200124022

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

Significant Index Nos.: 501.03-33
513.04-00

Date: 3/13/2001

Contact Person:

ID Number:

T:EO:B 3

Telephone Number:

Employer Identification Number:

Legend:

X =
Y =
Z =
City =
M =
N =
O =

Dear Sir or Madam:

This is in reference to a ruling request submitted by counsel for X regarding the federal income tax consequences of certain proposed transactions (the "Transactions").

X is a not-for profit organization organized in 1967. X has been determined to be a charitable organization described in section 501(c)(3) of the Internal Revenue Code and has been classified as an organization described in section 170(b)(1)(A)(vi) of the Code and not as a private foundation as defined in section 509(a).

Y was organized by X in 1998 as a limited liability company (LLC) and since formation has been wholly owned by X, its sole member. Y was formed by X for the sole purpose of carrying out the Transactions and the subsequent activities contemplated by the Transactions. X intends that for federal income tax purposes Y will be treated as a "division" of X and will not be treated as a separate taxable entity.

X was formed through the collaboration of the City, local community, civic, and business leaders to transform one the older downtown sections of the City into a center of industry, commerce, housing, transportation, governmental services, and cultural and higher educational opportunities. The Downtown serves over half-a-million people, most of whom are members of minority or immigrant populations. The Downtown is located next to the area's most distressed low-income minority community.

In the 1960's, Z, a section 501(c)(3) organization that works to improve the quality of life in the metropolitan area, produced a report that identified the community-wide benefits that could be achieved by revitalizing and rebuilding the Downtown. In response to this report, the then Mayor of the City offered to

/22

establish an office to help combat the degenerative social and economic climate that had taken hold in the community. In response to the Mayor's initiative, X was formed to work with the newly-formed Mayor's office. In 1968, X and the Mayor's office began their collaborative efforts by jointly producing development plans for the Downtown and a neighboring area. X and the Mayor's office worked together to plan and facilitate a multitude of projects in the Downtown area, including such projects as the designation by the City of a 10-acre site for acquisition under the City's urban renewal powers for clearance and redevelopment; the launching of an art center in a vacant building owned by the City; and, the implementation of small capital improvements for certain public streets, including the securing of federal funding for the improvements and the supervision of their construction.

Currently, X's activities fall into three broad categories: (i) planning and development, which involves strategic planning for commercial growth in the Downtown, including forming alliances with local business people and constituents of the area; (ii) business services, which involves providing resources to local small businesses, including a loan program funded by the United States Economic Development Agency and being designated by the Treasury Department's Community Development Financial Institution Program; and (iii) quality of life issues, which involves the development and support of cultural and artistic activities in the area and the formation of special assessment districts for other neighborhood groups to operate.

The Downtown has a significant parking shortage due to the completion of several major development projects, the majority of which have resulted in the loss of spaces available for public parking. These projects have also created new demand for parking (from employees, patrons and visitors who travel to these facilities) and, thereby, have had a doubly adverse impact on the Downtown's parking shortage because, in some instances, these projects failed to account properly for even the needs of their own employees. Additionally, the current parking shortage in the Downtown will be exacerbated by the anticipated completion of two major developments in the core of Downtown.

Having previously become concerned about the looming parking shortage in the Downtown, X had commissioned a preliminary parking study in 1995 by an independent consultant. The study predicted parking shortages in several sections of the Downtown, particularly where a new courthouse was being constructed and where the City planned to put a new building.

As part of its planning and development activities, X organized Y in order to address the need for available, affordable parking in the Downtown as a means of sustaining an upward trend in the Downtown's economic growth.

X, through and in conjunction with Y, intends to undertake the following transactions:

1. <u>The Financing</u>

M, a corporate governmental agency, will issue revenue bonds to assist Y in the acquisition of one parking garage and two parking lots (the "Parking Facilities") from N, a not-for profit local development corporation organized and controlled by the City. N will have acquired title to the Parking Facilities from the City as part of the Transactions. Y will lease the Parking Facilities to M for a nominal payment. M will then lease the Parking Facilities back to Y pursuant to a lease requiring rental payments equal to the principal and interest due under the bonds.

2. <u>The Acquisition</u>

Prior to beginning contractual negotiations with Y, M, on behalf of the City, submitted the proposed

disposition of the Parking Facilities to two public review procedures as mandated by law and, in accordance with those procedures, the sale was approved. The purchase price represents a significant concession by the City to promote the Transactions. The concession consists of the City having forgone establishing the price at competitive auction and having given a credit of 100% of the projected amount of the costs for renovating the Parking Facilities.

3. The Renovation

The parking garage is an aging structure in need of extensive capital repairs, including structural strengthening and repair, and lighting improvements. The majority of the improvements to the parking lots relate to the replacement of parking meters with a computerized pay-as-you go system, and certain structural improvements.

4. The Operation of the Facilities

Y is negotiating a management contract with O, a commercial parking lot owner and manager. The parking lots will be serviced by attendants. All Parking Facilities will be open to all members of the general public on the same terms.

Disregarded Entitities

In Announcement 99-102 1999-43, I.R.B. 545 the Internal Revenue Service expressed its intention to modify the instructions to 1999 Forms 990, 990-EZ, and 990-PF to clarify the reporting requirements of tax-exempt owners of entities disregarded for federal tax purposes under Regulation 301.7701-1 *et seq.* According to this announcement, when an entity wholly-owned by an organization exempt from tax under section 501(a) is disregarded, its operations are treated as a branch or division of its owner.

