TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200532058**
Release Date: 8/12/05
235310/SE:T:EO:RA:T:2

Date: 05/18/05

Contact Person:

Identification Number:

Contact Number:
(202)

Uniform Issue List
501.03-19 514.06-00
513.00-00 4942.03-05
513.04-00 4942.05-02
514.04-00 4943.04-03

Employer Identification Number:

Legend:

M =
N =
O =
P =
Q =
R =

Dear :

We have considered M's ruling request dated August 10, 2004, submitted on M's behalf by its authorized representative, relating to the retention of M's tax exempt status under section 501(c)(3) of the Internal Revenue Code, the application of the unrelated business income tax provisions of the Code (sections 511-514) to the proposed transactions described below, and the applicability of Code sections 4942(g) and 4943(d)(3), relating to excise taxes for private foundations, to the proposed transactions.

FACTS:

M is a nonprofit corporation located in the State of N and organized under the laws of N. M has been recognized by the Internal Revenue Service as exempt from federal income tax as an organization described in section 501(c)(3) of the Code. M has also been classified as a private non-operating foundation within the meaning of section 509(a) of the Code.

M's Articles of Incorporation and Bylaws state that M is organized and operated for the purpose of receiving and administering funds for "such religious, charitable, educational and scientific organizations", as permitted for organizations described in section 501(c)(3) of the Code, and, in particular, the making of distributions to qualified section 501(c)(3) organizations.

M now proposes to amend the above articles and bylaws to include the following language:

> To promote the health and welfare of the community by providing access to public recreational amenities and programs.
>
> To lessen the burdens of government by providing public recreational amenities and programs that shall be available to the general public without regard to race, creed, color or religion.

On the operational level, M proposes to own, build, maintain, and lease a public ice arena ("Ice Arena''), in order to promote the health and welfare of the community and to lessen the burdens of government. M has the support of local government in this endeavor. This support is evidenced by letters from two local officials, addressed to M. The letters, dated in June and July of 2004, are, respectively, from the Supervisor of R Township and the Mayor of a local city. Both officials point to the recreational benefits to people of all ages in the community from the establishment of an ice rink. The letter from the Supervisor also states that the R Township itself would undertake the project if it had the financial resources.

.

M would be the sole member of an N limited liability company (O), established for the purpose of buying land and developing Ice Arena. It is possible that Ice Arena would be developed on land owned by a governmental entity. O's governing documents, consisting of an Operating Agreement and Articles of Organization, would provide that O is to be managed by a governing board made up of individuals chosen by M. As sole member of O, M will at all times control O and any income produced by O would be applied to further M's exempt purposes.

Financing for the construction of Ice Arena would be obtained through a contribution to capital and/or loan from M to O, government grants, and loans from third party corporate banking institutions to O. O will not operate Ice Arena; O will only develop Ice Arena and be the landlord/facility owner. O would lease Ice Arena to third party entities at a fair market value rate. You have furnished a copy of the proposed lease.

The Ice Arena facility shall be approximately 110,000 square feet, with two ice sheets. Each ice sheet shall be 200 ft. x 85 ft., to conform with National Hockey League and college rink specifications. Each ice sheet shall have seating to accommodate up to 250 spectators. The Ice Arena shall also include a dry floor training center: a 100 ft. x 60 ft. dry floor rink. This is designed to supplement the ice sheet and allow for a full scale off-ice practice facility.

The Ice Arena will include a 2,000 sq. ft. pro shop. The pro shop will meet the needs of Ice Arena users by providing skate sharpening services and a full line of hockey and figure skating equipment and accessories. The Ice Arena will also include a 3,000 sq. ft. coffee shop and concession area. It will be designed to provide convenient access to food and beverage services for users of Ice Arena.

The Ice Arena may also include a 1,000 sq. ft. lounge. The lounge is designed to provide adult visitors a place to relax while their children use Ice Arena facilities. The Ice Arena may also include a 1,000 sq. ft. child room/day care center. This is designed to provide for a safe, educational environment for young children while parents or other family members use Ice Arena.

Other possibilities include a 2,000 sq. ft. conference center, a 10,000 sq. ft. gymnastics facility, and a 10,000 sq. ft. athletic medicine center.

