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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Dear Sir or Madam:

This is in response to B's private letter ruling request as supplemented, in which B requested certain rulings as described below.

B is recognized as an exempt organization under section 501(c)(3) of the Internal Revenue Code (the "Code"). C is the sole member of B. C was established to serve as the parent corporation of a group of corporations (the "Group"). The Group is the family of G-related companies in E. C is also the sole member of D, E's oldest and largest F. Both C and D are recognized as exempt organizations under section 501(c)(3). B, C, and D are all classified as .

B was incorporated for the purpose of receiving and administering funds for the maintenance, expansion, and general support of D. Among B's specific purposes are: (1) to

hold, manage, invest, reinvest, purchase, sell, lease, mortgage or otherwise dispose of lands, securities, and other investment properties belonging to or owned by B; and (2) to distribute such of its income as determined by the Board of Trustees to D, or as directed by C for the support and continued development of the activities of D and the support of F and G. For its fiscal year y and z, B had net operating income of $ x and $ x on operating revenues of $ x and $ x, respectively. B also earned $ x and $ x of investment income on its short-term investments and long-term pooled investment fund for fiscal years y and z, respectively. B had $ x and $ x of pre-tax debt-financed unrelated business income from its operations in fiscal years y and z, respectively. B's net income for fiscal years y and z was $ x and $ x, of which $ x and $ x was transferred to other members of the Group, primarily to D.

B holds a substantial amount of that was transferred from D in aa, including H (collectively, the "Property") that B operates and in which B leases or licenses space to various tenants. The Property is either in deteriorated condition or is underutilized because of poor building design. B wants to completely redevelop the Property into an I center that would not include J use. The proposed redevelopment will require the removal of all existing buildings. Although the Property represents only a fraction of B's acreage, it is significant to B in terms of land valuation and income.

In connection with the redevelopment of the Property, B's employees will negotiate contracts with independent contractors that will perform the actual construction and development work, approve construction plans, and monitor compliance of all work performed by independent contractors. Alternatively, if the Property is leased to one or more ground lessees, the lessees of the Property may conduct all or some of the construction and rehabilitation work on the Property. B would retain the right to review and approve construction plans and related construction contracts. B would also monitor compliance of all work performed by the lessees or independent contractors hired by the lessees.

Through its employees and independent contractors, B will negotiate the terms of leases. B will not enter into any lease arrangement under which the determination of the amount of rent paid by a tenant is based on the income or profit derived from the leased property. However, B may enter into a lease arrangement under which the determination of the amount of rent paid by a tenant is based on a known percentage of the gross receipts or sales from the leased property.

Through its employees or through independent contractors, B intends to provide certain services with respect to the Property. These services would include pest control, landscaping, fire protection, and routine security guard services in the common areas of the Property. B will provide repair services, such as repairing and repainting buildings and other structures, repairing roofs, and repairing or replacing ducts, conduits. In addition, B will provide routine common area janitorial and cleaning services. These services will include the cleaning of windows, public entrances, exits, stairwells, lobbies, and restrooms. All such maintenance, repair, and cleaning services that B intends to provide are ordinary, necessary, and customary services provided by owners of leased property in the state. Tenants will reimburse B for their pro rata share of the cost of these services, as well as their pro rata share of certain overhead

costs incurred by B in providing these services.

B will cause lines and conduits for the usual and customary utility services to be connected to the leased premises of the tenants of the Property. B will cause the appropriate utility company to provide utility services such as electricity, gas and water to its tenants, and will charge tenants for their allocable share of utilities. B will permit local telephone companies to install pay telephones in the common areas of the Property, and may provide space for these telephones in exchange for a rental fee. B will permit the installation of newspaper and other vending machines at certain locations in the common areas of the Property for a rental or licensing fee.

B may encourage or require tenants of the Property to participate in a "merchant association" to support and coordinate advertisements and promotions for the Property. B may also encourage or require tenants to participate in a marketing fund. The money in the marketing fund would be used for promotional expenditures for the Property as a whole and to induce the public to frequent the property. In the aggregate, these marketing and promotional activities will amount to less than seven percent of the total expenses associated with operating the Property and less than three percent of B's revenues from the Property.

