

A title holding corporation renting a building and trucks under separate unrelated leases to exempt fraternal beneficiary societies is engaged in the business of renting personal property independent of real property and is not exempt under section 501(c)(2) of the Code.

The Internal Revenue Service has been asked whether a corporation is exempt from Federal income tax under section 501(c)(2) of the Internal Revenue Code of 1954.

The corporation holds title to a building. The building is rented to three fraternal beneficiary societies exempt from Federal income tax under section 501(c)(8) of the Code. One of these societies is the parent of the title holding corporation, and the title holding corporation turns over all its income, less expenses, to this parent organization.

The title holding company also owns several small trucks. These trucks are rented to the same fraternal beneficiary societies on separate yearly leases not related to the building leases and are used by the lessees in their fraternal activities. The lessees are responsible for fueling, maintaining, and insuring the trucks. The income from these leases is a substantial part of the net earnings of the title holding company, and is turned over to the exempt parent in the same manner as the net earnings from the building rentals.

Section 501(c)(2) of the Code provides for the exemption from Federal income tax of corporations organized for the exclusive purpose of holding title to property, collecting income from the property, and turning over the entire amount, less expenses, to an organization which is itself exempt under section 501 of the Code.

Section 1.501(c)(2)-1 of the Income Tax Regulations states that an organization cannot be exempt under section 501(c)(2) of the Code if it engages in any business other than holding title to property and collecting income therefrom.

The basic question to be resolved here is whether rental of personal property (trucks in this case) independent of realty is a trade or business for purposes of section 501(c)(2) of the Code.

The rental of personal property unless leased with realty has consistently been treated as the conduct of a trade or business, whether with respect to exempt organizations or taxable entities. For example, income from rental of personal property would be subject to unrelated business income tax if received regularly by an exempt organization subject to the provisions of sections 511 through 514 of the Code. Revenue Ruling 60-206, C.B. 1960-1, 201, holds income from rental of tank cars to be

unrelated business taxable income to an employee's trust described in section 401(a) of the Code and otherwise exempt under section 501(a), even though the sole activity of the lessor is to receive the rental income, the lessee having the full responsibility for the operation and maintenance of the cars, and their replacement in case of destruction or loss.

In addition, section 1402(a) of the Code, which defines net earnings from the conduct of a trade or business, specifically provides in paragraph 1402(a)(1) that rentals from real estate and personal property leased with the real estate are excluded from this definition. The fact that personal property leased independent of realty is not excluded makes it evident that Congress viewed it as a business (the income from which is subject to self-employment tax).

Additional evidence that an exempt title holding company may not have income from rental of personalty is that section 1.501(c)(2)-1 of the regulations states that organizations exempt by virtue of section 501(c)(2) of the Code cannot have unrelated business taxable income as defined in section 512 other than unrelated business rental income described in section 514. Section 514 of the Code relates to certain types of indebtedness on real property. Section 514 further provides that for purposes of that section the term 'real property' includes personal property of the lessor leased by it to a lessee of its real estate only if the lease of such personal property is made under, or in connection with, the lease of such real estate.

Section 502 of the Code further reinforces this position. That section provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501 from taxation. For purposes of section 502, the term 'trade or business' does not include the rental by an organization of its real property (including personal property leased with the real property). It is significant that personal property leased without realty is not excluded.

In the facts described above, there is no direct relation between the rental of the building and the rental of the trucks, even though the arrangements were between the same parties. Accordingly, it is held that the corporation is engaged in the business of renting personal property independent of real property, and therefore it is not exempt from Federal income tax under section 501(c)(2) of the Code.