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June 9, 2025

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Internal Revenue Service
CC:PA:01:PR (Notice 2025-6)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: IRS Notice 2025-6, 2025-8 I.R.B. 799 (Request for Comments on Applying the Characterization Rules in §§ 1.861-18 and 1.861-19 to All Provisions of the Internal Revenue Code) ("Notice 2025-6")

We write in response to the above-referenced Notice 2025-6, published on February 18, 2025 in Internal Revenue Bulletin 2025-8. Thank you for this opportunity to explain our views. Please know that our comments below are our own and do not reflect the views of any institution to which we belong, *e.g.*, any college or university where we teach, or any bar association or other professional organization to which we belong.

As you will see from our detailed comments below, we reaffirm the spirit of an earlier round of comments made by Ameek Ashok Ponda in his letter dated October 24, 2019, in response to the then Proposed Regulations ("**Prop. Reg.**") §§ 1.861-18 and 1.861-19 (the "**Ponda Letter**", available here): *viz.,* that any final regulations under Internal Revenue Code ("**Code**") section 861 should not purport to implement or interpret Code section 7701(e), and that any such regulations should instead be limited in scope to the sourcing rules rather than apply more broadly to other parts of the Code. This key point was affirmed by the REIT industry group Nareit in its own, separate, November 12, 2019 comment letter to the then Prop. Reg. §§ 1.861-18 and 1.861-19, available here.[1] Ultimately, in its finalization of Treasury Regulations ("**Reg.**") §§ 1.861-18 and 1.861-19, Treasury accepted this key point from the Ponda Letter by eliminating the references to Code section 7701(e) and its several factors. What remains for further discussion and exploration is the question now posed by Notice 2025-6, regarding whether the now final

[1] Nareit recently, in a letter dated May 19, 2025 and in response to Notice 2025-6 in particular, reaffirmed the comments (particularly in spirit) made in its original November 12, 2019 letter and in support of the Ponda Letter (available here).

Reg. §§ 1.861-18 and 1.861-19 framework should be imported into other parts of the Code, including in particular Code sections 856-859.

As the Ponda Letter explained, the legal approach and standard for cloud transactions taken by the then Prop. Reg. §§ 1.861-18 and 1.861-19, no matter their ultimate contours, efficacy, and utility for the sourcing rules, should not displace, modify, or embellish the well-established (and decidedly different) legal standards for transactions that involve rent-plus-services that have been developed over decades under, *inter alia*, Code sections 163(j), 469, 512(b)(3), 856-859, and 7704. (Nareit too, in its own comment letter from 2019, agreed with and made this same point.) With Reg. §§ 1.861-18 and 1.861-19 now final, this key point continues to remain true. Accordingly, in this letter, we elaborate upon and reaffirm that the principles of Reg. §§ 1.861-18 and 1.861-19 should **not** be applied to other parts of the Code, and in particular that the principles and conclusions developed for Reg. §§ 1.861-18 and 1.861-19 should **not** be incorporated into Code sections 163(j), 469, 512(b)(3), 856-859, or 7704 or the published and private authorities thereunder. Our detailed reasoning is as follows.

First, the principle that "rent", or more accurately "rent-plus-services", might be defined one way under particular Code sections, but a decidedly different way under unrelated Code sections, should come as no surprise to Treasury and the Internal Revenue Service ("**IRS**" or "**Service**"). Indeed, over a decade ago, when Treasury first explored the need to formulate an updated and crisper definition of "real property" for purposes of Code sections 856-859, it looked very closely at whether that definition should be unified and homogenized with the definition of "real property" under other Code sections, *e.g.*, Code sections 168, 263, 469, 897, 1031, 1245, or 1250. *See* Notice of Proposed Regulations REG-150760-13, 79 Fed. Reg. 27,508, 27,510 (May 14, 2014):

> The IRS and the Treasury Department request comments, however, on the extent to which the various meanings of real property that appear in the Treasury regulations should be reconciled, whether through modifications to these proposed regulations or through modifications to the regulations under other Code provisions.

After considering the extensive received comments and their own close review, Treasury and the IRS concluded in the preamble to the final Reg. § 1.856-10 that no such uniformity was desirable or necessary. *See* Treasury Decision 9784 , 2016-39 I.R.B. 402:

> As discussed in the preamble to the proposed regulations, in drafting the proposed regulations, the Treasury Department and the IRS sought to balance (1) the general principle that common terms used in different provisions should have common meanings with (2) the particular policies underlying the definition used in the REIT provisions. These final regulations retain the language in § 1.856-10(a) of the proposed regulations

> stating that § 1.856-10 provides definitions for purposes of part II, subchapter M, chapter 1 of the Code. This language addresses the commenters' concerns by limiting the application of the definition of real property under these final regulations to sections 856 through 859.

