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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: MAY 16 2000

Contact Person:

ID Number:

Uniform Issue List: 514.06-00

Telephone Number:

OP:E:EO:T2

Legend:

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B =
C =
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Dear Applicant:

This letter is in reply to your request for a ruling regarding the effect of a proposed transaction in which you will lease a portion of a facility you purchased with borrowed funds to B.

You are an organization described in sections 501(c)(3) and 509(a)(1)/170(b)(1)(A)(vi) of the Internal Revenue Code. Your Articles of Incorporation state that you were organized to stabilize urban districts by developing and implementing human service programs. Your goals are to improve the quality of life of residents of inner city D by fostering employment and alleviating poverty. You will accomplish this by providing social services related to job training.

In specific, you seek to hold economic summits and job fairs. You will promote the creation of small businesses in D by sponsoring seminars and inviting financial institutions and potential small business owners. You seek to encourage community based banking and home-ownership through seminars. You seek to

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establish day care centers which provide second and third shift care as well as care for the mentally challenged.

Your facility is situated in an area of D where there are high rates of unemployment and poverty. You intend to lease a portion of this property to B and in turn B will sublet some of the property to C. B will use the facility to provide "one stop shopping" so that the recipients of your services will be able to take advantage of B's services in the same location. C, which is organized under section 501(c)(3), will use the facility to provide child care services to persons seeking to make use of B's and your services; this will do away with the parent's need to travel throughout the city with their children. The ultimate goal of this "joint venture" is to better enable your clients to make use of B's services as well as your own.

You perform several activities at your facility. You plan activities to be held at an adjacent recreational facility for people who are finishing school and preparing to work. You work to connect your target population with job opportunities and public transportation. You help to create a support network for extended families that simultaneously care for their elders and children. Lastly, you have established a support network to provide information on transportation, child care, elder care, affordable housing, money management, home ownership, and health care. Your programs are intended to increase the participation and the effectiveness of B's programs.

B will use your facility to bring support services directly to the residents of inner city D who are lacking job training, employment counseling, life education skills, and child care. Specifically, B will offer welfare counseling, job training, and assistance for unemployed and underemployed individuals at your facility. Together you and B intend to combat poverty and social deprivation in D.

You request the following ruling:

The lease of a portion of the property you own to B is substantially related to your charitable purposes so that rents received will not be treated as income from debt-financed property within the meaning of section 514 of the Code or otherwise as unrelated business income within the meaning of section 512 of the Code.

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, scientific, or certain other purposes.

Section 511(a)(1) of the Code imposes a tax on the unrelated business income of organizations described in section 501(c)(3).

Section 512(b)(3)(A)(i) of the Code excludes rents from real property from the definition of unrelated business income. However, section 512(b)(4) eliminates this exclusion in the case of debt-financed property.

Section 514(b)(1) of the Code defines debt-financed property as "any property which is held to produce income and with respect to which there is an acquisition indebtedness."

Section 514(c)(1) of the Code states "for purposes of this section, the term 'acquisition indebtedness' means, with respect to any debt-financed property, the unpaid amount of the indebtedness incurred by the organization in acquiring or improving such property."

Section 514(c)(2) of the Code states that when property is acquired subject to a mortgage or other similar lien, the amount of the indebtedness secured by such mortgage or lien shall be considered as an indebtedness of the organization incurred in acquiring such property.

Section 514(b)(1)(A) of the Code states that "any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501" is not debt-financed property.

Section 1.514(b)-1(b)(1) of the Regulations states that in making the determination of whether the exclusion set forth in section 514(b)(1)(A)(i) is applicable, the principles established in section 1.513-1 of the Regulations are applicable.

Section 1.513-1(d)(2) of the Regulations states that trade or business is related to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income); and it is substantially related for purposes of section 513, only if the causal relationship is a substantial one.

Rev. Rul. 69-572, 1969-2 C.B. 119 deals with an organization which was created to construct and maintain a building to house member agencies of a community chest, so as to facilitate

coordination among the agencies and to make more efficient use of the agencies' volunteer labor. The organization leases the building it owns to agencies for substantially less than the going rate for comparable commercial facilities. The organization demonstrated that its operations materially aided its tenants in the performance of their respective charitable functions. In addition, the proximity of different agencies enabled them to make frequent use of volunteer labor on an efficient basis and to promote the common interests of the agencies through the effective coordination of operations and services. Because of the close connection between this organization and the charitable functions of the tenant-organizations, the rental of the organization's facilities at rates substantially below their fair rental value, and the operation by the organization with the intention of realizing an amount sufficient only to meet their annual operating costs, the organization did not generate unrelated business income.

Rev. Rul. 77-47, 1977-1 C.B. 157 involved an exempt organization which acquired historically or architecturally significant buildings and promoted the appreciation of history and architecture by opening the buildings to the public. The organization leased the building to another entity and the public was neither accommodated nor encouraged to view the premises. The organization also leased some the buildings to generate income for itself and not for purposes that related to the building's historical or architectural importance. This activity generated unrelated business income.

Your mission is to improve the quality of life of individuals and families in inner city D by fostering employment and alleviating poverty. You will accomplish this by providing social services related to job training. You will use the facility you purchased with borrowed funds to provide social services related to employment and establish a support network to provide information on transportation, child care, elder care, affordable housing, money management, homeownership, and health care. You will lease a portion of the facility to B which will use the facility to provide services such as welfare counseling, job training, and assistance for unemployed and underemployed individuals. B will sublet a portion of the facility to C and C will use the facility to provide child care services. C's child care services will do away with the need of parents to travel throughout the city with children to make use of your and B's services. The services which B and you provide address similar problems and provide services to the same population. The services to be provided appear to be substantially related to the

performance of the charitable purpose constituting the basis for your exemption under section 501 of the Code.

Accordingly, we rule as follows:

The lease of a portion of the property you own to B is substantially related to your charitable purposes so that rents received will not be treated as income from debt-financed property within the meaning of section 514 of the Code and will not be unrelated business income within the meaning of section 512 of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which they are based. Any such change should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service office. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. A copy of this ruling is being forwarded to the Ohio TE/GE Customer Service office.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,
(signed) Garland A. Carter

Garland A. Carter
Manager, Exempt Organizations
Technical Group 2