



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200534025**
Release Date: 8/26/2005
SE:T:EO:PA:T:1

Date: May 31, 2005

Contact Person:

Identification Number:

Telephone Number:

UIL Code:
514.07-00

Employer Identification Number:

Legend:

L =

M =

N =

O =

P =

R =

S =

T =

Date a =

Date b =

Date c =

Date d =

e =

f =

Dear _____ :

This letter is in response to your ruling request under section 514(c)(9) of the Internal Revenue Code.

FACTS

The L ("the University") was established by the legislature of the State of M in Date a. The Internal Revenue Service has not recognized the University as an organization described in section 501(c)(3) of the Code.

The University conducted its initial educational activities on a tract of land located in the center of N. In Date b, the campus was relocated to its present site on the shores of O, but the University retained ownership of this site, which came to be known as the "P." Over the years, some P property was sold and other property was purchased. As a result, the present P site consists of approximately f acres in central N.

The improvements on the P consist of various office and commercial buildings with parking garages and a hotel and garage. The P properties are the subject of short-term and long-term leases and sub-leases to unrelated third parties. As a result of these leases, the University receives substantial amounts of rental income.

Some of these office and commercial buildings leased by the University are currently in need of renovation and repair. To finance these renovations and repairs, on Date c, the University entered into a Credit Agreement with R to borrow, on a revolving loan basis, up to \$e (the "S"). In order to clarify Sections 2.6 and 2.7 of the Credit Agreement, the University and R have amended the Credit Agreement as of Date d.

Section 2.6 of the Credit Agreement provides that the principal and interest on the S "shall be paid solely from "Initial Revenue." The term "Initial Revenue" includes the University's net rental revenue from the P leases ("T") and the University's general revenues. The amendment to Section 2.6 states that: "The University may, in its sole discretion, elect to pay such principal and/or interest from other University funds."

However, once the University gives notice to R (as described in Section 1.28 of the Credit Agreement), the S will be secured solely by a lien on the T. In addition, under Section 2.7 of the Credit Agreement, the S will be a special obligation of the University payable solely out of the T, which the University will deposit into a special fund that will be available only to pay the S. Further, the R will have a lien on the T. The S does not constitute a general obligation or a pledge of the faith and credit of the University, or a debt of any other system of the University, other than the P. The amendment to Section 2.7 of the Credit Agreement states that: "The University may, in its sole discretion, elect to pay such principal and/or interest from other University funds including, without limitation, General Revenues."

RULING REQUESTED

Amounts borrowed by the University under the Credit Agreement with R dated Date c, and amended as of Date d, do not constitute "acquisition indebtedness" under section 514(c)(9) of the Code.

APPLICABLE LAW

Section 501(c)(3) of the Code describes as exempt from federal income tax, as provided under section 501(a), organizations organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 511(a)(1) of the Code imposes income tax on the unrelated business taxable income (as defined in section 512) of organizations described in section 501(c).

Section 511(a)(2)(B) of the Code states that the tax imposed under section 511(a)(1) applies to any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions.

Section 512(a)(1) of the Code defines the term “unrelated business taxable income” as the gross income derived by any organization from an unrelated trade or business regularly carried on by it, less directly connected deductions, both computed with the appropriate modifications in section 512(b).

Section 512(b)(3)(A)(i) of the Code provides that all rents from real property are excluded from the computation of unrelated business taxable income.

However, section 512(b)(4) of the Code states that notwithstanding section 512(b)(3)(A)(i), rents derived from real property which is “debt-financed property” as defined in section 514, shall be included in the computation of unrelated business taxable income.

Section 514(b)(1) of the Code defines “debt-financed property” as including property on which there is “acquisition indebtedness” as defined in section 514(c).

Section 514(c)(9)(A) of the Code provides that the term “acquisition indebtedness” does not, for purposes of section 514, include indebtedness incurred by a qualified organization in acquiring or improving any real property.

However, section 514(c)(9)(B)(ii) of the Code states that this exception does not apply if:

“[T]he amount of the indebtedness or any other amount payable with respect to such indebtedness, or at the time for making any payment of such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived from such real property.”

RATIONALE

The University is an agency or instrumentality of the State of M, under section 511(a)(2)(B) of the Code. Therefore, it is subject to the tax imposed under section 511(a)(1) on any unrelated business taxable income it may earn, including rents derived from real property that is debt-financed property. Debt-financed property includes property on which there is acquisition indebtedness. Since the University will use the S to renovate repair the office and commercial buildings located on the P, the issue is whether the S constitutes “acquisition indebtedness, in which event, the T would be includible in the computation of the University’s unrelated business taxable income.

The Credit Agreement provides that initially the S is payable only from the T and the University’s general revenues. However, Section 2.6 of the Credit Agreement, as

amended, provides that the University has the sole discretion to elect to pay the principal and/or interest on the S from other University funds.

Once the University gives R the notice described in the Credit Agreement, the S will be secured solely by a lien on the T. In addition, the S will be a special obligation of the University payable solely out of the T, which, under the Credit Agreement, the University is required to deposit into a special fund that will be available only to pay the S. Further, the R will have a lien on the T. Finally, the S is not a general obligation of the University. Nevertheless, Section 2.7 of the amended Credit Agreement states that the University has the sole discretion to elect to pay the principal and/or interest on the S from other University funds, including, for example its general revenues.

Therefore, based on these facts, because the University has the discretion to pay the S from the T and/or from the general revenues of the University, the S is not dependent, in whole or in part, upon the T, within the meaning of section 514(c)(9)(B)(ii) of the Code. As a result, since the exception described in section 514(c)(9)(A) applies, the S is not acquisition indebtedness for purposes of section 514.

RULING

Amounts borrowed by the University under the Credit Agreement with R dated Date c, and amended as of Date d, do not constitute "acquisition indebtedness" under section 514(c)(9) of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

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 is directed only to the organization that requested it. Section 6110(k)(3) of the Internal Revenue 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.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based.

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.

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.

In accordance with the Powers of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Lawrence M. Brauer

Debra Kaweck
Manager,
Exempt Organizations
Technical Group 1

Enclosure
Notice 437