

## 502. Feeder organizations

(a) General rule. -- An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

(b) Special rule. -- For purposes of this section, the term "trade or business" shall not include --

(1) the deriving of rents which would be excluded under section 512(b)(3), if section 512 applied to the organization,

(2) any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or

(3) any trade or business which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

## 503. Requirements for exemption

(a) Denial of exemption to organizations engaged in prohibited transactions. --

(1) General rule. --

(A) An organization described in section 501(c)(17) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after December 31, 1959.

(B) An organization described in section 401(a) which is referred to in section 4975(g)(2) or (3) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954.

(C) An organization described in section 501(c)(18) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after December 31, 1969.

(2) Taxable years affected. -- An organization described in section 501(c)(17) or (18) or paragraph (1)(B) shall be denied exemption from taxation under section 501(a) by reason of paragraph (1) only for taxable years after the taxable year during which it is notified by the Secretary that it has engaged in a prohibited transaction, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.

(b) Prohibited transactions. -- For purposes of this section, the term "prohibited transaction" means any transaction in which an organization subject to the provisions of this section --

(1) lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest,

to;

(2) pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

(3) makes any part of its services available on a preferential basis to;

(4) makes any substantial purchase of securities or any other property, for more than adequate consideration in money or money's worth, from;

(5) sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or

(6) engages in any other transaction which results in a substantial diversion of its income or corpus to; the creator of such organization (if a trust); a person who has made a substantial contribution to such organization; a member of the family (as defined in section 267(c)(4)) of an individual who is the creator of such trust or who has made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(c) Future status of organizations denied exemption. -- Any organization described in section 501(c)(17) or (18) or subsection (a)(1)(B) which is denied exemption under 501(a) by reason of subsection (a) of this section, with respect to any taxable year following the taxable year in which notice of denial of exemption was received, may, under regulations prescribed by the Secretary, file claim for exemption, and if the Secretary, pursuant to such regulations, is satisfied that such organization will not knowingly again engage in a prohibited transaction, such organization shall be exempt with respect to taxable years after the year in which such claim is filed.

(d) Repealed. Pub.L. 101-508, Title XI, (Section)11801(a)(22), Nov. 5, 1990, 104 Stat. 1388-521.)

(e) Special rules. -- For purposes of subsection (b)(1), a bond, debenture, note, or certificate or other evidence of indebtedness (hereinafter in this subsection referred to as "obligation") shall not be treated as a loan made without the receipt of adequate security, if --

(1) such obligation is acquired --

(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or (ii) if the obligation is not traded on such a national securities

exchange, at a price not less favorable to the trust than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) directly from the issuer, at a price not less favorable to the trust than the price paid currently for a substantial portion of the same issue by persons independent of the issuer;

(2) immediately following acquisition of such obligation --

(A) not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the trust, and

(B) at least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer; and

(3) immediately following acquisition of the obligation, not more than 25 percent of the assets of the trust is invested in obligations of persons described in subsection (b).

(f) Loans with respect to which employers are prohibited from pledging certain assets. -- Subsection (b)(1) shall not apply to a loan made by a trust described in section 401(a) to the employer (or to a renewal of such a loan or, if the loan is repayable upon demand, to a continuation of such a loan) if the loan bears a reasonable rate of interest, and if (in the case of a making or renewal) --

(1) the employer is prohibited (at the time of such making or renewal) by any law of the United States or regulation thereunder from directly or indirectly pledging, as security for such a loan, a particular class or classes of his assets the value of which (at such time) represents more than one-half of the value of all his assets;

(2) the making or renewal, as the case may be, is approved in writing as an investment which is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and no other such trustee had previously refused to give such written approval; and

(3) immediately following the making or renewal, as the case may be the aggregate amount loaned by the trust to the employer, without the receipt of adequate security, does not exceed 25 percent of the value of all the assets of the trust. For purposes of paragraph (2), the term "trustee" means, with respect to any trust for which there is more than one trustee who is independent of the employer, a majority of such independent trustees. For purposes of paragraph (3), the

determination as to whether any amount loaned by the trust to the employer is loaned without the receipt of adequate security shall be made without regard to subsection (e).

