Internal Revenue Service

Department of the Treasury

Washington, DC 20224 200030033

UIL: 512.01-01

Contact Person:

Telephone Number:

In Reference to:

T:EO:RA:T:3

Date: MAY 1 2000

E.I.N.:

LEGEND:

X:

Y:

Z:

Dear Sir or Madam:

This is in response to a ruling request dated September 1, 1999, submitted on your behalf by your authorized representatives. You are seeking rulings on the federal income tax consequences of certain rental income that you will receive as more fully set forth below.

You are an organization that has been recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, and has been classified as a publicly supported organization described in sections 509(a)(1) and 170(b)(1)(A)(vi).

Your stated mission is to act as a catalyst in order to contribute to the long-range development of a successful Black entrepreneurial and business class in X, with emphasis on the Z area in Y. You promote the creation of jobs for African-Americans, specifically Z residents, promote the development of new businesses and industries and the expansion of existing businesses and industries within Z, and foster the establishment of Black-owned and operated business enterprises.

Among your many achievements over the past 17 years, you have (i) disbursed over $20 million in loans or equity funds to African-American enterprises in X, (ii) assisted in creating over 50 new African-American enterprises, (iii) provided offices and incubator space for over 100 minority-owned firms, and (iv) procured over $10 million worth of new business contracts for over 200 Black-owned enterprises.

In order to facilitate economic development in the X Enterprise Zone wherein Z is located, you submitted a proposal to the Board of County Commissioners of X to develop, design, construct and manage an office complex in Z located near a Y rapid transit system station (the "Project").

The Project will consist of approximately 200,000 square feet of office space. The primary tenant will be the X government, which will use the office facility to accommodate certain of its administrative offices. It is estimated that X will lease approximately 95% of the Project's available space for these administrative offices. Any remaining space available will be leased to either minority-owned businesses at below-market rates or other section 501(c)(3) organizations.

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You expect that the project will have the following economic impact on and benefits to the African-American Inner City Community:

In excess of 200 direct temporary construction jobs will be created by the Project, over 60% of which jobs are expected to be filled by minorities;

The relocation of X's administrative offices to Z will provide Z residents with potential employers in their community, making it possible for those residents without their own method of transportation to obtain jobs which were previously geographically unreachable. X indicates that one of its administrative offices will have approximately 100 job openings after its relocation to the Project's office complex;

The office complex will be located in one of X's Enterprise Zones located in X's Empowerment Zone, which is one of the most economically depressed areas of X. The Enterprise/Empowerment Zone (the "Zone") contains many of X's poorest communities. The poverty rate within the Zone has grown at three times the poverty rate of X as a whole, and now stands at 48%. The African-American poverty rate, in particular, within the Zone is 53%. The unemployment rate within the Zone is estimated to be 13%–twice the rate of unemployment in X as a whole. In order to improve the economic conditions and employment opportunities of the residents within the Zone, new businesses need to be brought in to the area to generate jobs. These new businesses would need a "critical mass" of customers in order to prosper. In addition to the Project's contribution to the area's image and beautification, the estimated 800 employees it will house will contribute to the economy through their consumption demands. Thus, the Project's office complex would become the "critical mass" that will not only facilitate a clean and safe environment, but will foster economic growth and development. The Project will contribute to the Zone's image and economic revitalization and generate employment opportunities.

An African-American owned property management company will be formed to manage the facilities of the Project and its financing, and an African-American owned asset management company will be formed to manage your real estate portfolio, of which the Project will be the greatest asset. It is anticipated that the Project will give these new companies the experience necessary for them to seek similar opportunities in the future.

The Project will be constructed on land that is leased to you by X pursuant to a 30 year ground lease. Substantially all of the construction of the Project will be funded by the sale of Industrial Development Bonds by the Industrial Development Authority (the "Bonds"). You will receive rental income from the lease of the Project's office space to X initially at $17 per square foot. Of that amount, initially $7 per square foot will go to the maintenance and operation of the facility (based on the parties' best estimate as to the actual costs of such maintenance and operation) and $10 per square foot will go to you to pay the debt-service on the Bonds and for use by you for your other exempt activities. After the first year, X will be charged a rent equal to the sum of: (i) $10 per square foot, plus (ii) the actual costs of operating and maintaining the facility. The rent expected to be charged to X for the rental space is below the market rate for such a facility. In addition, the cost to you with respect to the development and construction of the Project will be less than the costs X would have incurred if X were directly involved in the development and construction of the Project. Moreover, the present value, over 30 years, of the total cost incurred by X with respect to the Project (the total lease

payments and the cost of relocation) is less than the present value of what X currently pays to lease the present locations of the relocating administrative offices. You expect to charge any minority-owned businesses a rental rate of less than $17 per square foot for any space leased in the Project that is below market rate.

The gross rental revenue that you expect to receive from the Project will constitute a substantial portion of your total annual revenue, and the net revenue expected to be derived will constitute a substantial portion of your annual net revenue, which net revenue will, in turn, be used to further your exempt purposes.

Supplemental information submitted in support of your ruling request includes a copy of the proposal that you submitted to X with respect to the Project. You also included a copy of a Feasibility Analysis on relocating X's offices. The feasibility of X relocating its office facilities was estimated based on the following factors:

(1) Costs

(2) X's ability to finance a new office building

(3) Effect on X's operations

(4) Effect on employee commuting and safety

(5) The zoning and land use at the site and the compatibility of an office development with adjacent land uses, and the environmental conditions at the site.

The Feasibility Analysis concluded that relocation to the new site would be less costly to X than remaining at the present site under virtually all circumstances. X's costs would be reduced by as much as one-third below the current level. X's overall operations would not be materially affected by relocating to the new site.

Also included in your supplemental submission was a letter from X containing X's assessment of your proposal, indicating that the Project would produce intangible benefits including economic stimulation in the communities through temporary and permanent jobs, potential increased use of mass transit, thereby reducing the subsidies paid by X for its operations, and the retention by X of a major asset at the expiration of the lease.

Section 501(c)(3) of the Code provides an exemption from federal income tax for organizations organized and operated exclusively for charitable, educational, and other purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable," as used in section 501(c)(3) of the Code is used in its generally accepted legal sense, and is not limited by the separate enumeration in section 501(c)(3) of purposes that fall within the broad outline of "charity" as developed by judicial decisions. Thus, the term "charitable" includes 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

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rights secured by law, or combat community deterioration and juvenile delinquency.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations exempt under section 501(c).

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 1.512(b)-1(c)(2) of the regulations provides (with certain exceptions not here relevant) that rents from real property (including personal property leased with the real property) and the deductions directly connected therewith shall also be excluded in computing unrelated business taxable income.

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 delineates when trade or business is "substantially related" to an organization's exempt purposes. The regulation provides that for the conduct of trade or business to be substantially related to purposes for which exemption is granted, producing or distributing the goods or performing the services must contribute importantly to accomplishing those purposes.

Section 514(a) of the Code says that in computing unrelated business taxable income under section 512, there shall be included certain amounts of income, less allowable deductions, derived from debt-financed property.

Section 514(b)(1)(A) of the Code excludes from the definition of "debt-financed property," for purposes of section 514, any property substantially all the use of which is substantially related (aside from the organization's need for income or funds) to the organization's exercise or performance of its exempt purpose.

Rev. Rul. 76-419, 1976-2 C.B. 146, holds that an organization that encouraged businesses to locate new facilities in an economically depressed area, to provide more employment opportunities for low-income residents in the area, was organized and operated for the charitable purpose of promoting social welfare by organizations designed to relieve the poor and distressed, to lessen neighborhood tensions, or to combat community deterioration.

Rev. Rul. 74-587, 1974-2 C.B. 162, holds that an organization that devoted its resources to programs to stimulate economic development in high density urban areas inhabited mainly by low income minority or other disadvantaged groups qualified 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. Funds for its program were obtained from foundation grants and public contributions.

Rev. Ruls. 85-1 and 85-2, 1985-1 C.B. 178, describe organizations that are lessening the burdens of government and, therefore, qualify for exemption under section 501(c)(3) of the Code. The Rev. Ruls. identify the following criteria to determine whether an organization's activities are lessening the burdens of government: 1) whether the governmental unit considers the organization's activities to be its burden, and 2) whether these activities actually lessen the burden of the governmental unit. An activity is a burden of the government if there is an objective manifestation by the governmental unit that it considers the activities to be its burden.

One of your major purposes is the stimulation of economic development and the creation of jobs in Z, an economically depressed area. Like the organizations discussed in Rev. Ruls. 74-587 and 76-419, both cited above, the development, construction, ownership, leasing and operation of the Project in Z will combat community deterioration and stimulate the creation of jobs for residents of the area in a number of ways, such as by inducing businesses to relocate to the area. Based on all the information submitted, we conclude that the Project contributes importantly to your exempt charitable purposes under section 501(c)(3) of the Code and, therefore, is substantially related to your exempt purposes, as required by section 513(a).

In addition, the supplemental information you provided, such as the Feasibility Analysis and X's assessment of the proposal indicates that your activities in association with the Project are something that X itself would do, and that your undertaking this project relieves X of the responsibility of conducting the activity. Under these circumstances, and in accordance with Rev. Ruls. 85-1 and 85-2, supra, we conclude that you are relieving a burden of government within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations.

Since the Project relieves a burden of government, and, otherwise contributes importantly to your other exempt purposes, it will not adversely affect your exempt status under section 501(c)(3) of the Code. Likewise, your activities in connection with the Project will not constitute an unrelated trade or business within the meaning of section 513(a). Furthermore, since the use of the office building is substantially related to your exempt purposes, the building is excluded from the definition of debt-financed property pursuant to section 514(b)(1)(A).

Based on the information submitted and the representations made therein, we rule as follows:

(1) Your development, construction, ownership, leasing and operation of the Project does not constitute unrelated trade or business within the meaning of section 513(a) of the Code.

(2) The gross income derived from the lease of the Project's office space does not constitute unrelated business taxable income within the meaning of section 512 of the Code.

(3) The construction, ownership, and leasing of the Project will not adversely affect your exempt status under section 501(c)(3) of the Code.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based.

These rulings are directed only to the organization that requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited by others as precedent.

Please keep a copy of this ruling letter in your permanent records.

Sincerely,

Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3