

underreported its income tax liability for 2001. Because X was treated as a separate corporation for its 2001 taxable year, the deficiency may be assessed against X and, in the event that X fails to pay the liability after notice and demand, a general tax lien will arise against all of X's property and rights to property.

Example 3. X is a qualified REIT subsidiary of Y under the provisions of section 856(i). In 2001, Z, a domestic corporation that reports its taxes on a calendar year basis, merges into X in a state law merger. Z was not a member of a consolidated group at any time during its taxable year ending in December 2000. Under the applicable state law, X is the successor to Z and is liable for all of Z's debts. In 2004, the IRS seeks to extend the period of limitations on assessment for Z's 2000 taxable year. Because X is the successor to Z and is liable for Z's 2000 taxes that remain unpaid, X is the proper party to sign the consent to extend the period of limitations.

(c) *Effective date.* This section applies on or after April 1, 2004.

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§ 1.856-10 Definition of real property.

(a) *In general.* This section provides definitions for purposes of part II, subchapter M, chapter 1 of the Internal Revenue Code. Paragraph (b) of this section defines real property, which includes land as defined under paragraph (c) of this section and improvements to land as defined under paragraph (d) of this section. Improvements to land include inherently permanent structures as defined under paragraph (d)(2) of this section and structural components of inherently permanent structures as defined under paragraph (d)(3) of this section. Paragraph (e) of this section provides rules for determining whether an item is a distinct asset for purposes of applying the definitions in paragraphs (b), (c), and (d) of this section. Paragraph (f) of this section identifies intangible assets that are real property or interests in real property. Paragraph (g) of this section provides examples illustrating the rules of paragraphs (b) through (f) of this section. Paragraph (h) of this section provides the effective/applicability date for this section.

(b) *Real property.* The term *real property* means land and improvements to land. Local law definitions are not con-

trolling for purposes of determining the meaning of the term real property.

(c) *Land.* Land includes water and air space superjacent to land and natural products and deposits that are unsevered from the land. Natural products and deposits, such as crops, water, ores, and minerals, cease to be real property when they are severed, extracted, or removed from the land. The storage of severed or extracted natural products or deposits, such as crops, water, ores, and minerals, in or upon real property does not cause the stored property to be recharacterized as real property.

(d) *Improvements to land—(1) In general.* The term *improvements to land* means inherently permanent structures and their structural components.

(2) *Inherently permanent structure—(i) In general.* The term *inherently permanent structure* means any permanently affixed building or other permanently affixed structure. Affixation may be to land or to another inherently permanent structure and may be by weight alone. If the affixation is reasonably expected to last indefinitely based on all the facts and circumstances, the affixation is considered permanent. A distinct asset that serves an active function, such as an item of machinery or equipment, is not a building or other inherently permanent structure.

(ii) *Building—(A) In general.* A building encloses a space within its walls and is covered by a roof.

(B) *Types of buildings.* Buildings include the following distinct assets if permanently affixed: Houses; apartments; hotels; motels; enclosed stadiums and arenas; enclosed shopping malls; factory and office buildings; warehouses; barns; enclosed garages; enclosed transportation stations and terminals; and stores.

(iii) *Other inherently permanent structures—(A) In general.* Other inherently permanent structures serve a passive function, such as to contain, support, shelter, cover, protect, or provide a conduit or a route, and do not serve an active function, such as to manufacture, create, produce, convert, or transport.

(B) *Types of other inherently permanent structures.* Other inherently permanent structures include the following distinct assets if permanently affixed: Microwave transmission, cell, broadcast, and electrical transmission towers; telephone poles; parking facilities; bridges; tunnels; roadbeds; railroad tracks; transmission lines; pipelines; fences; in-ground swimming pools; offshore drilling platforms; storage structures such as silos and oil and gas storage tanks; and stationary wharves and docks. Other inherently permanent structures also include outdoor advertising displays for which an election has been properly made under section 1033(g)(3).

(iv) *Facts and circumstances determination.* If a distinct asset (within the meaning of paragraph (e) of this section) does not serve an active function as described in paragraph (d)(2)(iii)(A) of this section and is not otherwise listed in paragraph (d)(2)(ii)(B) or (d)(2)(iii)(B) of this section or in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter), the determination of whether that asset is an inherently permanent structure is based on all the facts and circumstances. In particular, the following factors must be taken into account:

(A) The manner in which the distinct asset is affixed to real property;

(B) Whether the distinct asset is designed to be removed or to remain in place indefinitely;

(C) The damage that removal of the distinct asset would cause to the item itself or to the real property to which it is affixed;

(D) Any circumstances that suggest the expected period of affixation is not indefinite (for example, a lease that requires or permits removal of the distinct asset upon the expiration of the lease); and

(E) The time and expense required to move the distinct asset.

