

TaxNewsFlash

United States



No. 2020-131
March 20, 2020

PLR: Lease rights constitute real property for REIT purposes

The IRS issued a private letter ruling* concluding that certain lease rights are in the nature of a leasehold interest and, thus, constitute real property and real estate assets. Further, the IRS ruled that the percentage rent from tenants of billboard sites as adjusted for agency fees and continuity discounts does not depend in whole or in part on the income or profits derived by any person at the billboard site for purposes of the REIT rules.

Read [PLR 202012012](#) [PDF 87 KB] (dated December 17, 2019, and release date of March 20, 2020)

*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

Presumably, the no income/profits ruling is part of the determination that payments received pursuant to the lease rights are "rents from real property." However, the IRS specifically noted that no opinion was expressed as to whether the taxpayer otherwise has qualifying rents from real property with respect to the lease rights. It is worth noting that the business model described in PLR 202012012 is very similar to that in PLR 200831020 (April 15, 2008), in which the IRS similarly ruled that lease rights constitute interests in real property and, thus, real property. Additionally, the IRS previously ruled in PLR 200831020 that income associated with the lease rights constitutes "rents from real property" for REIT purposes.

Summary

In PLR 202012012, the fee owners of land, building rooftops, and other assets (collectively, the "sites") lease the sites to third parties (the "ground leases").

While redacted in the letter ruling, the sites appear to be used for cell towers and billboards as examples.

At some point during the term of a ground lease, the REIT directly or indirectly acquired the fee owner's right, title, and interest in the ground lease (the "lease rights"). The agreements conveying the lease rights run with the land and any subsequent purchaser of a site would be subject to the terms of the relevant agreement. Further, the agreements or memoranda of the agreements conveying the lease rights will be recorded with the appropriate office in the county in which each site is located. Additionally, with respect to each of the sites, the REIT can enter into a "successor lease," which provides that upon termination or expiration of a ground lease, the REIT automatically becomes the tenant on that site on terms consistent with those contained in the terminated ground lease, except that the REIT has no obligation to pay any rent or other consideration to the lessor. Each successor lease runs until a date specified in the lease rights purchase agreement and expressly permits the REIT to sublease the site to a substitute third-party tenant until such date.

The IRS cited Reg. section 1.856-10(f)(1) and reasoned that the lease rights (1) are intangible assets that derive their value from the underlying site or lease thereon, (2) are not separable from the underlying site and lease, and (3) only contribute to the production of rental income for use of the site, and thus do not contribute to the production of income other than consideration for the use or occupancy of space. Furthermore, the lease rights provide an interest in rights under a lease with respect to real property, and the operation of the successor lease, or option thereon, converts the lease rights into a traditional lease. Accordingly, the IRS ruled that the lease rights constitute real property under Reg. section 1.856-10(f) and are real estate assets for purposes of section 856(c)(4).

In PLR 202012012, with respect to certain ground leases of sites used for billboards, the third-party tenant pays a percentage rent that is equal to the specified percentage of such tenant's gross revenue or receipts from the billboards reduced by agency fees and continuity discounts. The letter ruling described that the agency fee is paid by the tenant to an advertising agency for locating a billboard customer and is added to the rent charged by the tenant (to the billboard customer). The IRS reasoned that the agency fees are transaction fees akin to sales taxes or credit card fees in a retail merchandise business. The billboard site tenant sometimes pays a portion of the charge received back to the billboard customer in the form of a continuity discount, which is for customer's committing to place advertisements on multiple billboards owned by the tenant or for using a specific billboard for an extended period of time. Rather than reducing the rent charged, a tenant will reimburse or rebate the continuity discount to the billboard customer once certain thresholds are met. For the continuity discount, the IRS reasoned if tenant's gross receipts were not reduced by the continuity discount, the gross receipts would overstate the amount of rent received by the tenant from its customer. Accordingly, the IRS ruled that adjusting for agency fees and continuity discounts more accurately reflects the third-party tenant's gross receipts and does not cause the rent received by the REIT to be based on the income or profits of any person.

KPMG observation

The ruling with respect to the agency fees and continuity discounts is similar the ruling in PLR 201549013 (August 19, 2015), which was issued to a publicly traded partnership that derives income from leases of raw land and building rooftops to tenants, which construct, own and maintain freestanding cellular towers, rooftop wireless and broadband internet installations, billboards, wind turbines or solar arrays on the sites.

In PLR 201549013, the tenant's gross revenue or receipts received from the billboards may be reduced by one or more of the following: (1) agency fees or commissions, which are amounts paid by the tenant to the advertising agency that identified the advertiser on the site; (2) illumination charges; (3) business license fees, which are amounts paid by the tenant for a license to advertise on the site; (4) continuity discounts; and (5) taxes (other than income taxes) paid or payable by the tenant in connection with the tenant's billboards located on the site. The IRS ruled in PLR 201549013 that income earned attributable to these leases qualifies as "rents from real property" under section 856(d), as modified by section 7704(d)(3), and therefore, constitutes qualifying income within the meaning of section 7704(d)(1)(C).

For more information, contact a tax professional with KPMG's Washington National Tax:

Stephen Giordano | +1 (202) 533-3535 | stephengiordano@kpmg.com

David W. Lee | +1 (202) 533-4071 | dwlee@kpmg.com

The information contained in TaxNewsFlash is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230, as the content of this document is issued for general informational purposes only, is intended to enhance the reader's knowledge on the matters addressed therein, and is not intended to be applied to any specific reader's particular set of facts. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

KPMG International is a Swiss cooperative that serves as a coordinating entity for a network of independent member firms. KPMG International provides no audit or other client services. Such services are provided solely by member firms in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any member firm in any manner whatsoever.

Direct comments, including requests for subscriptions, to [Washington National Tax](#). For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at +1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.

To unsubscribe from TaxNewsFlash-United States, reply to [Washington National Tax](#).

[Privacy](#) | [Legal](#)