



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

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Contact Number:

UIL: 501.03-03; 509.01-01; 512.00-00; 4940.03-00

Legend

State =
Condominium Property =

Dear _____ :

This is in response to your ruling request, dated July 25, 2011. You are requesting certain rulings with respect to the income tax consequences to you under §§ 501(c)(3) and 511 of the Internal Revenue Code ("Code") of the sale of income property.

Facts

You are a charitable trust organized under the laws of the State. You are exempt under § 501(a) as an organization described in § 501(c)(3), and are recognized as a private operating foundation under § 4940(d). Your operations include nine children's centers in State to provide counseling, support, and education to children and their families/caregivers, and to help communities strengthen their systems of care available to orphans and destitute children.

You own over 6,000 acres of land, the majority of which you received by bequest in 1917. Your trust instrument directs your trustees to use your property for the benefit of orphans and other destitute children in State, and directs the trustees to retain and invest a sufficient portion of the trust corpus in income-producing property or securities to provide for the continued maintenance and support of your charitable activities. You have maintained the majority of this land to produce rental income to fund your charitable and educational activities.

In 1959, you entered into a master lease for a parcel of land in State, with a developer who constructed an apartment building and parking structure and then sublet the apartments. In 1971, another party acquired the leasehold and subleasehold interests and submitted them, along with your interests in the land to a declaration of condominium property to create the current condominium project ("Condominium Property"). The master lease was cancelled and you then entered into a separate land lease with the owner of each unit in the project. Thereafter, you collected rents directly from the condominium owners. You currently own the parcel of land but do not own the condominium units on those lands.

You are subject to annual review by a probate court and the State Attorney General. In probate court reports, the court has recommended that you continue to review and evaluate the

advantages and disadvantages of diversification of trust assets in light of your mission and goals. In response to the recommendations, your trustees made significant progress towards the recommended diversification. The court appointed special master reports you have made significant progress towards achieving the court recommended goals such as yield on assets, particularly in the face of the ongoing market uncertainties, and commends you while encouraging you to continue to move forward towards achieving those goals. However, you state that you have not yet achieved the recommended target asset allocations. Accordingly, your trustees have reexamined your holding of interests in the Condominium Property.

The Condominium Property is located in an area that is at risk of damage from hurricanes and flooding. Furthermore, since construction of the Condominium Property, numerous land reform laws and ordinances have been enacted, and you report significant legislative activity for proposed land reform laws, which are adverse to lessors. Existing and proposed laws threaten condemnation or rent control of your leasehold interests including the parcel of land. Thus, while you have traditionally endeavored to retain the land you were bequeathed to produce rental income, your trustees have determined that holding your interests in the Condominium Property is no longer in your best interest.

You plan to liquidate your interests in the Condominium Property by selling them to the current leaseholders and to their condominium association. You are required by State law to give the association a right of first refusal to purchase any interests in the Condominium Properties that you offer to sell. You plan to offer to sell your interests in parcel of land directly to the Condominium Property leaseholders and their condominium association. Your appraiser estimates first year sales of about 42% of units due to historical absorption rates and the balance of the lease to fee conversions occurring over the following fourteen years. Therefore, sales of the Condominium Property may occur for a period as long as fifteen years.

You state that your real estate broker will hold separate information meetings with the leaseholders to describe your leased fee interest in the Condominium Properties, your plans to sell such interests, and the process and procedures involved in such sales. You state that if you are unable to sell all of your interests in the Condominium Property to the lessees and condominium associations, or through unsolicited offers, then you may offer to sell your remaining interests to investment trust(s), developer(s), or other interested investor(s) or buyer(s).

You state that you do not regularly buy or sell real property. You have from time to time sold other lands that you acquired through your founder's gift or bequest, primarily to government or quasi-government entities for public purposes, or in response to mandatory lease-to-fee conversion laws of State, or to comply with court recommended financial strategy. However, you have never sold any of your interests in the Condominium Property.

Because you own the land on which the condominiums sit but not the condominiums themselves, you have neither made nor will make any improvements to any of the Condominium Property.

Rulings Requested

1. Your sales of the leased fee interests in the Condominium Property will not generate unrelated business taxable income under § 511.

2. Your sales of the leased fee interests in the Condominium Property will not adversely affect your current § 501(c)(3) exempt status.

Law

Section 511 imposes a tax on the unrelated business taxable income of exempt organizations, including those described in § 501(c)(3).

Section 512(a)(1) defines "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions, both computed with the modifications listed in § 512(b).

Section 512(b)(5)(B) excludes from the computation of unrelated business taxable income all gains or losses from the sale, exchange, or other disposition of property other than property held primarily for sale to customers in the ordinary course of a trade or business.

Rev. Rul. 55-449, 1955-5 C.B. 599 states that the construction and sale of 80 houses by a foundation otherwise exempt under § 501(c)(3) over a period of 18 months for the sole purpose of raising funds for the support of a church constituted unrelated trade or business within the meaning of § 513, because construction and sale of houses is a business of a kind ordinarily carried on for-profit.