If any tangible personal property is leased by M as lessor, the amount of rent to be received from such leasing will not exceed 15% of the total rent for the real property and fixtures of Ice Arena plus such personal property.

The Ice Arena and all related facilities shall be available for use by the general public at fair market value rates without regard to race, creed, color, or religion. In a letter sent by FAX on May 18, 2005, M's authorized representative, an attorney, assures us that M, O, and any other entities the Ice Arena is leased to will not charge rents that are in excess of commercially reasonable rates for the facility and geographic area involved. This provision will be made a condition of any lease or sublease that is entered into.

The pro shop, coffee shop, and day care center will be leased to independent, for profit third parties at fair market value rates. Neither the creator of M or any family member thereof, nor any member of M's Board of Directors, disqualified persons or officers of M or persons controlled, directly or indirectly, by such private interests, will have any ownership interests in any third party entity to which O leases or contracts regarding Ice Arena. Your submission includes the Business Plan for Ice Arena.

The lease for Ice Arena will require the lessee to offer the following or comparable programs or facilities at cost:

(1) A P Program shall be offered to provide disadvantaged youth in the local area the opportunity to learn to skate and to attend a day program at Ice Arena.

(2) A Friday Night Q Program shall be offered to provide a safe and fun alternative for high school age students at Ice Arena.

(3) Senior citizens are to be provided with dedicated exercise and meeting space at Ice Arena.

(4) Meeting rooms are to be made available on a first come, first serve basis for any government or nonprofit organization.

M has been working closely with local municipalities to ensure their interest in the Ice Arena project. M has received assurances that the proposed Ice Arena would be a valuable community asset because it would provide a public recreation amenity for the local residents. You have included copies of correspondence to this effect.

RULINGS REQUESTED:

You request that we rule as follows:

(1) The development of Ice Arena through a limited liability company (O), of which M is the sole member, will not jeopardize M's exemption under section 501(c)(3) of the Code with respect to its qualification under the organizational test of section 501(c)(3).

(2) The development of Ice Arena through O, of which M is the sole member, wherein O will lease Ice Arena to independent third parties, will not jeopardize M's exemption under section 501(c)(3) of the Code with respect to its qualification under the operational test of section 501(c)(3).

(3) Even if Ice Arena includes certain segments that are not in furtherance of exempt purposes under section 501(c)(3) of the Code, the development of such facilities will not adversely affect M's tax exempt status under section 501(c)(3).

(4) Income derived by M through the development of Ice Arena will not be subject to tax under section 511 of the Code inasmuch as ownership of Ice Arena has a substantial causal relationship to the achievement of M's exempt purposes, as set forth in section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations.

(5) Income derived by M through the ownership, maintenance, and leasing of certain ancillary facilities will not be subject to tax under section 511 of the Code, based on application of the "fragmentation rule" set forth in section 513(c).

(6) Income derived by M through the development of Ice Arena will not constitute debt financed income within the meaning of section 514 of the Code and, accordingly, will not be subject to tax under section 511.

(7) Lease payments received by M with respect to Ice Arena, whether or not in furtherance of an exempt purpose under section 501(c)(3) of the Code, but subject to section 514, will be excluded from the computation of unrelated business taxable income under section 512(b)(3) as rent from real property and rents for personal property that are an incidental amount of the total rents received.

(8) The development of Ice Arena is not an unrelated trade or business under section 513 of the Code.

(9) The activities contemplated by M in connection with Ice Arena will not constitute a "business enterprise" within the meaning of section 4943(d)(3) of the Code.

(10) Expenditures incurred by M to develop Ice Arena will be treated as qualifying distributions under section 4942(g)(2) of the Code.

(11) O does not need a separate ruling with regard to its tax treatment because it is wholly owned by M; the tax status and treatment of M are applicable to O.

LAW:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations that are organized and operated "exclusively" for charitable, religious, educational, or other specified exempt purposes, no part of the net earnings of which 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 qualify for exemption under Code section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that, in general, an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes, and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

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 exempt purposes under Code 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. Thus, in construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau v. United States, 236 U.S. 279 (1945), the Supreme Court of the United States stated, "This plainly means that the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for a section 501(c)(3) purpose unless it serves a public rather than a private interest. Thus, it is necessary that the organization establish that it is not operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense and includes the promotion of social welfare through the relief of the poor and distressed or of the underprivileged, erection or maintenance of public buildings, monuments, or works, lessening of the burdens of government, or attempting (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; and (iv) to combat community deterioration and juvenile delinquency.

