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

November 17, 2021 By: Rick Battershell

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 <u>substantially related</u> 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
 - o 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

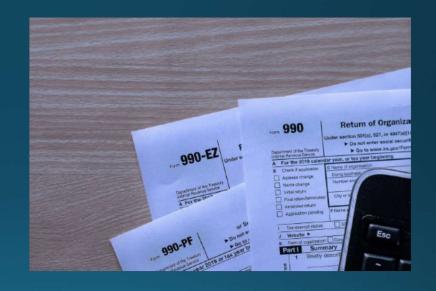
Cell Tower Rental Income – owned land

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

Reporting IRS Unrelated Business Income

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



CPE needed?

By November 24, 2021 send an email requesting CPE, complete the course evaluation, and provide the list of CPE codes provided during the presentation to:

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