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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

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CC:DOM:FI&P:2- PLR-111194-99
Date:
October 20, 1999

LEGEND

Company =

State A =

City A =

Year A =

a =

b =

c =

d =

This letter responds to a letter dated June 21, 1999, and subsequent correspondence, from your authorized representative requesting a private letter ruling that activities associated with the ownership and operation of self-storage facilities (as described below) will not cause otherwise qualifying amounts received by Company from its business to be treated as other than "rents from real property" under section 856(d) of the Internal Revenue Code.

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FACTS

Company is a publicly traded State A corporation that has elected to be taxed as a real estate investment trust ("REIT") under section 856(d). Company owns, acquires, develops, constructs and franchises miniwarehouse self-storage facilities (the "Facilities" and each a "Facility"). The Facilities are operated through an operating partnership ("OP") in which Company is the sole general partner and other lower-tier partnerships in which Company holds a direct or indirect interest. Company also owns stock in two companies that are not qualified REIT subsidiaries as defined in section 856(i). With respect to the two companies, OP owns stock representing more than 95 percent of the value but less than 10 percent of the vote.

The Facilities rent self-storage space, primarily to individuals and small businesses. A Facility is subdivided into storage spaces of varying sizes. Tenants lease an individual storage space for terms of not less than 30 days. On-site managers ("Managers") handle the day-to-day operations of a Facility. Managers enter into and renew rental agreements as well as collect and deposit rents. Managers are prohibited from assisting tenants in loading or unloading their goods, or in otherwise assisting tenants in storing items or removing them from storage.

The Facilities have paved parking areas for tenants on an unreserved, no-charge basis. Company only provides customary maintenance and lighting of these parking spaces. Tenants have unlimited access to their storage space during normal business hours.

Transportation Service

In Year A, Company acquired six Facilities in the City A metropolitan area (the "City A Properties"). Consistent with the market demands of City A, the previous owner of the Facilities offered a transportation service in connection with the operation of the self-storage business ("Transportation Service"). Company intends to continue the Transportation Service through an independent service provider ("Trucking Contractor") that has acquired the trucks used by the previous owner of the City A Properties as well as other trucks. The trucks used in furnishing the Transportation Service will be painted with Company's logo, which will be done at Company's expense. Company represents that it holds no interest in and will not derive or receive any income from the Trucking Contractor's operation of the Transportation Service. Company represents that the Trucking Contractor will qualify as an independent contractor within the meaning of section 856(d)(3).

Under the terms of the agreement between Company and Trucking Contractor, Company will schedule appointments for the Transportation Service at the time a tenant leases a storage unit. Trucking Contractor employees will be dispatched to the

designated location at the appointed time. Trucking Contractor employees also may assist in the loading, unloading and storage of items.

Trucking Contractor will use its best efforts to complete each pick up and delivery within two hours starting from the time its truck arrives at the designated pick up location and ending when the customer's items have been unloaded at one of the City A Properties. Trucking Contractor invoices Company for all time charges. Trucking Contractor will charge $a for the first two hours of the Transportation Service. Company is responsible for paying that charge. In the event the Transportation Service exceeds two hours and Trucking Contractor has used its best efforts to keep within that two-hour window, Company shall collect from the tenant $b for each additional hour and remit such collections to Trucking Contractor upon receipt.

Trucking Contractor may park the trucks at the City A Properties when not being used. However, Trucking Contractor is solely responsible for maintenance of the trucks. Trucking Contractor also has sole responsibility for all matters relating to the employment, supervision, compensation, promotion and discharge of its employees.

Company represents that it is common for owners of self-storage centers in the City A metropolitan area to provide or arrange for the pick-up and delivery of goods from the tenant's location to the self-storage center. Company contends that this practice is dictated by the unique characteristics of that geographic market. Company represents that the Transportation Service is a customary service within the meaning of section 856(d)(1)(B).

Leasing Company

Company plans to enter into an agreement to allow a national truck leasing company ("Leasing Company") to conduct truck rental operations at all or selected Facilities. Leasing Company represents that trucks are frequently used by customers to transport goods into and out of storage, and because self-storage facilities are usually in visible locations, the agreement between Company and Leasing Company will conveniently serve the general public's need for access to truck rentals. At many of the selected Facilities, Company will permit Leasing Company to use parking spaces to place rental trucks, though Leasing Company may not receive designated areas for its trucks. At some Facilities, no trucks will be parked at the Facility. At each selected Facility, advertising in the form of brochures and signage will promote Leasing Company's trucks.

Managers will perform certain on-site activities related to the truck rental operations. In general, these activities will be limited to distributing, collecting and forwarding contracts supplied by Leasing Company, collecting payments, periodically checking and maintaining the oil and other fluid levels of the trucks, and when

necessary refilling such fluids. Leasing Company personnel (or independent contractors working for Leasing Company) will perform all maintenance for all trucks (including tune-ups, repairs and truck washing) and attend to any roadside emergencies reported by customers.

