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Expansion of REIT-able Assets and REIT Conversions

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In recent years, the US Internal Revenue Service has considerably expanded the categories of real estate assets that may be owned by a real estate investment trust (a "REIT"). This expansion of qualifying or "REIT-able" assets, along with liberalization of the rules governing "taxable REIT subsidiaries" ("TRSs") (which are corporate subsidiaries of REITs that operate businesses and hold assets that are not REIT-eligible), has encouraged many "C" corporations to convert to REITs.

Background on REITs

A REIT is an entity with special tax status under US federal income law. The REIT tax rules were enacted to promote and facilitate widely-held investment in portfolios of real estate. A REIT has a hybrid tax treatment. From an investor's tax perspective, a REIT is a separate taxable entity. Unlike an investor in a flow-through entity (such as a partnership), an investor in a REIT generally only is taxed on dividends paid by the REIT and on gains on the disposition of shares in the REIT. Tax-exempt and non-US investors also are not directly taxed on the REIT's underlying income. From the entity's tax perspective, the REIT is allowed a "dividends paid deduction" so that it generally is not subject to US corporate tax provided that each year it distributes to its shareholders an amount at least equal to its annual taxable income.

In order to qualify as a REIT, among other requirements, (i) at least 75 percent of the REIT's assets must be "real estate assets" (the "asset test"), (ii) at least 75 percent of the REIT's gross income must be from items related to real estate, such as "rents from real property", and (iii) at least 95 percent of the REIT's gross income must be from items related to real estate or certain passive investments ((ii) and (iii) together, the "income tests").

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For purposes of the asset test, "real estate assets" include interests in real property, which in turn includes land or improvements on land, such as buildings or other inherently permanent structures. Structural components of a building, such as plumbing systems, elevators or central air conditioning, generally are qualifying REIT assets, whereas machinery, individual air conditioning units and hotel furnishings generally are not. In private letter rulings ("PLRs") the IRS generally has applied a "movability" criterion to classify structural components as "real property", focusing on the manner of attachment to the land or the structure and the permanence of the structure. The less moveable and more connected to land or other permanent structures that property is, the more likely it is to be treated as real property for purposes of the asset test. The IRS also has recognized that real estate assets include intangibles, such as voting rights and goodwill, that are inextricably and compulsorily tied to real property or otherwise inseparable from real property.

Expansion of Qualifying Real Estate Assets

Traditionally, REITs have held real estate assets such as office buildings, warehouses, industrial complexes, shopping centers, multi-family residential properties and health care facilities. However, because of the tax benefits afforded to REITs, as well as the positive market perception and investor demand for REIT investments, in recent years owners of many other non-traditional forms of real property have looked to operate as REITs. The IRS has issued PLRs to REITs approving certain non-traditional real assets as qualifying REIT assets and the income on such assets as qualifying REIT income.

Summarized below are categories of non-traditional assets that the IRS has recognized as qualifying REIT assets. For each category of real estate asset, we have provided one or more PLRs or published rulings that have approved the category of asset, and we have provided examples of REITs holding such non-traditional assets. Please note that the rulings cited may not correspond to the specific REIT identified.

Rooftop Sites

Rooftop sites include the physical space on top of buildings and the right to use air space above a roof's surface, as well as leasehold interests in such space. Rooftop sites may be used for purposes such as telecommunication towers, solar panels or billboards.

- PLR 200831020 (8/1/2008). In the PLR, the IRS ruled that leasehold interests in rooftop space are qualifying REIT assets because the physical space on top of a roof relates to real property.
- Crown Castle International Corp. is a telecommunications REIT that owns and operates wireless communication towers. Crown Castle also leases rooftop space from building owners and then subleases the space to its own customers.

Wireless Communication Systems

Wireless communication systems include wireless communication towers, broadcast communication towers and the sites on which such towers are located, including such features of the sites as fencing, shelters and permanently installed backup generators.

