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With Iron Mountain Ruling, IRS Continues Consistent Approach to Defining REIT 'Real Estate'

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A significant amount of press attention has been given to an unusual press release filed with the SEC yesterday by Iron Mountain regarding its planned conversion to a real estate investment trust (REIT). Iron Mountain said that the IRS had informed the company that the IRS is “tentatively adverse” on Iron Mountain’s private letter ruling (PLR) request that racking structures constitute “real estate” for REIT purposes. The press release stated that a PLR confirming that racking structures are real property is necessary for Iron Mountain’s REIT conversion, presumably because of the significant value associated with these assets.

Racking structures are the steel storage racks inside Iron Mountain’s warehouses that hold the boxes stored by tenants. The IRS historically has taken the position that some racks are comparable to permanently secured supermarket counters and do not qualify as real property for REIT purposes. In that sense, close scrutiny by the IRS of these assets is not surprising, as the IRS carefully evaluates REIT PLR requests to ensure consistency with the REIT rules in the tax code and with the IRS’s prior rulings. In addition, there always will be areas in which changes in technology, for example, require the IRS to apply the definition of real property to new facts, requiring thorough analysis.

Iron Mountain stated that its “tentatively adverse” notice from the IRS occurred shortly before the company learned of the formation of a new internal IRS working group that is studying the current legal standards used to define “real estate” for purposes of the REIT provisions of the tax code. The IRS has been considering this issue for some time, and it has had the short term effect of slowing down the receipt of REIT PLRs. We believe the current heightened level of review is indicative of the agency’s continued desire to make careful and thoughtful decisions with regard to determining REIT status. We do not, however, believe that the IRS has changed its position on the fundamental definition of what assets constitute real property, nor do we believe the IRS will apply the REIT rules inconsistently with its prior and accurate interpretations of the law as written by Congress.

Recent REIT conversions that have garnered significant press attention are not a result of a change in the IRS definition of real estate. To be a REIT, a company must own real property. All of the companies that have recently converted to REITs own significant amounts of assets that qualified as real estate prior to their conversions — for each company, the relevant question was not *if* it could become a REIT, but rather *when* to become a REIT. Notwithstanding recent press stories to the contrary, the IRS has not expanded the definition of “real estate” to make the REIT structure more widely available than Congress originally intended. Rather, the IRS has interpreted the definition of real estate with remarkable consistency, applying the law strictly as Congress wrote it. Each ruling issued by the IRS with respect to REIT conversion simply has confirmed that the assets of these companies are real estate, as that term always has been understood.

Companies have become REITs over the years in response to economic incentives, including, in recent cases, the demand for high-yield investments at a time when alternative investment returns are at record lows. These types of investments are in short supply

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because of the Federal Reserve's policy of quantitative easing. The recent interest in REIT conversions is thus driven by market demand as opposed to a more permissive ruling posture at the IRS.

Iron Mountain's press release contains an unusual statement, speculating that the current scrutiny at the IRS will impact the timing of PLR requests submitted by other companies. While the ongoing study by the IRS may delay some rulings, PLR requests are confidential and individually considered based upon their particular facts. The position of the IRS with respect to Iron Mountain's assets should not be interpreted as any significant shift in the definition of assets qualifying as real property for REIT tax purposes. Companies considering REIT status have no reason to conclude that the focus on the meaning of real estate or the possible receipt of an adverse ruling by Iron Mountain will prevent their conversions.

At the end of the day, we are confident that, consistent with its prior practice, the IRS will remain consistent in its interpretation of what constitutes real estate. Assets that historically have not qualified as real estate will continue not to qualify. Assets that have historically fallen within the definition of real estate will continue to qualify as such. Assets for which no determination has been made will be given close scrutiny by the IRS.