

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

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Dear :

This is in response to your ruling request as to the proper treatment of certain revenue under section 512(a)(1) of the Internal Revenue Code.

You are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and classified as a private non-operating foundation under section 509(a). You provide theological education at various levels to your students and scholars.

You provide living quarters in buildings that you own for your students and faculty. You provide temporary living quarters for family members of your students and faculty, potential students and their parents, guests who are speakers at your institution, and guests of other non-affiliated non-profit organizations(B-l) in your immediate geographic area who are speakers or musical performers at your institution, and members of the general public.

You have requested the following rulings:

1. Revenue generated from providing living quarters in buildings that you own to your students and faculty; and temporary living quarters to family members of your students and faculty; potential students; family members of potential students; guests who are speakers at your institution; and guests of other non-affiliated non-profit organizations(B-l) in your immediate geographic area who

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are also speakers or musical performers at your institution do not constitute unrelated business taxable income under section 512(a)(1) of the Code.

2. Revenues generated by you from the renting of rooms to individuals who are not described in (1) above, i.e., members of the general public, constitute unrelated business taxable income under section 512(a)(1) of the Code.

LAW:

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3) which are organized and operated exclusively for charitable, educational, etc., purposes provided no part of the organization's net earnings inure to the benefit of any private shareholder or individual.

Section 511(a)(1) provides that provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 511(a)(2)(A) of the Code provides that the organizations subject to the tax imposed by section 511(a)(1) are any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1)) that is exempt, except as provided in this part of part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a).

Section 512(a) of the Code provides that, except as otherwise provided in this subsection, 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 this chapter that are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 512(b)(3) of the Code excludes from unrelated business income rents from real property and rents from personal property leased with real property if the rents attributable to personal property are incidental to the total amount of rents received or accrued under the lease, determined at the time the personal property is placed into service. However, rents from real property will be subject to unrelated business income if more than 50 percent of total rent received or accrued under the lease is attributable to personal property or if the determination of the amount of such rent 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 receipts or sales).

Section 513(a)(2) of the Code provides the term "unrelated trade or business" does not include any trade or business which is carried on by the organization primarily for the convenience of its members, students, patients, officers or employees.

Section 1.512(b)-1(c)(5) of the Income Tax Regulations provides that payments for the use or occupancy of rooms and other space where services are also rendered to occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses or storage garages, does not constitute rent from real property.

The regulation also states that, 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.

Section 513(a) of the Code provides that in the case of an organization that is subject to tax on unrelated business income, the term "unrelated trade or business" means any trade or business the conduct of which is not substantially related to the exercise or performance of the organization's tax-exempt purpose.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only when the conduct of the business activities has a causal relationship to the achievement of its exempt purposes. It is "substantially related" only if the causal relationship is a substantial one. To be substantially related, the production or distribution of the good or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Section 1.513-1(d)(3) of the regulations provides that, in determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function that they purport to serve. Thus, when income is realized by an exempt organization from activities that are in part related to the performance of its exempt functions, but that are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of an unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services that contribute importantly to the accomplishment of any exempt purpose of the organization.

Section 1.513-1(d)(4)(iii) of the regulations provides that, in certain cases, an asset or facility necessary to the conduct of exempt functions may also be employed in a commercial endeavor. In such cases, the mere fact of the use of that asset or facility in exempt purposes does not, by itself, make the income from the commercial endeavor gross income from an unrelated trade or business. The test instead, is whether the

activities productive of the income in question contribute importantly to the accomplishment of the exempt purposes.

Assume for example, that a museum described in section 501(c)(3) has a theater auditorium that is specially designed and equipped for showing educational films in connection with its program of public education in the arts and sciences. The theater is a principal feature of the museum and is in continuous operation during the hours the museum is open to the public. If the organization were to operate the theater as an ordinary motion picture theater for public entertainment during the evening hours when the museum was closed, gross income from such operation would be gross income from the conduct of the unrelated trade or business.

Rev. Rul. 69-69, 1969-1 C.B. 159, provides that leasing studio apartments and operating a dining hall by an exempt organization constitute unrelated trades or businesses when occupancy in the apartments is not primarily for the convenience of its members. The apartments are not made available to the tenants on the basis of membership in the club or any criteria that would further the exempt purpose of the organization. Thus, neither the leasing of the apartments nor operating the dining hall by the organization has a substantial causal relationship to the achievement of its exempt purposes. Because substantial services are rendered to the tenants, the payment by the tenants are not "rents" within the meaning of section 1.512(b)-1(c)(2) of the regulations.

Rev. Rul. 76-33, 1976-1 C.B. 169, provides that renting dormitory rooms and similar residential accommodations primarily to people under age 25 by an exempt organization whose purpose is to provide for the welfare of young people is substantially related to the purpose of constituting the basis for the organization's exemption. Furthermore, the activity does not constitute an unrelated trade or business within the meaning of section 513 of the Code. The residence units are operated on and as part of the same premises in which the organization carries on its social, recreational, and guidance programs. Membership in the organization for which a nominal fee is charged is required of those seeking room accommodations.

RATIONALE:

Based upon the information presented, your renting of rooms in the manner described above, is a trade or business regularly carried on within the meaning of section 512 of the Code.

Your activities consist of providing education at various levels to your students and faculty. Your provision of living quarters for your students is within the meaning of the convenience exception under section 513(a)(2) of the Code. The provision of living quarters for your faculty has a substantial causal relationship to furthering your exempt purpose as well as the provision of temporary living quarters to family members of your students and faculty, potential students, family members of potential students, and guest

who are speakers at your institution would further your exempt purposes.

There are situations where your educational activities are furthered when guests of B-I conduct speeches or music at your facility. Therefore, the rental of room space to guests of B-I furthers your exempt purposes, and would not be an unrelated trade or business under section 513(a) of the Code and be subject to unrelated business income tax as described in section 511(a) of the Code. See Rev. Rul. 76-33, supra and section 1.513-1(d)(2) of the regulations.

Any provision of room rental to individuals that are not guests of B-I and the general public is carried on in a regular commercial manner traditionally carried on by profit making organizations. Such use does not contribute importantly to your exempt purposes of advancing education and is not primarily for the convenience of persons described in section 513(a)(2), and would be considered to be income from an unrelated trade or business. See section 1.513-1(d) and Rev. Rul. 69-69, supra.

Section 512(b)(3) of the Code generally excludes "all rents from real property" from the definition of unrelated business taxable income. However, section 1.512(b)-1(c)(5) of the regulations provides, in part 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 of occupancy of rooms or other quarters in hotels, does not constitute rents from real property. The supplying of maid service, for example constitutes such service. Because the general public renting rooms from you will receive personal services such as maid services, then the rents received by you will not come within the section 512(b)(3) exception. See sections 1.512(b)-1(c)(5) and 1.513-1(d)(4)(iii) of the regulations, supra.

Based on the following we rule as follows:

1. Revenue generated from providing living quarters in buildings that you own to your students and faculty; and temporary living quarters to family members of your students and faculty; potential students; family members of potential students; guests who are speakers at your institution; and guests of other non-affiliated non-profit organizations (B-I) in your immediate geographic area who are also speakers or musical performers at your institution do not constitute unrelated business taxable income under section 512(a)(1) of the Code.
2. Revenues generated by you from the renting of rooms to individuals who are not described in (1) above, i.e., members of the general public, constitute unrelated business taxable income under section 512(a)(1) 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

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6110(k)(3) of the Code provides that they may not be used or cited by others as precedent.

These rulings do not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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.

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

Sincerely,

Steven B. Grodnitzky
Acting Manager,
Exempt Organizations
Technical Group 1