(3) *Structural components*—(i) *In general.* The term *structural component* means any distinct asset (within the meaning of paragraph (e) of this section) that is a constituent part of and integrated into an inherently permanent structure, serves the inherently permanent structure in its passive

function, and, even if capable of producing income other than consideration for the use or occupancy of space, does not produce or contribute to the production of such income. If interconnected assets work together to serve an inherently permanent structure with a utility-like function (for example, systems that provide a building with electricity, heat, or water), the assets are analyzed together as one distinct asset that may be a structural component. A structural component may qualify as real property only if the real estate investment trust (REIT) holds its interest in the structural component together with a real property interest in the space in the inherently permanent structure served by the structural component. A mortgage secured by a structural component is a real estate asset only if the mortgage is also secured by a real property interest in the inherently permanent structure served by the structural component. If a distinct asset is customized in connection with the rental of space in or on an inherently permanent structure to which the asset relates, the customization does not affect whether the distinct asset is a structural component.

(ii) *Types of structural components.* Structural components include the following distinct assets and systems if integrated into the inherently permanent structure and held together with a real property interest in the space in the inherently permanent structure served by that distinct asset or system: Wiring; plumbing systems; central heating and air-conditioning systems; elevators or escalators; walls; floors; ceilings; permanent coverings of walls, floors, and ceilings; windows; doors; insulation; chimneys; fire suppression systems, such as sprinkler systems and fire alarms; fire escapes; central refrigeration systems; security systems; and humidity control systems.

(iii) *Facts and circumstances determination.* If an interest in a distinct asset (within the meaning of paragraph (e) of this section) is held together with a real property interest in the space in the inherently permanent structure served by that distinct asset and that asset is not otherwise listed in paragraph (d)(3)(ii) of this section or in

guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii) of this chapter), the determination of whether that asset is a structural component is based on all the facts and circumstances. In particular, the following factors must be taken into account:

(A) The manner, time, and expense of installing and removing the distinct asset;

(B) Whether the distinct asset is designed to be moved;

(C) The damage that removal of the distinct asset would cause to the item itself or to the inherently permanent structure to which it is affixed;

(D) Whether the distinct asset serves a utility-like function with respect to the inherently permanent structure;

(E) Whether the distinct asset serves the inherently permanent structure in its passive function;

(F) Whether the distinct asset produces income from consideration for the use or occupancy of space in or upon the inherently permanent structure;

(G) Whether the distinct asset is installed during construction of the inherently permanent structure; and

(H) Whether the distinct asset will remain if the tenant vacates the premises.

(e) *Distinct asset*—(1) *In general.* A distinct asset is analyzed separately from any other assets to which the asset relates to determine if the asset is real property, whether as land, an inherently permanent structure, or a structural component of an inherently permanent structure.

(2) *Facts and circumstances.* The determination of whether a particular separately identifiable item of property is a distinct asset is based on all the facts and circumstances. In particular, the following factors must be taken into account:

(i) Whether the item is customarily sold or acquired as a single unit rather than as a component part of a larger asset;

(ii) Whether the item can be separated from a larger asset, and if so, the cost of separating the item from the larger asset;

(iii) Whether the item is commonly viewed as serving a useful function

independent of a larger asset of which it is a part; and

(iv) Whether separating the item from a larger asset of which it is a part impairs the functionality of the larger asset.

(f) *Intangible assets*—(1) *In general.* To the extent that an intangible asset, including an intangible asset established under generally accepted accounting principles (GAAP) as a result of an acquisition of real property or an interest in real property, derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of space, the intangible asset is real property or an interest in real property.

(2) *Licenses and permits.* A license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold or easement generally is an interest in real property. A license or permit to engage in or operate a business is not real property or an interest in real property if the license or permit produces or contributes to the production of income other than consideration for the use or occupancy of space.