Rev. Rul. 67-325, 1967-2 C.B. 113, holds that an organization which provides recreational facilities without charge to the residents of a township is not organized and operated exclusively for charitable purposes where the use of the facilities is restricted

to less than the entire community on the basis of race. Accordingly, the organization does not qualify for exemption under section 501(c)(3) of the Code.

The organization is a nonprofit organization formed for the purpose of providing community recreational facilities, including a swimming pool, an athletic field, and a pavilion suitable for picnics and other activities. The facilities are available without charge to residents of the community without regard to age, physical condition, or social or economic circumstances. However, the organization restricts the use of the facilities to persons of a particular race.

Rev. Rul. 67-325 notes that prior to 1959, the Internal Revenue Service did not generally recognize that contributions to organizations providing community recreational facilities were deductible for income tax purposes, i.e., such entities were not tax exempt under Code section 501(c)(3), even though the facilities were provided free of charge for use by all the residents of the particular community. In 1959, however, the previously published nonacquiescence in the decision of the Tax Court of the United States in *Isabel Peters v. Commissioner,* 21 T.C. 55 (1953), nonacquiescence, 1955-1 C.B. 8, was withdrawn and an acquiescence was published in 1959-2 C.B. 6. Rev. Rul. 59-310, 1959-2 C.B. 146, states the reasons for the acquiescence.

The *Peters* case involved an issue as to deductibility under section 23(o) of the Internal Revenue Code of 1939 (corresponding to section 170 of the 1954 and 1986 Codes) of a contribution by an individual to a nonprofit corporation formed to operate a public beach, playground, and bathing facilities for the residents of a particular geographical area. No charge was made for the use of the beach. The Tax Court specifically found as a fact that there was “no restriction or discrimination” in the use of the beach other than its restriction to the residents of the defined community. The corporation was otherwise organized and operated in accordance with the requirements of section 23(o) of the1939 Code. However, the Service had ruled that the organization was only entitled to exemption under section 101(8) of the 1939 Code (corresponding to section 501(c)(4) of the 1954 and 1986 Codes) and accordingly, had not been included in the Cumulative List of Organizations (now Publication 78), the volume which lists the names of organizations contributions to which are tax deductible.

The Tax Court stated (at page 59) the following:

> The evidence clearly shows that the dominant purpose in establishing and maintaining the foundation was to provide convenient swimming and recreation facilities for all persons residing in Cold Spring Harbor School district of the Town of Huntington and especially those who could not afford individually to acquire and maintain such facilities. A contribution was not a prescribed condition to the use of … (the community beach and recreation

> facilities) by any resident of Cold Spring Harbor. … No fees were charged. … In our opinion, the Foundation, a nonprofit organization dedicated solely to the promotion of social welfare, should be classified as charitable as that term is used in the statute relied upon.

Rev. Rul. 59-310, supra, dealt with an organization wherein the facts were in all respects similar to those in the *Peters* case except that the organization did not receive all of its funds from public subscription. Instead, the organization derived some income from charges for admission to the swimming pool. However, this fact was regarded as not controlling because such income was minor in amount and viewed as "purely incidental to the operation of the pool." The revenue ruling then concluded as follows:

> Accordingly, since the property and its uses are dedicated to members of the general public of the community and are charitable in that they serve a generally recognized public purpose which tends to lessen the burdens of government, it is concluded that the instant organization is exclusively charitable within the meaning of section 501(c)(3) of the Code and is entitled to exemption from Federal income tax under section 501(a) of the Code.

Rev. Rul. 67-325 then comments as follows: "The conclusions reached in the *Peters* case and in Revenue Ruling 59-310 are in accord with the general law of charity, that is, that community recreational facilities may be classified as charitable if they are provided for the use of the general public of the community. If that condition is satisfied, a sufficient public purpose is deemed to be served to justify treatment of the dedication of the facility as charitable for purposes of the law of charitable trusts… "

Rev. Rul. 70-86, 1970-1 C.B. 128, holds that a nonprofit organization formed to preserve and improve a lake used extensively as a public recreational facility qualifies for exemption under section 501(c)(3) of the Code.