504. Status after organization ceases to qualify for exemption under section 501(c)(3) because of substantial lobbying or because of political activities

(a) General rule. -- An organization which --

(1) was exempt (or was determined by the Secretary to be exempt) from taxation under section 501(a) by reason of being an organization described in section 501(c)(3), and

(2) is not an organization described in section 501(c)(3)

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(A) by reason of carrying on propaganda, or otherwise attempting, to influence legislation, or

(B) by reason of participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for public office,  
shall not at any time thereafter be treated as an organization described in section 501(c)(4).

(b) Regulations to prevent avoidance. -- The Secretary shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of subsection (a), including regulations relating to a direct or indirect transfer of all or part of the assets of an organization to an organization controlled (directly or indirectly) by the same person or persons who control the transferor organization.

(c) Churches, etc. -- Subsection (a) shall not apply to any organization which is a disqualified organization within the meaning of section 501(h)(5) (relating to churches, etc.) for the taxable year immediately preceding the first taxable year for which such organization is described in paragraph (2) of subsection (a).

505. Additional requirements for organizations described in paragraph (9), (17), or (20) of section 501(c)

(a) Certain requirements must be met in the case of organizations described in paragraph (9) or (20) of section 501(c). --

(1) Voluntary employees' beneficiary associations, etc. -- An organization described in paragraph (9) or (20) of subsection (c) of section 501 which is part of a plan shall not be exempt from tax under section 501(a) unless such plan meets the requirements of subsection (b) of this section.

(2) Exception for collective bargaining agreements. -- Paragraph (1) shall not apply to any organization which is part of a plan maintained pursuant to an agreement between employee representatives and 1 or more employers if the Secretary finds

that such agreement is a collective bargaining agreement and that such plan was the subject of good faith bargaining between such employee representatives and such employer or employers.

(b) Nondiscrimination requirements. --

(1) In general. -- Except as otherwise provided in this subsection, a plan meets the requirements of this subsection only if --

(A) each class of benefits under the plan is provided under a classification of employees which is set forth in the plan and which if found by the Secretary not to be discriminatory in favor of employees who are highly compensated individuals, and

(B) in the case of each class of benefits, such benefits do not discriminate in favor of employees who are highly compensated individuals.

A life insurance, disability, severance pay, or supplemental unemployment compensation benefit shall not be considered to fail to meet the requirements of subparagraph (B) merely because the benefits available bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees covered by the plan.

(2) Exclusion of certain employees. -- For purposes of paragraph (1), there may be excluded from consideration --

(A) employees who have not completed 3 years of service,

(B) employees who have not attained age 21,

(C) seasonal employees or less than half-time employees,

(D) employees not included in the plan who are included in a unit of employees covered by an agreement between employee representatives and 1 or more employers which the Secretary finds to be a collective bargaining agreement if the class of benefits involved was the subject of good faith bargaining between such employee representatives and such employer or employers, and

(E) employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)).

(3) Application of subsection where other nondiscrimination rules provided. -- In the case of any benefit for which a provision of this chapter other than this subsection provides nondiscrimination rules, paragraph (1) shall not apply but the requirements of this subsection shall be met only if the nondiscrimination rules so provided are satisfied with respect to such benefit.

(4) Aggregation rules. At the election of the employer, 2 or more plans of such employer may be treated as 1 plan for purposes of this subsection.

(5) Highly compensated individual. -- For purposes of this subsection, the determination as to whether an individual is a

highly compensated individual shall be made under rules similar to the rules for determining whether an individual is a highly compensated employee (within the meaning of section 414(q)).

(6) Compensation. -- For purposes of this subsection, the term "compensation" has the meaning given such term by section 414(s).

(7) \$200,000 compensation limit. -- A plan shall not be treated as meeting the requirements of this subsection unless under the plan the annual compensation of each employee taken into account for any year does not exceed \$200,000. The Secretary shall adjust the \$200,000 amount at the same time and in the same manner as under section 415(d). This paragraph shall not apply in determining whether the requirements of section 79(d) are met.