The Property will include parking lots for use by tenants and customers of the Property. B will not directly operate the parking lots but, instead, will lease the parking lots to a third-party operator. B will not enter into any parking lot lease under which the amount paid by the third-party operator is based on the profits derived from the parking lot.

In addition to the redevelopment of the Property, B expects to maintain, renovate, develop, and improve its other land holdings over the next four years. This includes renovation of a K into a state-of-the-art G conferencing center that will be used primarily by D.

The following rulings are requested:

1. After taking into account B's existing real estate activities, the proposed renovations to the K and the proposed redevelopment of the Property (whether done by B itself, by a lessee of the Property, or by a partnership in which B is a partner) will not provide the basis for the revocation of B's exempt status under section 501(c)(3) of the Code.

2. After taking into account B's existing real estate activities, B's increased rental activities in connection with the redeveloped Property (including negotiating leases, collecting rents, and maintaining the Property for rent) will not provide a basis for revocation of B's exempt status under section 501(c)(3) of the Code.

3. After taking into account B's existing real estate activities, B's proposed renovations to the K, B's proposed redevelopment of the Property, and B's increased rental activities with respect to the Property will not provide a basis for finding that B is a feeder organization for purposes of section 502 of the Code.

4. The redevelopment activities undertaken by B at the Property will not cause the income

generated by the Property to be treated as something other than "rents from real property" as set forth in section 512(b)(3) of the Code.

5. The lease management activities undertaken by B at the Property will not cause the income generated by the Property to be treated as something other than "rents from real property" as set forth in section 512(b)(3) of the Code.

6. The customary owner services related to the Property, including (a) maintenance, repair, and cleaning services, (b) utility services, (c) additional leasing services, and (d) marketing and promotional activities related to the Property will not cause the income generated by the Property to be treated as something other than "rents from real property" as set forth in section 512(b)(3) of the Code.

7. Even if the Service determines that the marketing and promotional activities related to the Property fail to meet the two-prong test of section 1.512(b)-1(c)(5) of the Income Tax Regulations (the "regulations"), the income received from the operation of the Property still constitutes "rents from real property" within the meaning of section 512(b)(3) of the Code since the marketing and promotional activities are insubstantial in relation to all of the permissible activities carried on in operating the Property.

8. The rental income from the parking lots on the Property will be treated as "rents from real property" as set forth in section 512(b)(3) of the Code, and the services provided by the Taxpayer related to the parking lots will not cause such lease income to be treated as something other than rents from real property as set forth in section 512(b)(3).

Section 501(c)(3) of the Code exempts from Federal income tax organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513 of the Code. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

Rev. Rul. 64-182, 1964-1 C.B. 186, describes an organization that derives its income principally from the rental of space in a large commercial office building that it owns, maintains and operates. The charitable purposes of the organization are carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such other organizations for charitable purposes. The organization is deemed to meet the primary purpose test of section 1.501(c)(3)-1(e)(1) of the regulations, and to be entitled to exemption from Federal income tax under section 501(c)(3), where it is shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources.

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 502(b)(1) of the Code provides that the term "trade or business" shall not include the deriving of rents which would be excluded under section 512(b)(3), if section 512 applied to the organization.

Section 511 of the Code imposes a tax on the unrelated business taxable income (as defined in section 512) of certain organizations otherwise exempt from Federal income tax.

Section 512(a)(1) of the Code provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by chapter 1 of the Code which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in section 512(b).

The term "unrelated trade or business," as defined in section 513 of the Code, means any trade or business, with certain specified exceptions, the conduct of which is not substantially related (aside from the needs of the organization for income or funds of the use it makes of the profits derived) to the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 512(b)(3) of the Code provides that, in determining unrelated business taxable income, there shall be excluded all rents from real property and all rents from personal property leased with such real property if the rents attributable to such personal property are an incidental amount of the total rents received under the lease.

Section 1.512(b)-1(c)(2)(i) of the regulations provides that, for taxable years beginning after December 31, 1969, rents from property described in section 1.512(b)-1(c)(2)(ii), and the deductions directly connected with them, shall be excluded in computing unrelated business taxable income. However, certain rents from, and certain deductions in connection with, debt-financed property (as defined in section 514(b)) shall be included in computing unrelated business taxable income.