(g) *Examples.* The following examples demonstrate the rules of this section. *Examples 1* and *2* illustrate the definition of land as provided in paragraph (c) of this section. *Examples 3* through *10* illustrate the definition of improvements to land as provided in paragraph (d) of this section. Finally, *Examples 11* through *13* illustrate whether certain intangible assets are real property or interests in real property as provided in paragraph (f) of this section.

Example 1. Natural products of land. A is a REIT. REIT A owns land with perennial fruit-bearing plants. REIT A leases the fruit-bearing plants to a tenant and grants the tenant an easement to enter the land to cultivate the plants and to harvest the fruit. The lease and easement are long-term and REIT A provides no services to the tenant. The unsevered plants are natural products of the land and are land within the meaning of paragraph (c) of this section. The tenant annually harvests fruit from the plants. Upon

severance from the land, the harvested fruit ceases to qualify as land. Storage of the harvested fruit upon or within real property does not cause the harvested fruit to be real property.

Example 2. Water space superjacent to land. REIT B leases a marina from a governmental entity. The marina is comprised of U-shaped boat slips and end ties. The U-shaped boat slips are spaces on the water that are surrounded by a dock on three sides. The end ties are spaces on the water at the end of a slip or on a long, straight dock. REIT B rents the boat slips and end ties to boat owners. The boat slips and end ties are water space superjacent to land that is land within the meaning of paragraph (c) of this section and, therefore, are real property.

Example 3. Indoor sculpture. (i) REIT C owns an office building and a large sculpture in the atrium of the building. The sculpture measures 30 feet tall by 18 feet wide and weighs five tons. The building was specifically designed to support the sculpture, which is permanently affixed to the building by supports embedded in the building's foundation. The sculpture was constructed within the building. Removal would be costly and time consuming and would destroy the sculpture. The sculpture is reasonably expected to remain in the building indefinitely. The sculpture does not manufacture, create, produce, convert, transport, or serve any similar active function.

(ii) The sculpture is not an asset listed in paragraph (d)(2)(iii)(B) of this section, and, therefore, the sculpture is an asset that must be analyzed to determine whether it is an inherently permanent structure using the factors provided in paragraph (d)(2)(iv) of this section. The sculpture—

(A) Is permanently affixed to the building by supports embedded in the building's foundation;

(B) Is not designed to be removed and is designed to remain in place indefinitely;

(C) Would be damaged if removed and would damage the building to which it is affixed;

(D) Will remain affixed to the building after any tenant vacates the premises and will remain affixed to the building indefinitely; and

(E) Would require significant time and expense to move.

(iii) The factors described in this paragraph (g) *Example 3* (ii)(A) through (E) all support the conclusion that the sculpture is an inherently permanent structure within the meaning of paragraph (d)(2) of this section and, therefore, is real property.

Example 4. Bus shelters. (i) REIT D owns 400 bus shelters, each of which consists of four posts, a roof, and panels enclosing two or three sides. REIT D enters into a long-term lease with a local transit authority for use of the bus shelters. Each bus shelter is prefab-

ricated from steel and is bolted to the sidewalk. Bus shelters are disassembled and moved when bus routes change. Moving a bus shelter takes less than a day and does not significantly damage either the bus shelter or the real property to which it was affixed.

(ii) The bus shelters are not permanently affixed enclosed transportation stations or terminals and do not otherwise meet the definition of a building in paragraph (d)(2)(ii) of this section nor are they listed as types of other inherently permanent structures in paragraph (d)(2)(iii)(B) of this section. Therefore, the bus shelters must be analyzed to determine whether they are inherently permanent structures using the factors provided in paragraph (d)(2)(iv) of this section. The bus shelters—

(A) Are not permanently affixed to the land or an inherently permanent structure;

(B) Are designed to be removed and are not designed to remain in place indefinitely;

(C) Would not be damaged if removed and would not damage the sidewalks to which they are affixed;

(D) Will not remain affixed after the local transit authority vacates the site and will not remain affixed indefinitely; and

(E) Would not require significant time and expense to move.

(iii) The factors described in this paragraph (g) *Example 4* (ii)(A) through (E) all support the conclusion that the bus shelters are not inherently permanent structures within the meaning of paragraph (d)(2) of this section. Although the bus shelters serve a passive function of sheltering, the bus shelters are not permanently affixed, which means the bus shelters are not inherently permanent structures within the meaning of paragraph (d)(2) of this section and, therefore, are not real property.