(c) Requirement that organization notify Secretary that it is applying for tax-exempt status. --

(1) In general. -- An organization shall not be treated as an organization described in paragraph (9), (17), or (20) of section 501(c) --

(A) unless it has given notice to the Secretary, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition of such status, or

(B) for any period before the giving of such notice, if such notice is given after the time prescribed by the Secretary by regulations for giving notice under this subsection.

(2) Special rule for existing organizations. -- In the case of any organization in existence on July 18, 1984, the time for giving notice under paragraph (1) shall not expire before the date 1 year after such date of the enactment.

#### 507. Termination of private foundation status

(a) General rule. -- Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if --

(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

(2) (A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c), and either such organization pays the tax imposed by subsection (c) for any portion not abated under subsection (g) or the entire amount of such tax is abated under subsection (g).

(b) Special rules. --

(1) Transfer to, or operation as, public charity. -- The status as a private foundation of any organization, with respect to which there have not been either willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under chapter 42, shall be terminated if --

(A) such organization distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding such distribution, or

(B)(i) such organization meets the requirements of paragraph (1), (2), or (3) of section 509(a) by the end of the 12-month period beginning with its first taxable year which begins after December 31, 1969, or for a continuous period of 60 calendar months beginning with the first day of any taxable year which begins after December 31, 1969,

(ii) such organization notifies the Secretary (in such manner as the Secretary may by regulations prescribe) before the commencement of such 12-month or 60-month period (or before the 90th day after the day on which regulations first prescribed under this subsection become final) that it is terminating its private foundation status, and

(iii) such organization establishes to the satisfaction of the Secretary (in such manner as the Secretary may by regulations prescribe) immediately after the expiration of such 12-month or 60-month period, that such organization has complied with clause (i).

If an organization gives notice under subparagraph (B)(ii) of the commencement of a 60-month period and such organization fails to meet the requirements of paragraph (1), (2), or (3) of section 509(a) for the entire 60-month period, this part and chapter 42 shall not apply to such organization for any taxable year within such 60-month period for which it does meet such requirements.

(2) Transferee foundations. -- For purposes of this part, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

(c) Imposition of tax. -- There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of --

(1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3)

status of such foundation, or

(2) the value of the net assets of such foundation.

(d) Aggregate tax benefits. --

(1) In general. -- For purposes of subsection (c), the aggregate tax benefit resulting from the section 501(c)(3) status of any private foundation is the sum of --

(A) the aggregate increases in tax under chapters 1, 11, and 12 (or the corresponding provisions of prior law) which would have been imposed with respect to all substantial contributors to the foundation if deductions for all contributions made by such contributors to the foundation after February 28, 1913, had been disallowed, and

(B) the aggregate increases in tax under chapter 1 (or the corresponding provisions of prior law) which would have been imposed with respect to the income of the private foundation for taxable years beginning after December 31, 1912, if (i) it had not been exempt from tax under section 501(a) (or the corresponding provisions of prior law), and (ii) in the case of a trust, deductions under section 642(c) (or the corresponding provisions of prior law) had been limited to 20 percent of the taxable income of the trust (computed without benefit of section 642(c) but with the benefits of section 170(b)(1)(A)), and

(C) interest on the increases in tax determined under subparagraphs (A) and (B) from the first date on which each such increase would have been due and payable to the date on which the organization ceases to be a private foundation.

(2) Substantial contributor. --

(A) Definition. -- For purposes of paragraph (1), the term "substantial contributor" means any person who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust.

(B) Special rules. -- For purposes of subparagraph (A) --

(i) each contribution or bequest shall be valued at fair market value on the date it was received,

(ii) in the case of a foundation which is in existence on October 9, 1969, all contributions and bequests received on or before such date shall be treated (except for purposes of clause (i)) as is received on such date,

(iii) an individual shall be treated as making all contributions and bequests made by his spouse, and

(iv) any person who is a substantial contributor on any date shall remain a substantial contributor for all subsequent periods.