Company and Managers will be compensated in the following manner. Leasing Company will remit a flat percentage of the gross rental fee that it receives on each truck rental to Company. Managers will be paid between c to d % of the amount received by Company. Company will maintain separate books and records that track its income and expenses relative to the truck rental activity.

The trucks will be marked with the name and logo of both Company and Leasing Company. Company and Leasing Company expect to cooperate in joint advertising efforts, including ads in telephone directories, newspapers and other print advertisements. A display regarding the truck rental operation may be added to the marquee or billboard of the applicable Facility. The parties may enter into certain cross-marketing, incentive and promotional arrangements designed to promote both the truck rental and self-storage business, which might include discounts granted by Company to customers of Leasing Company or vice versa.

Records Management Business

A section of one Facility is dedicated to the operation of a records management business. To make space ready for that purpose, the individual storage units were replaced with open warehouse space and rows of shelving designed to hold boxes containing business records. The shelving is placed from floor to ceiling. The Facility uses forklifts, ladders and other equipment to retrieve and store boxes. A computerized system tracks the location of each box at the Facility.

Customers of the records management business include individuals and businesses. Customers deliver or may request that records be transported to the Facility. Company charges customers a one-time fee to open an account. In addition, customers pay a fixed monthly fee per stored box. Charges are not specifically based upon the amount of space used by the customer.

Customers may at their discretion request to have certain boxes delivered to a specified location, usually the customer's place of business. Alternatively, customers may view records in a common area at the Facility. After the customer is finished using the records, Company employees will retrieve the boxes, make a record in the computer of their return and see that they are stored. Company charges customers a separate fee for each delivery or retrieval of records from storage.

To protect the safety of the customers as well as to safeguard the information contained in the stored records, no customer is permitted access to the warehouse area. The delivery and retrieval of records is conducted through vans owned by Company and operated by Company employees. In some instances, the same employees will be involved with the self-storage activity and the records management operations taking place at the Facility. However, Company will maintain separate books and records for each of these activities.

Tenants of the self-storage activity undertaken at the applicable Facility as well as the general public may be customers of the records management business. However, the self-storage tenants are expected to represent an insubstantial portion of the customer base and self-storage tenants will not be offered a discount by the records management business.

APPLICABLE LAW

Section 856 provides that to qualify as a REIT, a corporation must: (1) derive at least 95% of its gross income (excluding gross income from prohibited transactions) from sources listed therein which include dividends, interest, rents from real property and certain other items; (2) derive at least 75% of its gross income (excluding gross income from prohibited transactions) from sources listed therein which include rents from real property and certain other items; and (3) have at least 75% of the value of its assets represented by real estate assets, cash and cash items (including receivables) and government securities.

Section 856(d)(1) provides that "rents from real property"' include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property, (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated, and (C) rent attributable to both the real and personal property 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, such lease.

Section 856(d)(2)(C) excludes from the definition of "rents from real property"' any impermissible tenant service income as defined in section 856(d)(7). Section 856(d)(7)(A) provides, in relevant part, that impermissible tenant service income means, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for managing or operating such property. Section 856(d)(7)(B) provides that de minimis amounts of impermissible tenant service income, i.e., amounts less than one percent of all amounts received or accrued by the REIT with respect to a particular property during the taxable year, will not cause otherwise qualifying amounts to not be treated as rents from real property.

Section 856(d)(7)(C)(i) excludes from the definition of impermissible tenant service income amounts received for services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT itself does not derive or receive any income. Additionally, section 856(d)(7)(C)(ii) excludes amounts 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).

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for the tenant's convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, and the collection of trash are not considered as services rendered to the occupant. Payments for the use or occupancy of entire private residences or living quarters in duplex or multiple housing units or offices in an office building are generally treated as rent from real property.

Rev. Rul. 69-178, 1969-1 C.B. 158, holds that amounts received by an exempt organization for the occasional use by others of its meeting hall are "rents from real property" within the meaning of section 512(b)(3). The only services provided by that exempt organization consisted of the provision of utilities and janitorial services. Rev. Rul. 80-297, 1980-2 C.B. 196, holds that the leasing of tennis facilities to a third party without services and for a fixed fee is excluded from unrelated business taxable income as rent from real property under section 512(b)(3) and the regulations thereunder. Rev. Rul. 80-298, 1980-2 C.B. 197, holds that income from the lease of a football stadium by an exempt university to a professional football team is not excluded from unrelated business taxable income as rent from real property under section 512(b)(3) and the regulations thereunder because the university provided substantial services for the convenience of the team.

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

Section 1.856-4(b)(1) provides that services provided to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings which are of a similar class are customarily provided with the service. Such services include the furnishing of water, heat, light, air conditioning and telephone answering services. Where it is customary in a particular geographic marketing area to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of such utilities to tenants in such buildings will be considered a customary service.

Section 1.856-4(b)(5)(ii) provides that trustees or directors of the REIT 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 including establishing rental terms, choosing tenants, entering into renewal of leases, and dealing with taxes, interest and insurance relating to the REIT's property. The trustees or directors may also make capital expenditures with respect to the REIT's property and may make decisions as to repairs of the property the cost of which may be borne by the REIT. See also Rev. Rul. 67-353, 1967-2 C.B. 252.

ANALYSIS

Company represents that it is common for owners of self-storage centers in the City A metropolitan area to provide or arrange for the pick-up and delivery of goods from the tenant's location to the self-storage center. Company represents that the Transportation Service is a service customarily furnished to tenants by owners of property of a comparable type and located in the same geographic area as the City A Properties within the meaning of section 856(d)(1)(B). Company also represents that the Trucking Contractor constitutes an independent contractor from whom the Company does not receive any income. The Transportation Service furnished by Trucking Contractor with respect to the City A Properties will not generate impermissible tenant service income for purposes of section 856(d)(2)(C) because the services are being performed by an independent contractor. Accordingly, Trucking Contractor's performance of the Transportation Service will not cause amounts received from the self-storage activities undertaken at the City A Properties to be treated as other than "rents from real property" for purposes of section 856(d)(2)(C).

Leasing Company offers its services to both tenants of Company and the general public. Tenants of Company are not required to lease a truck from Leasing Company and are free to utilize other truck leasing companies. Managers will perform limited on-site activities related to the truck rental operations. Company will maintain separate books and records that track its income and expenses relative to the truck rental activity.

In return for providing Leasing Company with access to Company's tenants and a location to attract others in need of a truck, Company receives a flat percentage of the gross revenues derived by Leasing Company from each rental. Such amounts are not charges for services rendered in connection with the rental of real property under section 856(d)(1)(B). Because amounts received by Company from Leasing Company will not qualify as "rents from real property" under section 856(d)(1), Company will treat these amounts as non-qualifying income for purposes of sections 856(c)(2) and 856(c)(3).

However, the limited activities of Company and its Managers with respect to Leasing Company's business are not rendered to or for the tenants of the Facilities in connection with the rental of real property by those tenants. As a result, the performance of the these activities by Company and its Managers as agents of Leasing Company will not cause rental income of Company derived from its lease of self-storage units at the Facilities to be treated as other than "rents from real property" under section 856(d).

At one of its Facilities, Company will operate a records management business along with the self-storage business. While some persons might be tenants of both, it

is expected that in general different customers will be serviced by these businesses. Company represents that the records management business is an independent profit center that is not dependent upon any customers it might draw from the self-storage business. In addition, each business is expected to implement separate advertising strategies.

It is expected that some employees will be shared by the self-storage and records management businesses. However, Company represents that separate books and records will be maintained for each business.

While the records management business uses a warehouse to store boxes, it is a service activity that relies on real property as a component of its service business. This business involves the management of the business records and commitment to courier the records to and from a customer's place of business. These activities are not rendered in connection with the rental of real property, and as such, the income received from the activities are not amounts received with respect to real property. The amounts received from the records management business is based on the number of items stored and the use of the courier service. These amounts should be treated as income from a separate trade or business.

Amounts received or accrued by Company in connection with the records management business will not be treated as "rents from real property" under sections 856(c)(2) and 856(c)(3). However, because Company's activities with respect to this business are not rendered to or for the tenants of the Facilities in connection with the rental of real property by those tenants, the activities will not cause rental income of Company derived from its lease of self-storage units at the same Facility to be treated as other than "rents from real property" under section 856(d).

CONCLUSIONS

Based on the facts as represented by Company, we rule that:

(1) Trucking Contractor's performance of the Transportation Service will not cause amounts received from the self-storage activities undertaken at the City A Properties to be treated as other than "rents from real property" for purposes of section 856(d).

(2) Amounts received by Company from Leasing Company will not be treated as "rents from real property" under sections 856(c)(2) and 856(c)(3). However, the performance of certain activities, described above, by Company and its Managers as agents of Leasing Company will not cause rental income of Company derived from its lease of self-storage

units at the Facilities to be treated as other than "rents from real property" under section 856(d).

(3) Amounts received or accrued by Company in connection with the records management business will not be treated as "rents from real property" under sections 856(c)(2) and 856(c)(3). However, Company's activities with respect to this business will not cause rental income of Company derived from its lease of self-storage units at the same Facility to be treated as other than "rents from real property" under section 856(d).

Except as specifically set forth above, no opinion is expressed regarding the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed regarding the qualification of Company as a REIT for federal tax purposes. Furthermore, no opinion is expressed concerning whether Company meets the ten percent voting securities limitation of § 856(c)(4)(B) through its interest in two companies that are not qualified REIT subsidiaries as defined in section 856(i).

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

A copy of this letter should be attached to the federal income tax returns of Company for the taxable year in which the transactions covered by this ruling are consummated.

In accordance with the power of attorney on file, we are sending a copy of this letter to Company's authorized representative.

Sincerely,

Assistant Chief Counsel
Financial Institutions & Products

By: William Coppersmith
William Coppersmith
Chief, Branch 2