Internal Revenue Service

Department of the Treasury

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Legend:

Trust =

OP =

LLC 1 =

Corporation A =

a =

b =

c =

d =

e =

Corporation C =

Corporation D =

Country A =

f =

g =

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i =

Airport =

Town =

LLC 2 =

Parking Company =

Year 1 =

This is in reply to a letter dated August 2, 1999, and subsequent submission, requesting rulings on behalf of Trust. Specifically, the following rulings are requested:

1) The activities of LLC1 and Corporation C will not cause Trust's share of rents received by OP from OP tenants that are clients of LLC1, to be considered as other than "rents from real property" under § 856(d) of the Internal Revenue Code;

2) The Concession Agreement between Town and OP represents an "interest in real property" for purposes of § 856(c)(5)(C) and therefore, qualifies as a "real estate asset" for purposes of § 856(c)(4)(A); and,

3) Payments received by OP from Parking Company under the Subconcession Agreement qualify as "rents from real property" under § 856(d).

Facts:

Trust, a publicly traded real estate investment trust (REIT), owns all of its assets and conducts all of its operations through OP, a domestic limited partnership. Trust is the managing general partner of OP and owns, directly and indirectly, approximately a percent of OP's outstanding partnership interests. OP owns and has interests in commercial office properties and stand-alone parking facilities located throughout the United States.

Corporation A, a newly formed domestic corporation, has two classes of common stock: voting stock representing b percent of the equity in the corporation and non-voting stock representing c percent of the equity in the corporation. OP owns all of the nonvoting common stock of Corporation A. Corporation B owns all of the voting stock of Corporation A. OP will loan d dollars (approximately e percent of the total capitalization of Corporation A) to Corporation A. Corporation A and Corporation B have the same officers and directors.

The shareholders of Corporation B are b individuals, one of whom is a trustee of Trust and all of whom are officers of Trust. The president and another officer of Corporation B are also employees of Trust.

LLC1

LLC1 is a domestic limited liability company formed in 1999 by Corporation A and Corporation C, an indirect wholly-owned subsidiary of Corporation D. Corporation A and Corporation C each own a 50 percent membership interest in LLC1. Corporation A and Corporation C intend that LLC1 be treated as a partnership for federal income tax purposes. LLC1 is managed on a day-to-day basis by Corporation C. Corporation A and Corporation C each intend to contribute capital of b million dollars to LLC1.

LLC1 leases space from OP in h of OP's i commercial office buildings and expects to lease space in h additional OP office buildings by December 31, 2000. Trust represents that it will treat its share of any rent received by OP from LLC1 as related party rent under § 856(d)(2)(B) and thus as nonqualifying income for purposes of §§ 856(c)(2) and (3), because Trust owns, by attribution through Corporation A and OP, more than 10 percent of LLC1.

LLC1 was formed to own and operate business centers in office building space that it will lease from OP. Corporation C, together with Corporation D and its subsidiaries (hereafter, The Group), is one of the largest operators of business centers in the world. Like the Group, LLC1 will furnish ready-to-use office space to clients on a short-term basis and will provide clients with office furnishings, office equipment, and office personnel support. Typical amenities in connection with a sublease or license will include a furnished private office, furnished reception room with receptionist, telephone greeting, voice mail, office supplies, conference room with audio-visual facilities, utilities and maintenance, janitorial services, and parking facilities.

Clients of LLC1 may also be tenants of OP either in that building or at another property. Regardless of any overlapping relationships between OP tenants and LLC1 clients, all leases and other arrangements between a tenant and OP or the tenant and LLC1 will be negotiated separately in an arm's length manner and will be on commercially reasonable terms. In no instance will the arrangement between a client and LLC1 depend on any arrangement between that client and OP. Similarly, any arrangement between OP and any tenant that is a client of Corporation A or the Group will be independent from the arrangement between that tenant and Corporation A or the Group.

Notwithstanding their overlapping clientele, OP and LLC1 will operate as separate and independent businesses. None of the officers, directors, or employees of the Group are officers, directors, or employees of Trust, OP, or their affiliates (excluding LLC1). LLC1 will not have its own employees. The officers and directors of Corporation A and Corporation B are different from the officers and directors of Trust and the officers of the Group (excluding LLC1).

