Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856–4: Rents from real property.

REITs; parking facilities. This ruling identifies circumstances in which a real estate investment trust's (REIT's) income from providing parking facilities at its rental real properties qualifies as rents from real property under section 856(d) of the Code.

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ISSUE

If a real estate investment trust (REIT) provides parking facilities at its rental real properties, under what circumstances do amounts received by the REIT for providing the parking facilities qualify as rents from real property under § 856(d) of the Internal Revenue Code?

FACTS

Situation 1

Corporation *R* has elected to be a REIT as defined in § 856. *R* owns commercial real properties such as office buildings, shopping centers, and residential apartment complexes. Each property includes one or more buildings containing space that *R* rents out for office, retail, or multi-family residential use. Each property also includes parking facilities for the use of the tenants of the buildings and their guests, customers, and subtenants. Each parking facility is located in or adjacent to a building occupied by tenants of *R* and is appropriate in size for the number of tenants and their guests, customers, and subtenants who are expected to use the facility.

The parking facilities do not have parking attendants. *R* maintains, repairs, and lights the parking facilities. As needed to manage the REIT itself, *R* also performs fiduciary functions, such as dealing with taxes and insurance, as permitted by § 1.856–4(b)(5)(ii) of the Income Tax Regulations. No other activities are performed in connection with the parking facilities.

Situation 2

The facts are the same as in *Situation 1* except as follows. At some of *R*'s parking facilities, parking spaces are reserved for use by particular tenants. *R* assigns and marks the reserved spaces in connection with leasing space in the buildings to the tenants. Any recurring functions unique to the reserved spaces (such as enforcement) are provided by an independent contractor as defined in § 856(d)(3) from whom *R* does not derive or receive any income within the meaning of §§ 856(d)(7)(C)(i) and 1.856–4(b)(5)(i).

Situation 3

The facts are the same as in *Situations 1* and *2* except as follows.

Although each parking facility is appropriate in size for the expected number of tenants and their guests, customers, and subtenants, some of the parking facilities are available for use not only by those parties, but also by the general public. In addition, the parking facilities have parking attendants. *R* performs the same activities it performs in *Situations 1* and *2*, but corporation *S* manages and operates the parking facilities under a management contract with *R*. *S* is an independent contractor as defined in § 856(d)(3). Although *S* typically remits to *R* parking fees from those using the parking facilities, *S* receives arm's-length compensation under the terms of its management contract with *R*, and *R* does not derive or receive any income from *S* within the meaning of §§ 856(d)(7)(C)(i) and 1.856–4(b)(5)(i). *S* employs all of the individuals who manage and operate the parking facilities, including the parking attendants. *S* is directly responsible for providing all salary, wages, benefits, administration, and supervision of its employees.

In addition to collecting parking fees from those using the parking facilities, the parking attendants may park cars in order to achieve the maximum capacity of the parking facility or for reasons of safety or security. No separate fee is charged for an attendant to park a car. Occasionally, when necessary, an attendant may provide minor, incidental, emergency service at a parking facility, such as charging a battery or changing a flat tire. No other services are provided at the parking facilities.

LAW

To qualify as a REIT, an entity must derive at least 95 percent of its gross income from sources listed in § 856(c)(2) and at least 75 percent of its gross income from sources listed in § 856(c)(3). "Rents from real property" are among the sources listed in both of those sections. Section 856(d)(1) defines rents from real property to include (subject to the exclusions in § 856(d)(2)) the amounts described in § 856(d)(1)(A), (B), and (C). Section 856(d)(1)(B) refers to "charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated." Section 856(d)(2)(C) excludes "impermissible tenant service income" from the definition of rents from real property. Thus, to qualify as rents from real property, charges for services must be for services customarily furnished or rendered in connection with the rental of real property and must not be impermissible tenant service income.

Section 1.856–4(b)(1) provides the following guidance on determining whether services are customarily furnished or rendered in connection with the rental of real property:

> ... 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 (such as luxury apartment buildings) are customarily provided with the service. ... To qualify as a service customarily furnished, the service must be furnished or rendered to the tenants of the real estate investment trust or, primarily for the convenience or benefit of the tenant, to the guests, customers, or subtenants of the tenant. ...

Thus, to qualify as a service described in § 856(d)(1)(B), a service furnished at a REIT's property must be customarily provided to tenants of properties of a similar class in that particular geographic market (the geographic market test). Section 1.856–4(b)(1) also mentions the furnishing of parking facilities as an example of a service that is customarily furnished to the tenants of a particular class of buildings in many geographic markets. Reflecting the statutory requirement of "connection with the rental of real property," § 1.856–4(b)(1) also provides that to qualify as a service described in § 856(d)(1)(B), the service must be furnished to the REIT's tenants or their guests, customers, or subtenants.

Section 1.856–4(b)(5)(ii) discusses the fiduciary functions of a REIT's trustees or directors, as follows:

> The trustees or directors of the real estate investment trust 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. For example, the trustees or directors may establish rental terms, choose tenants, enter into and renew leases, and deal with taxes, interest, and insurance, relating to the trust's property. The trustees or directors may also make capital expenditures with respect to the trust's property (as defined in section 263) and may make decisions as to repairs of the trust's property (of the type which would be deductible under section 162), the cost of which may be borne by the trust.