- PLR 201129007 (7/22/2011). In the PLR, the IRS emphasized the permanence of the wireless communication structures as being important to their treatment as real estate assets. The fact that the tower systems were large steel structures built deep below the ground and constructed to remain permanently in place demonstrated that these were real property assets for purposes of the asset test and the income tests.
- American Tower is a REIT that leases antenna space on multi-tenant communications sites to wireless service providers, radio and television broadcast companies, wireless data providers, government agencies and municipalities and tenants in a number of other industries.
- Crown Castle International Corp. is a telecommunications REIT that owns and operates wireless communication towers.

Manufactured Housing

Manufactured housing includes manufactured homes and land available for lease by manufactured home owners.

- PLR 8931039 (5/8/1989). In the PLR, the IRS emphasized the difficulty and cost in relocating a manufactured home, which demonstrated its permanence.
- UMH Properties, Inc. is a REIT that owns and operates manufactured home communities in the northeastern United States; Equity LifeStyle Properties, Inc. is a REIT that owns manufactured home communities, recreational vehicle resorts and campgrounds.

Power Distribution Facilities

Power distribution facilities include systems of physically connected and functionally interdependent assets that serve as a conduit to allow a created-by-generation source to flow through the system to an end-user.

- PLR 200725015 (6/22/2007). In the PLR, the IRS emphasized the fact that it was not feasible to move all or any substantial part of the power distribution system and that each component was intended to serve indefinitely and remain in place once affixed to other system parts and to the underlying land. The IRS compared the system parts to railroad tracks and other components that allow transmission through a railroad system.
- Hannon Armstrong Sustainable Infrastructure Capital, Inc. is a REIT that will provide debt and equity financing to renewable energy systems and energy efficiency projects (debt secured by qualifying real estate assets is itself a qualifying real estate asset). Hannon Armstrong received a PLR from the IRS regarding the qualification of its assets, but the PLR has not yet been made public.

Timberlands

- PLR 8838016 (6/21/1988), PLR 199927021 (7/12/1999), PLR 199945055 (8/13/1999) and PLR 200052021 (9/28/2000)
- Rayonier, Inc., Potlatch Corporation and Plum Creek Timber Co, Inc. are REITs that own significant amounts of forestland in the United States and internationally.

The sale of timber is treated as qualifying REIT income and not the sale of "dealer property". This is because timber REITs may elect under US Internal Revenue Code Section 631(a) to treat the cutting and sale of timber as a sale or exchange that could be treated as a gain from the sale of real property.

Pipeline Systems

Pipeline systems include interests in land associated with the pipelines, structures for storage and pumping of gas or oil.

- PLR 200937006 (9/11/2009) and PLR 201005018 (2/5/2010)
- Hunt Consolidated Inc. owns a private REIT engaged in natural gas transmission.

Railroads

Railroads include railroad land and associated structures, including tracks, roadbeds, buildings, bridges and tunnels.

- Revenue Ruling 69-94
- Power REIT is a REIT that owns, among other REIT qualifying assets, land and tracks leased to the Norfolk Southern railroad.

Refrigerated Warehouses

Refrigerated warehouses include a central refrigeration system, which includes the structural components of the building and refrigeration system.

- PLR 199904019 (10/30/1998). In the PLR, the IRS ruled that a refrigeration system that is designed such that the components are physically and functionally interdependent and each component is intended to serve indefinitely and remain in place once affixed to the system and the underlying property is a real estate asset for purposes of the REIT asset test.
- Americold Realty Trust is a REIT that owns and operates temperature-controlled warehouses.

Billboards

Billboards include the physical billboard structures that can be attached to other building structures or separately constructed structures which are designed and constructed to remain permanently in place.

- PLR 201143011 (10/28/2011) and PLR 201204006 (1/27/2012). In the PLRs, the IRS ruled that because billboard sign structures are bolted to real property and designed to permanently stay in place, they are real estate assets for purposes of the REIT asset test, and the fees for using such structures are rents from real property for purposes of the REIT income tests.
- CBS Outdoor, the billboard advertising unit of CBS Corp., is in the process of converting into a REIT that will eventually be spun off to shareholders of CBS Corp. Lamar Advertising also is converting into a REIT.