Corporation C is the day-to-day manager of LLC1. All personnel necessary for the operation of LLC1 business centers will be employees of Corporation C. Services

provided to LLC1 clients will be provided by employees of the Group. LLC1 will bear all direct costs of the business centers, including out-of-pocket costs and expenses of hiring and compensating on-site personnel employed by Corporation C and will also bear a portion of the indirect and overhead costs of Corporation C and Corporation D attributable to the operation of the LLC1 business centers.

OP and LLC1 entered into a Master Agreement to Lease (Agreement). Under the Agreement, both OP and LLC1 have the right to request that the other party enter into a new business center lease for a particular OP office building. However, neither party is obligated to accept the request of the other party. A lease will permit LLC1 to establish and operate a business center in the leased space, including the right to license or sublease the temporary use of all or a portion of the space to third parties for general office use.

Corporation A, on the one hand, and Corporation C and Corporation D, jointly and severally, on the other hand, will be required to individually guarantee the payment of 50 percent of the payment obligations of LLC1 to OP under the lease.

The Group currently sells various services to the general public (including tenants in a building where its business center is located, even if those tenants are not otherwise Group clients). Under the Agreement (and after the receipt of this private letter ruling), LLC1 will have the same practice at its centers in OP buildings. Any OP tenants that use LLC1's services will be charged (by LLC1) market rates and will not have preferential access to those services over the general public. LLC1 will not offer any services or amenities at it business centers to OP tenants that are not offered to the general public. Additionally, although OP may refer tenants to LLC1 or engage in joint marketing efforts with LLC1, OP will not promote the presence of a LLC1 business center in a particular OP building as a service to its tenants in that building. Trust

represents that no more than g percent of LLC1's gross revenues from a business center are expected to be from tenants in that building.

The Agreement does not limit OP's marketing or leasing activities with respect to space in its buildings, including leasing space to others for the operation of business centers. OP can freely negotiate rental fees with LLC1 and any other tenant, whether or not the tenant operates a business center. OP is not required to confer any benefits or privileges to LLC1 that it offers to other tenants. Under the Agreement, OP is required to use good faith efforts to make available to LLC1 the benefit of any volume discounts or rebates that OP may have with third-party service providers, although LLC1 must bear the cost of its expenses.

Under the Agreement, OP will receive a referral fee for new business center customers that are specifically referred by OP. The referral fees will be paid for any client entering into a license at a LLC1 business center if that client was specifically

referred by OP to that business center. Unless otherwise agreed by OP and LLC1, a referral fee will equal g percent of the total fee payable by the client under the license until the earliest of (a) the expiration of the license, (b) the first date upon which the license would have terminated had the client exercised an available "break" option, or otherwise failed to extend or renew the term of the license, or (c) one year from commencement of the license. Trust represents that it will treat its share of any referral fees that it receives from LLC1 for referring customers to business centers operated in OP buildings as impermissible tenant service income for purposes of § 856(d).

Trust and LLC1 anticipate engaging in certain joint marketing efforts. These efforts may include local, regional, and national advertising in newspapers, business journals, and real estate trade magazines, use of the news and other media to publicize the LLC1 business centers, and joint presentations at real estate organization conferences.

The business centers may be promoted at Trust buildings through property newsletters and other printed materials including general letters to tenants, advertising on signs in the building lobby, and electronic billboards operated by a third party in the building elevators. At the national level, Trust may include the business centers in its corporate brochures, advertising campaign, and website to promote the worldwide availability of the business centers to potential Trust tenants. Trust represents that it will take into account any expenditures it makes promoting those business centers in determining its impermissible tenant service income for those buildings.

Trust represents that commencing January 1, 2001, all business centers that fall within the scope of this ruling will be operated by a corporation that qualifies as a "taxable REIT subsidiary" (TRS) under § 856(l), as it will become effective on January 1, 2001, or by a partnership, limited liability company, or joint venture in which Trust only owns an interest through a TRS.

