

[Exemptions]

[Federal income tax exempt status issued by IRS &/or as declared by Taxpayers]

26 U.S. Code § 501 (c)(2)



501(c)(2) — Title Holding Corporation for Exempt Organization



Part 7. Rulings and Agreements

Chapter 25. Exempt Organizations Determinations Manual

Section 2. Single Parent Title Holding Corporations

7.25.2 Single Parent Title Holding Corporations

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Manual Transmittal

December 04, 2014

Purpose

(1) This transmits the text for IRM 7.25, Exempt Organizations Determinations Manual, Section 2, Single Parent Title Holding Corporations.

Material Changes

- (1) IRM 7.25.2.9, Digests of Publishing Rulings, was expanded to include the exemption disqualifier.
- (2) Editorial changes were made throughout.

Effect on Other Documents

IRM 7.25.2 dated July 30, 2001 is superseded.

Audience

TE/GE (Exempt Organizations)

Effective Date

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7.25.2.1 (12-04-2014)

Overview

1. This section discusses the operation of Single Parent Title Holding Corporations under IRC 501(c)(2).
2. IRC 501(c)(2) describes corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization exempt in IRC 501(a).
3. The organization cannot have unrelated business taxable income, except as noted in IRM 7.25.2.7.
4. Also, an IRC 501(c) (2) organization cannot retain its exemption if it accumulates its income rather than turning it over to its parent.

7.25.2.2 (12-04-2014)

Form of Organization

1. The term "corporations" as used in the Code includes "associations." See IRC 7701(a)(3). Accordingly, it also includes business or commercial trusts classified as associations for purposes of the Code. However, since it does not include "ordinary trusts," within the meaning of the regulations (Treas. Reg. 301.7701-4(a)), an ordinary trust cannot qualify for exemption as an IRC 501(c)(2) organization. See IRM 7.25.2.5.1 for discussion of the legal relationship that must exist between the IRC 501(c)(2) organization and the exempt organization for which it holds title.

7.25.2.3 (12-04-2014)

Charter Powers

1. IRC 501(c)(2) refers to corporations "organized for the exclusive purpose" of holding title to property and collecting income.
 - A. This organizational purpose is established by reference to the activities of the organization, by the events surrounding its incorporation, and also by the language of its charter.
 - B. If the charter states corporate purposes and powers that go beyond holding property and collecting income by empowering the corporation to engage in other business, this is evidence that the corporation was not organized for the "exclusive purpose" required by the Code.
2. When a newly organized corporation having no actual history of operations requests exemption, the charter language will weigh heavily in a determination of the organization's purpose.
3. Exemption was denied to an organization that possessed broad powers and business purposes beyond those necessary to a holding company and, in addition, used part of its income to reduce indebtedness on property that would ultimately revert to private individuals. See Rev. Rul. 58-566, 1958-2 C.B. 261 and IRM 7.25.2.9(1). The charter language was not alone determinative, but when combined with the other facts and circumstances, it established that the corporation was not organized exclusively for IRC 501(c)(2) purposes.
 - A. The relative weight given to various factors depends on the circumstances of the individual case. When actual operations are beyond the scope of IRC 501(c)(2), even an impeccable charter will not qualify the corporation for exemption.
 - B. Similarly, if events surrounding an organization's formation reveal a purpose outside the scope of IRC 501(c)(2), then charter language alone cannot establish exemption.
4. When an organization's history and activities point to an acceptable IRC 501(c)(2) operation, but its charter does not, the Service will look favorably upon an offer to amend the charter. Where the charter amendment merely conforms the charter to the actual intent of the organizers, exemption will ordinarily be recognized for all years.
5. An organization's refusal to relinquish charter purposes and powers which are clearly outside the acceptable scope for a titleholding company is a good indication that the organization intends to use those powers to engage in activities beyond those proper for an IRC 501(c)(2) title holding company.

7.25.2.4 (12-04-2014)

Holding Title to Property

1. The Code limits the activities of IRC 501(c)(2) organizations to holding title to property, collecting the income there from, and turning over the entire amount, less expenses, to an exempt organization. By so doing, it automatically limits the sources from which they may receive income. See Reg. 1.501(c)(2)-1(a).

