



TaxNewsFlash

United States



No. 2020-125
March 19, 2020

PLR: REIT's operation of cold storage warehouses, treatment of amounts received for providing space and freezing

The IRS publicly released a private letter ruling* in which the IRS addressed the proposed operation of cold storage warehouses by a real estate investment trust (REIT). The IRS ruled that amounts received under storage agreements for providing space and freezing will qualify as rents from real property within the meaning of section 856(d).

In [PLR 202012003](#) [PDF 156 KB] (dated December 17, 2019, and release date of March 20, 2020), there were four issues addressed by the IRS, but the majority of the letter ruling focuses on the use of warehouses on a non-exclusive basis by customers pursuant to long-term storage agreements, under which a customer's pallets of goods may remain at the warehouse for an average of days.

Notwithstanding the storage interval appears to be less than 30 days or would be typically considered a short term, the IRS ruled that amounts received under the storage agreements for providing space and [redacted] will qualify as rents from real property within the meaning of section 856(d).

However, the storage agreements are long-term agreements and occupancy is managed to maintain available space for those with storage agreements. Further, as described in the letter ruling, either expressly under the storage agreements or effectively through the practice, space is reserved for all customers. Based on understandings of this property type, the redacted text is likely "freezing," which the IRS confirmed to be an unrelated business taxable income (UBTI)-permitted activity without the need to use a taxable REIT subsidiary (TRS) or an independent contractor (IK) from whom the REIT does not derive income. This ruling also includes amounts for handling services performed by a TRS or an IK. Thus, both the taxpayer and the IRS confirmed that handling services are likely considered primarily for the convenience of customers and, thus, require the use of a TRS or an IK, but are considered customary in the relevant geographic market.

*Private letter rulings are taxpayer-specific rulings furnished by the IRS Office of Chief Counsel in response to requests made by taxpayers and can only be relied upon by the taxpayer to whom issued. Pursuant to section 6110(k)(3), written determinations such as private letter rulings are not intended to be relied upon by third parties

and may not be cited as precedent. These written determinations may, however, offer an indication of the IRS's position on the issues addressed.

KPMG observation

It is not entirely clear how far this ruling can apply to other businesses (such as co-working or salvage yard), which similarly allow others to use their real property on a non-exclusive basis but pursuant to a long-term contract. After all, once a given space (which could be a desk/table or a portion of the land parcel) is occupied by a user or user's goods, no other persons can use the same space.

Background

In the letter ruling, the REIT intends to raise capital through a public offering or other sale of its stock and contribute the proceeds to an operating partnership, through which the REIT will acquire, develop, and lease cold storage warehouses and provide customers with storage space as well as handling and other supply chain services. The REIT and its subsidiaries (referred to as the group) may rent to a customer an entire warehouse ("Warehouse Lease"), a set amount of reserved space in a warehouse for a set term that is generally one year ("Warehouse Agreement"), or non-exclusive space in a warehouse ("Storage Agreement").

For customers using Storage Agreements, space is measured by the cubic feet occupied by a pallet of goods (a "Unit"). The group enters into a long-term Storage Agreement with each Storage Agreement customer that contains the terms and obligations of both parties when the customer presents a pallet of goods for storage in one of the warehouses. Each Storage Agreement contains a profile that projects the type, size, and number of pallets the customer expects to store over a period of time within a specified warehouse ("Customer Profile"). The Customer Profile also indicates the length of time each pallet is expected to remain in the warehouse. The group uses the Customer Profile and the desired amount of revenue per Unit in the warehouse to determine the specified storage rate the customer will be charged per pallet under that Storage Agreement. The specified storage rate is based on a set storage interval (generally a days) and is charged on a recurring basis if the pallet remains in the warehouse beyond that interval. Across warehouses, pallets remain in a warehouse for an average of b days. To determine the group receives the desired amount of revenue per Unit, a customer's Storage Agreement will be renegotiated if customer's actual storage data differs significantly from its Customer Profile projections.

