



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Person to Contact and ID Number:

Contact Telephone Number:

Dear *****:

I am responding to your inquiry to Congressman Mike Kelly. You asked about the tax consequences of income *****, a section 501(c)(3) tax-exempt organization, received from an oil and gas lease with *****. Specifically, you asked whether ***** risks losing its exemption because of the oil and gas lease and, if not, whether royalties received under the lease are taxable. Congressman Kelly wrote to us on your behalf and asked us to respond directly to you.

I cannot give you a ruling on the tax consequences of any specific activities except in accordance with the provisions of Rev. Proc. 2012-4, 2012-1 I.R.B. 125 (updated annually). However, I can provide general information that I hope you find helpful.

In general, a section 501(c)(3) tax-exempt organization risks losing its exemption if more than an insubstantial part of its activities does not further one or more tax-exempt purposes (section 501(c)(3) of the Internal Revenue Code (the Code)). A section 501(c)(3) tax-exempt organization must be organized and operated exclusively for the support of one or more tax-exempt purposes (sections 501(c)(3) of the Code and 1.501(c)(3)-1(a) of the Treasury Regulations). An organization operates exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3) of the Code. An organization is not operating exclusively in this manner if more than an insubstantial part of its activities does not further an exempt purpose (section 1.501(c)(3)-1(c)(1) of the Treasury Regulations).

An organization may meet the requirements of section 501(c)(3) of the Code, even though it operates a trade or business as a substantial part of its activities, if its operations further the organization's exempt purpose and its primary purpose is not the carrying on of an unrelated trade or business (section 1.501(c)(3)-1(e)(1) of the

Treasury Regulations). Under the Regulations, an unrelated trade or business is not substantially related (aside from the organization's need for income, funds, or use of derived profits) to an organization's exercise or performance of charitable, educational, or other functions that constitute the basis for section 501(c)(3) exemption (section 513(a) of the Code).

A tax applies to unrelated business taxable income (UBTI) of section 501(c)(3) organizations (section 512(a)(1) of the Code). The UBTI is the gross income an organization derives from any unrelated trade or business (described above) that it regularly carries on, less the deductions that are directly connected with carrying on the trade or business, both computed with the modifications provided in section 512(b) (section 512(a)(1) of the Code).

An organization excludes from the calculation of the UBTI all royalties (including overriding royalties), whether measured by production or by gross or taxable income from property, and all deductions directly connected with the income (section 512(b)(2) of the Code). However, an organization does not exclude from the calculation of the UBTI the income from a working interest in an oil and gas property where, under the terms of the agreement, an organization owning the interest either is not relieved of its share of the development costs associated with the interest or is relieved of the development costs but not of the operating costs (section 1.512(b)-1(b) of the Treasury Regulations; Revenue Ruling 69-179, 1969-1 C.B. 158).

This letter is for informational purposes only and provides general statements of well defined law. This letter is not a ruling, and taxpayers cannot rely on it as such (Revenue Procedure 2012-4, 2012-1, Internal Revenue Bulletin 125 (IRB) (or its successor)). We will make this letter available for public inspection after deleting names, addresses, or other identifying information as appropriate under the Freedom of Information Act (Announcement 2000-2, 2000-2 I.R.B. 295).

If you would like a ruling specific to your oil and gas lease, you, or your representative, can submit a letter ruling request and user fee to:

Internal Revenue Service
Attention: EO Letter Rulings
P.O. Box 27720
McPherson Station
Washington, DC 20038

You can find instructions for submitting a letter ruling request in section 9 of Revenue Procedure 2012-4, available at www.irs.gov/irb/2012-01_IRB/ar09.html. The user fee for letter ruling requests is \$10,000 (Revenue Procedure 2012-8, section 8.08).

I hope this information is helpful. If you have any questions, please contact
*****, Identification Number *****, at *****.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

cc: The Honorable Mike Kelly
Attention: *****