(C) Person ceases to be substantial contributor in certain cases. --

(1) In general. -- A person shall cease to be treated as a substantial contributor with respect to any private foundation as of the close of any taxable year of such foundation if --

(I) during the 10-year period ending at the close of such taxable year such person (and all related persons) have not made any contribution to such private foundation,

(II) at no time during such 10-year period was such person (or any related person) a foundation manager of such private foundation, and

(III) the aggregate contributions made by such person (and related persons) are determined by the Secretary to be insignificant when compared to the aggregate amount of contributions to such foundation by one other person.

For purposes of subclause (III), appreciation on contributions while held by the foundation shall be taken into account.

(ii) Related person. -- For purposes of clause (i), the term "related person" means, with respect to any person, any other person who would be a disqualified person (within the meaning of section 4946) by reason of his relationship to such person. In the case of a contributor which is a corporation, the term also includes any officer or director of such corporation.

(3) Regulations. -- For purposes of this section, the determination as to whether and to what extent there would have been any increase in tax shall be made in accordance with regulations prescribed by the Secretary.

(e) Value of assets. -- For purposes of subsection (c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation.

(f) Liability in case of transfers of assets from private foundation. -- For purposes of determining liability for the tax imposed by subsection (c) in the case of assets transferred by the private foundation, such tax shall be deemed to have been imposed on the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation.

(g) Abatement of taxes. -- The Secretary may abate the unpaid portion of the assessment of any tax imposed by subsection (c), or any liability in respect thereof, if --

(1) the private foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period

of at least 60 calendar months, or

(2) following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer within one year notifies the Secretary, in such manner as the Secretary may by regulations prescribe, that corrective action has been initiated pursuant to State law to insure that the assets of such private foundation are preserved for such charitable or other purposes specified in section 501(c)(3) as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action, the Secretary receives certification from the appropriate State officer that such action has resulted in such preservation of assets.

508. Special rules with respect to section 501(c)(3) organizations (a) New organizations must notify Secretary that they are applying for recognition of section 501(c)(3) status. -- Except as provided in subsection (c), an organization organized after October 9, 1969, shall not be treated as an organization described in section 501(c)(3) --

(1) unless it has given notice to the Secretary, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition of such status, or

(2) for any period before the giving of such notice, if such notice is given after the time prescribed by the Secretary by regulations for giving notice under this subsection.

(b) Presumption that organizations are private foundations. -- Except as provided in subsection (c), any organization (including an organization in existence on October 9, 1969) which is described in section 501(c)(3) and which does not notify the Secretary, at such time and in such manner as the Secretary may by regulations prescribe, that it is not a private foundation shall be presumed to be a private foundation.

(c) Exceptions. --

(1) Mandatory exceptions. -- Subsections (a) and (b) shall not apply to --

(A) churches, their integrated auxiliaries, and conventions or associations of churches, or

(B) any organization which is not a private foundation (as defined in section 509(a)) and the gross receipts of which in each taxable year are normally not more than \$5,000.

(2) Exceptions by regulations. -- The Secretary may by regulations exempt (to the extent and subject to such conditions as may be prescribed in such regulations) from the provisions of subsection (a) or (b) or both --

(A) educational organizations described in section 170(b)

(1) (A) (ii), and

(B) any other class of organizations with respect to which the Secretary determines that full compliance with the

provisions of subsections (a) and (b) is not necessary to the efficient administration of the provisions of this title relating to private foundations.

(d) Disallowance of certain charitable, etc., deductions.

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(1) Gift or bequest to organizations subject to section 507(c) tax. -- No gift or bequest made to an organization upon which the tax provided by section 507(c) has been imposed shall be allowed as a deduction under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, if such gift or bequest is made --

(A) by any person after notification is made under section 507(a), or

(B) by a substantial contributor (as defined in section 507(d)(2)) in his taxable year which includes the first day on which action is taken by such organization which culminates in the imposition of tax under section 507(c) and any subsequent taxable year.

