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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: JUL 09 2002

Contact Person:

Telephone Number:

0512.00-00

In reply refer to:
T:EO:RA:T:1

E.I.N.

LEGEND

M =
N =
O =
P =
A =
x =

Dear Sir/Madam:

This is in response to a ruling request submitted on behalf of M that gain from the sale of real property will not result in unrelated business income tax, because the property sold does not constitute property held primarily for sale to customers in the ordinary course of a trade or business within the meaning of section 512(b)(5)(B) of the Internal Revenue Code.

FACTS

M is a nonprofit corporation organized under the laws of the State of N and operates in furtherance of religious and educational purposes. Pursuant to a group ruling issued to O, M is exempt under section 501(a) of the Code as an organization described in section 501(c)(3) and is not a private foundation within the meaning of section 509(a)(3). M operates a religious school to promote, maintain and sustain a resident monastic community, and to promote religious education, life and values.

M owns x acres of land where the monastery and school are located. This property

was acquired over the past 45 years through purchases, gifts and bequests. The initial parcel of land that M acquired was purchased from the family of A. Upon the death of A more than 15 years ago, M was bequeathed approximately 25 acres of land. Approximately 15 acres of the 25-acre parcel consists of a ridge, the top of which lies between 80 and 100 feet above M's campus. The 15-acre portion was deemed not suitable for campus facilities, and a decision was made that such property should be disposed of as surplus property. After consulting with members of a Citizens Advisory Board who are knowledgeable about real estate, it was decided that the highest and best use for the surplus property was as residential building purposes.

Because the surplus land did not constitute a lot of record, Town of P ordinances required that M obtain subdivision approval prior to selling the surplus land. Since the surplus land did not have frontage on a public street or access to public utilities, local ordinances also required that roadways leading to public streets and public utilities be designed, engineer approved and constructed as a condition to the granting of subdivision approval. After several years, M obtained approval for the division of its surplus land into three residential building lots, ranging in size from four and one-half to almost six acres with a total acreage of slightly more than 15 acres.

As a condition to subdivision approval, the Town of P required that M enter into a Subdivision Agreement, which required that M construct certain improvements, primarily the installation of roadways and utilities providing access and services to the three lots. The roadways that must be constructed are short extensions from the end of existing public streets. Furthermore, the Town of P required M to install drainage and landscaping, construct a pedestrian/equestrian trail across the lots, and grant the Town of P an open space easement over a parcel of land which lies between the subdivided land and the campus. Finally, the Town of P required M to post a bond to guarantee M would make the required improvements.

M will hire a contractor to complete the required improvements and sell the lots to one or more third parties. M does not intend to advertise or market the lots for sale. However, if the lots are not sold by means of unsolicited offers within a reasonable period of time, then M may retain a local real estate broker to sell the lots.

During its 45 years of existence, M has never subdivided any of its land, nor sold any portion of its campus. M does not intend to sell any of its remaining land, or purchase any additional land for development or subdivision purposes.

RULING REQUESTED

M's surplus real estate acquired by bequest is not property held primarily for sale to customers in the ordinary course of a trade or business within the meaning of section 512(b)(5)(B) of the Code and consequently the gain to be realized by M on the sale of the surplus real estate is excludable from unrelated business taxable income under section 512(b)(5) and, therefore, will not be subject to the unrelated business income tax under section 511(a).

LAW AND ANALYSIS

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

Section 512(a)(l) of the Code defines the term "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 section 512(b).

Section 512(b)(5)(B) of the Code 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 the trade or business.

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 of the Code. The Court interpreted the word "primarily" to mean "of first importance" or "principally." By this standard, ordinary income would not result unless a sales purpose is of first importance.

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, cut in 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. The fact that he did not buy additional land did not prevent the sales activities from being a business as he had enough land for a business without buying more.

Rev. Rul. 55-449, 1955-5 C.B. 599, states that the construction and sale of 80 houses by a foundation otherwise exempt under section 501(c)(3) of the Code over a period of 18 months for the sole purpose of raising funds for the support of a church constitutes unrelated trade or business within the meaning of section 513 notwithstanding the fact that the organization did not plan to engage in further similar activities.

Factors that have been considered by the courts in determining whether the sale of property has been carried out in the regular course of the taxpayer's business are:

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

As an organization described in section 501(c)(3) of the Code, M is subject to section

511 regarding the imposition of tax on its unrelated business income. M plans to sell a portion of its property, and the question presented is whether the amounts M derives from the sale of such property may be excluded from the computation of unrelated business taxable income as gain from the sale of property under section 512(b)(5). In determining whether this modification is applicable in this case, the factors listed above must be considered.

The information submitted indicates that the property which is the subject of the ruling request was bequeathed to M, and M has held the property for over 15 years. Since M received the property by bequest, it had no business purpose in mind when it initially received the property. Although one purchaser may buy all three or possibly two of M's lots, the maximum number of sales M will make is three, consisting of slightly more than 15 acres. M has neither sold nor subdivided any of its land in the past and has no plans to acquire or sell any of its property in the future. The improvements undertaken by M are the minimum that must be made to the property pursuant to the subdivision approval granted by the Town of P. The creation of access to a public street and the extension of utilities to the land were required by local ordinance, and no development activity will be done to the lots beyond that which is mandated by the Town of P. M has undertaken no marketing effort with respect to the sale of the property; no promotional or sales material has been prepared, and no signs advertising the property for sale have been posted on the land.

The fact that the property was received by bequest and held for 15 years; the small number of lots and acreage to be sold; the fact that improvements were mandated by the Town of P and its local ordinances, and the lack of marketing efforts and advertising of the property differentiates this situation from that of a taxpayer which holds property for sale to customers in the ordinary course of a trade or business for purposes of section 512(b)(5)(B) of the Code.

RULING

Based on the facts and information submitted and the representations made, we conclude that:

M's surplus real estate acquired by bequest is not property held primarily for sale to customers in the ordinary course of a trade or business within the meaning of section 512(b)(5)(B) of the Code and consequently the gain to be realized by M on the sale of the surplus real estate is excludable from unrelated business taxable income under section 512(b)(5) and, therefore, will not be subject to the unrelated business income tax under section 511(a).

Except as specifically ruled upon above, no opinion is expressed concerning the federal tax treatment of the transaction described above under any other provision of the Code

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. You should keep a copy of this letter in your permanent records.

This letter 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.

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

Sincerely yours,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, EO Technical
Technical Group 1