



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Uniform Issue List:

511.00-00
512.00-00
513.00-00

Contact Person:
Identification Number:
Telephone Number:
Employer Identification Number:

Legend:

M =
R =
S =
T =
U =
V =
W =
Date =

Dear

We have considered your request dated February 18, 2009, requesting a ruling that the receipt of a brokerage commission by M which constitutes income to M under section 61(a)(1) of the Internal Revenue Code ("Code") does not constitute unrelated business taxable income under section 511(a).

FACTS

M is an organization exempt from Federal income tax under section 501(c)(3) of the Code. M directs, coordinates, and supports the health care industries of the R. M seeks to integrate all of the health care ministries of R. The entities involved include

S is the President and Chief Executive Officer of M. S is also a licensed real estate broker and the sole proprietor of T. S is employed pursuant to an employment agreement with M. The agreement requires him to dedicate his full-time and exclusive services for the sole benefit of M. This includes the use of his real estate license for the purpose of saving M some or all of any commission charged by brokers in real estate transactions.

M entered into a rental lease agreement with U for a building located in V. M will use the building for office space for its general administrative use and for use as medical offices. M uses the building in connection with its charitable activities.

S served as a co-broker in the negotiation of the leasehold interest on behalf of M. A check in the amount of \$ _____ was made payable to T. S promptly endorsed the full amount of the check over to M. S's action in endorsing the check over to M reflected his understanding and employment agreement with M that his brokerage license was to be used solely for the benefit of M in any real estate transaction involving M.

S's actions were confirmed in a letter from W, Board Chair of M dated Date, noting that, as required by his employment contract, S was to dedicate his full-time and exclusive services for the sole benefit of M, including the use of his real estate license for transactions involving M. Since his employment with M, S has not engaged in any other brokerage activities.

Real estate transactions of this nature are not typical for M. This is the only transaction in the last five years in which M received a brokerage commission.

RULING REQUESTED

M is requesting a ruling that the receipt of the brokerage commission by M, which M has stipulated in its request, is income to M, is not unrelated business taxable income (UBTI) within the meaning of section 511(a) of the Code.

LAW

Section 501(a) of the Code provides that an organization described in sections 501(c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under sections 502 or 503.

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for religious and charitable purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 511 of the Code imposes a tax on the unrelated business taxable income of certain tax exempt organizations.

Section 512(a) (1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business as defined in section 513, regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 513(a) of the Code defines the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code provides that for purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(a) of the Income tax Regulations ("regulations") provides that the term unrelated business taxable income means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions and subject to the modifications provided in section 512 of the Code ... unless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if: (1) It is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations states in general that any activity of an organization subject to section 511 of the Code which is carried on for the production of income and which otherwise possesses the characteristics required to constitute trade or business within the meaning of section 162 --and which, in addition, is not substantially related to the performance of exempt functions-- presents sufficient likelihood of unfair competition to be within the policy of the tax. Accordingly, for purposes of section 513 the term trade or business has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(c) (1) of the regulations states in part that in determining whether trade or business from which a particular amount of gross income derives is regularly carried on, within the meaning of section 512 of the Code, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. For example, specific business activities of an exempt organization will ordinarily be deemed to be regularly carried on if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

Section 1.513-1(d)(1) of the regulations provides in general, that gross income derives from unrelated trade or business, within the meaning of section 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question--the activities, that is, of producing or distributing the goods or performing the services involved--and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d) (2) of the regulations provides that a trade or business is related to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is substantially related, for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which

exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Section 1.513-1(d)(3) of the regulations provides that in determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.

In Museum of Flight Foundation v. United States, 63 F. Supp. 2d 1257 (1999), the court applied the regularly carried on requirement in the context of a one-time lease of a donated Boeing 747 jumbo jet by the Museum of Flight Foundation to the Boeing Corporation. Originally, Boeing contributed the jet to the museum in 1990, and the museum began work to restore the aircraft for permanent display. Shortly after Boeing donated the aircraft, Boeing identified the need for a test bed airframe for new jet engines and sought to lease the Boeing 747 jumbo jet back from the museum. The museum agreed to lease the aircraft back to Boeing for a two-year term, which was extended slightly. The museum has never before or since leased aircraft for testing or any other purpose. The court concluded that the lease was not an activity that was regularly carried on, because it was a one-time, completely fortuitous lease of unique equipment that was unavailable on the open market.

ANALYSIS

Under sections 511 and 512 of the Code, an organization described in section 501(c)(3) that provides services for a fee will have unrelated trade or business taxable income if the three conditions in section 1.513-1(a) of the regulations are satisfied. First, the income must be from a trade or business. Second, the trade or business is regularly carried on. Third, the trade or business is not substantially related to the organizations performance of its exempt function. The term trade or business has the same meaning for the purposes of section 513 as it does for section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services (See section 1.513-1(b)).