In Malat v. Riddell, 383 U.S. 569, 86 S. Ct. 1030 (1966), the Supreme Court defined the standard to be applied in determining whether property is held "primarily" for sale to customers in the ordinary course of business for purposes of section 1221. The Court interpreted the word "primarily" to mean "of first importance" or "principally."

In Brown v. Commissioner, 143 F.2d 468 (5th Cir. 1944), the taxpayer owned 500 acres of unimproved land used for grazing purposes. He decided to sell the land and subdivided it into lots, built streets, installed storm sewers, constructed gas and electric lines and other activities of the kind usually carried out by a real estate development company. Each year 20 to 30 lots were sold. The court held that the taxpayer was holding lots for sale to customers in the regular course of business.

In Farley v. Commissioner, 7 T.C. 198 (1946), the taxpayer purchased platted land to use in his nursery business. Twelve years later, the city built streets through the property that made it less useful for his business. Even though he made no active sales effort and made no improvements, he sold 25 and a half lots in one year. The court opined that the sales were essentially made "in the nature of a gradual and passive liquidation of an asset" and not in the ordinary course of a trade or business.

In Adam v. Commissioner, 60 T.C. 996 (1973), the Tax Court held that a taxpayer who purchased 11 and sold nine parcels of undeveloped land over four years was not engaged in the trade or business of buying and selling land for purposes of § 1221. The taxpayer utilized brokers to aid him in disposing of some of the land. However, neither he nor the brokers ever sought out or solicited prospective buyers or advertised the properties for sale. The court analyzed the following factors in determining that the taxpayer was not engaged in the operation of the trade or business of buying and selling land:

- (1) the purpose for which the property was acquired;
- (2) the frequency, continuity, and size of the sales;
- (3) the activities of the owner in the improvement and disposition of the property;
- (4) the extent of improvements made to the property;
- (5) the proximity of sale to purchase; and,
- (6) the purpose for which the property was held.

In Adam, 60 T.C. 996 and subsequent cases, courts have found that no one of these factors is controlling but all are relevant to consider in determining whether the sale of property occurred in the regular course of a taxpayer's trade or business. See Biedenharn Realty Co., Inc. v. United States, 526 F.2d 409 (5th Cir. 1976); Houston Endowment, Inc. v. United States, 606 F.2d 77 (5th Cir. 1979); Buono v. Commissioner, 74 T.C. 187 (1980).

Analysis

You received the parcel of land by gift, and have held the parcel for more than 100 years. In 1959, you arranged for the development of this land into Condominium Property. You now desire to liquidate your interests in this land because of changed circumstances, including a lack of liquid assets to meet the needs of your beneficiaries and otherwise support your charitable and educational activities, and existing and future threats of eminent domain and rent control.

The information submitted indicates several facts that distinguish your situation from that of a taxpayer that holds property for sale to customers in the ordinary course of a trade or business for purposes of § 512(b)(5)(B): the land was received by gift and bequest from your founder for the purpose of furthering your charitable activities; you have held the land for nearly 100 years, and as Condominium Property for over 50 years, as an income-producing investment without selling any of it; you have neither made nor will be making any improvements to the properties on the land; and you have not advertised your interest in the land for sale to the general public.

Your facts are distinguishable from those in Rev. Rul. 55-449, supra, in which a foundation constructed and sold 80 houses over a period of 18 months for the sole purpose of raising funds to support a church. They are also distinguishable from the facts in Brown v. Commissioner, 143 F.2d 468 (5th Cir. 1944), in which a taxpayer subdivided and developed property for the purpose of selling the property, then sold 80 lots. In both of these cases, the taxpayers' efforts in acquiring and developing the properties for sale suggested that they were holding the property primarily for sale to customers in the ordinary course of a trade or business. In contrast, you propose to liquidate assets held for investment purposes, as in Farley v. Commissioner, 7 T.C. 198 (1946).

Accordingly, under the primary purpose test of Malat v. Riddell, 383 U.S. 569, 86 S. Ct. 1030 (1966), and the facts and circumstances test of Adam v. Commissioner, 60 T.C. 996 (1973), we conclude that you do not hold your interests in the Condominium Property primarily for sale to customers in the ordinary course of a trade or business. Therefore, your sale of the interests in the Condominium Property will not generate unrelated business taxable income under §§ 511 and 512(b)(5) (and thus will not constitute an excess business holding under § 4943), and will not adversely affect your exempt status under § 501(c)(3).

Rulings

1. Your sales of the leased fee interests in the Condominium Property will not generate unrelated business taxable income under § 511.
2. Your sales of the leased fee interests in the Condominium Property will not adversely affect your current § 501(c)(3) exempt status.

This ruling is based on the understanding that there will be no material change in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service.

This ruling does not address the applicability of any section or regulations to the facts submitted other than with respect to the sections described.

This ruling will be made available for public inspection under § 6110 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) provides that it 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,

Theodore R. Lieber
Manager, Exempt Organizations,
Technical Group 3

Enclosure
Notice 437

cc: