

April 18, 2024

**VIA ELECTRONIC SUBMISSION**

Internal Revenue Service  
Attn: CC:PA:01:PR (Notice 2024-28) Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

Re: Recommendations for the 2024-2025 Priority Guidance Plan

To Whom It May Concern:

Under cover of this letter, we at Sullivan & Worcester LLP submit the attached thought piece, "[Enabling REITs to Deploy Renewable Energy: Toward a Workable Legal Standard](#)", pursuant to Notice 2024-28, I.R.B. 2024-13. As further described in our submission, we respectfully request that the Department of Treasury ("Treasury") and the Internal Revenue Service ("IRS") issue precedential guidance that (i) confirms that the revenue generated by a real estate investment trust (a "REIT") providing electricity to its tenants from renewable-source energy that is produced onsite does not constitute Section 856(d)(7)(A) "impermissible tenant service income" and (ii) enables a REIT to deploy renewable energy infrastructure during periods of ramp up or tenant vacancies pursuant to an "appropriate in size" for the building (or other property) legal standard.

In furtherance of developing such guidance, the attached thought piece (i) summarizes the current state of the law, (ii) identifies common commercial situations unaccounted for by the current net metering standard of the safe harbor, and (iii) proposes an additional legal standard, consistent with existing REIT principles, that would provide REITs with greater certainty in their ability to satisfy the applicable REIT gross income and asset tests during a ramp-up period or periods of economic downturn.

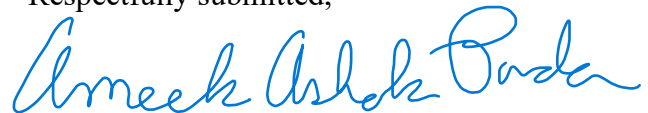
Issuing the guidance requested herein, including the proposed general legal standard discussed in the attached thought piece, would be consistent with or further the factors referenced in Notice 2024-28. Specifically, the requested guidance and the proposed legal standard would:

1. support the ability of the Treasury and IRS to resolve significant issues faced by a broad class of taxpayers because the guidance will apply to all REITs across a variety of real property sectors;
2. provide clarity for REITs deploying renewable energy infrastructure, thereby reducing controversy and taxpayer and IRS burden in evaluating complex factual circumstances;

3. provide clarity for REITs considering deploying renewable energy infrastructure (including in reliance on incentives provided under the Inflation Reduction Act of 2022, Pub. L. No. 117-169 (August 16, 2022)) at new construction or in facilities that are experiencing or may experience reduced tenant occupancy;
4. clarify and streamline existing guidance that a REIT's provision of electricity to its tenants from renewable-source energy that is produced onsite does not constitute Section 856(d)(7)(A) "impermissible tenant service income";
5. promote sound tax administration by addressing REIT taxpayers' pressing need for guidance on this topic, all within the parameters of existing REIT tax principles;
6. be administrable on a uniform basis because it applies across all REITs, regardless of real property sector, and is based in existing REIT tax principles; and
7. readily allow the IRS to draft impactful guidance (in the form of a regulation, Revenue Ruling, Notice, or other written guidance) that REIT taxpayers can understand and apply easily.

Thank you for considering our request and submission. We welcome any opportunities for discussion with the Treasury and IRS regarding our recommendation. For additional inquiries or information, please contact Aameek Ashok Ponda ([aponda@sullivanlaw.com](mailto:aponda@sullivanlaw.com); 617-338-2443).

Respectfully submitted,



Aameek Ashok Ponda

Enclosure

cc:

Mr. Paul W. Decker, Esq., Sullivan & Worcester LLP

Ms. Connie S. Lee, Esq., Sullivan & Worcester LLP

Ms. Sarah D. Wellings, Esq., Sullivan & Worcester LLP

## Enabling REITs to Deploy Renewable Energy: Toward a Workable Legal Standard

By: Ameet Ashok Ponda, Paul W. Decker, Sarah D. Wellings, Connie S. Lee

April 18, 2024

When Treasury promulgated [Treasury Decision 9784, I.R.B 2016-39](#) nearly a decade ago, the net metering renewable energy safe harbor (Section XI “Renewable Energy”, Subsection A) was welcome guidance that was fit for the time and the technology. But given the advances in renewable energy technology and today’s commercial realities, Treasury and IRS should now issue additional guidance that fully enables REITs to deploy renewable energy infrastructure in commercially sensible ways.