(2) Gift or bequest to taxable private foundation, section 4947 trust, etc. -- No gift or bequest made to an organization shall be allowed as a deduction under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, if such gift or bequest is made --

(A) to a private foundation or trust described in section 4947 in a taxable year for which it fails to meet the requirements of subsection (e) (determined without regard to subsection (e)(2)), or

(B) to any organization in a period for which it is not treated as an organization described in section 501(c)(3) by reason of subsection (a).

(3) Exception. -- Paragraph (1) shall not apply if the entire amount of the unpaid portion of the tax imposed by section 5079c) is abated by the Secretary under section 507(g).

(e) Governing instruments. --

(1) General rule. -- A private foundation shall not be exempt from taxation under section 501(a) unless its governing instrument includes provisions the effects of which are --

(A) to require its income for each taxable year to be distributed at such time and in such manner as not to subject the foundation to tax under section 4942, and

(B) to prohibit the foundation from engaging in any act of self-dealing (as defined in section 494(d)), from retaining any excess business holdings (as defined in section 4943(c)), from making any investments in such manner to subject the foundation to tax under section 4944, and from making any taxable expenditures (as defined in section 4945(d)).

(2) Special rules for existing private foundations. -- In the case of any organization organized before January 1, 1970,

paragraph (1) shall not apply --

(A) to any period after December 31, 1971, during the pendency of any judicial proceeding begun before January 1, 1972, by the private foundation which is necessary to reform, or to excuse such foundation from compliance with, its governing instrument or any other instrument in order to meet the requirements of paragraph (1), and

(B) to any period after the termination of any judicial proceeding described in subparagraph (A) during which its governing instrument or any other instrument does not permit it to meet the requirements of paragraph (1).

#### 509. Private foundation defined

(a) General rule. -- For purposes of this title, the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than --

(1) an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii));

(2) an organization which --

(A) normally receives more than one-third of its support in each taxable year from any combination of --

(i) gifts, grants, contributions, or membership fees, and

(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of \$5,000 or 1 percent of the organization's support in such taxable year, from persons other than disqualified persons (as defined in section 4946) with respect to the organization, from governmental units described in section 170(c)(1), or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)), and

(B) normally receives not more than one-third of its support in each taxable year from the sum of --

(i) gross investment income (as defined in subsection (e)) and

(ii) the excess (if any) of the amount of the unrelated business taxable income (as defined in section 512) over the amount of the tax imposed by section 511;

(3) an organization which --

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph (1) or (2),

(B) is operated, supervised, or controlled by or in

connection with one or more organizations described in paragraph (1) or (2), and

(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2); and

(4) an organization which is organized and operated exclusively for testing for public safety.

For purposes of paragraph (3), an organization described in paragraph (2) shall be deemed to include an organization described in section 501(c)(4), (5) or (6) which would be described in paragraph (2) if it were an organization described in section 501(c)(3).

(b) Continuation of private foundation status. -- For purposes of this title, if an organization is a private foundation (within the meaning of subsection (a)) on October 9, 1969, or becomes a private foundation on any subsequent date, such organization shall be treated as a private foundation for all periods after October 9, 1969, or after such subsequent date, unless its status as such is terminated under section 507.

(c) Status of organization after termination of private foundation status. -- For purposes of this part, an organization the status of which as a private foundation is terminated under section 507 shall (except as provided in section 506(b)(2)) be treated as an organization created on the day after the date of such termination.

(d) Definition of support. -- For purposes of this part and chapter 42, the term "support" includes (but is not limited to) --

(1) gifts, grants, contributions, or membership fees,

(2) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in any activity which is not an unrelated trade or business (within the meaning of section 513),

(3) net income from unrelated business activities, whether or not such activities are carried on regularly as a trade or business,

(4) gross investment income (as defined in subsection (e)),

(5) tax revenues levied for the benefit of an organization and either paid to or expended on behalf of such organization, and

(6) the value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit referred to in section 170(c)(1) to an organization without charge.