7.25.2.4.1 (12-04-2014)

Permissible Holdings and Sources of Income

1. IRC 501(c)(2) organizations may hold title to passive investments and collect the income they yield.
 - A. Traditionally, investment in stocks and bonds is an allowable source of income under IRC 501(c)(2). It is not proscribed by the regulations and is not prohibited by the restrictions on "business" income (as a primary source of income) imposed on feeder organizations by IRC 502. Clearly, an IRC 501(c)(2) organization exempt under may invest in stocks and bonds and passively collect the income from these investments. However, permissible passive investment activities should be distinguished from the active "business" of securities trading.
 - B. Rent from real property is the other traditional source of income for title holding companies. At the time IRC 501(c)(2) was enacted, many title -holding companies had rental income, and available information indicates that Congress meant to exempt this type of organization. Nothing in IRC 501(c)(2) prevents organizations described in that provision from renting their realty to the general public. See Rev. Rul. 69-381, 1969-2 C.B. 113, and IRM 7.25.9(9). In general, the definition of rent from real property for purposes of IRC 501(c)(2) is the same as that under IRC 512(b)(3). However, see IRM 7.25.2.4.2 for some important differences.
 - C. Oil (and mineral) production payments sometimes raise the problem of distinguishing between the receipt of certain kinds of passive investment income on the one hand and participation in a business venture on the other. The question arises where an exempt organization holds the right to receive oil or mineral production payments—a fairly common investment for title-holding corporations in certain parts of the country. Generally, holding a royalty interest in such property, as opposed to an active working interest, would fall within the IRC 512(b)(2) exclusion from the definition of unrelated business taxable income and would be a permissible source of income. On the other hand, holding a working interest in such property would not fall within the IRC 512(b)(2) exclusion and would be an impermissible source of unrelated business income for an IRC 501(c)(2) title holding corporation, and could result in revocation of exempt status under the provisions of Reg. 1.501(c)(2)-1(a).
 - D. There are certain transactions (sometimes referred to as ABC transactions) in which title holding company derives income through the acquisition, with borrowed funds, of oil and gas production payments. The payments are not from working interests. The income received from each production payment exceeds the amount the organization is charged on the borrowed funds. The income derived by an exempt title holding corporation from oil and gas production payments purchased with borrowed funds would not affect the title holding corporation's exemption under IRC 501(c)(2) but would constitute unrelated business taxable income under IRC 514. See Rev. Rul. 66-295, 1966-2 C.B. 207, and IRM 7.25.29(4).
 - E. IRC 501(c)(2) provides that rules similar to the rule of IRC 501(c)(25)(G) shall apply for purposes of IRC 501(c)(2). IRC 501(c)(25)(G) provides that an organization will not qualify as a title holding company if disqualifying income derived incidentally from the holding of real property exceeds 10 percent of its gross income for the taxable year. However, this treatment will not apply if the organization establishes to the IRS's satisfaction that the receipt of excess disqualifying income was inadvertent, and reasonable steps are being taken to correct the circumstances giving rise to the income.

Disqualifying income includes income from the leasing of parking spaces and vending machine revenue.

7.25.2.4.2 (12-04-2014)

Prohibited Holdings and Sources of Income

1. Except as noted in IRM 7.25.2.7, an IRC 501(c)(2) organization may not hold title to properties which generate unrelated business income.
 - A. Recognition was denied under IRC 501(c)(2) to a student bookstore (Stanford University Bookstore v. Commissioner, 29 B.T.A. 1280 (1934), affd. 83 F.2d 710 (D.C. Cir. 1936)) and a public utility (Sand Springs Railway Co. v. Commissioner, 21 B.T.A. 1291 (1931)) because their activities constituted business beyond merely holding title to property. It did not matter that income was turned over to an exempt organization.
 - B. Reg. 1.501(c)(2)-1(a) was amended in 1980 to address the problems of applying the revisions in the unrelated business income tax provisions made by the Tax Reform Act of 1969 (Pub. L. 91-172, 83 Stat. 543) to exempt title-holding corporations. The regulation provides exceptions to the general prohibition against title holding corporations engaging in unrelated business by permitting title holding corporations to retain exemption (even though they would still be subject to tax on their related business taxable income) in cases where they have certain enumerated types of unrelated business taxable income. See IRM 7.25.2.7(2) for a description of the types of unrelated business taxable income that an IRC 501(c)(2) title holding corporation may have and yet still retain exemption.
 - C. The rental of personal property, unless leased with realty, has consistently been treated as the conduct of a trade or business thus, income from rental of personal property is subject to the unrelated business income tax (UBIT) if received regularly by an exempt organization subject to UBIT under IRC 511(a)(2). The leasing of trucks, even though the lessees were responsible for fueling, maintaining, and insuring them, has been held to be engaging in a trade or business that would preclude recognition as an organization described in IRC 501(c)(2). It was not material that the parties to the lease, a title holding company as lessor and three exempt fraternal beneficiary societies as lessees, were also parties to a separate lease involving realty. See Rev. Rul. 69-278, 1969-1 C.B. 148 and IRM 7.25.2.9(8) .