Parking Facilities

OP owns many stand-alone parking facilities throughout the United States. OP typically owns fee simple title to the parking facility and land or leases the parking facility from the owner under a long-term ground lease. In either case, OP does not operate the parking facility itself. Instead, OP generally leases (or subleases) the parking facility to an unrelated parking operating company.

OP has acquired a long-term interest in the parking facilities at Airport through its wholly-owned subsidiary LLC2. Town is the owner of Airport and the parking facilities. Because of perceived legal obstacles to entering into a long-term lease, Town requires that the arrangement with OP be denominated a "concession agreement" (Concession Agreement). Under the Concession Agreement, Town grants OP the exclusive right, concession, and privilege to operate all the parking facilities at Airport for 30 years, so

long as OP performs its obligations. The Concession Agreement provides OP with "peaceable and quiet enjoyment of the Premises during the Term without any interruption by Town, its successors or assigns, or any person or company claiming by or through it."

Under the Concession Agreement, OP pays Town an annual "concession fee" (fee), based solely on a specified percentage of the gross receipts collected from public parkers at the parking facilities. Gross receipts are generally defined to mean the total revenues received from public parkers or for the storage of motor vehicles, including late fees and business interruption insurance proceeds. Gross receipts does not include amounts payable to any governmental authority on account of parking taxes, sales or use taxes, personal property taxes, and service taxes or similar charges imposed relative to the use and operation of the premises. OP bears the costs of the operation of the parking facilities, except for lawn maintenance, security throughout the airport outside the parking premises, repair and maintenance of signs outside the parking premises, and light ballasts. OP pays the fee in monthly installments. The fee is payable regardless of whether OP earns a profit from the operation of the parking facilities. OP therefore benefits from any cost savings or economies realized in operating the parking facilities. Although initial parking rates are set forth in the Concession Agreement, OP has the right to periodically propose adjustments in the parking rates, subject to Town approval. Trust represents that the fee is analogous to ground rent.

The Concession Agreement also requires OP to expand the parking facilities by at least 1,000 spaces. OP is obligated to pay up to b million dollars to complete this project. Town will repay the cost of the project over a 30-year period, with interest. OP will be paid from the fees otherwise payable to Town under the Concession Agreement. In addition, OP has the right of first refusal to provide capital for any future expansion of the parking facilities (except in cases in which Town does not have to bear the cost of capital provided by another governmental authority or a third party.)

OP, through LLC2, has entered into a 30-year Subconcession Agreement with Parking Company, a nationally recognized parking operating company. Parking Company will operate the parking facilities on a day-to-day basis, paying OP a subconcession fee based on one or more fixed percentages of the gross revenues from the parking facilities. Parking Company bears the costs of operating the parking facility, except for all non-routine repairs and replacements, including the replacement of parking and revenue control equipment and garage vehicles.

Law:

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."

Under § 1.856-3(g) of the Income Tax 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, the interest of a partner in the partnership's assets is 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 retain the same character in the hands of the partners for all purposes of § 856.

Section 856(d)(1) provides that "rents from real property" include (subject to exclusions provided in § 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 tax year attributable to both the real and personal property leased under, or in connection with, the lease.

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

Section 1.856-4(b)(5)(ii) of the regulations provides that the trustees or directors of a REIT are not required to delegate or contract out their fiduciary duty to manage the trust 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 trust itself.

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

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

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C) provides that for purposes of § 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 shall not be treated as furnished, rendered, or provided by the REIT, and there shall not be taken into account 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 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, and the collection of trash are not considered as services rendered to the occupant.

Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities. Section 856(c)(5)(B) defines the term "real estate assets", in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 856(c)(5)(C) provides that the term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to

acquire leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

Section 1.856-3(b)(1) provides that the term "real estate assets" means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or other improvements thereon), and shares in other qualified REITs.

Section 1.856-3(c) provides that the term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon. The regulation further provides that the term includes timeshare interests that represent an undivided fractional fee interest, or undivided leasehold interest, in real property, and that entitle the holders of the interests to the use and enjoyment of the property for a specified period of time each year. The term does not include mineral, oil, or gas royalty interests, such as a retained economic interest in coal or iron ore with respect to which the special provisions of § 631(c) apply.

