

Internal Revenue Service

Department of the Treasury

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Date:

April 10, 2000

LEGEND

Corporation =

State A =

Date 1 =

Date 2 =

Date 3 =

x =

Dear

This is in response to a letter dated October 25, 1999, requesting a ruling on behalf of Corporation. Corporation requests a ruling that its cold storage warehouses and central refrigeration systems (described below) constitute real property for purposes of section 856(c) of the Internal Revenue Code.

FACTS

Corporation is a State A corporation that was formed on Date 1 to operate various cold storage warehouses. In Date 2, Corporation sold the portion of its business operations that generated income from services typically provided in the cold storage industry. Following the sale, Corporation's only remaining directly and indirectly held assets are cold storage warehouses and central refrigeration systems. Corporation intends to elect to be taxed as a real estate investment trust (REIT) under subchapter M of Chapter 1 of the Code for the tax year beginning on Date 3.

Corporation, directly and indirectly, owns and leases over x refrigerated warehouses that are constructed in substantially the same manner as other refrigerated warehouses in the industry. The interior clearance for each warehouse is approximately _____ feet and each warehouse generally encompasses 200,000 to 400,000 square feet. The warehouses are not designed nor intended to be dismantled or relocated.

PLR-117689-99

The foundations of the warehouses are reinforced concrete slabs approximately six inches thick, installed over a gravel base with galvanized steel framing. The foundations are designed to maintain cold temperatures within the warehouse. To prevent the ground beneath the floors from freezing and cracking the warehouse floors, an underground heating system is generally installed comprised of piping originating from the roof that keeps the floor at approximately 40 degrees Fahrenheit. The exterior freezer walls are poured concrete tilt-up insulated with six inches of pink fiberglass insulation over wood paneling. The dock walls are corrugated steel construction. The warehouse roofs generally consist of a heavy-duty tar product covering 12 inches of pink fiberglass insulation.

The construction of the warehouses is designed to maintain cold temperatures. The warehouses include tilt-up concrete construction with either wood or steel trussed roofs, insulated interior walls and ceilings, and built-up composition roofing. The warehouses generally include a large central room maintained at zero degrees Fahrenheit, one or more smaller rooms for long-term storage maintained at a temperature well below zero degrees Fahrenheit, docking stations, a small office, a small machine shop, and an engine room. The engine room is either within the main warehouse or attached to the warehouse.

The interiors of the freezer sections are large open areas used to store food. Each section contains steel or wood shelving used for stacking customer products. Several mechanically operated doors with fiberglass exteriors over insulation connect the cold storage areas with the docking areas. Floors of the freezer sections are treated concrete with vapor barriers.

Approximately 90 percent of the space in the warehouses is temperature-controlled freezer space, maintained at zero degrees Fahrenheit and below. The remaining space is cooler and/or dry storage space. Docking space for loading and unloading represents only a minimal portion of each location.

Human activity in the refrigerated and freezer sections of the warehouse is restricted to unloading deliveries, storing the packaged goods, maintaining inventory, and loading shipments. Occasionally, minor repairs or maintenance are performed in the cold sections.

Each of Corporation's central refrigeration systems (systems) was installed as part of the original construction of the warehouse. None of the systems have ever been moved in their entirety to another location. These systems are either ammonia or freon systems and include compressors, boosters, condensers, pumps, evaporators, vessels, motors, storage tanks, and insulated piping that connect the components of the systems. Although every component can be identified as a separate unit, each component works in conjunction with the other components to form a complete closed refrigeration system. The components function as a unit so that no component by itself is useful nor is the system functional without all the components.

PLR-117689-99

The compressors and boosters lower the temperature of the ammonia or freon. The cooled refrigerant is pumped through insulated pipes to the evaporators within the freezer or refrigerated areas. Evaporators attached to the ceilings of the refrigeration and freezer storage areas within the warehouses cool the storage area by forcing air, provided from the condensers, past the refrigerant into the storage area.

The condensers are set on structural steel stands on the warehouse roof. Each stand is supported by beams that run from the roof through the facility to the concrete floor of the warehouse. The condensers generally weigh between 15,000 to 40,000 pounds, and require a crane to be installed or dismantled. As a result, a condenser is only dismantled when it is no longer functional.

The compressors and evaporators also weigh several thousand pounds and must be transported by forklifts for installation or disassembly. The compressors are anchored to concrete stands by securing each foot of the compressor over an anchor stud in poured concrete. The evaporators are bolted to the roof of the warehouse. As a result, the compressors and evaporators are difficult and expensive to dismantle, and thus are infrequently dismantled or replaced.

The refrigerant pumps are connected to the storage vessels and pump the refrigerant, either ammonia or freon, throughout the system. Both the vessels and pumps are anchored in concrete. The refrigerant flows from the storage vessel through the compressor, to the condenser, into the evaporator, and back to the storage vessels. Although the pumps, storage vessels and boosters are somewhat more portable than the other components, they are rarely ever moved.

Pursuant to an audit by the Service for the tax years ended

Corporation treats the cold storage warehouses as real property and currently treats the central refrigeration systems as personal property depreciable over seven years. Corporation represents that it will file a Form 3115 and treat the central refrigeration systems as nonresidential real property for depreciation purposes.

