Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
April 2, 2003

Legend:

Company =

EIN:

Operating Partnership =

State A =

State B =

TY:

Dear :

This responds to your May 30, 2002 letter submitted on behalf of Company in which you requested a ruling regarding the qualification of certain income as rents from real property for purposes of § 856(d) of the Internal Revenue Code.

Facts:

Company is a State A corporation. Company uses the accrual method, and has elected to be treated as a REIT under § 856. Company conducts its business principally through Operating Partnership, a State B limited partnership. Through Operating Partnership, Company develops and operates a portfolio of luxury multi-family properties, some of which include retail properties and office space in various metropolitan areas. Company is the sole general partner and a limited partner of Operating Partnership. Through Operating Partnership, Company presently owns, and intends to acquire properties (“Properties”). Operating Partnership owns Properties through sub-tier partnerships, limited partnerships, and limited liability companies (the "Sub-Tiers") formed to own and operate rental real estate.

Some Properties have related parking facilities that are located in the Property itself. Other Properties have their parking facility situated adjacent to them. Finally, in some Properties the parking facility is located in the same overall complex as the Property (collectively: ”Parking Facilities”). Operating Partnership is not involved in the management or operation of the Parking Facilities, except as described below.

Operating Partnership intends to enter into exclusive license agreements (each a "Parking Management Contract") with third parties (each a "Parking Operator") to operate and manage one or more of the Parking Facilities. Operating Partnership has represented that each Parking Operator will qualify either as an independent contractor under § 856(d), or as a taxable REIT subsidiary (TRS) under § 856(l).

Each Parking Management Contract will grant Parking Operator the exclusive right to operate a Parking Facility. Parking Management Contracts will require all personnel to be employees of Parking Operator. Each Parking Operator will provide and be directly responsible for all salaries, benefits, labor, administration, and supervision of employees in Parking Facilities that it operates. In addition, each Parking Operator will be responsible for establishing all major policies with respect to Parking Facilities that it operates, subject to the approval of Operating Partnership. However, in some cases Parking Operator, together with Operating Partnership, will establish parking rates and policies in order to maintain the reputation and quality of the related Property. Further, Parking Operator may be required to consult with Operating Partnership regarding staffing levels, rules and regulations. Operating Partnership may also have the ability to request the removal of a specific employee of Parking Operator from a Parking Facility if the employee's continued presence is not in the best interests of the operation of that Parking Facility or the related Property.

Company represents that the relationship with each Parking Operator will be at arm's length; Parking Operator employees will not be subject to the direct control of Company; and that Parking Operators will be adequately compensated. Company also represents that the fees generated by Parking Management Contracts will be commensurate with fees charged to operate similar parking facilities within the geographic markets in which

Parking Facilities are located. Operating Partnership does not derive or receive any income from Parking Operator.

Parking Operator's compensation may take any of the following forms: a fixed dollar amount; a fixed dollar amount plus a percentage of Parking Facility's net or gross revenues; a percentage of net or gross revenues plus an additional fixed dollar amount paid only in certain circumstances; or a percentage of net or gross revenues only.

In most cases, Parking Facilities' patrons will pay Parking Operator directly. Parking Operator will remit net revenues to Operating Partnership. Net revenues will be based on revenues received, and amounts deemed received as a result of possible tenant discounts, less Parking Operator's compensation and aggregate operating expenses of Parking Facilities. However, Operating Partnership may collect fees on behalf of Parking Operator directly from parking patrons who are also its tenants. All fees collected by Operating Partnership will be treated in the same manner as fees collected directly by Parking Operator (for example, for purposes of determining Parking Operator's compensation). In substance, Operating Partnership will collect such fees as a conduit of Parking Operator.

Aggregate operating expenses may include: liability insurance, electricity, repairs, snow removal, cleaning, payroll, payroll taxes, employee benefits, supplies, legal and accounting fees, and any sales or excise taxes imposed by any governmental authority with respect to the price or charge for parking collected from parking patrons. Aggregate operating expenses will not include debt service or property taxes on any Parking Facility or structural repairs or other capital improvements thereto. Generally, aggregate operating expenses will be incurred by Parking Operator pursuant to an annual budget that is subject to the reasonable approval of Operating Partnership.

Estimated operating expenses, staffing needs and proposed parking rates will be presented by Parking Operator to Operating Partnership in an annual budget, that will be subject to the reasonable approval of Operating Partnership. However, Parking Operator may be required to obtain prior written consent from Operating Partnership, in advance of undertaking purchases exceeding certain threshold amounts.

Throughout the year, Operating Partnership will receive periodic accounting statements from the Parking Operator. In addition, there may be periodic meetings between Parking Operator and representatives of Operating Partnership or Company, to review the results of operations at Parking Facility. Parking Operator, Operating Partnership or Company can each call a special meeting if any of them believe that the parking rates should be changed from the amount set forth in the approved budget.

In some Parking Facilities, parking spaces will be exclusively for the use of the tenants of the related building, on a reserved or unreserved basis. In others, parking spaces may also be available to the general public on an hourly, daily, weekly, or monthly unreserved

basis, or on a weekly or monthly reserved basis. In Properties comprised of both multi-family apartment units and commercial properties (either retail, office space or both), parking spaces will be available to the general public on an hourly, unreserved basis. In certain Parking Facilities, parking spaces will be available to owners and tenants of adjacent properties on a monthly reserved or unreserved basis. Sometimes, discounted parking may be available to the tenants.

