

§ 8013—Unrelated Business Income

34 Am Jur 2d

erty leased under or in connection with the lease of real property.³

Distributions received on shares of a *qualified* Code Sec. 856 real estate investment trust aren't treated as lease income even though the real estate investment trust derives its income from rents received from mortgaged real estate. The distributions are treated as corporate distributions which are excluded from unrelated business taxable income.⁴

Business lease deductions include:

... Taxes and other expenses with respect to the leased real property.

... Interest on the business lease indebtedness.

... Depreciation on the leased property.⁵

In general, only that percentage of the rents and deductions allocable to the business lease indebtedness is included in computing unrelated business taxable income. This is the same percentage (not over 100%) as the business lease indebtedness is of the adjusted basis of the leased premises, at the close of the taxable year.⁶

The adjusted basis of the leased premises is determined under the rules applicable to taxpayers generally for the entire period since acquisition of the property by the exempt organization. Thus depreciation must be deducted for all taxable years whether or not the organization was exempt in any year. And the entire amount of depreciation must be deducted from basis notwithstanding that only a portion of the depreciation is taken into account in computing unrelated business taxable income.⁷

The Treasury regs contain examples illustrating the computation of business lease income.⁸

1. Code Secs. 512(b)(4) and 514(a).
2. Code Sec. 514(b)(1).
3. Code Sec. 514(b).
4. Rev. Rul. 66-106, IRB 1966-18, 12.
5. Code Sec. 514(a)(3).
6. Code Sec. 514(a).
7. Regs. § 1.514(a)-1(a)(2).
8. Regs. § 1.514(a)-1(b).

§ 8013. Leases related to exempt purpose aren't business leases. The following aren't "business leases":

... Lease entered into primarily for purposes substantially related (apart from need for funds) to the purpose constituting the basis for the organization's exemption.

... Lease of premises in a building primarily designed for occupancy, and occupied, by the exempt organization.¹

A lease, under ordinary commercial arrangements, by an exempt foundation of a school building to an exempt educational institution was held not to be for a purpose substantially related to the foundation's exempt purposes notwithstanding that the foundation was or-

ganized in part for educational purposes.² But lease of a building by a foundation, organized in part for medical purposes, to a clinic was held not to be a business lease by a district court which found the lease to be within the ambit of the foundation's exempt purpose. This decision was later reversed on stipulation without consideration of its merits.³

1. Code Sec. 514(b)(3).
2. Rev. Rul. 58-547, CB 1958-2, 275.
3. *Huron Clinic Foundation v. U.S.*, 212 F. Supp. 847, rem'd on stip. 324 F. (2d) 43.

§ 8014. When is term of lease over 5 years. Only a lease for a term of more than 5 years is a business lease. The term of a lease includes:¹

... Any period for which a renewal or extension option may be exercised. This includes a renewal option in a separate agreement.²

... The period of the prior lease, in the case of a lease made by exercise of a renewal or extension option.

If real property is acquired by the exempt organization subject to a lease, the term is deemed to begin on the date of acquisition.

Even though there is no over-5 year lease or any lease at all, real property will be deemed to be occupied under a lease for a term of more than 5 years beginning with the 6th year of continuous occupancy by the same tenant. Successive tenants are considered to be the same tenant where they are so related that losses on sales or exchanges between them would be disallowed under the Code provision barring recognition of losses in transactions between related taxpayers.³

✓ *observation:* The mere fact that the lease term isn't over 5 years doesn't necessarily mean that rents received by the tax exempt organization aren't taxable. The rents may be taxed under the general definitions of unrelated business taxable income unless they fall within the Code Sec. 512(b)(3) exclusion for rents from real property. The Treasury may attempt to tax such rents if it determines that they are really profits rather than rents, as noted at § 8008.

1. Code Sec. 514(b).
2. *Chamber of Commerce of Kansas City, Kans.*, 35 T.C. 362.
3. Code Sec. 514(b)(2).

§ 8015. Property only partly leased for over 5 years. If real property is partly leased for a term of over 5 years and partly for 5 years or less, the over-5 year leases will be considered business leases during the taxable year *only if one* of the following requisites is satisfied:

... The over-5 year leases account for 50% or more of the rents for the year.