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Legend

X =

State =

Lease =

Lessee =

Location1 =

Location2 =

a =

b =

c =

d =

e =

Dear :

This letter responds to a letter, dated March 12, 2012, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting

a ruling under § 7704(d)(1)(C) of the Internal Revenue Code of 1986, as amended (Code).

FACTS

X is a limited partnership organized under the laws of State. X is a publicly traded partnership within the meaning of § 7704(b).

X is in the process of negotiating a Lease of an offshore platform and related machinery and equipment installed on the platform (the Facility) to an unrelated party, Lessee. The Facility will consist of an offshore oil and gas platform, and related machinery and equipment installed on the platform located in deep water offshore Location1 in Location2. The platform will consist of three sections that will be designed and constructed to be permanently connected and operate as a single structure: (i) a vertical hull; (ii) a topside section attached to the hull consisting of a working decks; and (iii) a mooring system to permanently attach the Facility to the seabed (the Platform). The three sections of the Platform are designed and will be constructed to be permanently connected and operated as a single structure. Neither the three sections of the Platform nor the machinery and equipment required for the maintenance and operation of the Platform will extract crude from the undersea wells, separate the oil and gas from the crude, or condition the oil and gas for export into the oil and gas pipelines.

Under the Lease, machinery and equipment installed on the Platform will be used by the Lessee to (i) remotely extract crude produced by the Lessee from existing or future undersea oil and gas wells located on a specified oil and gas lease owned by the Lessee, (ii) separate oil and gas from the crude; and (iii) condition such oil and gas for export in undersea oil and gas gathering pipelines (Extraction, Separation and Condition Machinery). In addition, certain machinery and equipment that will be installed on the Platform will support both the extraction, separation, and conditioning equipment and machinery and machinery and equipment required to support the operation and maintenance of the Platform (Support Machinery) (Extraction, Separation and Condition Machinery together with Support Machinery, the Machinery). In addition, motor control equipment will control the Machinery. Separate agreements will cover the transportation of oil and gas from the Facility to on-shore pipeline systems.

The Platform is intended to remain in operation at the selected location indefinitely, and no similar off-shore platform has ever been removed. It is estimated that a relocation of the Platform could take b to c months at a cost of approximately $d.

The Lease will have an initial e year exclusive use period (Exclusive Use Period) during which Lessee will make fixed monthly payments to X in addition to monthly fees based on quantities of oil and gas separated from the crude from the Lessee's wells that are exported in the oil and gas gathering pipelines. The monthly costs of operating and maintaining the Facility during the Exclusive Use Period will be allocated 100 percent to

the Lessee. After the Exclusive Use Period, the Lessee will have the right to use specified amounts of the production handling capacity of the Facility. The Lessee will pay monthly fees based on the quantities of oil and gas separated from the crude from the Lessee's wells that are exported from the Facility in the oil and gas gathering pipelines. The Lessee will have the right to elect to reserve additional production handling capacity in specified increments and pay a fixed monthly fee based on the additional production handling capacity it has reserved, regardless of whether it uses such additional capacity. After the Exclusive Use Period, X will be allowed to enter into additional leases with other producers for the use of any production handling capacity of the Facility that the Lessee does not have a right to use. The monthly costs of operating and maintaining the Facility after the Exclusive Use Period will be allocated among the producers. X represents that the Lease constitutes a "true lease" for federal income tax purposes.

Under an operating agreement (Operating Agreement) with the Lessee, the Lessee will be the operator of the Facility with the exclusive right and obligation to operate and maintain the Facility using its own personnel for the Exclusive Use Period. X and Lessee may extend the Operating Agreement beyond the Exclusive Use Period by mutual agreement. During the Exclusive Use Period, X will have one or two employees on board the Facility only to monitor the Lessee's operation and maintenance of the Facility. These employees ensure that Lessee is operating and maintaining the Facility as required by the Lease. These employees will not perform any services for the benefit or convenience of the Lessee.

X requests a ruling that income derived from leasing the facility will constitute rents from real property under § 856(d) and therefore constitutes qualifying income under § 7704(d)(1)(C).

LAW AND ANALYSIS

Qualifying Income

Section 7704(a) provides that, except as provided in § 7704(c), a publicly traded partnership will be treated as a corporation.

Section 7704(b) provides that the term "publicly traded partnership" means any partnership if (1) interests in that partnership are traded on an established securities market, or (2) interests in that partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Section 7704(c)(1) provides that § 7704(a) does not apply to a publicly traded partnership for any taxable year if such partnership meets the gross income requirements of § 7704(c)(2) for the taxable year and each preceding taxable year

beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence.

Section 7704(c)(2) provides, in relevant part, that a partnership meets the gross income requirements of § 7704(c)(2) for any taxable year if 90 percent or more of the gross income of the partnership for the taxable year consists of qualifying income.

Section 7704(d)(1)(C) provides that the term “qualifying income” includes income derived from real property rents.

Section 7704(d)(3) provides that the term "real property rent" means amounts which would qualify as rent from real property under § 856(d) if (A) § 856(d) was applied without regard to § 856(d)(2)(C) (relating to independent contractor requirements), and (B) stock owned, directly or indirectly, by or for a partner would not be considered as owned under § 318(a)(3)(A) by the partnership unless 5 percent or more (by value) of the interests in such partnership are owned, directly or indirectly, by or for such partner.

