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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

OCT 29 2002

NO THIRD PARTY CONTACTS

SIN: 501.03-00
501.03-08
501.03-25
513.00-00

Employer Identification Number:

Dear Sir or Madam:

This is in response to your letter of September 30, 2002, in which you request a private letter ruling that the provision of student-housing will not adversely affect your exempt status under section 501(c)(3) of the Internal Revenue Code, or your status as an entity which is not a private foundation under section 509 of the Code. In addition, you request a ruling that the renting of available space to students will not result in unrelated business income tax under sections 511 through 513.

You have been recognized as exempt from federal income tax under section 501(a) of the Code by virtue of being an organization described in section 501(c)(3). You have also been classified as a publicly supported organization described in sections 509(a)(1) and 170(b)(1)(A)(vi). You were created for charitable purposes including community development, and the fostering of low-income housing.

You have been active in various communities providing low-income housing for those who qualify for assistance. You have been approached by community leaders and colleges familiar with your mission to assist them in addressing student-housing needs. You indicate that you are particularly interested in helping in this area since it furthers your holistic approach to meeting low-income housing needs. You believe that providing educational opportunities to low-income and other students reduces the risk that those individuals will need low-income housing in the future.

You propose to review a needs assessment for student-housing from interested communities and colleges prior to acquiring or developing any facilities. Once you have established the need for a facility in collaboration with the interested community and college, you will create a separate Limited Liability Company, (LLC) to own and operate the facility. You will be the sole member of each LLC. Each LLC will have a five-member management board which will include one member from the college in the community, two community members and

two members selected by you. The Articles of Incorporation of each LLC will name the college or community that it will support and cannot be changed without the unanimous consent of the management board.

Under your proposed transaction, each LLC will purchase existing housing from an unrelated for-profit corporation with the first group of properties coming from the same seller who is not related to you. The purchase price will be determined on an arm's-length fair-market-value basis with appraisals supporting the amount paid for each property. The housing owned and operated by each LLC will be leased to students of the named college. Initially, some of the housing units you acquire may house some non-students. You represent that any non-student holdover tenants will vacate the property within a reasonable transition period of not more than one year. Thereafter, all of the units will be converted to student-housing. The LLCs may hire a manager to manage the day-to-day operations of the facility. If an outside manager is used, a management agreement would be negotiated on an arm's length basis with an unrelated third party.

You plan to provide scholarships, counseling and other services to students, including low-income students to the extent funds are available. In addition, each LLC will provide a number of counseling and tutoring services to supplement the college and community activities. Virtually all of the net cash flow from the facilities will be used to provide scholarships for low-income individuals to cover rental charges. Up to 5% of the available units will be made available for those on housing scholarships provided the funds are available. The housing scholarships will provide free housing for students who would qualify based upon income tests. General scholarships may also be provided to students based on need if funds are available.

The LLCs will be required to submit reports, at least annually, to the college and community regarding its planned activities and goals for the next year. In addition, you plan that each LLC will work with prospective students in lower-income areas to help them locate additional financial aid for tuition, books, housing and fees.

Section 501(c)(3) of the Code provides, in part, that an organization is exempt from Federal income tax if it is organized and operated exclusively for charitable purposes, and if no part of the net earnings of the organization inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education as well as relieving the poor, distressed or underprivileged, lessening the burdens of government, and promotion of social welfare by organizations designed to lessen neighborhood tensions, eliminate prejudice and discrimination, defend human and civil rights secured by law, or combat community deterioration and juvenile delinquency.

Section 509(a)(2) of the Code provides that an organization will be a public charity (and not a private foundation) if it normally receives more than one-third of its support in each taxable year from gross receipts from performance of services or furnishing of facilities, among other, in an activity which is not an unrelated trade or business and not more than one-third of its support from gross investment income.

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

Section 512(a)(1) of the Code defines "unrelated business taxable income" as the gross income an organization derives from any unrelated trade or business (defined in section 513) it regularly carries on, less allowable deductions, with certain modifications.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the organization's need for funds or the use it makes of the profits derived) to the organization's exercise or performance of the purpose or function constituting the basis for its exemption under section 501.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than production of income); and it is "substantially related" only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those exempt purposes.