7.25.2.5 (12-04-2014)

Parent Organization

1. IRC 501(c)(2) requires an exempt title-holding corporation to turn over certain income to an organization that is "exempt under this section." The phrase "exempt under this section " applies to organizations exempt under IRC 501(a) and therefore includes pension trusts described in IRC 401(a). Thus, a pension trust is an acceptable recipient for the income of a title holding corporation.
2. Rev. Rul. 76-335, 1976-2 C.B. 141, holds that an organization incorporated as a subsidiary of an exempt title holding corporation for the exclusive purpose of holding title to investment property, collecting the income therefrom, and turning over such income, less expenses, to the parent, qualifies for recognition under IRC 501(c)(2). See IRM 7.25.2.9(12).

7.25.2.5.1 (12-04-2014)

Relationship Required

1. An exempt organization receiving support from a title-holding company must exercise some control or ownership over the title-holding company supporting it. See Rev. Rul. 71-544, 1971-2 C.B. 227 and IRM 7.25.2.9(11) .
 - A. Such control ensures proper distribution.
 - B. Some examples of the necessary control are owning the voting stock of the title holding company, possessing the power to select nominees to hold the voting stock, appointing directors, etc.
2. The absence of some control by the supported organization will be fatal to the exemption of the title-holding corporation.
 - A. For example, in Rev. Rul. 71-544, a nonprofit corporation was formed by a group of philanthropists to hold title to securities and turn over its income to a selected organization exempt under IRC 501(a). The exempt organization did not own or control the title holding corporation. The corporation was independent of the distributee and had complete discretion in selecting the distributee. The revenue ruling held that the organization was not an exempt title holding corporation under IRC 501(c)(2).
3. A parent-subsidiary relationship commonly exists, but such a relationship is not required by the statute. If the title holding company is a stock corporation, its stock need not be held by an exempt organization, as long as the stock confers no rights to dividends or liquidating distributions and all income from the property, less expenses, is paid over to the exempt organization. See Rev. Rul. 68-222 1968-1 C.B. 243 and IRM 7.25.2.9(7).

7.25.2.5.2 (12-04-2014)

Limitations Arising from Relationship

1. The fact that the parent is not subject to IRC 511 does not relieve the title holding company of its obligation to pay the tax on its unrelated business taxable income with respect to payments to the parent. See Rev. Rul. 68-490, 1968-2 C.B. 241 (see IRC511(a)(2)(A)), unless IRC 511(c) applies. See IRM 7.25.2.7(3).
2. The fact that the relationship between the title-holding company and its parent might be very close does not mean that the title-holding company may carry on all the activities its parent can. The strict limitations of IRC 501(c)(2) and the pertinent regulations apply, regardless of the parent is organized and operated. See Rev. Rul. 66-150, 1966-1 C.B. 147.

7.25.2.6 (12-04-2014)

Turning Over Income to Parent

1. Although neither the Code nor the Regulations specify the actual timing of remittance, an IRC 501(c)(2) organization should turn over its net income to its parent as soon as practicable, but at least annually.

7.25.2.6.1 (12-04-2014)

Accumulation Prohibition

1. Reg. 1.501(c)(2)–1(b) states that a corporation described in section 501(c)(2) cannot accumulate income and retain exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is itself exempt under section 501(a).
 - A. Regarding the actual timing of the divestiture, neither the Code nor regulations specifies that it must be turned over as soon as earned; however, it can be readily deduced from the wording of the regulation that the intent of the law would be violated if divestiture were delayed beyond a period sufficient to allow for normal accounting and administrative action by the holding company.
 - B. An abnormal delay in distribution could create a hardship for the exempt recipient. It might also distort the income and therefore the support test under IRC 509 for organizations exempt under IRC 501(c)(3).

