

Acquisition indebtedness; subsidiary of labor union. Indebtedness owed to a labor union by its wholly owned tax-exempt subsidiary title-holding company resulting from a loan to pay debts incurred to acquire two income-producing office buildings is not 'acquisition indebtedness' within the meaning of section 514(c) of the Code.

'Advice has been requested whether, under the circumstances described below, an indebtedness owed by a subsidiary organization to its parent organization is 'acquisition indebtedness' within the meaning of section 514(c) of the Internal Revenue Code of 1954.

'The subsidiary is a corporation exempt from Federal income tax under section 501(c)(2) of the Code as a title-holding company. It is wholly owned by a labor union that is exempt from Federal income tax under section 501(c)(5). It was created by the union to hold title to real property with the intent that all of the income therefrom be remitted to the union. It holds title to two office buildings, collects the income therefrom, and turns over the entire amount thereof, less expenses, to the union.

'The union advanced funds, from existing resources and without any borrowing, to the subsidiary to pay a debt owed by the subsidiary to a third party, which debt was previously incurred in acquiring the property. Since that time, neither the union nor the subsidiary has incurred any indebtedness with respect to acquiring or improving the property. The only indebtedness with respect to the acquisition or improvement of the property is that owed by the subsidiary to the union for its advances. The union has no outstanding indebtedness with respect to the property. The subsidiary's indebtedness to the union is represented by a demand note on which payments are made whenever the subsidiary has the available cash to do so. The books of the union and the subsidiary list the outstanding debt as 'interorganizational indebtedness'.

'Section 514 of the Code provides that, in computing an exempt organization's unrelated business taxable income, there shall be included as an item of gross income from unrelated trade or business a percentage of the gross income derived from any property held for the production of income and with respect to which there is an acquisition indebtedness at any time during the taxable year.

'Section 514(c)(1) of the Code provides, in general, that the term 'acquisition indebtedness' means the unpaid amount of

(A) the indebtedness incurred by the organization in acquiring or improving debt-financed property;

(B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(C) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

'The intent of section 514 of the Code is to treat an otherwise exempt organization in the same manner as an ordinary business enterprise to the extent that the exempt organization purchases property through the use of borrowed funds. H.R. Rep. No. 91-413, 91st Cong., 1st Sess. 46 (1969), 1969-3 C.B. 200, 230. Although the subsidiary's books show an indebtedness to the union, such indebtedness is not the type contemplated under section 514. In this situation, the very nature of the title-holding company as well as the parent-subsidiary relationship show this indebtedness to be merely a matter of accounting between the organizations rather than an indebtedness as contemplated by section 514.

Accordingly, the interorganizational indebtedness owed to the union by its wholly owned subsidiary title-holding company is not acquisition indebtedness within the meaning of section 514(c) of the Code.