Specifically, in addition to retaining the existing net metering renewable energy safe harbor, Treasury and IRS should issue precedential guidance that (i) confirms that the income generated by a REIT’s provision of electricity to its tenants from renewable source energy that is produced onsite (*e.g.*, via an onsite solar or wind installation) does not constitute Section 856(d)(7)(A) “impermissible tenant service income” and (ii) enables a REIT to deploy and utilize renewable energy infrastructure during a “ramp up” period or a period of tenant vacancy pursuant to an “appropriate in size” for the building (or other property) legal standard.

As a means to advance the discussion of developing guidance that REITs may rely on in all seasons, we at Sullivan & Worcester LLP provide the following outline to describe (i) the current state of the law, (ii) common commercial situations unaccounted for by the current net metering standard of the safe harbor, and (iii) a proposed additional legal standard that is both consistent with existing REIT principles and that would provide REITs with greater certainty in their ability to satisfy the applicable REIT gross income and asset tests during a ramp up period or periods of economic downturn.

- **Background.** REIT landlords are routinely called upon to make available reliable, clean, and economical electricity to their property common areas and their property tenants. Notably, electrical utilities in many states may be unable to keep up with local power demands, and REITs may need to deploy renewable energy infrastructure as a means to ensure consistent power access for their property common areas and their property tenants. See [“Amid Explosive Demand, America is Running out of Power”, Portland Press Herald, Mar. 7, 2024.](#)
  - A REIT landlord providing such electricity to tenants, whether as part of a bundled or separate charge, earns Section 856(d)(1)(B) “rents from real property” because such provision of electricity to common areas and to tenants is geographically customary.
- **Not ITSI – Definitive Pronouncement.** Treasury and the IRS should confirm that the income generated by a REIT landlord’s provision of electricity to its tenants from renewable source energy that is produced onsite does not constitute Section 856(d)(7)(A) “impermissible tenant service income” (ITSI) because Section 856(d)(7)(C)(ii) affords protection from that adverse result.
  - There is already authority, including some legal precedent, for this favorable conclusion, including: [Treas. Reg. § 1.512\(b\)-1\(c\)\(5\)](#), [Rev. Rul. 69-178](#), PLRs [200828025](#), [201301007](#), [201450017](#), [201901001](#), [202132002](#), [202133003](#), and [202150014](#).
  - But a more modern and more definitive IRS pronouncement on this point would bring welcome clarity, because classifying as ITSI the income from the provision of such onsite

produced electricity has the very real potential to disqualify all of the REIT's revenues from the affected property for REIT income testing purposes, per Section 856(d)(7)(B) and [Rev. Rul. 98-60](#).

- Current Safe Harbor & Workable Legal Standard. In addition to retaining the existing safe harbor in the above-cited Treasury Decision, the Treasury and IRS should articulate a workable general standard, as suggested below, in order to address a “ramp up” tax year, tenant vacancies, and other natural and often unexpected or unplanned fluctuations in electricity usage.
  - Current Safe Harbor Standard – “Net Metering”. Currently, the safe harbor applies only when, over the course of the taxable year, the REIT landlord purchases more electricity from the grid than it sells to the grid.
    - When the safe harbor condition precedent is satisfied, three favorable conclusions follow, *viz.*:
      - (i) the renewable energy installation is not disqualified from structural component status (and can thus be Section 856 “real property”),
      - (ii) the sales of electricity to the grid are ignored for purposes of REIT income testing, and
      - (iii) the sales of electricity to the grid will not give rise to dealer property gains subject to Section 857(b)(6) taxation.
    - However, there is a “cliff effect” in the safe harbor: even 1kW of excess electricity sales to the grid over the course of the taxable year can remove the subject renewable energy installation from these three favorable conclusions by placing the entire series of transactions outside of the safe harbor.
  - Cliff Effect Risk in Ramp Up and Downturn Periods. This “cliff effect” may occur in several commercially common situations, such as the “ramp up” during the initial taxable year of a building’s construction, or a taxable year where there is an unexpected tenant vacancy (and particularly if the vacancy occurs at the beginning of the taxable year).
    - REIT landlords are on the calendar taxable year, per Section 859.
    - For properties in the northern hemisphere, the days and weeks surrounding the June 21 summer solstice are longer than days and weeks surrounding the December 21 winter solstice; this means, of course, that solar panels will generate larger amounts of electricity in the summer than in the winter. Similarly, other seasonal patterns may affect wind energy production over the course of a calendar taxable year.
    - Ramp-up risk: For a REIT landlord that completes its building construction (including for example the solar installations therein) in the late spring, its initial taxable year of installation will not be representative of its net metering experience with the grid in subsequent years, because several of the shorter daylight months will be missing from this initial taxable year; this can be expected to skew an otherwise reasonable scale of solar installation at a