See also Ameek A. Ponda, "REIT Taxation Developments", Boston Tax Forum (May 1, 2017), available here. Ultimately, and in our view correctly, Treasury and the IRS in Reg. § 1.856-10 ended up agreeing with Ralph Waldo Emerson: "A foolish consistency is the hobgoblin of little minds…." Similarly, as explained further below, there would seem little point to transplant the Reg. § 1.861-19 analytical approach merely for the sake of uniformity, as it contains a strong and implicit bias toward classification of complex transactions as "service" transactions, while other parts of the Code have already developed adequately around very different statutory legal standards.

Second, the Ponda Letter was concerned most with the fact patterns that have now become Examples 1, 2, and 7 of Reg. § 1.861-19 in the final regulations, and as to which Reg. § 1.861-19 concludes are cloud transactions and thus "service" transactions. Yet, those three examples recite fact patterns that are understood to be (or, at a minimum, are economically indistinguishable from, and so with slight changes in facts and/or proper legal documentation could be molded into) rental or rental-plus-rent-related-service transactions under other parts of the Code. This tension starts with the very roots of the Reg. § 1.861-19 conceptual framework and its implicit bias toward finding "service" transactions: to begin, Reg. § 1.861-19(b) defines "cloud transaction" quite broadly to encompass many forms of access to and use of computer hardware and similar resources (perhaps even including access to the real property that underlies or houses that computer hardware); next, Reg. § 1.861-19(c)(2) defines a transaction with multiple components in its entirety as a "cloud transaction" if the "predominant character" of the underlying components are "cloud transactions"; and finally, Reg. § 1.861-19(c)(1) defines all cloud transactions as the provision of "services" (as opposed to finding a bifurcation of some rent plus some services, or finding a nuanced composite that is a rent-plus-services transaction).

Whatever the efficacy and utility of the foregoing Reg. § 1.861-19 framework for the sourcing rules, this framework and its bias toward finding complex transactions to be solely the provision of "services" is simply not the way the concepts of rent and rent-plus-rent-related-services have developed in other parts of the Code, including and especially Code sections 856-859. For example, the provision of dedicated computer servers to the customer on the customer's premises, as recited in Reg. § 1.861-19(d)(2)(Example 2), is almost certainly a rental transaction for purposes of the Code section 469 passive activity loss rules even though it is a "cloud transaction" and thus the provision of services under

now final Reg. § 1.861-19.[2] By way of further example and again in contrast to the Reg. § 1.861-19 framework, Congress enacted a quite dissimilar three-part framework when it defined "rents from real property" for purposes of Code sections 856-859. That is, Code section 856(d)(1) defines "rents from real property" as the composite of three elements, as follows: to start, "rents from real property" includes the basic rent for the use of real property, per Code section 856(d)(1)(A);[3] then, "rents from real property" includes all payments for rent-related-services (whether or not separately stated) that are described in Code section 856(d)(1)(B) (without any consideration as to how the amount of these services, by value or by any other metric, would compare to the amount of basic rent);[4] and finally, "rents from real property" includes rent for use of *de minimis* personal property as described in the 15-percent standard of Code section 856(d)(1)(C). Collectively, all three of these components comprise Code section 856(d)(1) "rents from real property".[5]

Therefore, when analyzing a particular rent-plus-services value proposition from provider to customer, the results could be very different under distinct regulatory (*e.g.,* Reg. § 1.861-19) versus other statutory or regulatory provisions under the Code (*e.g.,* Code section 856(d)). In several instances in a Reg. § 1.861-19 "cloud transaction", the underlying "rental value" of property is simply subsumed and thereby the economic value related to that rental value becomes a payment for services.[6] However, under Code section 856(d), the basic rental relationship provides the anchor upon which rent for use of *de minimis* personal property and for rent-related-services (which might even be numerically predominant) may be added, and the overall, composite "rent plus rent-related-services plus rent for *de minimis* personal property" transaction amount would

[2] Reg. § 1.469-1T(e)(3).

[3] Reg. § 1.856-4(a) ("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]").

[4] Nowhere in Treasury or IRS pronouncements spanning decades is there any articulation that the Code sections 856-859 concept of "rents from real property", a statutory term which by definition subsumes both "rent" and all rent-related-services, should be decided or even informed by a predominance test similar to that in the now-final Reg. § 1.861-19. Rather, per our reading and understanding, all Treasury and IRS pronouncements addressing Code section 856 "rents from real property" to date have, as prescribed by statute, placed no restrictions on the quantum of rent-related-services described in Code section 856(d)(1)(B).