Example 5. Cold storage warehouse. (i) REIT E owns a refrigerated warehouse (Cold Storage Warehouse). REIT E enters into a long-term lease with a tenant. REIT E neither operates the Cold Storage Warehouse nor provides services to its tenant. The tenant uses the Cold Storage Warehouse to store perishable products. Certain components and utility systems that are integrated into the Cold Storage Warehouse have been customized to accommodate the tenant's need for refrigerated storage space. For example, the Cold Storage Warehouse has customized freezer walls and a central refrigeration system. Freezer walls within the Cold Storage Warehouse are specifically designed to maintain the desired temperature within the Cold Storage Warehouse. The freezer walls and central refrigeration system comprise a series of interconnected assets that work together to serve a utility-like function within the Cold Storage Warehouse, were installed during construction of the building, and will remain in place when the tenant vacates the

premises. The freezer walls and central refrigeration system were designed to remain permanently in place.

(ii) Walls and central refrigeration systems are listed as structural components in paragraph (d)(3)(ii) of this section and, therefore, are real property. The customization of the freezer walls does not affect their qualification as structural components of REIT E's Cold Storage Warehouse within the meaning of paragraph (d)(3) of this section. Therefore, the freezer walls and central refrigeration system are structural components of REIT E's Cold Storage Warehouse.

Example 6. Data center. (i) REIT F owns a building that it leases to a tenant under a long-term lease. REIT F neither operates the building nor provides services to its tenant. To accommodate the particular requirements for housing computer servers, certain interior components and utility systems within the building have been customized to provide a higher level of functionality than a conventional office building. These customized systems are owned by REIT F and include an electrical distribution and redundancy system (Electrical System), a central heating and air-conditioning system, a telecommunication infrastructure system, an integrated security system, a fire suppression system, and a humidity control system (each, a System). In addition, the space for computer servers in REIT F's building has been constructed with raised flooring that is integrated into the building to accommodate the Systems. Each System is comprised of a series of interconnected assets that work together to serve a utility-like function within the building. The Systems are integrated into the office building, were installed during construction of the building, and will remain in place when the tenant vacates the premises. Each of the Systems was customized to enhance the capacity of the System in connection with the rental of space within the building.

(ii) The central heating and air-conditioning system, integrated security system, fire suppression system, and humidity control system are listed as structural components in paragraph (d)(3)(ii) of this section and, therefore, are real property. The customization of these Systems does not affect the qualification of these Systems as structural components of REIT F's building within the meaning of paragraph (d)(3) of this section. Therefore, these Systems are structural components of REIT F's building.

(iii) In addition to wiring and flooring, which are listed as structural components in paragraph (d)(3)(ii) of this section and, therefore, are real property, the Electrical System and telecommunication infrastructure system include equipment used to ensure that the tenant is provided with uninterruptible, stable power and telecommunication services. The Electrical System and tele-

communication infrastructure system are not listed in paragraph (d)(3)(ii) of this section, and, therefore, they must be analyzed to determine whether they are structural components of the building using the factors provided in paragraph (d)(3)(iii) of this section. The Electrical System and telecommunication infrastructure system—

(A) Are embedded within the walls and floors of the building and would be costly to remove;

(B) Are not designed to be moved and are designed specifically for the particular building of which they are a part;

(C) Would not be significantly damaged upon removal and, although removing them would damage the walls and floors in which they are embedded, their removal would not significantly damage the building;

(D) Serve a utility-like function with respect to the building;

(E) Serve the building in its passive functions of containing, sheltering, and protecting computer servers;

(F) Produce income as consideration for the use or occupancy of space within the building;

(G) Were installed during construction of the building; and

(H) Will remain in place when the tenant vacates the premises.

(iv) The factors described in this paragraph (g) *Example 6* (iii)(A), (B), and (D) through (H) all support the conclusion that the Electrical System and telecommunication infrastructure system are structural components of REIT F's building within the meaning of paragraph (d)(3) of this section and, therefore, are real property. The factor described in this paragraph (g) *Example 6* (iii)(C) would support a conclusion that the Electrical System and telecommunication infrastructure system are not structural components. However this factor does not outweigh the factors supporting the conclusion that the Electric System and telecommunication infrastructure system are structural components.

