevant part that, except as provided in §1.856-4(b)(6)(ii), no amount received or accrued, directly or indirectly, with respect to any real property (or personal property leased under, or in connection with, real property) qualifies as rents from real property where the determination of the amount depends in whole or in part on the income or profits derived by any person from the property. However, any amount so accrued or received 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. An amount will not qualify as rents from real property if, considering the lease and all the surrounding circumstances, the arrangement does not conform with normal business practice but is in reality used as a means of basing the rent on income or profits.

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 the 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.

If a taxpayer that has elected to be taxed as a REIT for U.S. federal income tax purposes fails to qualify as a REIT for any reason (including as a result of undertaking actions or failing to undertake actions required by a public utility commission or other state governmental authority), the taxpayer will cease to be taxed as a REIT. See section 856(g).

Taxpayer represents that the Pipelines are real property for purposes of section 856. The Pipeline Use Agreements have a term of b and Pipeline Users generally utilize the Pipelines on a continuous and consistent basis for extended periods, often years. No Pipeline Use Agreement will have a term of less than b. Taxpayer represents that the Pipeline Use Fee will not depend, in whole or in part, on the income or profits of any person. The Pipeline Use Fees are a regulated fee multiplied by the amount of product placed on the Pipeline by a Pipeline User. This amount based upon the volume of product put through the Pipeline is comparable to amounts received based upon a percentage of gross receipts. Each Pipeline User will exclusively use the Pipeline for the applicable monthly nomination period to deliver product extracted from a particular field or area to a point connected to the Pipeline, and Subsidiary will agree to accept and reserve capacity for that product. Accordingly, the Pipeline Use Fees are an amount received for the use of, or the right to use, real property of Taxpayer and qualify as rents from interests in real property under section 856(d)(1)(A).

Taxpayer represents that Subsidiary will only undertake activities with respect to the Pipelines that are consistent with its fiduciary duty to manage the REIT itself or are services the amounts for 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). Subsidiary will inspect and monitor the physical condition of the Pipelines, mark the location of underground Pipelines, and make decisions with respect to, and supervise the IK performing, maintenance, repair, and construction of the Pipelines. Subsidiary may test product as it enters a Pipeline to ensure the safety and integrity of the Pipeline and the environment. A TRS or IK will perform all other services in connection with the Pipelines. Therefore, the activities and services performed by Subsidiary and by a TRS or IK 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 Pipeline Users in connection with a Pipeline Use Agreement are customarily

provided to tenants of similar properties in the geographic market in which the respective Pipeline is located.

Taxpayer represents that, with respect to each Pipeline, the Pipeline Use Fees attributable to the pumps, compressors, meters, and other personal property used in connection with the reserved use of space on the Pipeline does not exceed 15 percent of the total Pipeline Use Fees attributable to both the real and personal property reserved for use by Pipeline Users for the taxable year.

## CONCLUSION

Based on the facts submitted and representations made by Taxpayer, we rule that Taxpayer's allocable share of the Pipeline Use Fees qualify as rents from real property under section 856(d) for purposes of section 856(c)(2) and (c)(3).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. 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.

Furthermore, we express no opinion regarding whether any assets are real property for purposes of section 856, any amount received by Taxpayer through Subsidiary will depend 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 property does not exceed 15 percent of the total rent under section 856(d)(1)(C).

This ruling does not apply to the extent there is a change in the facts set forth herein, including, but not limited to, a change in facts as a result of the Commission exercising its authority to require any of the Taxpayer, Subsidiary, or the Pipeline Companies to change the manner in which they operate.

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

cc: