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IRS Releases PLR 202012003 on Treatment of Cold Storage Warehouse Operations

Executive Summary: On March 20, 2020, the Internal Revenue Service (“IRS”) released a Private Letter Ruling (“PLR”) addressing the treatment of cold storage warehouse operations by a real estate investment trust (“REIT”). The Service ruled that amounts received under storage agreements for providing space will qualify as rents from real property within the meaning of Internal Revenue Code (“IRC”) §856(d).



The REIT, together with the operating partnership and subsidiaries, will own storage warehouses and provide unrelated manufacturers, distributors and retailers with storage space as well as handling and other supply chain services.

Background

In order for an entity to qualify as a REIT, at least 75% of a REIT’s gross income must be derived from sources that include rents from real property, gain from the sale or other disposition of real property, dividends from REIT stock, and/or abatements and refunds on taxes on real property. Further, at least 95% of its gross income must be derived from sources that include qualifying income from the 75% test, plus dividends, interest, and gain on sale or other disposition of stock and securities¹.

Facts

The REIT, together with the operating partnership and subsidiaries, will own storage warehouses and provide unrelated manufacturers, distributors and retailers with storage space as well as handling and other supply chain services. The REIT may rent to a customer an entire warehouse, a set amount of reserved space in a warehouse for a set term that is generally one year, or non-exclusive space in a warehouse. Storage rates are based on an anticipated number of days a customer will store goods in a warehouse. Some storage agreements may provide for a fixed

¹ §856(c)(2) and §856(c)(3)

minimum storage commitment. While the REIT may not guarantee available space to customers under each type of storage agreement, based on customer data and space utilization planning, each customer is effectively guaranteed space in a particular warehouse.

Customers generally do not have unrestricted access to the inside of the storage facilities; therefore, storage agreements provide for handling services, which include loading, unloading, and moving pallets of goods into, out of and around the facilities. The handling services are customarily provided to customers of warehouses in the geographic market in which each of the REIT's warehouses are located. The REIT also offers transportation services with third-party carriers and other services to its customers for additional fees.

The REIT intends to form one or more taxable REIT subsidiaries ("TRS") to provide services, other than the usual and customary services provided to its customers. The TRS will receive separately stated, arm's-length amounts for providing services. In connection with the provision of handling and other services, the TRS may lease from the REIT space at warehouses and other facilities owned by the REIT. The REIT notes that either (1) at least 90 percent of the total space leased at each warehouse or other facility will be leased to persons other than a TRS and persons who are related tenants with respect to the REIT, or (2) any rents paid by a TRS for space in that warehouse or other facility will be treated as nonqualifying income for purposes of IRC §856(c)(2) and (3). Payments made by a TRS to the REIT or an affiliate for the lease of space at a warehouse or other facility will be arm's length and will be substantially comparable to rents paid by unrelated tenants for comparable space at the warehouse or facility.

There are certainly other less obvious provisions with regard to carryback claims – for example, the acquiring corporations in a merger/acquisition may be able to carry back NOLs to pre-merger/acquisition years. (However, the details of the purchase and sale agreement would have to be scrutinized to determine the true owner of the refund.)

Additionally, the CARES Act included provisions for accelerated depreciation and increased interest expense deductions for qualified investment property. These changes also create a layer of complexity for corporations and need to be carefully considered to be most tax efficient, i.e. secure the highest refund. These provisions require additional guidance from the IRS, which we all eagerly await.

Ruling

Ruling 1: With respect to storage agreements, the IRS concluded that amounts received by the REIT under the storage agreements for providing space and presumably, cold storage and for handling services performed by a TRS or an independent contractor from whom the REIT does not derive or receive any income, will qualify as rents from real property within the meaning of IRC §856(d).

Ruling 2: With respect to rents received by the REIT from a TRS for the leasing of space in a warehouse or facility, the IRS ruled that based on the REIT's representations, and provided at least 90 percent of the leased space in a warehouse or facility is leased to persons other than TRSs or related parties described in IRC §856(d)(2)(B), rents received by taxpayer from a TRS for the leasing of space in a Warehouse or other facility will be treated as rents from real property under IRC §856(d).



Takeaway

For storage warehouses or facilities, the short-term nature of storage agreements does not create non-qualifying income for REIT purposes.

Reminder that PLRs are intended only for the taxpayer requesting the ruling and only apply to this specific set of facts. While PLRs are not intended to be relied upon by third parties, they do offer an indication of the IRS's position on the issues addressed.

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LAURA JACKSON

Senior Managing Director
+1 973.852.8148
laura.jackson@fticonsulting.com

SCOTT DRAGO

Managing Director
+1 646.632.3864
scott.drago@fticonsulting.com

ADAM KEARNEY

Director
+1 646.632.3810
adam.kearney@fticonsulting.com

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