



TaxNewsFlash

United States



No. 2022-157
May 20, 2022

PLR: Tax treatment of REIT's section 481(a) adjustment

The IRS today released a private letter ruling* in which it exercised its authority under section 856(c)(5)(J)(i) to treat a section 481(a) adjustment as includible in the taxable income of an electing real estate investment trust (REIT) over a four-year period, and not as gross income solely for purposes of the income tests.

Read [PLR 202220012](#) [PDF 74 KB] (released May 20, 2022, and dated February 22, 2022)

* Private letter rulings are taxpayer-specific rulings furnished by the IRS Office of Chief Counsel in response to requests made by taxpayers and can only be relied upon by the taxpayer to whom issued. Pursuant to section 6110(k)(3), written determinations such as private letter rulings are not intended to be relied upon by third parties and may not be cited as precedent. These written determinations may, however, offer an indication of the IRS's position on the issues addressed.

Summary

In the letter ruling, a corporation intending to elect to be taxed as a REIT filed a Form 3115, *Application for Change in Accounting Method*, to change its method of accounting for a certain interest expense with respect to its designated property, from not capitalizing to capitalizing the interest with respect to its designated property. This method of accounting change resulted in a positive adjustment under section 481(a).

The IRS reasoned that excluding the section 481(a) adjustment from the taxpayer's gross income solely for the income test purposes would be consistent with the purposes of the REIT rules. Accordingly, the IRS ruled that, under section 856(c)(5)(J)(i), the section 481(a) adjustment would not be treated as gross income for purposes of section 856(c)(2) or (3).

KPMG observation

The ruling released today is consistent with the findings in earlier letter rulings. The section 481(a) adjustment is not actual income, but rather the reversal of a prior deduction—a common thread found in these earlier letter rulings. See, e.g., PLR 202213003 (in which the adjustment relates to a change to allocate and capitalize certain administrative and mixed service costs related to the property, rather than deducting these costs) and PLRs 202024003, 202035008, 201652012, and 201537020 (in which the adjustments relate to depreciation and amortization of certain assets).

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