Example 7. Partitions. (i) REIT G owns an office building that it leases to tenants under long-term leases. REIT G neither operates the office building nor provides services to its tenants. Partitions are owned by REIT G and are used to delineate space between tenants and within each tenant's space. The office building has two types of interior, non-load-bearing drywall partition systems: a conventional drywall partition system (Conventional Partition System) and a modular drywall partition system (Modular Partition System). Neither the Conventional Partition System nor the Modular Partition System was installed during construction of the office building. Conventional Partition Systems are comprised of fully integrated gypsum board partitions, studs, joint tape, and covering joint compound. Modular Partition Systems are comprised of assembled panels,

studs, tracks, and exposed joints. Both the Conventional Partition System and the Modular Partition System reach from the floor to the ceiling.

(ii) Depending on the needs of a new tenant, the Conventional Partition System may remain in place when a tenant vacates the premises. The Conventional Partition System is integrated into the office building and is designed and constructed to remain in areas not subject to reconfiguration or expansion. The Conventional Partition System can be removed only by demolition, and, once removed, neither the Conventional Partition System nor its components can be reused. Removal of the Conventional Partition System causes substantial damage to the Conventional Partition System itself but does not cause substantial damage to the building.

(iii) Modular Partition Systems are typically removed when a tenant vacates the premises. Modular Partition Systems are not designed or constructed to remain permanently in place. Modular Partition Systems are designed and constructed to be movable. Each Modular Partition System can be readily removed, remains in substantially the same condition as before, and can be reused. Removal of a Modular Partition System does not cause any substantial damage to the Modular Partition System itself or to the building. The Modular Partition System may be moved to accommodate the reconfigurations of the interior space within the office building for various tenants that occupy the building.

(iv) The Conventional Partition System is comprised of walls that are integrated into an inherently permanent structure, and thus are listed as structural components in paragraph (d)(3)(ii) of this section. The Conventional Partition System, therefore, is real property.

(v) The Modular Partition System is not integrated into the building and, therefore, is not listed in paragraph (d)(3)(ii) of this section. Thus, the Modular Partition System must be analyzed to determine whether it is a structural component using the factors provided in paragraph (d)(3)(iii) of this section. The Modular Partition System—

(A) Is installed and removed quickly and with little expense;

(B) Is designed to be moved and is not designed specifically for the particular building of which it is a part;

(C) Is not damaged, and the building is not damaged, upon its removal;

(D) Does not serve a utility-like function with respect to the building;

(E) Serves the building in its passive functions of containing and protecting the tenants' assets;

(F) Produces income only as consideration for the use or occupancy of space within the building;

(G) Was not installed during construction of the building; and

(H) Will not remain in place when a tenant vacates the premises.

(vi) The factors described in this paragraph (g) *Example 7* (v)(A) through (D), (G) and (H) all support the conclusion that the Modular Partition System is not a structural component of REIT G's building within the meaning of paragraph (d)(3) of this section and, therefore, is not real property. The factors described in this paragraph (g) *Example 7* (v)(E) and (F) would support a conclusion that the Modular Partition System is a structural component. These factors, however, do not outweigh the factors supporting the conclusion that the Modular Partition System is not a structural component.

Example 8. Solar energy site. (i) REIT H owns a solar energy site, among the components of which are land, photovoltaic modules (PV Modules), mounts and an exit wire. REIT H enters into a long-term lease with a tenant for the solar energy site. REIT H neither operates the solar energy site nor provides services to its tenant. The mounts support the PV Modules. The racks are affixed to the land through foundations made from poured concrete. The mounts will remain in place when the tenant vacates the solar energy site. The PV Modules convert solar photons into electric energy (electricity). The exit wire is buried underground, is connected to equipment that is in turn connected to the PV Modules, and transmits the electricity produced by the PV Modules to an electrical power grid, through which the electricity is distributed for sale to third parties.

(ii) REIT H's PV Modules, mounts, and exit wire are each separately identifiable items. Separation from a mount does not affect the ability of a PV Module to convert photons to electricity. Separation from the equipment to which it is attached does not affect the ability of the exit wire to transmit electricity to the electrical power grid. The types of PV Modules and exit wire that REIT H owns are each customarily sold or acquired as single units. Removal of the PV Modules from the mounts that support them does not damage the function of the mounts as support structures and removal is not costly. The PV Modules serve the active function of converting photons to electricity. Disconnecting the exit wire from the equipment to which it is attached does not damage the function of that equipment, and the disconnection is not costly. The PV Modules, mounts, and exit wire are each distinct assets within the meaning of paragraph (e) of this section.