Section 1.856-3(d) provides that the term "real property" means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items that are structural components of those buildings or structures). In addition, real property includes interests in real property. Local law definitions do not control for purposes of determining the meaning of the term real property as used in § 856 and the regulations thereunder. The term includes, for example, the wiring of a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in the building, or other items that are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment that is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings or a motel, hotel, or office building, etc., even though those items may be termed fixtures under local law.

Analysis:

LLC1

LLC1, through attribution, is partly owned by and is a tenant of OP. Consequently, Trust through OP derives income from LLC1, and LLC1 does not qualify as an independent contractor for purposes of § 856(d). The issue, then, is whether OP is providing a service to tenants of properties in which LLC1 business centers are located so that Trust's share of rents received from those tenants will be treated as other than rents from real property under § 856(c).

The LLC1 business center is a separate business operation, independent of and unrelated to the office leasing business of Trust and OP. The Group, including Corporation C, has been operating its business centers on an independent basis since Year 1. Despite overlapping clientele, OP, LLC1, and Corporation C will be run as separate and independent businesses. LLC1 and Corporation C provide business centers at OP properties that may be used by both tenants and non-tenants of those properties. The LLC1 business centers are operated by employees of Corporation C. None of the officers or directors of the Group are officers or directors of Trust or OP. LLC1 will not give OP tenants preferential treatment over clients that are not tenants of OP. LLC1 clients that are OP tenants negotiate at arm's length on commercially reasonable terms with LLC1. A client's relationship with LLC1 is not premised in any manner upon the rental of office space from OP. Additionally, no more than g percent of LLC1's gross revenues from a business center are expected to come from tenants of the building.

Accordingly, subject to the restrictions of § 856(d)(7), the activities described above conducted by LLC1 and Corporation C as manager of LLC1 will not cause Trust's share of rents received from tenants at properties in which an LLC1 business center is located to be considered other than rents from real property under § 856(d). Also, the use by an OP tenant of an LLC1 business center at a location other than the OP property in which the tenant leases space will not cause Trust's share of rents received from the tenant to be treated as other than rents from real property under § 856(d).

Concession Agreement

The second issue is whether the Concession Agreement is an interest in real property for purposes of § 856(c)(5)(C) and is thus a real estate asset for purposes of § 856(c)(4)(A). The tax consequence of the Concession Agreement depends on its substance and not on its form. Commissioner v. Court Holding Co., 324 U.S. 331 (1945), 1945 C.B. 58.

The Concession Agreement grants OP (through LLC2) a 30-year right to occupy and operate the parking facilities at Airport. This right is exclusive and cannot be abrogated unless LLC2 fails to perform under the agreement. In exchange, OP is required to make periodic payments to Town. The periodic payments, like rents described in § 856(d), are not based on or contingent upon OP's profits or losses from the operation of the parking facilities. Also, similar to many commercial leases, OP bears all of the expenses related to the operation of the parking facilities.

Based upon the information provided, we conclude that the Concession Agreement is analogous to a lease and thus is an interest in real property for purposes of § 856(c)(5)(C) and qualifies as a real estate asset for purposes of § 856(c)(4)(A). Similarly, we conclude that the Subconcession Agreement between LLC2 and Parking

Company is analogous to a lease. Consequently, the income derived by OP from the subconcession fee will qualify as rents from real property under § 856(c).

Other Information:

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of the transaction discussed in this letter. No opinion is expressed concerning whether Trust qualifies as a REIT under § 856 or concerning the tax status of any other entity described herein. Furthermore, no opinion is expressed or inferred concerning the effect of any services provided by OP to LLC1 as a tenant in an OP building. Additionally, no opinion is expressed whether Trust meets the 10 percent voting securities requirement of § 856(c)(4)(B) with respect to Corporation A, as a result of Trust's interest in Operating Partnership.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
Assistant Chief Counsel
(Financial Institutions & Products)
By: Jonathan Zelnik
Assistant to the Chief, Branch

Enclosure:
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