7.25.2.6.2 (12-04-2014)

Method of Payment

1. The type of distribution is immaterial. It could be termed a dividend on stock or given some other description. What is important is that the distribution must actually be paid over to the exempt organization. A mere obligation to use the income for the parent's benefit, or parental control of the title holding company would not satisfy this requirement.
2. Often an exempt parent occupies realty owned by the title-holding company. There is commonly no payment of rent. In this situation, the statutory requirement that income be paid over to the parent is satisfied if the title-holding company turns over whatever income is available. Though there may be no cash income, the benefit to the parent from use of the property is real enough.

7.25.2.6.3 (12-04-2014)

Deductible Expenses

1. As used here the term "expenses " includes the operating costs that could be deductible by a taxable corporation.
 - A. Depreciation is included. See Rev. Rul. 66–102, 1966–1 C.B. 133 and IRM 7.25.2.9(2) .
 - B. Corporate deductions such as charitable contributions, which do not represent costs, are not included.
2. The retirement of indebtedness by a title holding company is one exception to the rule. Although this is a capital outlay rather than an expense, income used for this purpose is not treated as part of the accumulated earnings of the title holding company. If a title holding company were required to remit all its net income to its parent every year, it would have no funds to meet its own indebtedness on the property it holds. It would then have to turn repeatedly to the organization for which it holds title for additional contributions to its capital. This would in part defeat the very purpose for which most title holding companies are set up—i.e., to serve as an administrative convenience for their parent organizations.
 - A. The Service has ruled that a title holding company may retain part of its income each year to apply to indebtedness on property to which it holds title. See Rev. Rul.77-429, 1977-2C.B. 189 and IRM 7.25.2.9(5).

7.25.2.7 (12-04-2014)

Unrelated Business Income

1. As a general rule, an exempt IRC 501(c)(2) organization may engage only in the business of holding title to property for an exempt parent and turning over the income to the parent. Ordinarily, an exempt title holding corporation may not have unrelated business taxable income (UBTI) and would be revoked if it engaged in an unrelated trade or business.
2. There are several exceptions to this general rule. See Reg. 1.501(c)(2)-1(a) (note, however, that this provision does not fully reflect current law). A title-holding corporation may retain exemption if it has income that is treated as UBTI solely because of the applicability of:
 - A. IRC 512(a)(3)(C), making the unrelated business income rules covering an IRC 501(c)(7), IRC 501(c)(17), or IRC 501(c)(20) organization applicable to its title-holding corporation;
 - B. IRC 514, making income from debt-financed property subject to unrelated business income tax;
 - C. IRC 512(b)(3)(B)(ii), removing rents from the IRC 512(b)(3)(A) rental exclusion, the amount of which are, based on the income or profits derived by any person from the leased property, from the IRC 512(b)(3) rental exclusion;
 - D. IRC 512(b)(13), treating as UBTI dividends, interest, annuities, royalties, rents, and similar payments received from a controlled organization by a controlling organization;
 - E. IRC 512(b)(3)(A)(ii), excluding from UBTI rents from personal property leased with real property, if the rents attributable to the personal property are an incidental amount of the total rents received under the lease ; or
 - F. IRC 512(b)(3)(B)(i), removing rents from the IRC 512(b)(3)(A) rental exclusion, if more than 50 percent of the total rent received under a lease is attributable to personal property.
3. IRC 511(c) sets out the special rule for imposing a tax on the UBTI of an IRC 501(c)(2) title-holding corporation. For purposes of imposing the IRC 511 tax, an IRC 501(c)(2) corporation is treated, as being organized and operated for the same purposes as its exempt IRC 501(a) parent, in addition to the purposes described in IRC 501(c)(2), if it pays any amount of its net income for the tax year to the exempt parent (or would pay such an amount if it were available but for expenses) and the IRC 501(c)(2) organization and its exempt parent file a consolidated income tax return (Form 990-T) for the tax year.
4. IRC 1501 allows an affiliated group of corporations to file a consolidated income tax return. IRC 1504(e) confers the consolidated filing privilege on "two or more organizations exempt from taxation under section 501, one or more of which is described in section 501(c)(2) and the others of which derive income from such 501(c)(2) organizations . . . "

7.25.2.8 (12-04-2014)

Application for Exemption

1. A corporation applying for exemption as an organization described in IRC 501(c)(2) files Form 1024, Application for Recognition of Exemption.