Section 1.512(b)-1(c)(2)(ii) of the regulations provides that the rents which are excluded from unrelated business taxable income under section 512(b)(3)(A) are: (a) all rents from real property; and (b) all rents from personal property leased with real property if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease.

Section 1.512(b)-1(c)(2)(iii)(b) of the regulations provides that section 1.512(b)-1(c)(2)(ii) shall not apply if the determination of the amount of such rents depends in whole or in part on the income or profits derived by any person from the property leased, other than an amount

based on a fixed percentage or percentages of the gross receipts or sales.

Section 1.512(b)-1(c)(5) of the regulations provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or for the use or occupancy of space in parking lots, warehouses, or storage garages, does not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, the collection of trash, etc., are not considered as services rendered to the occupant.

Rev. Rul. 80-298, 1980-2 C.B. 197, held that an exempt university that leased its stadium to a professional football team for several months of the year and provided utilities, ground maintenance, dressing room linen, and stadium security services was engaged in an unrelated trade or business. The activity did not have a substantial causal relationship to the achievement of the university's exempt purposes as required by 1.513-1(d)(2) of the regulations. In addition, because the organization provided substantial services for the convenience of the lessee that went beyond those usually rendered in connection with the rental of space for occupancy only, the income could not be excluded from unrelated business taxable income as rent from real property under section 512(b)(3) of the Code and section 1.512(b)-1(c)(5) of the regulations.

Section 512(b)(4) of the Code provides that, in the case of debt-financed property (as defined in section 514), there shall be included as an item of gross income derived from an unrelated trade or business the amount ascertained under section 514(a)(1), and there shall be allowed as a deduction the amount ascertained under section 514(a)(2).

Section 514(b)(1) of the Code provides that the term "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in section 514(c)) at any time during the taxable year.

The requested rulings are discussed below:

1. and 2.

Aside from express statutory limitations on business activity, such as section 502 of the Code, there is no quantitative limitation on the amount of unrelated business an organization may engage in under section 501(c)(3) other than that implicit in the fundamental requirement of charity law that charity property must be administered exclusively in the beneficial interest of the charitable purpose to which the property is dedicated.

Section 1.501(c)(3)-1(e) of the regulations provides that a section 501(c)(3) organization may operate substantial business activities so long as the organization is not organized or operated for the primary purpose of carrying on unrelated trade or business. The test is

satisfied if the facts show that an organization is carrying on a charitable program reasonably commensurate with its financial resources, including income from business activities.

The organization described in Rev. Rul. 64-182, *supra*, carried out its charitable purposes by making contributions and grants to other charitable organizations from income derived from renting space in a commercial office building. The organization was deemed to meet the primary purpose test upon a showing that its program of contributions and grants was commensurate in scope with the organization's financial resources.

B has historically distributed a substantial amount of its annual net income to members of the Group. For the fiscal years bb through z, B averaged net income of $ x of which $ x, on average, was transferred to the Group for its use in carrying out the Group's charitable activities. These distributions represent, on average, [illegible]% of net income and % of operating income, which excludes investment income retained in the long-term investment portfolio. The income retained by B will be used either to finance the improvements to B's properties or will eventually be distributed to members of the Group for use in their charitable activities (B is required by its charter of incorporation to distribute its income to D or the other members of the Group). Under the facts and circumstances as represented, B is carrying on a charitable program commensurate in scope with its resources. Therefore, B is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

3.

Section 502 of the Code is a narrowly drawn exception to the general principal that the administration of property exclusively in the beneficial interest of charity is the ultimate test of whether an organization is being operated for a charitable purpose under section 501(c)(3). Section 502 denies exemption to organizations operated for the primary purpose of carrying on a trade or business for profit where such organization's sole charitable activity is that its profits are payable to organizations exempt from taxation under section 501. In determining whether an organization is engaged in a trade or business, section 502(b)(1) excludes the deriving of rents that would be excluded from unrelated business taxable income under section 512(b)(3), if section 512 applied to the organization. However, income derived from debt-financed property is considered income from an unrelated trade or business under section 512(b)(4) in the amount ascertained under section 514(a), and, therefore, not excluded under section 512(b)(3). Since such income from debt-financed property would not be excluded under section 512(b)(3), the deriving of such income would be considered a trade or business under section 502(a).