The organization is financed by contributions from lake front owners, members of the community adjacent to the lake, and municipalities bordering the lake. The lake is used extensively by the public for recreational purposes. The organization's principal activity is to treat the water, to remove algae, and to otherwise improve the condition of the water for recreational purposes. Rev. Rul. 70-186 states that by ensuring the continual use of the lake for public recreational purposes, the organization is performing a charitable activity. Rev. Rul. 67-325, discussed supra, is cited.

Rev. Rul. 70-186 further states that any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. "In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners. See Revenue

Ruling 66-358, 1966-2 C.B. 218, which relates to an organization exempt under section 501(c)(3) of the Code operating and maintaining a public park with incidental private benefits."

Rev. Rul. 66-358, supra, describes a situation wherein a corporation contributed funds and realty adjacent to its plant reception area to a section 501(c)(3) organization. The exempt organization used the funds and realty to establish a park for the use of the general public. Held, acceptance of this gift by the exempt organization will not affect its exempt status even though the donor retained the right to continue using the picture of a certain scene in the park as its brand symbol.

Rev. Rul. 66-258 cites the definition of the term "charitable" in section 1.501(c)(3)-1(d)(2) of the regulations to include the erection or maintenance of public buildings, monuments, or works, the lessening of the burdens of government, and the promotion of social welfare by organizations designed to accomplish any of these purposes. "Establishing and maintaining a public park is an activity similar to those mentioned and may qualify as charitable."

Concerning the unrelated business tax issues presented:

Section 511 of the Code imposes a normal tax and a surtax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c)(3) of the Code.

Section 512(a)(1) of the Code provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business.

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of section 513, only if the causal relationship is a substantial one. For this relationship to exist, the production or the performance of the service from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes. Whether the

activities productive of gross income contribute importantly to such purposes depends in each case upon the facts and circumstances involved.

Section 514(a) of the Code defines the term “unrelated business taxable income” to include a percentage of the net income derived from “debt-financed property”. This percentage, in general, has as its numerator and denominator the average “acquisition indebtedness” and the average adjusted basis, respectively, for the year with respect to the debt-financed property.

Section 514(b)(1)(A) of the Code defines the term “debt-financed property” to mean property that is held to produce income and with respect to which there is an “acquisition indebtedness”, except that such term does not include 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 exempt purposes.

Section 514(c)(1)((A) of the Code defines the term “acquisition indebtedness” to mean, with respect to any debt-financed property, the unpaid amount of –

(A) the indebtedness incurred by the organization in acquiring or improving such property;

(B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and

(C) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Section 1.514(b)-1(b)(1)(ii) of the regulations excludes from the definition of “debt-financed property” any property the use of which is substantially related to the exercise or performance of an organization’s charitable, educational, or other exempt purpose if 85 percent or more of such property is devoted to the organization’s exempt purposes.

Rev. Rul. 74-399, 1974-2 C.B. 172 holds that the operation of a dining room, cafeteria, and snack bar by an exempt art museum for use by the museum staff, employees, and members of the public visiting the museum does not constitute an unrelated trade or business activity within the meaning of section 513 of the Code. The ruling states that the facilities in question are accessible from the museum’s galleries and other public areas but are not directly accessible from the street. The patronage of

the eating facilities by the general public is not directly or indirectly solicited nor are the facilities contemplated or designed to serve as a public restaurant.
Profits, if any, are dedicated to the furtherance of the museum's exempt purposes.

Rev. Rul. 74-399 first cites the definition of "unrelated trade or business" in Code section 513 and then cites section 1.513-1(d)(2) of the regulations, which states that a trade or business is "substantially related" only if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of exempt purposes.

The revenue ruling discusses Rev. Rul. 69-268, 1969-1 C.B. 160, wherein a hospital operated a cafeteria and coffee shop that was open to persons visiting hospital patients. The Service held that the operation of the eating facilities was not unrelated trade or business within the meaning of Code section 513 pursuant to the following rationale: Visits by outsiders are a form of supportive therapy that assists in the recovery of patients. The provision of eating facilities enabled the visitors to spend more time with the patients and thus contributed importantly to the hospital's exempt purpose.