The "check the box" regulations at section 301.7701 of the Procedure and Administration Regulations allow certain organizations to choose treatment as either a partnership or a corporation, or to be treated as a disregarded entity for federal tax purposes. Announcement 99-102, 1999-43 I.R.B. 545, confirms that a single member limited liability company (LLC) is presumed to be a disregarded entity. Where the sole member is a tax-exempt organization described in section 501(c)(3), the LLC is treated as an activity of the tax-exempt organization.

An organization that accomplishes its charitable purposes through a program of providing housing for low and, in certain circumstances, moderate income families, may be exempt under section 501(c)(3) of the Code. Rev. Rul. 70-585, 1970-2 C.B. 115 describes four different nonprofit housing organizations created to lessen neighborhood tensions, eliminate prejudice and discrimination, and combat community deterioration by providing housing for low or moderate income families. Three of the organizations qualify for exemption under section 501(c)(3).

Rev. Rul. 76-419, 1976-2 C.B. 146, holds that an organization that encourages businesses to locate new facilities in an economically depressed area to provide more employment opportunities for low-income residents in the area, is organized and operated for the charitable purpose of promoting social welfare by relieving the poor and distressed,

lessening neighborhood tensions and combating community deterioration.

Rev. Rul. 74-587, 1974-2 C.B. 162, holds that an organization that devotes its resources to programs to stimulate economic development in high density urban areas inhabited mainly by low income minority or other disadvantaged groups qualifies for exemption under section 501(c)(3) of the Code. The organization made loans to and purchased equity interests in businesses unable to obtain funds from conventional sources. The organization established that its investments were not undertaken for profit or gain but to advance its charitable goals.

Rev. Rul. 67-217, 1967- 2 C.B. 181, recognizes an organization formed to provide housing and food service exclusively for students and faculty of a specific university lacking such facilities as exempt under section 501(c)(3) of the Code. The housing facility was constructed by the organization on land near the university and made available to the students of the university at rates comparable to those offered by the university in its own facilities. While the facility was run by a commercial management company, any surplus from operations was donated to the university and the university had an option to purchase the facility at any time for an amount equal to the outstanding indebtedness. Providing the housing under these circumstances served to advance education.

You indicate that none of the single member LLCs you will create will elect to be treated as a corporation. Accordingly, the single member LLCs will be treated as disregarded entities and their activities will be treated as your own pursuant to Announcement 99-102 and section 301.7701 of the regulations.

You have indicated that your primary purposes are charitable in that you provide low-income housing in the manner approved in Rev. Rul. 70-585. Your activities stimulate economic development and create jobs in your target communities, which are economically depressed areas. Your undertaking the provision and expansion of housing for low-income students through the use of housing scholarships as described above furthers your purposes of relieving poverty and combating community deterioration in a manner similar to the organizations described in Rev. Ruls. 74-587 and 76-419.

In addition, developing and operating student-housing facilities in cooperation with a specific college and community furthers your charitable purposes by advancing education in a manner similar to the organization described in Rev. Rul. 67-217. You will be helping the college fulfill its educational purposes and aiding its students to attain an education. This activity advances education and is charitable within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations.

Because your proposed activities will contribute importantly to the accomplishment of your exempt purposes within the meaning of section 1.513-1(d)(2) of the regulations, they will not be considered "unrelated trade or business" within the meaning of section 513. The income derived from these activities will not be considered unrelated business taxable income under section 512(a)(1) of the Code.

Based on the above discussion, we rule as follows:

1. The provision of student housing to various communities as described above will not adversely affect your exempt status under section 501(c)(3) of the Code or your foundation classification under section 509(a).

2. Your leasing of the facilities to students as described above will not constitute an unrelated trade or business within the meaning of section 513(a) of the Code and will not result in your receipt of unrelated business taxable income under section 511.

3. Your creation of single member limited liability company (LLC) to own and operate each student-housing facility, will not adversely affect your exempt status under section 501(c)(3) of the Code. Each LLC will be treated as a disregarded entity under section 301.7701 of the Procedure and Administration Regulations, and its activities will be treated as your own.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service.

Except as specifically ruled upon above, no opinion is expressed concerning the federal tax treatment of the transaction described above under any other provision of the Code.

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 by others as precedent.

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

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4