The majority of B's real estate rental activities fall within the protected class of rents set forth in section 502(b)(1) of the Code. B's debt-financed rental income, to the extent treated as unrelated business taxable income under section 512, is not large enough to cause B to be treated as being operated for the primary purpose of carrying on a trade or business under section 502(a). For its fiscal year ended June 30, z, B had total income of approximately $ x and only $ of debt-financed rental income (roughly %). Following completion of the improvements to the Property, B estimates that the amount of debt-financed income may increase from $ to approximately $ x. This level of debt-financed income would constitute only approximately % of B's total projected income, and is not sufficient to cause B

to be operated for the primary purpose of carrying on a trade or business. The majority of B's rental activities qualify for the exception under section 502(b)(1). Thus, B is primarily involved in activities that would not be considered a trade or business for purposes of section 502. Accordingly, although B will have unrelated business taxable income from its debt-financed rental income to the extent determined under section 514, B is not a feeder organization under section 502.

4.

B is organized to receive and administer funds for the maintenance, expansion and general support of D. In that regard, one of B's purposes is to hold, manage, invest, reinvest, sell, lease, mortgage, or otherwise dispose of lands, securities and other investment properties belonging to or owned by it. Thus, B has an obligation to properly manage the Property and to use the revenue of the Property to support D and other members of C. In its current condition, the Property is ill-designed and deteriorated. The development activities proposed by B with respect to the Property are designed to improve the long-range earning capacity of the Property and are reasonable measures to protect the value of the Property. Thus, the real estate development activities of the Property by B will not, in itself, cause the rent received from the property to fall outside the modification under section 512(b)(3) for rents from real property. Similarly, if B leases all or a portion of the Property to a developer/ lessee who will perform the development activities, such arrangement, in itself, will not cause rent from the Property to fall outside the modification under section 512(b)(3) for rents from real property.

5.

The lease management activities undertaken by B at the Property, such as negotiating lease terms and billing for rent and other payables, are activities that are normal and incidental to the management of real estate investments. Therefore, such lease management activities, in themselves, will not cause the income generated by the Property to be treated as something other than rents from real property under section 512(b)(3) of the Code. Moreover, since B will not enter into any arrangement with respect to the Property under which the determination of the amount of rent paid by a tenant will be based in whole or in part on the income or profits derived from the Property, the lease terms related to the Property will not, in themselves, cause the income generated by the Property to be treated as something other than rents from real property under section 512(b)(3) of the Code.

6.

B will provide maintenance services, such as pest control, landscaping, fire protection, and guard services in connection with the overall operation of the Property. Such services are distinguishable from those described in Rev. Rul. 80-298. The services described in the revenue ruling included crowd and traffic control, guarding the stadium and maintaining the privacy of practice session. The services provided by B are in connection with the overall operation of the Property. The areas maintained are primarily common areas, not individual lease space. Such services are of the type provided primarily for the convenience of the landlord, not the tenant, and thus are not impermissible services for purposes of section

1.512(b)-1(c)(5) of the regulations. Similarly, repair services to the building, its roof, ducts, conduits, and similar items are necessary for the preservation of the Property and are not primarily services for the convenience of the occupant. Likewise, janitorial and cleaning services to the common areas of the property, such as cleaning of windows, public entrances, stairwells, lobbies, and restrooms, are not considered services rendered to the occupant under section 512(b)-1(c)(5) of the regulations.

B will cause lines and conduits to be connected to the leased premises to allow for the provision of utility services such as electricity, gas, and water to the tenants. Electricity, water, and gas are substantially similar to those services which, under section 1.512(b)-1(c)(5) of the regulations, are not considered rendered to the occupant. These services are essential to the operation of the Property and thus are not primarily rendered for the convenience of the tenants. They are also customarily rendered in connection with the rental of property. Moreover, since heat and light are specifically cited in section 1.512(b)-1(c)(5) of the regulations as services that are not considered as rendered to the occupant, electricity and gas (which are generally necessary for the generation of heat and light) also are not services rendered to the occupant. Accordingly, the provision of utility services does not affect the characterization of otherwise qualifying rents from real property within the meaning of section 512(b)(3) of the Code.