Thus, § 1.856–4(b)(5)(ii) permits the trustees or directors of a REIT to perform activities needed to manage the REIT itself, as distinguished from rendering services to tenants of the REIT's property or managing or operating the REIT's property.

As noted above, § 856(d)(2)(C) excludes impermissible tenant service income from the definition of rents from real property. Pursuant to § 856(d)(7)(A), impermissible tenant service income means, with respect to any real property, any amount received or accrued directly or indirectly by a REIT for furnishing services to the tenants of the property or managing or operating the property. Section 856(d)(7)(C)(i), however, provides that services rendered or management or operation provided is not treated as furnished by the REIT for this purpose if furnished through an independent contractor (as defined in § 856(d)(3)) from whom the REIT does not derive or receive any income. Thus, amounts received by a REIT for services furnished to its tenants, or for property management or operation, do not constitute impermissible tenant service income if the services or management or operation is furnished through an independent contractor (as defined in § 856(d)(3)) from whom the REIT does not derive or receive any income.

Moreover, pursuant to § 856(d)(7)(C)(ii), an amount is not treated as impermissible tenant service income if the amount would be excluded from unrelated business taxable income under § 512(b)(3) if received by an organization described in § 511(a)(2) (referred to, for purposes of this revenue ruling, as an exempt organization). Thus, services provided directly by a REIT do not give rise to impermissible tenant service income if the charges for those services would be excluded from unrelated business taxable income if received by an exempt organization.

Section 512(b)(3)(A)(i) excludes rents from real property from unrelated business taxable income. Section 1.512(b)–1(c)(5) provides, however, that payments for the use of space where services are also rendered to the occupant are not rents from real property. That section mentions space in parking lots as an example of space where services are also rendered to the occupant. Thus, payments for the use of parking space are not excluded from unrelated business taxable income under § 512(b)(3) if received by an exempt organization.

The conference report underlying the 1986 revision of § 856(d) (the 1986 conference report) provides the following guidance on services performed directly by REITs:

> 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 section 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.

2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II–220 (1986), 1986–3 (Vol. 4) C.B. 220. Thus, the 1986 conference report indicates that, in some circumstances, REITs may directly perform activities in connection with parking facilities without causing charges for providing the parking facilities to fail to qualify as rents from real property under § 856(d).

The difference between this congressional intent and the treatment of exempt organizations under § 512(b)(3) reflects differences between §§ 856(d) and 512(b)(3), as well as differences between the regulations interpreting those sections. The definition of rents from real property in § 856(d), which applies to REITs, differs significantly in scope and structure from the definition of rents from real property under § 512(b)(3), which applies to exempt organizations. For example, unlike § 512(b)(3), § 856(d)(7)(C)(i) treats services provided by an independent contractor as not provided by the REIT. The definition of rents from real property under § 512(b)(3) does not have a comparable provision.

ANALYSIS

Situation 1

In *Situation 1*, *R* provides unattended parking facilities at its rental real properties. *R* maintains, repairs, and lights the unattended parking facilities and performs fiduciary functions permitted by § 1.856–4(b)(5)(ii). These activities are customarily performed at parking facilities located at rental real properties in all geographic markets. No other activities are performed in connection with *R*'s unattended parking facilities. Therefore, the furnishing of *R*'s unattended parking facilities will be treated as meeting the geographic market test of § 1.856–4(b)(1).

R's unattended parking facilities are part of *R*'s rental real properties and are provided for the use of *R*'s tenants and their guests, customers, and subtenants. Each parking facility is located in or adjacent to a building occupied by tenants of *R* and is appropriate in size for the number of tenants and their guests, customers, and subtenants who are expected to use the facility. Therefore, the furnishing of *R*'s unattended parking facilities meets the requirement of § 1.856–4(b)(1) that services be furnished to the REIT's tenants or their guests, customers, or subtenants. Because it meets both that requirement and the geographic market test, the furnishing of *R*'s unattended parking facilities is a service customarily furnished or rendered in connection with the rental of real property under § 856(d)(1)(B).

The 1986 conference report indicates that the activities performed by *R* at its unattended parking facilities described in *Situation 1* should not cause charges for providing those parking facilities to fail to qualify as rents from real property under § 856(d). Therefore, although in *Situation 1* payments for the use of parking space are not excluded from unrelated business taxable income under § 512(b)(3) if received by an exempt organization, the furnishing of *R*'s unattended parking facilities will be treated as not giving rise to impermissible tenant service income under § 856(d)(2)(C) and (d)(7). Accordingly, because the furnishing of *R*'s unattended parking facilities qualifies as a service described in § 856(d)(1)(B) and does not give rise to impermissible tenant service income, amounts received by *R* for furnishing these parking facilities qualify as rents from real property under § 856(d).

