

New Real Estate Investment Trust Tax Guidance on Parking, Amenity Space and Modern Tenant Services

By Shiukay Hung, Maximilian Viski-Hanka, Jesse A. Criz, Allen P. Ashley, Katie LaKoma, Joshua Lingerfelt and Allan Bowen*

In this article, the authors review a recent private letter ruling released by the Internal Revenue Service on parking, amenity space and modern tenant services in the office real estate investment trust context.

The Internal Revenue Service (the IRS) recently released a comprehensive private letter ruling (PLR) on parking, amenity space, and modern tenant services in the office real estate investment trust (REIT) context. Although a PLR may not be used or cited as precedent, PLR 202304003 (the 2023 Private Letter Ruling) provides helpful guidance to office REITs.

This article reviews the 2023 Private Letter Ruling and provides some practical observations.

OVERVIEW

The provision of tenant services and amenities requires special tax planning for REITs. The REIT rules permit some services (e.g., customary services that are not primarily for the convenience of tenants) to be provided directly by a REIT while other impermissible

services (e.g., noncustomary services or customary services that are primarily for the convenience of tenants) are required to be provided by a REIT's taxable REIT subsidiary (TRS) and/or an independent contractor (IK) from whom such REIT derives no income.

Failing to comply with these rules could lead to the generation of impermissible tenant service income (ITSI). All the rental income from a particular project could be "bad income" and ultimately cause a REIT to lose its REIT status if its ITSI exceeds 1% of all amounts received or accrued by the REIT with respect to an applicable property for a particular tax year.

2023 PRIVATE LETTER RULING

The taxpayer in the 2023 Private Letter Ruling is a publicly traded REIT that owns class A office buildings. The buildings provide a suite of services and amenities to tenants and

*The authors, attorneys with DLA Piper, may be contacted at shiukay.hung@dlapiper.com, maximilian.viski-hanka@dlapiper.com, jesse.criz@dlapiper.com, allen.ashley@dlapiper.com, katie.lakoma@dlapiper.com, joshua.lingerfelt@dlapiper.com and allan.bowen@dlapiper.com, respectively.

guests, such as parking facilities, storage areas, staffed and unstaffed fitness facilities, and a variety of modern tenant services, such as organic waste refrigeration and virtual concierge software. The taxpayer asked the IRS to rule on each of the following:

Parking Facilities

The taxpayer intends to engage either its TRS or an IK to operate the parking facilities. Under IRS Revenue Ruling 2004-24 (Rev. Rul. 2004-24), a REIT may engage an IK to operate an attended parking facility that is attached to or adjacent to the property of the REIT, provided that the parking facility is appropriate in size for the number of tenants and their guests and is predominantly used by the building's tenants and their guests, customers, and subtenants.

Consistent with prior IRS guidance in PLR 201341015, the IRS expanded the application of Rev. Rul. 2004-24 in the 2023 Private Letter Ruling and held that the taxpayer may use a TRS instead of an IK to operate the parking facilities. As a departure from prior guidance, it is noteworthy that the 2023 Private Letter Ruling did not include a taxpayer representation that the parking facility is predominantly used by tenants. Office REITs often struggle with the day-to-day challenges of documenting the actual use of parking facilities by tenants versus non-tenants, especially as office tenants are increasingly moving to a daily parking model instead of a monthly parking pass model. Taxpayers would benefit from further IRS clarification of this point in future guidance.

Amenity Space

Consistent with prior guidance in PLR 201812009 in the residential building context,

and PLR 202237004 and PLR 201944011 in the marina context, the 2023 Private Letter Ruling held that the provision of common space that is available for use by all tenants at no additional charge is not the provision of a service and is therefore not an impermissible tenant service.

Accordingly, an office REIT may provide to all tenants, free of charge, a designated storage area for scooters and bicycles and an unstaffed fitness center. In addition, consistent with the IRS's implied guidance in PLR 9440026, the IRS held in the 2023 Private Letter Ruling that the REIT may engage an IK to provide clean towels to tenants without requiring tenants to be separately charged for the towel service. This is welcome news to office REITs, as separately charging tenants for clean towels is often impractical and an operational challenge.

Various Complimentary Modern Tenant Services

The 2023 Private Letter Ruling favorably considered several complimentary modern tenant services such as organic waste refrigeration, electronic signs, and virtual concierge software. The IRS held that the organic waste registration service could be provided by the REIT and that the REIT may engage an IK to manage the electronic signs and virtual concierge software to tenants without a separate tenant charge. This builds upon the IRS's prior guidance in PLR 200106016 in which the IRS considered the treatment of a website that functioned like a virtual concierge.

CONCLUSION

The 2023 Private Letter Ruling provides helpful guidance for office REITs. This guid-

ance is especially timely as landlords are creatively offering new amenities and services to attract office tenants to return to physical offices. The 2023 Private Letter Ruling shows

a willingness on the part of the IRS to modernize the REIT rules for the new real estate environment.