B will lease space in the common areas of the Property to telephone companies to install and maintain pay telephones. B will also lease or license space in the common areas of the Property to vendors to provide and maintain newspaper and other vending machines. Payments to B for the use or right to use such space constitute rents from real property within the meaning of section 512(b)(3) of the Code since such space subject to the lease or license is real property.

7.

The marketing and promotion activities that B will provide with respect to the Property, such as the operation of a "merchants' association" that would coordinate advertisements and promotions for the property, are activities that are primarily for the convenience of the tenants and are other than services usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. However, even though such marketing and promotion activities are impermissible services, they are insubstantial in relation to all of the permissible activities carried on in operating the Property. The expenses associated with such marketing and promotion activities will constitute less than seven percent of total expenses associated with operating the Property, and less than three percent of the total revenues from the Property. Accordingly, the marketing and promotion activities will not, in themselves, cause the income received from operating the Property to be classified as other than rents from real property under section 512(b)(3) of the Code.

8.

The provision of parking for tenants and visitors to the Property is necessary if the Property is to be a productive investment. Since B will not directly operate the parking lots but, instead, lease the parking lots to a third-party operator, the revenue from such leases will be

considered rents from real property under section 512(b)(3) of the Code. The maintenance, repair, cleaning, and lighting of the parking lots is necessary for their use and preservation, and are services usually and customarily rendered in connection with the rental of parking lots to third-party operators. Consequently, if B provides maintenance, repairs, cleaning, and lighting for the parking lots, such services will not, in themselves, cause the revenue from B's lease of the parking lots to be considered anything other than rents from real property under section 512(b)(3).

Accordingly, based on the facts represented, we rule that:

1. After taking into account B's existing real estate activities, the proposed renovations to the K and the proposed redevelopment of the Property, whether done by B itself, by a lessee of the Property, or by a partnership of which B is a partner, will not provide the basis for the revocation of B's exempt status under section 501(c)(3) of the Code.

2. After taking into account B's existing real estate activities, B's increased rental activities in connection with the redeveloped Property (including negotiating leases, collecting rents, and maintaining the Property for rent) will not provide a basis for revocation of B's exempt status under section 501(c)(3) of the Code.

3. After taking into account B's existing real estate activities, B's proposed renovations to the K, B's proposed redevelopment of the Property, and B's increased rental activities with respect to the Property will not provide a basis for finding that B is a feeder organization for purposes of section 502 of the Code.

4. The redevelopment activities undertaken by B at the Property will not affect the characterization of otherwise qualifying "rents from real property" within the meaning of section 512(b)(3) of the Code.

5. The lease management activities undertaken by B at the Property will not affect the characterization of otherwise qualifying "rents from real property" within the meaning of section 512(b)(3) of the Code.

6. The maintenance, repair, and cleaning services, utility services, and additional leasing services (such as those for the provision of pay telephones and vending machines) related to the Property will not affect the characterization of otherwise qualifying "rents from real property" within the meaning of section 512(b)(3) of the Code.

7. The marketing and promotion activities related to the Property, although impermissible services under section 1.512(b)-1(c)(5) of the regulations, will not affect the characterization of otherwise qualifying "rents from real property" within the meaning of section 512(b)(3) of the Code because they are insubstantial in relation to all of the permissible activities carried on in operating the property.

8. The rental income from the parking lots on the Property operated by independent contractors will be treated as "rents from real property" within the meaning of section 512(b)(3)

of the Code, and the services provided by B related to the parking lots will not affect the characterization of otherwise qualifying "rents from real property" within the meaning of section 512(b)(3) provided such services are usually and customarily rendered in connection with the lease of parking lots to independent contractors.

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

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. You should keep a copy of this letter in your permanent records.

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

Sincerely,

/s/

Joseph Chasin
Acting Manager
Exempt Organizations
Technical Group 2