Situation 2

In *Situation 2*, the facts are the same as in *Situation 1* except that at some of *R*'s unattended parking facilities, parking is available to tenants on a reserved basis. The furnishing of these parking facilities qualifies as a service described in § 856(d)(1)(B) for the reasons discussed above with respect to *Situation 1*.

The 1986 conference report indicates that income from reserved parking should qualify as rents from real property only if services are performed by an independent contractor. In *Situation 2*, any recurring functions unique to the reserved parking spaces (such as enforcement) are performed by an independent contractor. *R* assigns and marks the reserved spaces in connection with leasing space to its tenants and provides maintenance, repair, lighting, and fiduciary functions permitted by § 1.856–4(b)(5)(ii). These basic activities performed by *R* are not services to tenants that the conferees intended to prevent REITs from performing directly at parking facilities. Section 1.856–4(b)(5)(ii) permits the trustees or directors of a REIT to perform activities needed to manage the REIT itself, as distinguished from rendering services to tenants of the REIT's property or managing or operating the property. Therefore, although in *Situation 2* payments for the use of parking space are not excluded from unrelated business taxable income under § 512(b)(3) if received by an exempt organization, the furnishing of *R*'s unattended, reserved parking facilities will be treated as not giving rise to impermissible tenant service income under § 856(d)(2)(C) and (d)(7). Accordingly, because the furnishing of *R*'s unattended, reserved parking facilities qualifies as a service described in § 856(d)(1)(B) and does not give rise to impermissible tenant service income, amounts received by *R* for furnishing these parking facilities qualify as rents from real property under § 856(d).

Situation 3

In *Situation 3*, *R* provides attended parking facilities at its rental real properties. *R* performs the same activities it performs in *Situations 1* and *2*, and *S* manages and operates the attended parking facilities. Attendants at these facilities generally collect parking fees. Attendants may also park cars in order to achieve the maximum capacity of the parking facility or for reasons of safety or security, and no separate fee is charged for an attendant to park a car. Occasionally, when necessary, an attendant may provide minor, incidental, emergency service at a parking facility. These services typically are provided at attended parking facilities at rental real properties in all geographic markets. No other services are provided at *R*'s attended parking facilities. Therefore, the furnishing of *R*'s attended parking facilities will be treated as meeting the geographic market test of § 1.856–4(b)(1).

Some of *R*'s attended parking facilities are available for use not only by *R*'s tenants and their guests, customers, and subtenants, but also by the general public. However, the 1986 conference report indicates that tenant parking facilities also available to the general public should not be precluded from qualifying under § 856(d)(1)(B). *R*'s attended parking facilities are part of *R*'s rental real properties, and each parking facility is located in or adjacent to a building occupied by tenants of *R* and is appropriate in size for the number of tenants and their guests, customers, and subtenants who are expected to use the facility. Because of this proximity to the tenants and appropriate size, the attended parking facilities that also are available to the general public can reasonably be expected to be used predomi-

nantly by *R*'s tenants and their guests, customers, and subtenants. For these reasons, the furnishing of *R*'s attended parking facilities will be treated as meeting the requirement of § 1.856–4(b)(1) that services be furnished to the REIT's tenants or their guests, customers, or subtenants. Because it meets both that requirement and the geographic market test, the furnishing of *R*'s attended parking facilities is a service customarily furnished or rendered in connection with the rental of real property under § 856(d)(1)(B).

The 1986 conference report indicates that income from parking that is reserved or available to the general public should qualify as rents from real property only if services are performed by an independent contractor. The only activities that *R* performs in connection with its attended parking facilities are maintenance, repair, lighting, fiduciary functions, and assigning and marking reserved spaces. As noted above, these basic activities are not services to tenants that the conferees intended to prevent REITs from performing directly at parking facilities. All of the other activities involved in furnishing *R*'s attended parking facilities are performed by *S*, an independent contractor as defined in § 856(d)(3). Although *S* typically collects parking fees and remits the fees to *R*, *S* receives arm's-length compensation under the terms of its management contract with *R*, and *R* does not derive or receive any income from *S* within the meaning of §§ 856(d)(7)(C)(i) and 1.856–4(b)(5)(i). *S* employs all of the individuals who manage and operate the attended parking facilities and is directly responsible for providing all their salary, wages, benefits, administration, and supervision. Therefore, although in *Situation 3* payments for the use of parking space are not excluded from unrelated business taxable income under § 512(b)(3) if received by an exempt organization, the furnishing of *R*'s attended parking facilities will be treated as not giving rise to impermissible tenant service income under § 856(d)(2)(C) and (d)(7). Accordingly, because the furnishing of *R*'s attended parking facilities qualifies as a service described in § 856(d)(1)(B) and does not give rise to impermissible tenant service income, amounts received by *R* for furnishing these parking facilities qualify as rents from real property under § 856(d).

HOLDING

Amounts received by *R* for furnishing unattended parking facilities, under the circumstances described in *Situations 1* and *2*, and for furnishing attended parking facilities, under the circumstances described in *Situation 3*, qualify as rents from real property under § 856(d).

DRAFTING INFORMATION

The principal author of this revenue ruling is Jonathan D. Silver of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Silver at (202) 622–3920 (not a toll-free call).