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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

T:EO:B4

Date: SEP 13 2002

NO THIRD PARTY CONTACTS

SIN: 501.03-25

Employer Identification Number:

Legend:
C =

Dear Sir or Madam:

This is in response to your letter of July 1, 2002, in which you request a private letter ruling regarding the effect of your construction, ownership, and leasing of a student housing project (Project) on your continued exemption under section 501(c)(3) of the Internal Revenue Code. In addition, you request a ruling that the operation of the Project 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). Your stated purposes are to operate a community development corporation for the advancement of charity and for other charitable purposes, by the distribution of funds for such purposes, and for the relief of the poor and distressed or underprivileged; the lessening of the burdens of government; and the promotion of social welfare by combating community deterioration and juvenile delinquency.

You state in your submission that you were established as part of a nationwide initiative to provide technical and financial assistance to community-based organizations and local anchor institutions that are working in partnership to revitalize low-asset communities. One of the goals of this program is to promote economic and community development around historically black colleges and universities. You are affiliated with C, an historically black college.

Your target community is the area within a six-block radius of C. Since your creation, you have accomplished the following: (i) disbursed several million dollars in loans or equity funds to various small business enterprises in the target community, (ii) assisted in creating more than 150 new jobs for low-income persons, (iii) provided moneys for home acquisition and renovation in the target community, (iv) developed hundreds of units of affordable multi-family and single-

family housing for the target community, and (v) operated numerous social programs, which include sexual and tobacco abstinence, GED preparation, drug prevention and job training.

You indicate that C has recently expressed a need for additional student and faculty housing. State resources have not been sufficient to permit C to meet its current housing demand. To assist C in this regard, you have undertaken the Project to provide housing for graduate students and faculty of C. The Project site is an abandoned commercial building within your target community and is approximately one-half mile from C's campus. The site qualifies as a Brownfield site under the HUD/EPA Brownfields initiative guidelines. You state further that the Project property, C, and you are located in a government designated Empowerment Zone/Enterprise Community as the term is defined in the 1993 Federal Omnibus Budget Reconciliation Act for purposes of community revitalization in impoverished areas.

The Project consists of an apartment complex of ten buildings with adjacent parking. You will develop, own, and operate the Project through a single member limited liability company (LLC). The LLC will finance the Project through the issuance of both taxable and tax-exempt bonds. The revenue in excess of that necessary to pay off the bonds will be donated to C on an annual basis, and the Project will be donated to C when the bonds are paid off at maturity.

You indicate that the Project, in addition to providing housing for students and staff of C, will provide temporary construction jobs and permanent employment opportunities in the target community. The Project will contribute to the improvement of the target community's image and contribute to economic revitalization and neighborhood beautification efforts.

Based on these representations, you request the following rulings:

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

2. Your creation of a sole member limited liability company (LLC) to serve as the developer, owner, and operator of the Project will not adversely affect your exempt status under section 501(c)(3) of the Code. The 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.

3. The development, construction, ownership, leasing and operation of the Project will not constitute an unrelated trade or business within the meaning of section 513(a) of the Code.

4. The gross income derived from leasing the Project's apartments will not constitute unrelated business taxable income within the meaning of section 512 of the Code.

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 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 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.

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 have not elected to have the single member LLC you created for the purpose of this Project treated as a corporation. Accordingly, it will be considered a disregarded entity and its 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 purpose is the stimulation of economic development and the creation of jobs in your target community, an economically depressed area. Your undertaking of the Project in the manner you describe will combat community deterioration and stimulate the creation of jobs for residents of the area in a manner similar to the organizations described in Rev. Ruls. 74-587 and 76-419.

In addition, developing and operating student housing facilities for the exclusive use of C's students furthers your charitable purposes by advancing education in a manner similar to the organizations described in Rev. Rul. 67-217. You will be helping C fulfill its educational purposes and aiding C's 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 construction, ownership, and leasing of the Project will not adversely affect your exempt status under section 501(c)(3) of the Code.

2. Your creation of a sole member limited liability company (LLC) to serve as the developer, owner, and operator of the Project will not adversely affect your exempt status under section 501(c)(3) of the Code. The 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.

3. The development, construction, ownership, leasing and operation of the Project will not constitute an unrelated trade or business within the meaning of section 513(a) of the Code.

4. The gross income derived from leasing the Project's apartments will not constitute unrelated business taxable 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 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,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4