Trade or Business

Section 513(c) of the Code provides that for purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. In addition, section 1.513-1(b) of the regulations states that for purposes of section 513 the term trade or business has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

M is exempt from federal taxation under section 501(c)(3) of the Code. M directs, coordinates and supports the health care industries of the R. M is not in the business of providing real estate brokerage services. A trade or business is defined under section 513(c) of the Code as an activity which is carried for the production of income from the performance of services.

M stipulates that the receipt of the brokerage commission constitutes income to M. M received the brokerage commission income, because S was acting as a real estate broker on behalf of M. Under the terms of S's employment contract with M, S was required to dedicate his full-time and exclusive services, including the use of his real estate license for the benefit of M. Therefore, S was acting as M's agent in negotiating this rental lease agreement. S's activity as an agent resulted in M receiving the brokerage commission income. The receipt of the commission constitutes the performance of services for a fee that results in a trade or business that generates income within the meaning of section 513(c) of the Code and section 1.513-1(b) of the regulations. Having met the trade or business requirement we must analyze whether or not the business activity is regularly carried on.

Regularly Carried On

The regulations provide that specific business activities of an exempt organization will ordinarily be deemed to be regularly carried on under section 1.513-1(c) (1) of the regulations, if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

M entered into a rental lease agreement with U for a building located in V. S, the President and Chief Executive Officer of M served as a co-broker in the negotiation of the leasehold interest on behalf of M. As noted above, S was acting as an agent on behalf of M and M received a brokerage commission. This was the only transaction of its type in which M received a brokerage commission in the past five years. Since his employment with M, S has not engaged in any other brokerage activities on behalf of M.

Entering into a real estate transaction of this nature is unusual for M and appears to be a one-time transaction. This is the only transaction in the last five years in which M received a brokerage commission. In a similar manner as the organization discussed in Museum of Flight Foundation v. United States, 63 F. Supp. 2d 1257 (1999), the receipt of the brokerage commission by M was a one-time, unique event. The receipt of the brokerage commission in this case does not constitute a business that was regularly carried on.

Substantially Related to Exempt Purpose

The regulations provide that a trade or business is related to exempt purposes under Section 1.513-1(d) (2) of the regulations, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is substantially related, for purposes of section 513 of the Code, only if the causal relationship is a substantial one. M's receipt of the brokerage commission income is not substantially related to M's tax-exempt purpose.

Although, M entered into the real estate lease agreement for the purpose of acquiring a building for office space to be used for its general administrative use and for use as medical offices. The receipt of the commission does not have a causal relationship to the achievement of M' exempt purpose.

In evaluating whether trade or business income is substantially related to an exempt function, we consider the relationship between the activity that generated the particular income and the accomplishment of the tax-exempt purpose. Section 1.513-1(d) (1) of the regulations. The activity is substantially related for the purposes of section 513 of the Code only if the causal relationship is a substantial one. Section 1.513-1(d) (2). A substantial casual relationship exists where the performance of the services (from which the income is derived) contributes importantly to the accomplishment of the organization's exempt purpose. See Section 1.513-1(d) (2). Therefore, where the services do not contribute importantly to the accomplishment of the organization's exempt purposes, the income earned is not derived from the conduct of related trade or business.

Among the reasons for which M was incorporated and granted exemption from tax under section 501(c)(3) of the Code are to direct, coordinate, and support the health care industry of the R. While the ultimate usage of the leased building may contribute importantly and be causally related to the performance of M's exempt purposes, the receipt of a real estate brokerage commission income does not contribute importantly to accomplishing M's exempt purpose. Therefore, the receipt of the brokerage commission income is not substantially related to M' tax exempt purpose.

Private Benefit/Inurement

An organization exempt from Federal income tax under section 501(c)(3) of the Code must be organized and operated exclusively for exempt purposes with no part of its net earnings inuring to the benefit of any private shareholder or individual as set out in Section 501(c)(3). In this case there was a potential for private benefit/inurement flowing to S. S, M's CEO, served as the co-broker on behalf of M in negotiating the leasehold interest. As a result a check in the amount of \$ _____ was made payable to the T, the name under which S works as a broker. Pursuant to his employment contract with M, S promptly endorsed the check over to M. Arguably, if S had kept this check and deposited into his personal checking account there possibly could have been an issue with private benefit/inurement. However, since S promptly endorsed the check over to M, no part of M' net earnings inured to the benefit of any private shareholder or individual.

CONCLUSION

Accordingly, based on the information submitted, M's activities concerning the receipt of the brokerage commission income by M will not result in imposition of the unrelated business income tax because the leasing activity is not regularly carried on by M within the meaning of section 513 of the Code. Therefore, the brokerage commission income received as a result of the rental lease agreement transaction is not unrelated business taxable income under section 512 and will not be subject to unrelated business income tax under section 511.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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 by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437