Rev. Rul. 74-399 then reasoned with respect to the facts it depicted that:

> …the operation of the eating facilities within the museum premises helps to attract visitors to the museum exhibits. Because there are places of refreshment in the museum visitors are able to devote a greater portion of their time and attention to the museum's collection, exhibits and other educational facilities than would be the case if they had to interrupt or terminate their tours of the museum to seek outside facilities at mealtime. The eating facilities also enhance the efficient operation of the entire museum by enabling the museum staff and employees to remain on its premises throughout the workday. Thus, the museum's operation of the eating facilities is a service that contributes importantly to the accomplishment of its exempt purposes.

Concerning the ruling requests pertaining to the foundation excise taxes:

Section 4942(g) of the Code defines "qualifying distributions" as any amount paid to accomplish one or more purposes described in section 170(c)(2)(B), or any amount

paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 53.4942(b)-1(b)(1) of the Foundation and Similar Excise Taxes Regulations provides that amounts paid to acquire or maintain assets, which are used directly in the conduct of the foundation's exempt activities, such as the operating assets of a museum, public park, or historic site, are considered direct expenditures for the active conduct of the foundation's exempt activities.

Section 4943(a) of the Code imposes an excise tax on a private foundation's excess business holdings in a business enterprise. Subparagraph (c) defines excess business holdings as the amount of stock or other interest in an enterprise, which the foundation would have to dispose of in order for its remaining holdings in that enterprise to be permitted holdings.

Section 4943(d)(3)(A) of the Code provides that the term "business enterprise" does not include a functionally related business (as defined in section 4942(j)(4)).

Section 4942(j)(4) of the Code provides that the term "functionally related business" means a trade or business which is not an unrelated trade or business (as defined in section 513), or an activity which is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exempt purposes of the organization.

Section 53.4943-10(a) of the regulations provides that a "business enterprise" includes the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services, and which constitutes an unrelated trade or business under section 513 of the Code. Subparagraph (b) states that the term "business enterprise" does not include a functionally related business as defined in section 4942(j)(4).

ANALYSIS:

The proposed amendments to M's articles and bylaws, as set forth in FACTS above, state purposes which are considered "charitable" within the meaning of Code section 501(c)(3) and section 1.501(c)(3)-1(d)(2) of the regulations. The development of Ice Arena by O, a limited liability company controlled by M, is in conformance with the purposes stated in the proposed amendments. Accordingly, M should continue to meet the organizational test under section 501(c)(3).

Concerning the operational test under section 501(c)(3), Ice Arena will be open to all members of the public without regard to race, creed, color, or religion. The provision of recreational facilities open to all residents of a particular community on a nondiscriminatory basis promotes social welfare within the definition of "charitable" in section 1.501(c)(3)-1(d)(2) of the regulations and Code section 501(c)(3). See the holdings and the reasoning in Rev. Ruls. 67-325, 59-310, 70-186, and 66-358, and the Tax Court case of *Isabel Peters v. Commissioner*, 21 T.C. 55 (1953), supra.

You have represented that any elements of Ice Arena that are not in furtherance of exempt purposes within the meaning of section 501(c)(3) will be "incidental in nature and amount". Such limited or insubstantial use of Ice Arena will not cause M to be disqualified under the operational test of section 501(c)(3). See section 1.501(c)(3)-1(c)(1) of the regulations and the comments in the *Better Business Bureau* case, supra.

The operation of an ice arena involves, in part, the conduct of activities carried on for the production of income from the sale of goods or the performance of services. These activities ordinarily manifest a frequency and continuity, and are pursued in a manner generally typical of for-profit entities, i.e., commercial skating rinks. However, M will not directly conduct such activities; instead, it will lease space to others, who, in turn, will undertake such activities. Amounts derived from leasing Ice Arena would be excluded from the computation of unrelated business taxable income under Code section 512(b)(3) as rent from real property and rents for personal property that are an incidental amount of the total rent received.

