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IRS Relaxes REIT Rules

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Until recently the type of property that could be admitted into a real estate investment fund (REIT) structure in accordance with IRS rules was stricter, but now the agency is relaxing the rules. New properties that can now fall into a trust include floating gaming facilities, billboards, cell phone towers and other properties that have long been held to be personal property as opposed to real property. The IRS has pushed for the shift itself by way of court battles it has won that have redefined property for tax purposes. It used to be that personal property was any property that could be moved, but now the IRS (and the courts) is looking to the intent of the property owner to inform their decisions. For more on this continue reading the following article from National Real Estate Investor.

The idea that the Internal Revenue Service is flexible would cause most Americans to laugh themselves silly. But REIT experts say the IRS has been both flexible *and* forward-thinking in allowing new assets to join the list of those that qualify for REIT status.

Recent additions to the REIT structure include billboards and related sign superstructures, floating gaming facilities, racking/shelving for computer servers and document storage, cell towers and electricity transmission lines. Beyond those, experts see potential in a number of assets that could be classified as real property such as railroad tracks, farmland and sporting venues such as arenas and ballparks.

“There is a trend toward relaxing REIT rules to include less traditional forms of real estate such as cell towers and infrastructure,” notes Roger Laty, a CPA and principal at Haskell & White LLP, one of Southern California’s largest independently owned accounting, auditing and tax consulting firms. “The IRS has blessed several new types of assets.”

DEBATING STRUCTURAL COMPONENTS

At the crux of the REIT structure debate is whether assets are personal property or real property. Land and improvements on the land such as buildings and other inherently permanent structures are considered real property. Up for debate: Which category is appropriate for structural components?

Recently, the IRS has modified the way it evaluates these components, says Robert Willens, a REIT tax specialist based in New York City. Historically, the federal agency has focused on the components’ physical aspects determine whether they should be classified as real property versus personal property.

For example, if an element was easily moved or not permanently attached to a structure, it would be considered personal property, and therefore would receive tax treatment appropriate

for personal property. Real property, for example, requires a longer depreciation period and results in greater tax revenue.

“Now the IRS is looking more at the owner’s intent—does the owner intend for the component to be moved? The fact that it can be moved is not nearly as important as whether the owner intends to move it,” Willens explains. “It’s a subtle shift, but a shift nonetheless.”

Willens points to a recent court case that was decided in favor of the IRS as an example of the shift. In the case,*AmeriSouth XXXII, Ltd. et al. v. Commissioner [of the IRS]*, the IRS argued successfully that shelving in apartment buildings constituted structural components of the buildings and were, therefore, real property. That case was instrumental in Iron Mountain’s decision to pursue REIT status, he adds, since racking constitutes the majority of the company’s assets.

Moreover, two recent IRS rulings, one issued in December 2011 and one in February 2012, also illustrate the IRS’ changing attitude. The rulings found that billboards and sign superstructure were real property even if the signs were just bolted to a building.

“Those rulings were instrumental in Lamar Advertising Company deciding to convert to a REIT,” Willens says. Lamar, which is one of the largest outdoor advertising owners and operators in the U.S. (billboards, benches, buses, etc), announced its intentions last month to seek out a private letter ruling.

SEEKING PRIVATE LETTER RULINGS

As evidenced by Lamar Advertising, companies seeking to obtain REIT status for a non-traditional asset class usually request a private letter ruling from the IRS, Willens says. As part of the process, they outline their argument and make the case why a certain asset class should be considered real property based on current tax code interpretation. The IRS evaluates the argument and issues a private letter ruling that either allows the companies to move forward with REIT structure or reinforces the asset’s position as personal property.

Hotels and healthcare facilities were among the first non-traditional REIT sectors to receive private letter rulings, Laty notes. Today, of course, those asset classes account for a significant portion of the REIT universe.

Recent special letter rulings and court rulings have given a number of existing companies the green light to convert to REIT status or compelled the creation of new REITs. For example, American Tower, which owns and operates cell towers, elected REIT status earlier this year, and both Iron Mountain and Equinix have both indicated they plan to convert to REIT status. (Iron Mountain specializes in document storage, and Equinix is a data center operator).

In addition, Hunt Power announced the creation of two REITs in 2010 to develop and acquire electricity and gas transmission and distribution assets primarily in Texas, the Great Plains and the Southwest regions. The company had applied to the IRS for a private letter ruling to place energy infrastructure in a REIT structure. The IRS clearly saw similarities between Hunt Power’s REITs and hotel REITs—like hotel REITs, these new infrastructure REITs develop and/or own assets and lease them to regional operators.

“IRS rulings set a precedent, and if they bless a new type of REIT, it opens the doors for others that operate the same type of business,” Laty says.

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