Such term does not include any gain from the sale or other disposition of property which would be considered as gain from the sale or exchange of a capital asset, or the value of

exemption from any Federal, State, or local tax or any similar benefit.

(e) Definition of gross investment income. -- For purposes of subsection (d), the term "gross investment income" means the gross amount of income from interest, dividends, payments with respect to securities loans (as defined in section 512(a)(5)), rents, and royalties, but not including any such income to the extent included in computing the tax imposed by section 511.

511. Imposition of tax on unrelated business income of charitable, etc., organizations

(a) Charitable, etc., organizations taxable at corporation rates. --

(1) Imposition of tax. -- There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a tax computed as provided in section 11. In making such computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income".

(2) Organizations subject to tax. --

(A) Organizations described in sections 401(a) and 501(c). -- The tax imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1)) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a).

(B) State colleges and universities. -- The tax imposed by paragraph (1) shall apply in the case of 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. Such tax shall also apply in the case of any corporation wholly owned by one or more such colleges or universities.

(b) Tax on charitable, etc., trusts. --

(1) Imposition of tax. -- There is hereby imposed for each taxable year on the unrelated business taxable income of every trust described in paragraph (2) a tax computed as provided in section 1(e). In making such computation for purposes of this section, the term "taxable income" as used in section 1 shall be read as "unrelated business taxable income" as defined in section 512.

(2) Charitable, etc., trusts subject to tax. -- the tax imposed by paragraph (1) shall apply in the case of any trust which is exempt, except as provided in this part or part II

(relating to private foundations), from taxation under this subtitle by reason of section 501(a) and which, if it were not for such exemption, would be subject to subchapter J (sec. 641 and following, relating to estates, trusts, beneficiaries, and decedents).

(c) Special rule for section 501(c)(2) corporations. -- If a corporation described in section 501(c)(2) --

(1) pays any amount of its net income for a taxable year to an organization exempt from taxation under section 501(a) (or which would pay such an amount but for the fact that the expenses of collecting its income exceed its income), and

(2) such corporation and such organization file a consolidated return for the taxable year, such corporation shall be treated, for purposes of the tax imposed by subsection (a), as being organized and operated for the same purposes as such organization, in addition to the purposes described in section 501(c)(2).

#### 512. Unrelated business taxable income

(a) Definition. -- For purposes of this title --

(1) General rule. -- Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

(2) Special rule for foreign organizations. -- In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be --

(A) its unrelated business taxable income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, plus

(B) its unrelated business taxable income which is effectively connected with the conduct of a trade or business within the United States.

(3) Special rules applicable to organizations described in paragraph (7), (9), (17), or (20) of section 501(c). --

(A) General rule. -- In the case of an organization described in paragraph (7), (9), (17), or (20) of section 501(c), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b). For

purposes of the preceding sentence, the deductions provided by sections 243, 244, and 245 (relating to dividends received by corporations) shall be treated as not directly connected with the production of gross income.

(B) Exempt function income. -- For purposes of subparagraph (A), the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph(1)), which is set aside --

(i) for a purpose specified in section 170(c)(4), or

(ii) in the case of an organization described in paragraph (9), (17), or (20) of section 501(c), to provide for the payment of life, sick, accident, or other benefits, including reasonable costs of administration directly connected with a purpose described in clause (i) or (ii). If during the taxable year, an amount which is attributable to income so set aside is used for a purpose other than that described in clause (i) or (ii), such amount shall be included, under subparagraph (A), in unrelated business taxable income for the taxable year.

(C) Applicability to certain corporations described in section 501(c)(2). -- In the case of a corporation described in section 501(c)(2), the income of which is payable to an organization described in paragraph (7), (9), (17), or (2) of section 501(c), subparagraph (A) shall apply as if such corporation were the organization to which the income is payable. For purposes of the preceding sentence, such corporation shall be treated as having exempt function income for a taxable year only if it files a consolidated return with such organization for such year.