- building to produce a violation of the net metering safe harbor (*i.e.*, the sale of electricity to the grid will likely go over the “cliff”).
- Downturn risk: Similarly, after the initial year, if a REIT experiences an unintended vacancy in the building, meaning that tenant demand for electricity drops (temporarily) below expected levels and there is thus more electricity to offload to the grid, and especially if this drop in tenant demand occurs during the early portion of the year and persists through the longer daylight months, these events also could skew an otherwise reasonable scale of solar installation at a property to produce a violation of the net metering safe harbor (*i.e.*, the sale of electricity to the grid will likely go over the “cliff”).
  - General Legal Standard – “Appropriate in Size”. The solution to the “cliff effect” is to preserve the existing safe harbor while adding a more general legal standard, *viz.*, that a REIT with a renewable energy installation “appropriate in size” for the building (or other property, *e.g.*, cellular tower compound) will be afforded the same three favorable conclusions afforded to REITs that satisfy the net metering safe harbor.
    - In particular, a general legal standard of “appropriate in size” for the property can permit a REIT landlord to benefit from the three favorable conclusions even if there are excess net metering sales from the property to the grid for a particular taxable year due to commercially common situations such as the ramp up period or an economic downturn.
    - This “appropriate in size” standard is, in effect, the workable legal standard for parking lots located within or adjacent to REIT buildings, including those parking lots that are open to the general public for parking. See [Rev. Rul. 2004-24, 2004-1 C.B. 550](#) (“Each parking facility is located in or adjacent to a building occupied by tenants of R and is appropriate in size for the number of tenants and their guests, customers, and subtenants who are expected to use the facility.”).
    - This “appropriate in size” standard is also the legal standard for whether particular facilities and amenities are part of the RIDEA property (healthcare facilities and lodging facilities) that may be leased to a related-party TRS under Sections 856(e)(6)(D)(i)(II) (“The term ‘qualified health care property’ means any real property (including interests therein), and any personal property incident to such real property, which...is necessary or incidental to the use of a health care facility.”) and 856(d)(9)(D)(iii) (“The term ‘lodging facility’ includes customary amenities and facilities operated as part of, or associated with, the lodging facility so long as such amenities and facilities are customary for other properties of a comparable size and class owned by other owners unrelated to such real estate investment trust.”). Compare, *e.g.*, PLR [201033022](#) with PLRs [201429024](#) and [201930003](#).
    - Finally, this “appropriate in size” standard is articulated in Treas. Reg. § 1.856-10(g) (Example 9), which concludes that solar panels, installed on the campus of an existing building that is apparently at full occupancy, constitute

“real property” for purposes of the REIT rules (“Although the [REIT’s] tenant occasionally transfers excess electricity produced by the Solar Energy Site Assets to a utility company, the Solar Energy Site Assets are designed 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.”). For maximum congruity between the REIT “real property” regulations of Treas. Reg. § 1.856-10 and the ITSI legal standard of Section 856(d)(7)(C)(ii), it must be the case that utility-like structural components described in Treas. Reg. § 1.856-10 do not generate ITSI (or other REIT qualification issues) and can thus reside within the REIT rather than being siloed into a TRS.

- Many states already impose limitations on the size and scope of a property owner’s renewable energy facility (which limitations may be based on the local utility’s determination of the expected onsite electricity needs of the property itself), and REITs are thus already limited on the amount of electricity that may be sold to the electrical grid from time to time in a steady state.