[5] Certain amounts are later statutorily excluded from "rents from real property" in Code section 856(d)(2), *viz.,* certain rents dependent on income or profits, certain rents received from certain related parties, and "impermissible tenant service income", but these excluded amounts are not at issue here.

[6] Reg. § 1.861-19(d)(2)(Example 2) ("[T]he transaction between Corp A and Corp B is the provision of on-demand network computing capacity and is therefore a cloud transaction with one element. Therefore, the transaction is treated solely as a cloud transaction under paragraph (b) of this section and is classified as the provision of services under paragraph (c)(1) of this section. If the transaction between Corp A and Corp B involved only the provision of a server by Corp A for use by Corp B, and not on-demand network access to computing capacity, the transaction would not be a cloud transaction and this section would not apply.").

still qualify as Code section 856(d)(1) "rents from real property", not as payment for services. Given that these two frameworks are so different at their very roots and in their execution, it makes little sense to import (or even to attempt to integrate) the Reg. § 1.861-19 framework into the existing and well-developed framework for Code section 856(d), as posited as a possibility by Notice 2025-6.

Applying the Congressionally mandated statutory framework of Code section 856(d), the Service over many decades has fleshed out the meaning of the statutory text in Code section 856(d) "rents from real property", which include quite a number of business models that provide for shared access to both realty and associated personal property (including property provided to tenants with rental charges based on usage volume or on-demand). For your convenience, we have compiled these IRS pronouncements in Exhibit A to this letter.[7] As you can see, these collected authorities treat tenant access to and use of the landlord's real and personal property as part of the basic rental relationship, even when such access and use are on a shared basis with other tenants, and even when such access and use are based on usage volume or on demand, which is the correct answer under the statutory standards of Code section 856. However, this result would be in tension with the services-biased approach of Reg. § 1.861-19, which defines all on-demand network access to computer hardware as the provision of "services".

Indeed, in the last several years alone, while Reg. § 1.861-19 has been awaiting finalization, the Service has continued to apply and flesh out the Code section 856 concept of rent plus rent-related-services plus rent for *de minimis* personal property in a manner that is consistent with (a) the Code section 856 statutory framework, (b) prior decades of IRS pronouncements, and (c) REIT industry practice. Accordingly, based on the authorities listed in Exhibit A (including those within the last several years), data center operators described in Reg. § 1.861-19(d), Examples 1 and 7 might well be earning (especially with proper legal documentation with their tenants) Code section 856(d) "rents from real property". Thus, if one now were to import the alien Reg. § 1.861-19 framework into Code sections 856-859, as Notice 2025-6 posits as a possibility, the IRS would have to overturn or revoke decades of IRS interpretations and authorities grounded in the statutory text of Code sections 856-859 as well as jeopardize the current REIT compliance practices of taxpayers who have relied on the same.

Third, even if access to computer hardware is somehow a service for Code section 856(d) purposes, contrary to the compiled authorities in Exhibit A, nevertheless that service in the REIT industry context can be and often still is "rents from real property" by virtue of

[7] An earlier version of this Exhibit A was also included in the original Ponda Letter. As discussed *supra* note 4, none of the authorities in Exhibit A purport to reference or apply a Reg. § 1.861-19(c)(2)-style "predominant character" standard to the REIT-provided offerings, for to do so would have been to ignore Congress' mandate in the text of Code section 856(d)(1)(B) that services described therein qualify as "rents from real property" regardless of their quantum or even their predominance.

being described in Code section 856(d)(1)(B) as a rent-related-service.[8] Both the Supreme Court[9] and the Tax Court[10] have made clear that the plain text of the statute alone is paramount in understanding its meaning, and that an agency such as Treasury or the Service does not possess the ability or agency deference to alter this meaning. Significantly, Code section 856(d)(1), in defining "rents from real property" and including within it applicable rent-related-services described in Code section 856(d)(1)(B), nowhere imposes either a numerical limit or the "predominant character" standard of Reg. § 1.861-19(c)(2) such that, if the quantity of the service component were ever to exceed the quantity of the basic rental component, then the overall transaction would somehow fail to qualify as generating Code section 856(d)(1) "rents from real property". Rather, the text of the statute itself speaks to the contrary: once there is a basic rental component of real property under Code section 856(d)(1)(A), then the rent-related-services described in Code section 856(d)(1)(B) are aggregated with the pure rental in Code section 856(d)(1)(A), and together they (along with the *de minimis* personal property rentals described in Code section 856(d)(1)(C)) are included within the Code section 856(d)(1) definition of "rents from real property", unless excluded by Code section 856(d)(2).[11] Treasury must respect this Code section 856(d) statutory framework and thus must not import or impose the Reg. § 1.861-19(c)(2) "predominant character" legal