LAW AND ANALYSIS

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

Section 856(c)(5)(B) defines the term "real estate assets", in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section

PLR-117689-99

856(c)(5)(C) provides that the terms "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil or gas royalty interests.

Section 1.856-3(b) of the Income Tax Regulations provides, in part, that the term "real estate assets" means real property. Section 1.856-3(d) provides that "real property" includes land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures.) Local law definitions will not be controlling for purposes of determining the meaning of "real property" for purposes of section 856 and the regulations thereunder. Under this regulation, "real property" includes, for example, the wiring in a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in a building, or other items which are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment which is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc. even though such items may be termed fixtures under local law.

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 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 taxable year attributable to both the real and personal property leased under, or in connection with, such lease.

Rev. Rul. 71-220, 1971-1 C.B. 210, considers whether mobile home units installed in a planned community are real property for purposes of section 856. The units were delivered to a site where they were set on foundations consisting of pre-engineered blocks. The wheels and axles were removed from the units, and the units were affixed to the ground by six or more steel straps. A carport or screened porch was attached to each unit and the unit was connected to utilities. The revenue ruling holds that the units are real property within the meaning of section 856.

Rev. Rul. 73-425, 1973-2 C.B. 222, considers whether a mortgage secured by a shopping center and its total energy system is an obligation secured by real property. A total energy system is a self-contained facility for the production of all the electricity, steam or hot water, and refrigeration needs of associated commercial or industrial buildings, building complexes, shopping centers, apartment complexes, and community developments. The system may be permanently installed in the building, attached to the building, or it may be a separate structure nearby. The principal components consist of electric generators powered by turbines or reciprocating engines, waste heat

PLR-117689-99

boilers, heat exchangers, gas-fired boilers, and cooling units. In addition, each facility includes fuel storage tanks, control and sensor equipment, electrical substations, and air handling equipment for heat, hot water, and ventilation. It also includes ducts, pipes, conduits, wiring, and other associated parts, machinery and equipment. The revenue ruling holds, in part, that a mortgage secured by the building and the system is a real estate asset, regardless of whether the system is housed in the building it serves or is housed in a separate structure apart from the building it serves. This is because the interest in a structural component is included with an interest held in a building or inherently permanent structure to which the structural component is functionally related.

Rev. Rul. 75-424, 1975-2 C.B. 270, concerns whether various components of a microwave transmission system are real estate assets for purposes of section 856. The system consists of transmitting and receiving towers built upon pilings or foundations, transmitting and receiving antennae affixed to the towers, a building, equipment within the building, and waveguides. The waveguides are transmission lines from the receivers or transmitters to the antennae, and are metal pipes permanently bolted or welded to the tower and never removed or replaced unless blown off by weather. The transmitting, multiplex, and receiving equipment is housed in the building. Prewired modular racks are installed in the building to support the equipment that is installed upon them. The racks are completely wired in the factory and then bolted to the floor and ceiling. They are self-supporting and do not depend upon the exterior walls for support. The equipment provides for transmission of audio or video signals through the waveguides to the antennae. Also installed in the building is a permanent heating and air conditioning system. The transmission site is surrounded by chain link fencing. The revenue ruling holds that the building, the heating and air conditioning system, the transmitting and receiving towers, and the fence are real estate assets. The ruling holds further that the antennae, waveguides, transmitting, receiving, and multiplex equipment, and the prewired modular racks are assets accessory to the operation of a business and therefore not real estate assets.

Corporation's cold storage warehouses are constructed to remain permanently in place, cannot be readily moved, are unlikely to be moved, and are not intended to be moved. Therefore, they are inherently permanent structures. See Rev. Rul. 71-220. Inherently permanent structures are real property, and the term "real estate assets" means real property. Section 1.856-3. The systems are designed and intended to be permanent. Although comprised of components that individually can be removed, the components are rarely if ever removed because they are part of a system. The systems are permanently affixed and functionally related to their associated warehouses. Moving all or part of the systems would be extremely difficult and would likely affect the function of the warehouse. Therefore, the systems are structural components of the warehouses, which are inherently permanent structures. See Rev. Rul. 73-425. Under section 1.856-3, real property includes items that are structural components of a permanent structure.

Accordingly, based on the information submitted and representations made, we conclude that Corporation's cold storage warehouses and central refrigeration systems, as described above, constitute real property for purposes of sections 856(c)(2)(C) and

PLR-117689-99

856(c)(3)(A). In addition, because the warehouses and systems are real property, they constitute real estate assets for purposes of sections 856(c)(4)(A) and 856(c)(5)(B).

No opinion is expressed concerning whether Corporation otherwise qualifies as a REIT under subchapter M, part II of Chapter 1 of the Code. No opinion is expressed or implied as to the federal tax consequences of this transaction under any provision not specifically addressed herein. No opinion is expressed whether cold storage warehouses and central refrigeration systems constitute real property under any section other than section 856. For example, no opinion is expressed whether cold storage warehouses and central refrigeration systems constitute section 1245 or section 1250 property for purposes of sections 167 and 168. Additionally, no opinion is expressed concerning the treatment of any shelving in Corporation's cold storage warehouses for purposes of section 856(d)(1)(C).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,
Assistant Chief Counsel
(Financial Institutions & Products)
By: William E. Coppersmith
Chief, Branch 2

Enclosures:

Copy of this letter
Copy for section 6110 purposes