X has represented that Y will treated as a disregarded entity for federal tax purposes. Therefore, the activities of Y will be treated as the activities of a branch or division of X for purposes of section 501(c)(3) of the Code.

Effect of the Transactions on X's' Exempt Status

Section 501(c)(3) of the Code provides, in part, for an exemption from federal income tax for corporations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the corporation's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as

"operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

In Rev. Rul. 85-2, 1985-1 C.B. 178 the Service determined that an organization that provided legal assistance to guardians ad litem who represent abused and neglected children before a juvenile court that requires their appointment lessens the burdens of government and, therefore, qualifies for exemption under section 501(c)(3) of the Code. As part of its analysis the Service examined whether the organization's activities are activities that a governmental unit considers to be its burdens, and whether such activities actually "lessen" such governmental burden. The ruling notes that a favorable working relationship between the government and the organization is strong evidence that the organization is actually "lessening" the burdens of the government.

The City and the other governmental entities involved in the Transactions have objectively manifested that they consider the provision of parking in the Downtown as a means of combating community deterioration to be their burden. The City has had a continuous close and cooperative relationship with X. Moreover, the City has granted concessions to X to encourage the Transactions. The parking facilities are necessary to serve the needs of several federal and city offices and cultural institutions as well as businesses.

Accordingly, the ownership and operation of the Parking Facilities by Y will qualify as charitable activiities. Since Y is a disregarded entity wholly owned by X, operation of the Parking Facilities will be regarded as a charitable activity of X.

Unrelated Business Income

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax under section 501(c).

Under section 512(a) of the Code, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less allowable deductions 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 business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of the purpose or function constituting the basis for its exemption.

Section I.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activity has a causal relationship to the achievement of any exempt purpose, and is "substantially related" for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income 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 for which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Section 512(b)(4) of the Code provides that, in the case of debt-financed real property, there shall be included, as an item of gross income derived from unrelated trade or business, the amount ascertained under section 514(a)(1) (relating to the percentage of the income from debt-financed property that is taken into account in computing tax under section 511).

Section 514(b)(1) of the Code defines the term "debt-financed property" to mean any property which is held to produce income and with respect to which there is an acquisition indebtedness as defined in section 514(c). Section 514(c)((1)(A) provides that the term "acquisition indebtedness" means, with respect to any debt-financed property, the unpaid amount of the indebtedness incurred by the organization in securing or improving such property.

Section 514(b)(1)(A)(i) of the Code provides that any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose of function constituting the basis for exemption under section 501 will not be included in the term "debt-financed property."

Rev. Rul. 69-269, 1969-1 C.B. 160 holds that the operation of a parking lot for patients and visitors only by a section 501(c)(3) hospital does not constitute unrelated trade or business under section 513 of the Code.

In Rev. Rul. 69-269, the hospital's charitable purposes were furthered by the operation of a parking facility. In its analysis, the Rev. Rul. notes that one of the hospital's stated purposes was the provision of health care for members of the community. The service then reasoned that since (i) the visitation of patients assists in patient treatment and encourages their recovery, and (ii) that the absence of adequate parking facilities may discourage visitation, thereby impeding the maximum effectiveness in achieving one of the hospital's purposes, that the hospital's provision of parking was substantially related to the hospital's exempt purpose.

Similarly, in the instant circumstances, Y's ownership and operation of the Parking Facilities is substantially related to X's exempt purposes. Many individuals who travel to Downtown do so by private automobile. An absence of adequate parking facilities Downtown will likely preclude or discourage individuals from traveling to this area, thereby impeding the Downtown's continued economic recovery and preventing X from achieving maximum effectiveness in accomplishing its purposes. Accordingly, X's ownership and operation of the Parking Facilities will be substantially related to its exempt-purpose.

Although the Parking Facilities will be financed by the issuance of debt, since, as discussed above, X's use of the Parking Facilities is substantially related to its exempt purpose, the Parking Facilities will not be treated as "debt-financed property."

Accordingly, we conclude as follows:

1. The separate legal existence of Y will be disregarded for federal income tax purposes and, as a consequence, the acquisition financing, renovation, operation and use of the Parking Facilities by Y will be treated for federal income tax purposes as the acquisition, financing, renovation, operation and use of the Parking Facilities by X.

2. The acquisition, financing, renovation, operation and use of the Parking facilities by Y will not adversely affect X's exempt status under section 501(a) as a publicly supported charitable organization described in section 501(c)(3).

3. The operation of the Parking Facilities by Y will be substantially related to X's charitable exempt purposes under section 501(c)(3) and will lessen the burdens of government within the meaning of section 1.501(c)(3)-(1)(d)(2) of the Income Tax Regulations.

4. The operation of the Parking Facilities by Y will not constitute an unrelated trade or business of X within the meaning of section 513.

5. The Parking facilities will not be considered to be "debt-financed property" under section 514(b)(1)(a).

6. The income generated by the Parking Facilities will not constitute unrelated business taxable income within the meaning of section 512(a) and will not be subject to tax under section 511.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

Also, this ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited by others as precedent.

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.

Sincerely,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3