(iii) The land is real property as defined in paragraph (c) of this section.

(iv) The mounts are designed and constructed to remain in place indefinitely, and they have a passive function of supporting the PV Modules. The mounts are not listed

in paragraph (d)(2)(iii)(B) of this section, and, therefore, the mounts are assets that must be analyzed to determine whether they are inherently permanent structures using the factors provided in paragraph (d)(2)(iv) of this section. The mounts—

(A) Are permanently affixed to the land through the concrete foundations or molded concrete anchors (which are part of the mounts);

(B) Are not designed to be removed and are designed to remain in place indefinitely;

(C) Would be damaged if removed;

(D) Will remain affixed to the land after the tenant vacates the premises and will remain affixed to the land indefinitely; and

(E) Would require significant time and expense to move.

(v) The factors described in this paragraph (g) *Example 8* (iv)(A) through (E) all support the conclusion that the mounts are inherently permanent structures within the meaning of paragraph (d)(2) of this section and, therefore, are real property.

(vi) The PV Modules convert solar photons into electricity that is transmitted through an electrical power grid for sale to third parties. The conversion is an active function. Thus, the PV Modules are items of machinery or equipment and therefore are not inherently permanent structures within the meaning of paragraph (d)(2) of this section and, so, are not real property. The PV Modules do not serve the mounts in their passive function of providing support; instead, the PV Modules produce electricity for sale to third parties, which is income other than consideration for the use or occupancy of space. Thus, the PV Modules are not structural components of REIT H's mounts within the meaning of paragraph (d)(3) of this section and, therefore, are not real property.

(vii) The exit wire is buried under the ground and transmits the electricity produced by the PV Modules to the electrical power grid. The exit wire was installed during construction of the solar energy site and is designed to remain permanently in place. The exit wire is permanently affixed and is a transmission line, which is listed as an inherently permanent structure in paragraph (d)(2)(iii)(B) of this section. Therefore, the exit wire is real property.

Example 9. Solar-powered building. (i) REIT I owns a solar energy site similar to that described in *Example 8*, except that REIT I's solar energy site assets (Solar Energy Site Assets) are mounted on land adjacent to an office building owned by REIT I. REIT I leases the office building and the solar energy site to a single tenant. REIT I does not operate the office building or the solar energy site and does not provide services to its tenant. Although the tenant occasionally transfers excess electricity produced by the Solar Energy Site Assets to a utility company, the Solar Energy Site Assets are de-

signed and intended to produce electricity only to serve the office building. The size and specifications of the Solar Energy Site Assets were designed to be appropriate to serve only the electricity needs of the office building. Although the Solar Energy Site Assets were not installed during construction of the office building, no facts indicate either that the Solar Energy Site Assets will not remain in place indefinitely or that they may be removed if the tenant vacates the premises.

(ii) With the exception of the occasional transfers of excess electricity to a utility company, the Solar Energy Site Assets serve the office building to which they are adjacent, and, therefore, the Solar Energy Site Assets are analyzed to determine whether they are a structural component using the factors provided in paragraph (d)(3)(iii) of this section. The Solar Energy Site Assets—

(A) Are expensive and time consuming to install and remove;

(B) Were designed with the size and specifications needed to serve only the office building;

(C) Will be damaged, but will not cause damage to the office building, upon removal;

(D) Serve a utility-like function with respect to the office building;

(E) Serve the office building in its passive functions of containing, sheltering, and protecting the tenant and the tenant's assets;

(F) Produce income from consideration for the use or occupancy of space within the office building;

(G) Were not installed during construction of the office building; and

(H) Will remain in place when the tenant vacates the premises.

(iii) The factors described in this paragraph (g) *Example 9* (ii)(A) through (C) (in part), (ii)(D) through (F), and (ii)(H) all support the conclusion that the Solar Energy Site Assets are a structural component of REIT I's office building within the meaning of paragraph (d)(3) of this section and, therefore, are real property. The factors described in this paragraph (g) *Example 9* (ii)(C) (in part) and (ii)(G) would support a conclusion that the Solar Energy Site Assets are not a structural component, but these factors do not outweigh the factors supporting the conclusion that the Solar Energy Site Assets are a structural component.