Operating Partnership may provide customary maintenance, cleaning, lighting, and repairs for some Parking Facilities, although those services generally will be provided through Parking Operator. All other services, except as described below, will be performed by Parking Operator. Some Parking Facilities may be operated on a "self-park" basis, in which patrons park their own vehicles. Other Parking Facilities will have attendant parking. Company represents that any and all services provided by Operating Partnership or Parking Operator will be customary in parking facilities related to buildings of a similar class to the Properties, in the geographic markets in which the Properties are located.

At certain Parking Facilities, an independent third party ("Car Service Provider") may offer routine car maintenance services, car washing services or car rental services, which are not customarily furnished in parking facilities related to buildings of a similar class to the Properties, in the geographic markets in which the Properties are located. In such cases, Parking Facility patrons will contract directly with Car Service Provider. Company represents that Car Service Provider will be either a TRS within the meaning of section 856(l) of the Code, or an independent contractor within the meaning of section 856(d). The cost of the services will be borne by Car Service Provider, separate charges will be made for the services, the amount of the separate charges will be received and retained by Car Service Provider, and Car Service Provider will be adequately compensated for providing the services. Neither Operating Partnership nor Parking Operator will receive any fees or income from Car Service Provider.

Company and Operating Partnership represent that no amounts received or accrued directly or indirectly, by Company or Operating Partnership, with respect to any real or personal property, are or will be dependent in whole or in part, on the income or profits derived by any person from such property within the meaning of § 856(d)(2)(A) of the Code.

No amounts received or accrued by Company as rents from real property will include amounts received or accrued directly or indirectly from any person in which Company owns (i) in the case of a corporation, stock of such corporation possessing 10 percent or more of the total combined voting power of all classes of stock entitled to vote, or 10 percent or more of the total number of shares of all classes of stock of such corporation or (ii) in the case of a person which is not a corporation, an interest of 10 percent or more

in the assets or net profits of such a person, all within the meaning of § 856(d)(2)(B) of the Code and after applying the attribution rules referred to in § 856(d)(5) of the Code.

LAW AND ANALYSIS

Section 856(c)(2) of the Code provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(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) of the Code provides that "rents from real property" include (subject to the exclusions in § 856(d)(2)): (i) rents from interests in real property, (ii) charges for services customarily furnished or rendered in connection with the rental of real property (whether or not such charges are separately stated), and (iii) rent attributable to personal property which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property for the taxable year does not exceed 15 percent of the total rent for the year attributable to both the real and personal property leased under, or in connection with the lease.

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

Section 856(d)(7)(C)(i) of the Code excludes from the definition of impermissible tenant service income amounts received for services furnished or rendered, or management or operation provided through either an independent contractor from whom the REIT itself does not derive or receive any income, or from a TRS of the REIT. Additionally, § 856(d)(7)(C)(ii) excludes from the definition of impermissible tenant service income any amount which would be excluded from unrelated business taxable income under § 512(b)(3) if received by an organization described in § 511(a)(2).

Section 1.856-4(b)(5) provides that no amount received or accrued, directly or indirectly, with respect to any real property qualifies as rents from real property if the REIT furnishes or renders services to the tenants of the property or manages or operates the property, other than through an independent contractor from whom the trust itself does not derive or receive any income. This section provides further that the requirement that the trust

not receive any income from an independent contractor requires that the relationship between the two be an arm's-length relationship. To the extent that services (other than those customarily furnished or rendered in connection with the rental of real property) are rendered to the tenants of a property by an independent contractor, the cost of the services must be borne by the independent contractor, a separate charge must be made for the services, the amount of the separate charge must be received and retained by the independent contractor, and the independent contractor must be adequately compensated for the services.

The Report of the Conference Committee on the Tax Reform Act of 1986, H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. 1 (1986), 1986-3 (Vol. 4) C.B. 1, 220, in discussing § 856(d)(2)(C) provides that:

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

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 of the Code, the interest of a partner in the partnership's assets shall be determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership, and items of gross income of the partnership, shall retain the same character in the hands of the partners for all purposes of § 856.

In this case, Operating Partnership may provide customary maintenance, cleaning, lighting, and repairs for some Parking Facilities, while all other services relating to the

provision of parking spaces in Parking Facilities to tenants of the Properties, their employees, customers, and guests, as well as to the general public, will be performed by Parking Operators. Company and Operating Partnership have represented that Parking Operators constitute either an independent contractor as defined in § 856(d), or a TRS of Company. The limited activities of Operating Partnership described above are not services for purposes of § 856(d)(2)(C) of the Code, which are required to be performed by an independent contractor, as described in the conference report above. In cases where Parking Operator collects the parking revenues (excluding fees for Car Services) and remits them to Operating Partnership net of its fees and operating expenses, Parking Operator is only functioning as a conduit for delivering the revenues to Operating Partnership. Consequently, under these circumstances, Operating Partnership and Company will not be treated as deriving or receiving income from Parking Operators.

CONCLUSION

Based on the facts submitted and representations made, we rule that Company's allocable share of amounts received by Operating Partnership from Parking Facilities, that are operated by Parking Operators pursuant to Parking Management Contracts, will qualify as "rents from real property" within the meaning of § 856(d) of the Code. Furthermore, operation of Parking Facilities by Parking Operators pursuant to Parking Management Contracts described in this letter ruling, will not disqualify any amounts derived or received by Company, that would otherwise qualify as "rents from real property", from being treated as such for purposes of § 856(d) of the Code.

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

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

Sincerely,

William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)