The group formally guarantees space in a warehouse for those customers under Warehouse Leases and Warehouse Agreements. Additionally, a customer's Storage Agreement may present a fixed minimum storage commitment, and such space is guaranteed for those customers as well. Although space is not formally guaranteed for other customers under their Storage Agreements, the group's provision of space in a warehouse is based on the Customer's Profile and the group carefully plans its storage capacity in each warehouse to allow it to have available space for all of its customers. Using the Customer Profiles, its space planning protocols, and the historical data from its long-term relationships with its customers, the group targets a c percent occupancy rate in each warehouse to determine it can accept products for storage that fall outside a customer's profile at any given time. Therefore, the group effectively reserves space for all its customers based on the Customer Profile regardless of whether the Storage Agreement guarantees the space.

Letter ruling

While redacted, the letter ruling appears to describe the common process of freezing customer's goods, such as room/blast freezing. Other common services at the warehouses include "handling" services—e.g., loading, unloading, and moving customers' pallets into, out of, and around the facilities.

With respect to Storage Agreements, the IRS reasoned:

Storage Agreements represent an agreement for the storage of pallets in Company Group Warehouses as they are received from Customers. Due to the industry needs of Customers, pallets of goods are entering and exiting Company Group Warehouses at varying intervals on a revolving basis, with each pallet remaining in a Warehouse for an average of every b days. A storage fee is collected for each pallet of goods entering a Warehouse. The storage fees under each of the Storage Agreements are calculated so that Company Group receives a set amount of revenue for each Unit of space in each of its Warehouses over the course of a year. Specifically, using the Customer Profile within the Storage Agreement and the desired amount of revenue for each Unit within each Warehouse, a storage fee is set for each pallet of goods stored by each Customer. Thus, the aggregate storage fees collected by Company Group for the storage of a Customer's pallets in a Warehouse are ultimately based on the amount of space that the Customer occupies over a year-long period.

With respect to freezing, the IRS reasoned:

Taxpayer and Operating Partnership provide [freezing] by setting a room or area's temperature control system to consistently maintain a _____ within a room or specified area. In this instance, [freezing] is achieved through the provision of power, or electricity, to operate the temperature control system used to [freeze] the spaces within each Warehouse. Taxpayer represents that the provision of [freezing], including the provision of power or electricity to run the temperature control system, is a service that is usually and customarily rendered in connection with the rental of space in _____ storage facilities and is not primarily for the convenience of Customers. The income from the provision of [freezing] is similar to the income from the provision of heat and is also the provision of the utility of power, or electricity, and, therefore, for purposes of determining whether the income is qualifying income for REIT qualification purposes, is income that would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Accordingly, the IRS ruled that amounts received under the Storage Agreements for providing space and freezing will qualify as rents from real property within the meaning of section 856(d).

KPMG observation

While each of a customer's pallets may remain in a warehouse for likely less than 30 days, the shorter-term nature by itself does not appear to change the fact that each pallet is using spaces within a warehouse similar to customers in a record storage facility described in PLR 201503010 (July 9, 2014).

Also, see Rev. Rul. 69-178, which involves an exempt organization that owns a meeting hall and permits its members and outside individuals and groups to use the hall for a fee. The individuals or groups normally use the facilities for a single afternoon or evening, but, at most, for periods of two or three days. The agreement to use the facilities is usually verbal, and only utilities and janitorial services are provided. Because the charges in this situation are made for the use and occupancy of space in real property and only utilities and janitorial services are provided, the receipts constitute rents from real property excludable from UBTI. Even though the use is only for a short period of time, it does not destroy the character of the receipts as rents from real property.

Citing Rev. Rul. 69-178 as authority, the IRS has ruled privately that payments received by REITs for the short-term use of conference rooms, party rooms, club houses, and common areas for art, cars, or antique shows and for flea markets and craft fairs, when no personal services were rendered, would be rents from real property.

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