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[8] As appropriate, that service may have to be provided via a so-called "taxable REIT subsidiary" on account of the "impermissible tenant service income" requirements of Code sections 856(d)(2)(C) and 856(d)(7) as articulated in Rev. Rul. 2002-38, 2002-2 C.B. 4. *See generally* Paul W. Decker, David H. Kaplan, & Ameek Ashok Ponda, *Non-Customary Services Furnished by Taxable REIT Subsidiaries*, 148 Tax Notes 413 (July 27, 2015), available here.

[9] The Supreme Court in *Bostock v. Clayton County*, 590 U.S. 644 (2020) indicated that a "textualist" approach is the correct way to interpret federal statutes generally (including presumably by the IRS with regard to the Code). S*ee St. Joseph Stock Yards Co.* v. *United States*, 298 U. S. 38, 51 (1936): "When the legislature itself acts within the broad field of legislative discretion, its determinations are conclusive," *quoted in Loper Bright Enterprises v. Raimondo,* 603 U.S. 369, 387 (2024).

[10] *See Varian Med. Sys., Inc. v. Comm'r*, 163 T.C. No. 4, 163 T.C.M. 46 (CCH) (2024) (L.Ed. and S.Ct. citations omitted):

> For the reasons we have described, Congress spoke clearly on the point at issue . . . . Appeals to policy and Congress's overarching purpose cannot overcome these choices, no matter how much the Commissioner may dislike them. *See Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 220 (2002) ("[V]ague notions of a statute's 'basic purpose' are . . . inadequate to overcome the words of its text regarding the *specific* issue under consideration." (quoting *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 261 (1993))); *see* also *Metzger Tr. v. Commissioner*, 693 F.2d 459, 472 (5th Cir. 1982) ("As understandable as it may be, yielding to the temptation to 'do equity' in a specific tax case by looking past plain language to judicially perceived purpose will not do."), *aff'g* 76 T.C. 42 (1981); *Metzger Tr.*, 76 T.C. at 59 ("Courts do not have the power to repeal or amend the enactments of the legislature even though they may disagree with the result; rather, it is their function to give the natural and plain meaning to the statutes as passed by Congress.").

[11] *See* note 5 *supra*.

framework onto Code section 856(d)(1) because Congress itself has very clearly chosen a different structure.

Thank you again for the opportunity to comment on the issues raised by Notice 2025-6. Please feel free to contact Ameek Ashok Ponda (aponda@sullivanlaw.com; 617-338-2443) or another member of the Sullivan Tax group in the cc line below if you would like to discuss these comments further or otherwise have any questions.

Respectfully submitted,

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Exhibit A

Examples of Leases to Tenants of Shared Real and Personal Property, including on the Basis of Rent that is Based on Usage Volume or On-Demand Access*

