



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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237801/SE:T:EO:RA:T:1

Legend:

C =

D =

E =

F =

Dear :

This is in response to your request for a ruling regarding a proposed sale of real property.

Facts

You are a charitable trust organized under the laws of the state of C. You are exempt under section 501(a) of the Code as an organization described in section 501(c)(3), and are recognized as a private operating foundation under section 4940(d).

Your trust instrument directs your trustees to use your property for the benefit of orphans and other destitute children in the state of C, 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 own over 6,000 acres of land, approximately 90% of which is under conservation or agricultural land use restrictions. Your founder gave you the majority of this land nearly 100 years ago. You have maintained the majority of this land to produce rental income to fund your charitable and educational activities. In particular, you operate nine children's centers in C 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.

Between and , you arranged for the development of three parcels of land (D, E, and F) into condominiums (collectively "Condominium Properties"). You currently own or co-own D, E, and F, but do not own the condominium units on those lands.

You and the co-owner of D entered into a master ground lease with a developer that built condominiums on D, sold each unit, and subleased the land to each condominium owner.

You and the co-owner of E entered into a master ground lease with a developer that built condominiums on E, sold each unit, and subleased the land to each condominium owner. Subsequently, you and the co-owner of E purchased the developer's "sandwich" position, and now collect rents directly from the condominium owners.

You own all the land underlying the condominiums on F, and have entered into ground leases with all the condominium owners directly; no "sandwich" position is involved.

You are subject to annual review by a probate court and the state attorney general. In recent 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. Accordingly, your trustees have reexamined your holding of interests in the Condominium Properties.

You are emerging from financial hardship and seeking greater financial stability, diversification of assets, and income for your charitable and educational activities as your beneficiaries' needs are growing. You are liquidity-challenged, with assets that yield less than 4% annually for your charitable activities. In addition, the Condominium Properties are located in an area that is at risk of damage from hurricanes and flooding. Thus, your trustees have determined that it is no longer in your best interest to continue holding your interests in the Condominium Properties.

You plan to liquidate your interests in the Condominium Properties by selling them to the current leaseholders and to their respective condominium associations. You are required by C law to give the associations 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 F directly to the F leaseholders and their condominium association. You plan to acquire the interests of the co-owners of D and E in those properties, and to acquire the "sandwich" leasehold interest of E's developer, so that you can sell the complete leased fee interests in D and E.

Your real estate broker will be holding 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 or your broker will mail an information notice to the leaseholders within two weeks of these meetings. You have not planned any additional marketing or advertising of your interests in the Condominium Properties. Nor have you placed a "for sale" sign on D, E, or F. If you are unable to sell all of your interests in the Condominium Properties to the leaseholders 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 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 C. However, you have never sold any of your interests in the Condominium Properties.

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 Properties.

Rulings Requested

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

Law

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)(1) of the Code 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 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 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 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 constituted unrelated trade or business within the meaning of section 513, because construction and sale of houses is a business of a kind ordinarily carried on for-profit.

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 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."

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 section 1221 of the Code. 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 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).

In Rymer v. Commissioner, T.C. Memo 1986-534, a taxpayer who held property acquired for investment purposes purchased an adjacent property to facilitate the sale of his investment property. The court held that the purchase of the adjacent property was not sufficient to raise the taxpayer's sales activities to the level of a trade or business, or to cause the sale to be treated as part of the ordinary course of a trade or business.

ANALYSIS

You received most of the D, E, and F land by gift, and have held these parcels for nearly 100 years. Between and you arranged for the development of this land into Condominium Properties. 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.

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 section 512(b)(5)(B) of the Code: 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 Properties for 25-29 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, supra, 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, supra.

You plan to purchase the interests of your co-owners and a "sandwich" holder in two of the Condominium Properties so that you can sell those properties to leaseholders and/or their respective condominium associations. As in Rymer v. Commissioner, supra, such purchase will facilitate your sale of the investment property and will not be in the ordinary course of a trade or business.

Accordingly, under the primary purpose test of Malat v. Riddell, supra, and the facts and circumstances test of Adam v. Commissioner, supra, we conclude that you do not hold your interests in the Condominium Properties primarily for sale to customers in the ordinary course of a trade or business. Therefore, your sale of the interests in the Condominium Properties will not generate unrelated business taxable income under sections 511 and 512(b)(5) of the Code, and will not adversely affect your exempt status under section 501(c)(3).

Rulings

1. Your sales of the leased fee interests in the Condominium Properties will not generate unrelated business taxable income under section 511 of the Code.
2. Your sales of the leased fee interests in the Condominium Properties will not adversely affect your current section 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 of the Code or regulations to the facts submitted other than with respect to the sections described.

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.

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,

Lawrence M. Brauer

Steven Grodnitzky
Manager
Exempt Organizations,
Technical Group 1

Enclosure: Notice 437

CC :