(iv) The result in this *Example 9* would not change if, instead of the Solar Energy Site Assets, solar shingles were used as the roof of REIT I's office building. Solar shingles are roofing shingles like those commonly used for residential housing, except that they contain built-in PV modules. The solar shingle installation was specifically designed and constructed to serve only the needs of REIT I's office building, and the solar shingles were installed as a structural component to

provide solar energy to REIT I's office building (although REIT I's tenant occasionally transfers excess electricity produced by the solar shingles to a utility company). The analysis of the application of the factors provided in paragraph (d)(3)(ii) of this section would be similar to the analysis of the application of the factors to the Solar Energy Site Assets in this paragraph (g) *Example 9* (ii) and (iii).

Example 10. Pipeline transmission system. (i) REIT J owns a natural gas pipeline transmission system that provides a conduit to transport natural gas from unrelated third-party producers and gathering facilities to unrelated third-party distributors and end users. REIT J enters into a long-term lease with a tenant for the pipeline transmission system. REIT J neither operates the pipeline transmission system nor provides services to its tenant. The pipeline transmission system is comprised of underground pipelines, isolation valves and vents, pressure control and relief valves, meters, and compressors. Although the pipeline transmission system as a whole serves an active function (transporting natural gas), one or more distinct assets within the system may nevertheless be inherently permanent structures that do not themselves perform active functions. Each of these distinct assets was installed during construction of the pipeline transmission system and will remain in place when the tenant vacates the pipeline transmission system. Each of these assets was designed to remain permanently in place.

(ii) The pipelines are permanently affixed and are listed as other inherently permanent structures in paragraph (d)(2)(iii)(B) of this section. Therefore, the pipelines are real property.

(iii) Isolation valves and vents are placed at regular intervals along the pipelines to isolate and evacuate sections of the pipelines in case there is need for a shut-down or maintenance of the pipelines. Pressure control and relief valves are installed at regular intervals along the pipelines to provide over-pressure protection. The isolation valves and vents and pressure control and relief valves are not listed in paragraph (d)(3)(ii) and, therefore, must be analyzed to determine whether they are structural components using the factors provided in paragraph (d)(3)(iii) of this section. The isolation valves and vents and pressure control and relief valves—

(A) Are time consuming and expensive to install and remove from the pipelines;

(B) Are designed specifically for the particular pipelines for which they are a part;

(C) Will sustain damage and will damage the pipelines if removed;

(D) Do not serve a utility-like function with respect to the pipelines;

(E) Serve the pipelines in their passive function of providing a conduit for natural gas;

(F) Produce income only from consideration for the use or occupancy of space within the pipelines;

(G) Were installed during construction of the pipelines; and

(H) Will remain in place when the tenant vacates the premises.

(iv) The factors described in this paragraph (g) *Example 10* (iii)(A) through (C) and (iii)(E) through (H) support the conclusion that the isolation valves and vents and pressure control and relief valves are structural components of REIT J's pipelines within the meaning of paragraph (d)(3) of this section and, therefore, are real property. The factor described in this paragraph (g) *Example 10* (iii)(D) would support a conclusion that the isolation valves and vents and pressure control and relief valves are not structural components, but this factor does not outweigh the factors that support the conclusion that the isolation valves and vents and pressure control and relief valves are structural components.

(v) Meters are used to measure the natural gas passing into or out of the pipeline transmission system for purposes of determining the end users' consumption. Over long distances, pressure is lost due to friction in the pipeline transmission system. Compressors are required to add pressure to transport natural gas through the entirety of the pipeline transmission system. The meters and compressors do not serve the pipelines in their passive function of providing a conduit for the natural gas, and are used in connection with the production of income from the sale and transportation of natural gas, rather than as consideration for the use or occupancy of space within the pipelines. The meters and compressors are not structural components within the meaning of paragraph (d)(3) of this section and, therefore, are not real property.

Example 11. Above-market lease. REIT K acquires an office building from an unrelated third party subject to a long-term lease with a single tenant under which the tenant pays above-market rents. The above-market lease is an intangible asset under GAAP. Seventy percent of the value of the above-market lease asset is attributable to income from the long-term lease that qualifies as rents from real property, as defined in section 856(d)(1). The remaining thirty percent of the value of the above-market lease asset is attributable to income from the long-term lease that does not qualify as rents from real property. The portion of the value of the above-market lease asset that is attributable to rents from real property (here, seventy percent) derives its value from real property, is inseparable from that real property, does not produce or contribute to the production

of income other than consideration for the use or occupancy of space, and, therefore, is an interest in real property under section 856(c)(5)(C) and a real estate asset under section 856(c)(5)(B). The remaining portion of the above-market lease asset does not derive its value from real property and, therefore, is not a real estate asset.

Example 12. Land use permit. REIT L receives a special use permit from the government to place a cell tower on Federal Government land that abuts a federal highway. Government regulations provide that the permit is not a lease of the land, but is a permit to use the land for a cell tower. Under the permit, the government reserves the right to cancel the permit and compensate REIT L if the site is needed for a higher public purpose. REIT L leases space on the tower to various cell service providers. Each cell service provider installs its equipment on a designated space on REIT L's cell tower. The permit does not produce, or contribute to the production of, any income other than REIT L's receipt of payments from the cell service providers in consideration for their being allowed to use space on the tower. The permit is in the nature of a leasehold that allows REIT L to place a cell tower in a specific location on government land. Therefore, the permit is an interest in real property.

Example 13. License to operate a business. REIT M owns a building and receives a license from State to operate a casino in the building. The license applies only to REIT M's building and cannot be transferred to another location. REIT M's building is an inherently permanent structure under paragraph (d)(2)(i) of this section and, therefore, is real property. However, REIT M's license to operate a casino is not a right for the use, enjoyment, or occupation of REIT M's building but is rather a license to engage in the business of operating a casino in the building. Therefore, the casino license is not real property.

(h) *Effective/applicability date.* The rules of this section apply for taxable years beginning after August 31, 2016. For purposes of applying the first sentence of the flush language of section 856(c)(4) to a quarter in a taxable year that begins after August 31, 2016, the rules of this section apply in determining whether the taxpayer met the requirements of section 856(c)(4) at the close of prior quarters. Taxpayers may rely on this section for quarters that end before the applicability date.

[T.D. 9784, 81 FR 59860, Aug. 31, 2016, as amended by 81 FR 68934, Oct. 5, 2016]

§ 1.857-1 Taxation of real estate investment trusts.

(a) *Requirements applicable thereto.* Section 857(a) denies the application of the provisions of part II, subchapter M, chapter 1 of the Code (other than sections 856(g), relating to the revocation or termination of an election, and 857(d), relating to earnings and profits) to a real estate investment trust for a taxable year unless—

(1) The deduction for dividends paid for the taxable year as defined in section 561 (computed without regard to capital gain dividends) equals or exceeds the amount specified in section 857(a)(1), as in effect for the taxable year; and

(2) The trust complies for such taxable year with the provisions of § 1.857-8 (relating to records required to be maintained by a real estate investment trust).

See section 858 and § 1.858-1, relating to dividends paid after the close of the taxable year.

(b) *Failure to qualify.* If a real estate investment trust does not meet the requirements of section 857(a) and paragraph (a) of this section for the taxable year, it will, even though it may otherwise be classified as a real estate investment trust, be taxed in such year as an ordinary corporation and not as a real estate investment trust. In such case, none of the provisions of part II of subchapter M (other than sections 856(g) and 857(d)) will be applicable to it. For the rules relating to the applicability of sections 856(g) and 857(d), see § 1.857-7.

(Sec. 856(d)(4) (90 Stat. 1750; 26 U.S.C. 856(d)(4)); sec. 856(e)(5) (88 Stat. 2113; 26 U.S.C. 856(e)(5)); sec. 856(f)(2) (90 Stat. 1751; 26 U.S.C. 856(f)(2)); sec. 856(g)(2) (90 Stat. 1753; 26 U.S.C. 856(g)(2)); sec. 858(a) (74 Stat. 1008; 26 U.S.C. 858(a)); sec. 859(c) (90 Stat. 1743; 26 U.S.C. 859(c)); sec. 859(e) (90 Stat. 1744; 26 U.S.C. 859(e)); sec. 6001 (68A Stat. 731; 26 U.S.C. 6001); sec. 6011 (68A Stat. 732; 26 U.S.C. 6011); sec. 6071 (68A Stat. 749; 26 U.S.C. 6071); sec. 6091 (68A Stat. 752; 26 U.S.C. 6091); sec. 7805 (68A Stat. 917; 26 U.S.C. 7805), Internal Revenue Code of 1954)

[T.D. 6598, 27 FR 4087, Apr. 28, 1962, as amended by T.D. 7767, 46 FR 11277, Feb. 6, 1981]