1. GCM 36334 (July 2, 1975): under former Code section 863, payments to the holder of an indefeasible right of use for access to a communications medium (including the realty and personal property components therein), such as an underwater trans-Atlantic cable (inclusive of amplifiers), represented rent related to "an international leasing business".
2. PLR 9428002 (Mar. 29, 1994): under Code section 2032A(b)(2), family received rent for shared access to and use of land pursuant to hunting leases.
3. PLR 9808011 (Oct. 14, 1997): shopping center REIT received rent for shared, nonexclusive easements granted to anchor store tenants.
4. PLR 199908023 (Nov. 27, 1998): office REIT owned and maintained office equipment that was available for shared use by all of a building's tenants.
5. PLR 200101012 (Sept. 30, 2000): student-housing REIT leased to students access rights to common areas (and the furnishings and consumer electronics therein).
6. PLR 200428019 (Mar. 25, 2004): warehouse REIT leased generally nondedicated storage space in temperature-controlled storage facilities.
7. PLR 200648031 (Sept. 6, 2006): under Code section 512(b)(3), exempt organization received rent for shared access to and use of land pursuant to hunting leases.
8. PLR 201149003 (Aug. 31, 2011): tower REIT leased to tenants use of both exclusive and nonexclusive easements.
9. PLR 201206001 (Aug. 16, 2011): office REIT leased to tenants a shared master antenna (and related multiplexer and transmission equipment) atop a desirable broadcast location.
10. PLR 201250003 (Sept. 6, 2012): under Code section 7704(d), publicly traded partnership leased production handling capacity in both realty and associated personal property (machinery) to initial lessee and to other tenants to the extent of production handling capacity above the initial lessee's reserved amount.
11. PLR 201317001 (Jan. 16, 2013): prison REITs leased to governmental tenants nondedicated correctional facility space and associated common areas for prisoners.
12. PLR 201320007 (Feb. 11, 2013): same as PLR 201317001.
13. PLR 201423011 (Feb. 20, 2014): data center REIT leased nonexclusive access to the common area and shared infrastructure provided within a "meet-me" room.
14. PLR 201431018 (Apr. 22. 2014): billboard REIT leased to tenants shared access (on a temporal division basis) to tenants.
15. PLR 201431020 (Apr. 16, 2014): same as PLR 201431018.
16. PLR 201450017 (Aug. 29, 2014): tower REIT leased to tenants shared access to and use of distributed antenna system, including extensive personal property components therein.
17. PLR 201503010 (July 9, 2014): warehouse REIT leased to tenants nondedicated warehouse space for document storage.
18. PLR 201522002 (Feb. 27, 2015): same as PLRs 201431018 and 020.
19. PLR 201537020 (May 22, 2015): data center REIT leased to tenants shared access and use rights to business recovery room and associated computer terminals and other personal property therein.
20. PLR 201741002 (July 12, 2017): same as PLR 201450017.

21. PLR 201812009 (Dec. 14, 2017): luxury apartment REIT provided shared access to all tenants to several items of real and personal property, noting that, although services may be provided at the facilities, "the [facilities (inclusive of the personal property therein)] themselves are not services".
22. PLR 201901001 (July 10, 2018): fiber REIT leased wavelengths or capacity to tenants on existing fiber or cable network; several revenue models do not give tenants an exclusive right to a specifically identified strand or wavelength within such a strand, but instead provide a prescribed throughput along a wave.
23. PLR 201907001 (Nov. 16, 2018): pipeline and storage tank REIT leased access to nondedicated pipelines and commingled storage areas, in respect of tenants' fungible products, requiring prioritization in both storage and withdrawal as well as charges based on volume of use.
24. PLR 202012003 (Dec. 17, 2019): same as PLR 200428019.
25. PLR 202035008 (May 29, 2020): same as PLR 201901001.
26. PLR 202132002 (Feb. 5, 2021): similar to PLR 201901001, except that wavelengths may also go from one origin point to several different destination points along nondedicated pathways.
27. PLR 202133003 (Feb. 5, 2021): same as PLR 202132002.
28. PLR 202150014 (May 14, 2021): similar to PLR 201907001, except that some tenants lease dedicated tanks and pipelines, while other tenants lease a portion of the commingled storage and pipeline capacity.
29. PLR 202346008 (May 20, 2023): similar to PLR 202150014, except that all tenants use nondedicated pipelines.
30. PLR 202410005 (Dec. 13, 2023): similar to PLR 201907001, except limited to pipelines.
31. PLR 202413004 (Sept. 29, 2023): outdoor industrial storage REIT (apparently leasing storage space for shipping containers) leased tenants either dedicated space or nondedicated space.
32. PLR 202510011 (Nov. 14, 2024): amounts received from airlines under leases or licenses to use shared common areas (and common equipment within those areas) (the "common space charge") and specified exclusive space (the "exclusive space charge") within a terminal complex represents rent from real property.
33. PLR 202510012 (Nov. 14, 2024): same as PLR 202510011.
34. PLR 202520010 (Feb. 18, 2025): same as PLR 202012003.

[*] Although prior PLRs and other unpublished documents such as GCMs may not be relied upon as precedent per Code section 6110(k)(3), they provide meaningful insight into the thinking of the Internal Revenue Service with respect to issues that are not otherwise the subject of published authority. *See* Internal Revenue Manual section 4.10.7.2.9(3-4) (2022) ("A private letter ruling to a taxpayer . . . provide[s] insight with regard to the Service's position on the law and serve[s] as a guide. Existing private letter rulings and memorandums . . . may be used as a guide with other research material in formulating an area office position on an issue."). *See also Hanover Bank v. Comm'r*, 369 U.S. 672, 686 (1962) (private letter rulings "reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws"); *Rowan Cos. v. United States*, 452 U.S. 247, 261 n.17 (1981) (private letter rulings provide "evidence" about the application of the Code).