Real Property

Section 1.856-3(d) provides that for purposes of the Income Tax Regulations (Regulations) under part II, subchapter M, chapter 1 of the Code, “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). In addition, the term “real property” includes interests in real property. 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 the Regulations, “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.

Rev. Rul. 71-220, 1971-1 C.B. 210, considers a REIT that develops a mobile home community on land that it had purchased. The community is situated in a planned site that has a country club, marina, parks, churches and schools. When units are delivered they are set on foundations consisting of pre-engineered blocks. The wheels and axles are removed from the units and the units are affixed to the ground by six or more steel straps. Each unit has a carport or screened porch attached to it. In addition, each unit is connected to water, sewer, gas, electric and telephone facilities. Rev. Rul.

71-220 concludes that the mobile homes are “real property” within the meaning of section 856 and section 1.856-3(d).

Rev. Rul. 75-424, 1975-2 C.B. 269, 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 further holds 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.

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 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.

Similar to the properties or structural components described in Rev. Rul. 71-220, Rev. Rul. 75-424 and Rev. Rul. 73-425 that qualify as real property for purposes of section 856, the Platform and the structural components described above are inherently

permanent structures. Although the Platform and structures help to facilitate the oil and gas extraction and refinery business of the Lessee, the Platform and structural components themselves are not assets accessory to the operation of a business like the examples set forth in section 1.856-3(d). However, the Machinery installed on the Platform is an asset accessory to the operation of a business for purposes of section 1.856-3(b) and, therefore, does not qualify as real property for purposes of section 856.

Rents from Real Property

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in § 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 the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

The flush language of section 856(d)(1) provides that for purposes of section 856(d)(1)(C), with respect to each lease of real property, rent attributable to personal property for the taxable year is that amount which bears the same ratio to total rent for the taxable year as the average of the fair market values of the personal property at the beginning and at the end of the taxable year bears to the average of the aggregate fair market values of both the real property and the personal property at the beginning and at the end of such taxable year.

Section 1.856-4(a)(1) provides that the term “rents from real property” means, generally, the gross amounts received for the use of, or the right to use, real property of the REIT. Section 1.856-4(b)(1) provides that, for purposes of sections 856(c)(2) and (c)(3), the term “rents from real property” also includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services rendered to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class are customarily provided with the service. In particular geographic areas where it is customary to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of those utilities to tenants in the buildings will be considered a customary service.

Section 1.856-4(b)(5)(ii) provides that the trustees or directors of a REIT are not required to delegate or contract out their fiduciary duty to manage the trust itself, as distinguished from rendering or furnishing services to the tenants of its property or managing or operating the property. Thus, the trustees or directors may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the trust itself.

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of "rents from real property." Section 856(d)(7)(A) defines "impermissible tenant service income" to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants at the property, or for managing or operating the property.

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C)(ii) provides that for purposes of section 856(d)(7)(A) there shall not be taken into account any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, and the collection of trash are not considered as services rendered to the occupant.

Payments under the Lease attributable to the leasing of the Facility are payments for the right to use space on the Facility. The Lease grants Lessee the right to use the Facility for a specified period of time in exchange for a fee. These payments are similar to rent payments that would be required under a lease. Therefore, the payments under the Lease attributable to the Facility qualify as "rents from real property" under section 856(d)(1) to the extent they are attributable to the leasing of real property as discussed below.

During the Lease, X's personnel on board the Facility will only monitor Lessee's operation and maintenance of the Facility and will not provide any services to the Lessee. X will not receive any amounts for services rendered primarily for the

convenience of Lessee or for the management or operation of the Facility. Such activities will be for the benefit of X rather than for the convenience or benefit of Lessee. The limited activities in which X is involved are not services rendered for the convenience of a lessee under section 1.512(b)-1(c)(5). Trustees or directors of X also may perform fiduciary functions as provided in section 1.856-4(b)(5)(ii). Therefore, X's activities with respect to the Facility will not cause amounts received under leases of the Facility to be treated as other than "rents from real property" under section 856.

CONCLUSION

Based solely on the information submitted and representations made, we conclude that income earned attributable to the Lease qualifies as "rents from real property" under section 856(d) so long as rent attributable to the leasing of the Machinery, as personal property, which is leased under, or in connection with, the Lease 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, the Lease. For this purpose, with respect to the Lease, rent attributable to personal property for the taxable year is that amount which bears the same ratio to total rent for the taxable year as the average of the fair market values of the personal property at the beginning and at the end of the taxable year bears to the average of the aggregate fair market values of both the real property and the personal property at the beginning and at the end of such taxable year.

Also, based on the information submitted and representations made, we conclude that X's activities with respect to the Facility will not cause amounts received under the Lease to be treated as other than "rents from real property" under section 856(d).

Accordingly, we conclude that income derived from leasing the Facility to Lessee under the terms of the Lease will constitute qualifying income within the meaning of § 7704(d)(1)(C).

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to whether X meets the 90 percent gross income requirement of § 7704(c)(1) in any taxable year for which this ruling may apply.

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 representative.

Sincerely,

Laura C. Fields
Laura C. Fields
Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes