

NEVADA STATE

a fraternal organization



NSEA Business Practices

Exclusion of Rent from Real Property from Unrelated Business Taxable Income

Rental income from real property received by exempt organizations is normally excluded from unrelated business taxable income (UBTI). However, rent may not fall under the exclusion in various circumstances, such as when substantial personal services are provided to lessees, if more than 50% of the rent is for the use of personal property, if the property is debt-financed income or leased to a controlled entity, or if the organization is exempt under Sections 501(c)(7), 501(c)(9) or IRC 501(c)(17).

IRC Section and Treas. Regulation

- IRC Section 512(b)(3) Rents from real property excluded from UBI
- IRC Section 512(b)(13) Special rules for certain amounts received from controlled entities
- IRC Section 514(b)(1) Definition of debt-financed property
- Treas. Reg. Section 1.512(b)-1(c) Rent modification

Resources (Court Cases, Chief Counsel Advice, Revenue Rulings, Internal Resources)

- Ocean Pines Ass'n v. Comm'r, 135 T.C. 276 (2010) The Tax Court held that revenue received by a 501(c)(4) homeowners' association's operation of parking lots was not rent from real property excluded from unrelated business taxable income by Section 512(b)(3).
- Gundersen Med. Found. v. United States, 536 F. Supp. 556 (W.D. Wis. 1982) A medical educational and research foundation exempt under section 501(c)(3) leased some of its buildings, which were subject to a mortgage, to a private non-exempt clinic. The court found that the rental income from debt-financed property was not unrelated business income, under Section 514(b)(1)(A)(ii), because the clinic's use of the leased real (and personal) property in providing medical services and training medical students was substantially related to the foundation's exempt purposes.
- Rev. Rul. 69-69, 1969-1 C.B. 159 The leasing of apartments and the operation of a dining hall by an exempt organization constitute unrelated trades or businesses where occupying the apartments is not primarily for the convenience of its members.
- Rev. Rul. 80-297, 1980-2 C.B. 196, amplifying Rev. Rul. 76-402, 1976-2 C.B. 177, holds that an exempt school that uses its tennis facilities for ten weeks in the summer as a public tennis club operated by employees of the school's athletic department is engaged in unrelated trade or business and the income earned is not excludable from unrelated business taxable income as rent from real property. If, however, the school leases the tennis facilities for a fixed fee to an unrelated individual who operates a tennis club for the public, the school is still engaged in unrelated trade or business, but the lease income is excluded from unrelated business taxable income as rent from real property.
- Rev. Rul. 80-298, 1980-2 C.B. 197 holds that income from the lease of a football stadium by a tax-exempt university to a professional football team is not rent from real property excluded under Section 512(b)(3) because the university provided substantial services (which did not constitute customary services) for the convenience of the team.

- [1989-B EO CPE Text](#) - Rents from Real Property - Rendering Services

Analysis

According to IRC Section 512(b)(3), rents from real property are excluded from unrelated business taxable income. Real property is land and any buildings or other structures permanently attached to land, and includes any property described in IRC Section 1245(a)(3)(C). However, there are several situations in which the exclusion does not apply. These may include:

Rent, if the rental of facilities includes the provision of services, such as food and beverage sales. Rental payments for the use of rooms or space where services are also rendered to the occupants does not constitute rent from real property. Services are considered rendered to occupants if they are primarily for their convenience. Those services usually or customarily rendered in connection with the rental are not considered rendered to occupants. See Treas. Reg. Section 1.512(b)-1(c)(5),

For example, the supplying of maid service constitutes service to the occupant, whereas the furnishing of heat and light, the cleaning of public areas, and the collection of trash, are not considered as services rendered to the occupant. Rental income from hotel rooms, storage units, or parking lots is not considered rent from real property. See Rev. Rul. 69-69, Rev. Rul. 80-287, and Rev. Rul. 80-298. Similarly, in *Ocean Pines Association, Inc.*, the court held that the revenue received from parking lots was not rent from real property and therefore the income was subject to UBIT.

Rent from “net profits” leases. Where the rental income is based on a percentage of the lessee's sales or profits, the rental income will not qualify for exclusion. See Treas. Reg. Section 1.512(b)-1(c)(2)(iii)(b).

Rent from “mixed leases.” Rent from a lease where more than 50 percent of the total rent is attributable to personal property will not be excluded from unrelated business taxable income. Treas. Reg. Section 1.512(b)-1(c)(2)(iii)(a)

Unrelated income from debt-financed property. Rent from property acquired with acquisition indebtedness, as defined in IRC Section 514(c), unless substantially all of the use of the property is substantially related to exempt purposes. IRC Section 514(b). For example, in *Gundersen Med. Found* the court concluded that more than 85% of the use of the debt-financed property was substantially devoted to the exempt purpose of the Foundation and therefore the rent was not subject to UBIT.

Rent received from a controlled entity. As described in IRC Section 512(b)(13), rent received from a controlled entity is includable in unrelated business income to the extent it reduces the net unrelated income of the controlled entity.

Rents received by organizations described in Sections 501(c)(7), 501(c)(9), and 501(c)(17), to which special UBIT rules apply under IRC Section 512(a)(3).

Issue Indicators or Audit Tips

- Did the return indicate rental income and a mortgage?
- Tour the facilities. Are there indications of areas or buildings being rented out? Identify which areas or buildings are debt-financed.
- Did taxpayer provide documentation such as a rent/lease agreement showing the income was from real property?
- Did the documents such as mortgage agreement provided show if the real property that the EO received income from is debt financed?
- Did taxpayer provide documents such as a service agreement showing whether services were provided for the rental income received?

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IRS Link:

<https://www.irs.gov/charities-non-profits/exclusion-of-rent-from-real-property-from-unrelated-business-taxable-income>