



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Number: **200537037**

Release Date: 9/16/2005

SE:T:EO:RA:T:2

514.06-00

Date: 06/20/05

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

Dear :

This is in reply to your ruling request of regarding a church and the neighborhood land rule of section 514(b)(3) of the Internal Revenue Code.

The information submitted shows that you are a church that is recognized as exempt from Federal income tax under section 501(c)(3) of the Code. You purchased two adjacent parcels of land with debt financing , with no structures other than a level ground parking lot. The land is presently used in part for church parking. You also leased the property in to a company, not related to the church, under a ten-year lease for public parking during periods (most of the week) when church is not in session. The rent payments are a flat fee. The lessee conducts paving, lighting, and cleaning; you are responsible for repairs to adjoining sidewalks.

The land was purchased for the purpose of church expansion. You have submitted your proposed plans for constructing a building that will be used for your church activities. The proposed building will be built on your present property and the purchased property.

You request a ruling that it is reasonably certain that the land will be used for an exempt purpose within 15 years of its acquisition, and that the property will be exempt from the debt-financed property provisions of sections 512(b)(4) and 514 of the Code as a result of the neighborhood land rule under section 514(b)(3).

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable and educational purposes, no part of the net earnings of which inures to the benefit of any individual.

Sections 511 to 514 of the Code generally impose a tax on the unrelated business taxable income of exempt organizations derived from the conduct of unrelated trade or business.

Section 512(b)(3) of the Code generally exempts from unrelated business taxable income rents from real property.

Sections 512(b)(4) and 514 of the Code generally impose income tax, notwithstanding the exception for rents under section 512(b)(3), on unrelated business taxable income from debt-financed property.

Section 514(b)(3)(A) of the Code provides a special rule for neighborhood land. If an organization acquires real property for the principal purpose of using the land (commencing within 10 years of the time of acquisition) for an exempt purpose and at the time of acquisition the property is in the neighborhood of other property owned by the organization which is used in such manner, the real property acquired for such future use shall not be treated as debt-financed property so long as the organization does not abandon its intent to so use the land within the 10-year period. The preceding sentence shall not apply for any period after the expiration of the 10-year period, and shall apply after the first 5 years of the 10-year period only if the organization establishes to the satisfaction of the Secretary that it is reasonably certain that the land will be used in the described manner before the expiration of the 10-year period.

Section 514(b)(3)(C) of the Code provides that subparagraph (A):

- (i) shall apply with respect to any structure on the land when acquired by the organization, or to the land occupied by the structure, only if (and so long as) the intended future use of the land for an exempt purpose requires that the structure be demolished or removed in order to use the land in such manner;

- (ii) shall not apply to structures erected on the land after the acquisition of the land; and

- (iii) shall not apply to property subject to a lease which is a business lease (as defined in this section immediately before the enactment of the Tax Reform Act of 1976).

Section 514(b)(3)(E) of the Code has a special rule for debt-financed property which extends the neighborhood land rule for churches to a 15-year period. In addition, churches are exempt from unrelated debt-financed income even if the acquired land does not meet the neighborhood test.

Section 1.514(b)-1(d)(1) of the regulations defines the basic "neighborhood land rule" excepting certain real property from "debt-financed property" if it is acquired for the principal purpose of using it in an exempt function within 10 years (15 years for churches) of the time of acquisition.

Section 1.514(b)-1(d)(1)(iii) of the regulations provides that in order to satisfy the Commissioner that future use of the acquired land in furtherance of the organization's exempt purpose before the expiration of the relevant period is reasonably certain, the organization does not necessarily have to show binding contracts. However, it must at least have a definite plan detailing a specific improvement and a completion date, and some affirmative action toward the

fulfillment of such a plan. This information shall be forwarded to the Commissioner of Internal Revenue, Washington, D.C. 20224, for a ruling at least 90 days before the end of the fifth year after acquisition of the land.

Sections 1.514(b)-1(d)(3)(i), (ii), and (iii) of the regulations correlate to sections 514(b)(3)(C)(i), (ii), and (iii) of the Code.

Section 1.514(b)-1(e)(1) of the regulations provides that if a church or association or convention of churches acquires real property, for the principal purpose of using the land in the exercise or performance of its exempt purpose, commencing within 15 years of the time of acquisition, such property shall not be treated as debt-financed property so long as the organization does not abandon its intent to use the land in such a manner within the 15-year period.

Section 1.514(b)-1(e)(2) of the regulations provides that this paragraph shall not apply to any property after the expiration of the 15-year period. Further, this paragraph shall apply after the first 5 years of the 15-year period only if the church or association or convention of churches establishes to the satisfaction of the Commissioner that use of the acquired land in furtherance of the organization's exempt purpose before the expiration of the 15-year period is reasonably certain. For purposes of the preceding sentence, the rules contained in paragraph (d)(1)(iii) of this section with respect to satisfying the Commissioner that the exempt organization intends to use the land within the prescribed time in furtherance of its exempt purpose shall apply.

Section 1.514(b)-1(e)(4) of the regulations provides that the limitations stated in paragraph (d)(3)(i) and (ii) of this section shall similarly apply to the rules contained in this paragraph.

You purchased land with debt financing and leased it to a third party for operating a parking lot. The amounts derived appear to constitute rents from real property excepted from unrelated business taxable income under section 512(b)(3) of the Code, unless the land is debt-financed property under sections 512(b)(4) and 514. You have requested a ruling that the neighborhood land rule applies to exempt the land from the definition of debt-financed property for 15 years from acquisition. You submitted your ruling request in a timely manner, and the information submitted satisfies us that it is reasonably certain that you will use the land in an exempt purpose or function within 15 years of acquisition.

The lease appears to constitute a business lease. We considered whether the limitation under sections 514(b)(3)(C)(iii) of the Code and 1.514(b)-1(d)(3)(iii) of the regulations for business leases operates to treat the land as debt-financed property under the circumstances presented. We think it does not, because this limitation is not referenced in the special rules for churches under section 1.514(b)-1(e)(4) as the limitations for demolition and subsequent construction are.

Accordingly, we rule that it is reasonably certain that the land will be used for an exempt purpose within 15 years of its acquisition, and that the properties are exempt from the debt-financed property provisions of sections 512(b)(4) and 514 of the Code as a result of the

neighborhood land rule under section 514(b)(3) for 15 years beginning with the dates that you acquired them.

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.

We are informing the \_\_\_\_\_ key district office of this ruling. Because this letter could help resolve any questions about your exempt status, you should keep it in your permanent records.

If there are any questions about reporting requirements or about excise, employment, or other federal taxes, please contact the \_\_\_\_\_

(a toll free number) or send correspondence to the following address:

\_\_\_\_\_. If there are any immediate questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Jane Baniewicz  
Manager, Exempt Organizations  
Technical Group 2

Enclosure:  
Notice 437