

Renting Property - IRS & WA State Tax Issues for Nonprofits Part 2

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IRS Taxes – Unrelated Business Income

- 3 conditions for classification [per Reg. 1.513-1(a)-1(d)] :
 1. Income from the activity must be a trade or business
 2. The trade or business must be regularly carried on
 3. The trade or business must not be substantially related to the exempt purpose of the organization (aside from the need for the funds)
- Unrelated Business Taxable Income (UBTI)
 - Exempt organizations pay tax at corporate rates

Washington State Business & Occupation Taxes

- Long-term rentals exemption from B&O tax
 - 30 continuous days or longer
 - 24/7 rental of facility (RCW 84.04.390)
- Other rentals:
 - A church or 501(c)(3) organization is considered as granting a license to use real estate, but does not confer exclusive control or dominion
 - Generally B&O taxed as “service and other activities”

Example – Regularly carried on

- Example: What are the IRS and Washington State tax ramifications of renting out the church parking lot for one day per week for the entire year?
 - IRS:
 - Considered “regularly carried on”, ... (not considered rental of real estate, only use of space). See IRS Pub 1828
 - WA State Excise Taxes:
 - This rental is subject to retail sales tax and retail business and occupation tax. (See Excise Tax Advisory 3030.2009)
 - WA State Property Taxes:
 - Considered taxable

IRS UBIT Rules: Parking Lot Rentals

- Example: A church located in downtown rents its entire parking lot to a third party who operates the church parking lot and pays a flat rental price, or rental price based on a percentage of gross rentals per month. What are the tax consequences, assuming that the church has no debt on its property?
 - IRS:
 - Rental of real estate is not taxable for IRS purposes
 - WA State Excise Taxes:
 - This is considered the rental of real estate and is not taxable for business and occupation taxes. (See WAC 458-20-118)
 - WA State Property Taxes:
 - Considered taxable

Substantially Related Income

- Example: A church rents its facility to another church because it believes the operation of this other church contributes importantly to the accomplishment its purposes as a church. The rental is during days of the week that the church does not use the facilities. What are the tax consequences?
 - IRS:
 - Since the rental is for a purpose that is substantially related to its exempt purposes, there is no tax.
 - WA State Excise Taxes:
 - This is not considered the rental of real estate and is taxable for B&O taxes. (If this is the only income subject to B&O taxes, there would be no tax if total annual rentals were \$46,667 or less.)
 - WA State Property Taxes:
 - If the church owns the property and has received a property tax exemption, as long as the rent charged does not exceed operating costs, such rental is considered a church use. Church exempt property is not jeopardized

“Substantially All” IRS Exception

Example: A church rents one of its rooms to a local government agency. The room comprises 8% of the church building. The remainder of the church’s property is used for religious purposes. The church property is debt-financed.

- IRS:
 - the rental income from debt-financed property is not subject to unrelated business income tax because at least 85% of the church building use is for church purposes.
- WA State Excise Taxes:
 - This is not considered the rental of real estate and is taxable for B&O taxes. (If this is the only income subject to B&O taxes, there would be no tax if total annual rentals were \$46,667 or less.)
- WA State Property Taxes:
 - The room and common space is considered taxable



“Neighborhood Land” Exception for IRS



Example: A 501(c)(3) organization purchases a residence which shares a property line with the nonprofit. The organization incurs a mortgage to purchase the property and is renting it to an unrelated party on a month-to-month basis. The nonprofit intends to demolish this to expand its facilities within 10 years

- IRS:
 - In the first 5 years, this meets the neighborhood land exception and rentals are not taxable. The nonprofit must obtain an IRS ruling after 5 years to continue receiving an exemption for rental income on the property.
- WA State Excise Taxes:
 - This is considered the rental of real estate and is not taxable for B&O taxes.
- WA State Property Taxes:
 - The property is subject to property taxes

Cell Tower Rental Income – owned tower

Example: A 501(c)(3) organization receives rents for the use of communication towers or antenna owned by the charity

- IRS:
 - This is not considered rental of real estate; broadcasting towers are considered personal property. See IRS PLR 200104031
- WA State Excise Taxes:
 - This is not considered the rental of real estate and is taxable for B&O taxes. (If this is the only income subject to B&O taxes, there would be no tax if total annual rentals were \$46,667 or less.)
- WA State Property Taxes:
 - Generally will be considered taxable (unless all equipment is inside church steeple, nothing can be seen from outside)

Cell Tower Rental Income – owned land

Example: A church receives a flat rental rate on a 50' x 50' portion of land on which the cell company constructs and maintains a cell tower. Assuming the property is debt free, is this rental taxable?

- IRS:
 - This is considered rental of real estate, and is not subject to UBIT.
- WA State Excise Taxes:
 - This is considered the rental of real estate and is not taxable for B&O taxes.
- WA State Property Taxes
 - Considered taxable

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Reporting IRS Unrelated Business Income

- If gross receipts > \$1,000
- Use IRS Form 990-T
 - Lower capital gains rates?
(no - use corporate rate)



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