7.25.2.9 (12-04-2014)

Digests of Published Rulings

1. Powers and purposes—A corporation will not be considered organized as a title-holding company within the meaning of IRC 501(c)(2) where it has broad powers and business purposes far beyond the scope necessary to a title-holding company. Furthermore, such a corporation will not be considered operated for exempt purposes where part of its income is used to reduce indebtedness on property that ultimately will revert to private individuals. Rev. Rul. 58-566, 1958-2 C.B. 261.
2. Depreciation as an expense—The term "expenses" as used in IRC 501(c)(2), includes a reasonable allowance for depreciation determined in accordance with IRC 167. Rev. Rul. 66-102, 1966-1 C.B. 133.
3. Operating facilities for parent disqualification—An organization that A holds title to a building housing its parent, a veteran organization described in IRC 501(c)(4), maintains the building and operates the social facilities located in the building, does not qualify for exemption IRC as an organization described by RC 501(c)(4), but does qualify as an organization described in IRC 501(c)(7). Rev. Rul. 66-150, 1966-1 C.B. 147.
4. Oil and gas production payments; —The acquisition with borrowed funds of oil and gas production payments from properties in which there is no ownership of working interests will not preclude exemption of an organization which otherwise meets the requirements for exemption from as an organization described in under IRC 501(c)(2). Rev. Rul. 66-295, 1966-2 C.B. 207.
5. Accumulating income to reduce property indebtedness—An exempt title-holding corporation may retain part of its income each year to apply to indebtedness on property to which it holds title. The transaction will be treated as if the parent received the income and used it to make a capital contribution to the title-holding corporation which in turn applied such contribution to the indebtedness. Rev. Rul. 77-429, 1977-2 C.B. 189
6. Exemption disqualifier—An exempt title holding company will be disqualified for exemption when one of the organizations to which it makes distributions of income ceases to qualify for exemption under IRC 501(a). Rev. Rul. 68-371, 1968-2 C.B. 204.
7. Stock held by others than an exempt organization—A corporation created to hold title to the chapter house of an exempt college fraternity may be exempt as an organization described in IRC 501(c)(2) even though its stock is held by members of the fraternity, provided that those members have no right to profits. Rev. Rul. 68-222, 1968-1 C.B. 243.
8. Unrelated leases—A title-holding corporation renting a building and trucks under separate unrelated leases to exempt fraternal beneficiary societies is engaged in the business of renting personal property independent of real property and is not exempt as an IRC 501(c)(2) organization. Rev. Rul. 69-278, 1969-1 C.B. 148.
9. Leasing to general public.—A title holding corporation that derives income from the rental of real property to the general public, is not precluded from exemption as an IRC 501(c)(2) organization. Rev. Rul. 69-381, 1969-2 C.B. 113.
10. Investment services—An organization regularly carrying on an investment service, that would have been unrelated trade or business if carried on by any of the exempt organizations on whose behalf it operates, is not exempt as an organization described in IRC 501(c)(2) or 501(c)(3). Rev.

Rul. 69-528, 1969-2 C.B. 127. (But see Rev. Rul. 71-529, 1971-2 C.B. 234, for a ruling under IRC 501(c)93) in which the facts are distinguishable from those in Rev. Rul. 69-528.)

11. Lack of parental control; securities—A nonprofit corporation formed to hold title to securities transferred to it by a group of philanthropists, and to turn over its income to a selected exempt organization that has no control over the corporation, is not an exempt title holding corporation. Rev. Rul. 71-544, 1971-2 C.B. 227.
12. Subsidiary of title-holding corporation—An organization incorporated as a subsidiary of an exempt title holding corporation for the exclusive purpose of holding title to investment property, collecting the income therefrom, and turning over such income, less expenses, to the parent, qualifies for exemption as an organization described in section 501(c)(2) of the Code. Rev. Rul. 76-335, 1976-2 C.B. 141.
13. Acquisition indebtedness;—Indebtedness owed to a labor union by its wholly owned tax-exempt subsidiary title-holding company resulting from a loan to pay debts incurred to acquire two income-producing office buildings is not "acquisition indebtedness" under IRC 514(c). Rev. Rul. 77-72, 1977-1 C.B. 157.
14. Leasing to the public—A corporation that holds a leasehold interest in an office building, derives all its income from subleasing space in the building to the general public, and turns over the net rents to its exempt parent qualifies for exemption as an IRC 501(c)(2). Rev. Rul. 81-108, 1981-1 C.B. 327.

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