Ordinarily, a portion of the rental payments for Ice Arena could constitute unrelated business taxable income under Code sections 512(b)(4) and 514 to the extent the facilities are debt financed property under section 514(b)(1). However, M's leasing of Ice Arena, pursuant to the conditions relating to community benefit imposed upon any lessor, as detailed above, will contribute importantly to M's charitable purposes. See section 1.501(c)(3)-1(d)(2) of the regulations and the cited letters from local officials. Inasmuch as these activities have a substantial causal relationship to the achievement of M's exempt purposes, all income, even debt financed income, derived by M from the operation of Ice Arena will not be subject to tax under section 511.

Even if M received some income directly from the sale of soft drinks or snacks or rental of skating equipment, such income should not constitute unrelated business taxable income under section 512(a)(i) of the Code, based on application of the "fragmentation rule" applicable under section 513(c) to ancillary activities of Ice Arena. See the discussion and holdings in Rev. Ruls. 74-399 and 69-268, supra. Furthermore, the receipt of such non-rental income would be unexpected and incidental. However, M acknowledges that income derived from the sale of clothing such as hats or shirts with

Ice Arena's logo may be unrelated business taxable income under section 512(a)(1). Such sales may be deemed to be not substantially related to the exempt purposes of M.

Concerning the issues of debt financed income under section 514 of the Code and excess business holdings under section 4943, income from the development of Ice Arena should not constitute unrelated business taxable income because such revenues will be derived from a trade or business that is substantially related to M's exempt purposes. Therefore, such income will not constitute debt financed income within the meaning of section 514, and, accordingly, will not be subject to tax under section 511; see section 1.514(b)-1(b)(1) of the regulations. In addition, M's development of Ice Arena is a functionally related business under section 4942(j)(4). As such, it is not a business enterprise pursuant to section 4943(d)(3)(A), as described in section 53.4943-10(a) and (b) of the regulations.

RULINGS:

Based on the foregoing, we rule as follows:

(1) The development of Ice Arena through a limited liability company (O), of which M is the sole member, will not jeopardize M's exemption under section 501(c)(3) of the Code with respect to its qualification under the organizational test of section 501(c)(3).

(2) The development of Ice Arena through O, of which M is the sole member, wherein O will lease Ice Arena to independent third parties, will not jeopardize M's exemption under section 501(c)(3) of the Code with respect to its qualification under the operational test of section 501(c)(3).

(3) Even if Ice Arena includes certain insubstantial segments that are not in furtherance of exempt purposes under section 501(c)(3) of the Code, the development of such facilities will not adversely affect M's tax exempt status under section 501(c)(3).

(4) Income derived by M through the development of Ice Arena will not be subject to tax under section 511 of the Code inasmuch as ownership of Ice Arena has a substantial causal relationship to the achievement of M's exempt purposes, as set forth in section1.501(c)(3)-1(d)(2) of the regulations.

(5) Income derived by M through the ownership, maintenance, and leasing of certain ancillary facilities will not be subject to tax under section 511 of the Code, based on application of the "fragmentation rule" set forth in section 513(c).

(6) Income derived by M through the development of Ice Arena will not constitute debt financed income within the meaning of section 514 of the Code and, accordingly, will not be subject to tax under section 511.

(7) Lease payments received by M with respect to Ice Arena, whether or not in furtherance of an exempt purpose under section 501(c)(3) of the Code, but subject to section 514, will be excluded from the computation of unrelated business taxable income under section 512(b)(3) as rent from real property and rents for personal property that are an incidental amount of the total rents received.

(8) The development of Ice Arena is not an unrelated trade or business under section 513 of the Code.

(9) The activities contemplated by M in connection with Ice Arena will not constitute a "business enterprise" within the meaning of section 4943(d)(3) of the Code.

(10) Expenditures incurred by M to develop Ice Arena will be treated as qualifying distributions under section 4942(g)(2) of the Code.

(11) O does not need a separate ruling with regard to its tax treatment because it is wholly owned by M; the tax status and treatment of M are applicable to O.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax exempt status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is 877-829-5500 (a toll free number).

Pursuant to a Power of Attorney on file in this office, we are sending a copy of this letter to your authorized representative.

We are also sending a copy of this ruling to the Ohio TE/GE Customer Service Office. Because this letter could help resolve any questions about your exempt status, it should be kept with your permanent records.

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

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 as precedent.

Thank you for your cooperation.

Sincerely,

Jane Baniewicz
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437