REIT Conversions Involving Non-Traditional Real Estate Assets

In recent years, operating companies that are not traditionally considered real estate companies but do own significant amounts of real property have announced their intention to convert, or begun the process of converting, from taxable "C" corporations to REITs. In order for a "C" corporation to convert to a REIT, it must take certain operational steps (as well as make sure its organizational documents contain provisions to maintain REIT status). First, to the extent the corporation has assets that are not qualifying REIT assets or income that is not qualifying income, it must either transfer such assets and activities to one or more TRSs or otherwise dispose of such assets or activities. Second, the corporation must distribute as a dividend all of its accumulated earnings and profits, which may require a significant distribution. The IRS allows up to 80 percent of the distribution to be paid in the form of stock of the REIT. In order for the distribution of stock to qualify as a dividend, shareholders must have the ability to elect to receive stock or cash in the distribution.

Each of the public companies listed below owns significant amounts of real estate and has recently announced that it is in the process of converting to a REIT or creating a related REIT entity.

1. CyrusOne Inc.: In August 2012, Cincinnati Bell Inc., a telecommunications company, announced its intention to form a separate publicly-traded subsidiary, CyrusOne, its data center unit, as a REIT to be taken public in an IPO. CyrusOne owns, operates and develops data center properties and leases out its data centers. Prior to completing the separation and IPO of CyrusOne, Cincinnati Bell received a PLR from the IRS (likely PLR 201314002) ruling that its data centers would be qualified real estate assets for purposes of the REIT asset tests. Certain assets of CyrusOne that were not qualifying assets for the purpose of the asset test were transferred to TRSs. Because CyrusOne was a new entity, it did not need to make a distribution of earnings and profits.

2. Geo Group, Inc.: In April 2012, Geo Group, Inc. (“Geo”), an operator of private correctional facilities, announced plans to convert to a REIT beginning on January 1, 2013. Prior to the conversion, Geo took steps to prepare its corporate structure and operations to allow it to qualify as a REIT. These steps included the December 2012 payment of a special dividend representing accumulated earnings and profits, divestiture of certain health care-related operations that were inconsistent with REIT status and the reorganization of Geo’s operations into separate wholly-owned business units and TRSs. Geo received a PLR from the IRS confirming its ability to operate as a REIT and that its correctional real estate assets would be qualifying REIT assets and would not be considered health care facilities (PLR 201317001).

3. Iron Mountain Inc.: In April 2012, Iron Mountain, a document storage business, announced plans to operate as a REIT beginning January 1, 2014. In connection with the conversion to a REIT, Iron Mountain announced plans to distribute accumulated earnings and profits of approximately $1.0 billion to $1.5 billion to stockholders, to be paid out in a combination of at least 20% cash and up to 80% Iron Mountain common stock. Iron Mountain obtained a PLR that its assets and operations would allow it to qualify as a REIT.

4. Lamar Advertising Co.: Lamar Advertising Co. (“Lamar”) is a provider of outdoor advertising including billboards, posters, digital billboards, buses, benches, transit shelters and highway logo signs. In August 2012, Lamar announced it was exploring converting into a REIT beginning January 1, 2014. In late 2013, Lamar requested a PLR from the IRS with respect to its qualification to be a REIT.

5. Ryman Hospitality Properties Inc. (formerly Gaylord Entertainment): Ryman Hospitality Properties Inc. ("Ryman") is a hospitality and entertainment company based in Nashville, Tennessee that owns notable properties such as the Grand Old Opry and numerous resorts and hotels. After announcing its intention to convert to a REIT, Ryman paid a special dividend representing accumulated earnings and profits of approximately $300 million in cash and stock and sold off segments of its hotel management business that would not be qualifying real estate assets for purposes of the income and asset tests. Ryman elected REIT status as of January 1, 2013.

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