TaxNewsFlash

United States

No. 2020-540
August 28, 2020

PLR: Payments under wireless service agreements constitute rents from real property for REIT

The IRS today publicly released a private letter ruling* that the IRS provided to a taxpayer that owns telecommunication infrastructure assets, grants wireless carriers the use of the systems pursuant to agreements, and intends to elect real estate investment tax (REIT) status.

Based on certain representations made by the taxpayer, including those relating to real property and services, the IRS ruled that amounts paid by users under these wireless service agreements for the use of a system would constitute rents from real property for purposes of the REIT's income tests.

The taxpayer also intends to change its method of accounting for the depreciation of certain assets beginning with its REIT election year, which will result in a positive adjustment under section 481(a) to be included in the taxpayer's taxable income over a period of four years. Pursuant to section 856(c)(5)(J)(i), the IRS ruled that the taxpayer's section 481(a) adjustment would not constitute gross income for purposes of REIT's income tests.

Read **PLR 202035008** [PDF 121 KB] (released August 28, 2020, and dated May 29, 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

Based on the description in the letter ruling, the subject telecommunication infrastructure assets appear to be distributed antenna systems—which the IRS has previously addressed in PLRs 201901001, 201741002, and 201450017.

Because the primary component of these systems is fiber optic cable that can be used by multiple customers at the same time, the letter ruling describes, among other things, that a user may have dedicated fiber optic strands and coaxial cable or dedicated wavelengths and frequencies on fiber optic strands and coaxial cables in a system, such that the users' signals will not be combined. Also, similar to earlier letter rulings, the IRS cautioned "an exempt organization providing the same services may have unrelated business taxable income because the income may not be excluded under section 512(b)(3) as rents from real property."

Summary

In the letter ruling released today, the taxpayer owns telecommunication infrastructure assets (referred to as systems) and intends to elect to be taxed as a REIT. The primary component of each system is fiber optic cable. Each system also includes optical converters, amplifiers, antennae, and other personal property associated with the systems that perform an active function (referred to as equipment). The taxpayer enters into agreements with unrelated wireless carriers (referred to as users), which grant users the use of the systems for an initial term of multiple years with several renewal options. A use agreement requires a user to pay the taxpayer a recurring monthly or quarterly charge for the use of the systems that may escalate annually based upon a fixed amount or an index that tracks inflation. In some cases, a use agreement may also require, at the inception of such agreement, a nonrecurring payment that the taxpayer represents is for the use of the systems over time.

The taxpayer reserves capacity for a user under a use agreement and does not oversell capacity. In addition, the user pays for such reserved capacity regardless of whether it uses that capacity. Each use agreement specifies a particular system, and each user will have dedicated fiber optic strands and coaxial cable or dedicated wavelengths and frequencies on fiber optic strands and coaxial cables in that system, such that the users' signals will not be combined. When a user has a right to a portion of the capacity of a fiber optic cable (rather than an entire strand), the user will have an exclusive right to use a dedicated wavelength within the specified fiber optic pathway, but may not have a right with respect to a specifically identified strand or specific wavelength within a specifically identified strand in a fiber optic cable. In other words, although the user may not be guaranteed a specific wavelength in a specific strand in the fiber optic cable, it is guaranteed a wavelength in a strand within the fiber optic cable in the system.

According to the letter ruling, the taxpayer performs certain activities with respect to the systems, including designing, constructing, repairing, maintaining, and monitoring the systems (other than monitoring and maintaining the equipment or any assets owned by a user). Further, the taxpayer may make adjustments to a system to ensure that a system is operational, safe, and secure (as opposed to maximizing the quality of a system's performance as to a particular user). The taxpayer represents that these activities are in furtherance of the taxpayer's fiduciary capacity to manage the affairs of the REIT itself.

The letter ruling also describes certain activities to be performed by a taxable REIT subsidiary (TRS) or an independent contractor, such as: (1) installing separate meters or disconnect boxes for power connection at specific locations along the systems; and (2) monitoring, operating, managing, maintaining and repairing the equipment, which may be owned by the taxpayer or a user.

The taxpayer represents that the systems are inherently permanent structures and are therefore real property, and that all services provided to users in connection with the lease of its systems are customarily provided by lessors of telecommunication infrastructure assets in the geographic area in which systems are located.

In the ruling, the IRS reasoned "[t]he User is required to pay for the contracted usage and Taxpayer does not oversell capacity in its Systems so that Users always have access to their contracted usage, regardless of the User's actual usage." Thus, based on certain representations made by the taxpayer, the IRS ruled amounts received by the taxpayer for the right to use or to occupy space on a system would qualify as rents from interests in real property under section 856(d)(1)(A).

The taxpayer also intends to change its method of accounting for the depreciation of certain assets beginning with its REIT election year, which will result in a positive adjustment under section 481(a) to be included in taxpayer's taxable income over a period of four years. Pursuant to section 856(c)(5)(J)(i), the IRS ruled that taxpayer's section 481(a) adjustment would not constitute gross income for purposes of REIT's income tests.

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

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