(D) Nonrecognition of gain. -- If property used directly in the performance of the exempt function of an organization described in paragraph (7), (9), (17), or (20) of section 501(c) is sold by such organization, and within a period beginning 1 year before the date of such sale, and ending 3 years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property. For purposes of this subparagraph, the destruction in whole or in part, theft, seizure, requisition, or condemnation of property,

shall be treated as the sale of such property, and rules similar to the rules provided by subsection (b), (c), (e), and (j) of section 1034 shall apply.

(E) Limitation on amount of setaside in the case of organizations described in paragraph (9), (17), or (20) of section 501(c). --

(i) In general. -- In the case of any organization described in paragraph (9), (17), or (20) of section 501(c), a set-aside for any purpose specified in clause (ii) of subparagraph (B) may be taken into account under subparagraph (B) only to the extent that such set-aside does not result in an amount of assets set aside for such purpose in excess of the account limit determined under section 419A (without regard to subsection (f)(6) thereof) for the taxable year (not taking into account any reserve described in section 419(c)(2)(A) for post-retirement medical benefits).

(ii) Treatment of existing reserves for post-retirement medical or life insurance benefits. --

(I) Clause (i) shall not apply to any income attributable to an existing reserve for post-retirement medical or life insurance benefits.

(II) For purposes of subclause (I), the term "reserve for post-retirement medical or life insurance benefits" means the greater of the amount of assets set aside for purposes of post-retirement medical or life insurance benefits to be provided to covered employees as of the close of the last plan year ending before the date of the enactment of the Tax Reform Act of 1984 or on July 18, 1984.

(III) All payments during plan years ending on or after the date of the enactment of the Tax Reform Act of 1984 of post-retirement medical benefits or life insurance benefits shall be charged against the reserve referred to in subclause (II). Except to the extent provided in regulations prescribed by the Secretary, all plans of an employer shall be treated as 1 plan for purposes of the preceding sentence.

(iii) Treatment of tax exempt organizations. -- This subparagraph shall not apply to any organization if substantially all of the contributions to such organization are made by employers who were exempt from tax under this chapter throughout the 5-taxable year period ending with the taxable year in which the contributions are made.

(4) Special rule applicable to organizations described in section 501(c)(19). -- In the case of an organization described in section 501(c)(19), the term "unrelated business taxable income" does not include any amount attributable to payments for life, sick, accident, or health insurance with respect to members of such organizations or their dependents which is set aside for the purpose of providing for the payment of insurance

benefits or for a purpose specified in section 1709c)(4). If an amount set aside under the preceding sentence is used during the taxable year for a purpose other than a purpose described in the preceding sentence, such amount shall be included, under paragraph (1), in unrelated business taxable income for the taxable year.

(5) Definition of payments with respect to securities loans. --

(A) The term "payments with respect to securities loans" includes all amounts received in respect of a security (as defined in section 1236(c)) transferred by the owner to another person in a transaction to which section 1058 applies (whether or not title to the security remains in the name of the lender) including --

(i) amounts in respect of dividends, interest, or other distributions,

(ii) fees computed by reference to the period beginning with the transfer of securities by the owner and ending with the transfer of identical securities back to the transferor by the transferee and the fair market value of the security during such period,

(iii) income from collateral security for such loan, and

(iv) income from the investment of collateral security.

(B) Subparagraph procedures to implement the obligation of the transferee to furnish to the transferor, for each business day during such period, collateral with a fair market value not less than the fair market value of the security at the close of business on the preceding business day,

(ii) termination of the loan by the transferor upon notice of not more than 5 business days, and

(iii) return to the transferor of securities identical to the transferred securities upon termination of the loan.

(b) Modifications. -- The modifications referred to in subsection (a) are the following:

(1) There shall be excluded all dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and annuities, and all deductions directly connected with such income.

(2) There shall be excluded all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

(3) In the case of rents --

(A) Except as provided in subparagraph (B), there shall be excluded --

(i) all rents from real property (including property described in section 1245(a)(3)(C)), and

(ii) all rents from personal property (including for

purposes of this paragraph as personal property any property described in section 1245(a)(3) (B)) leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

(B) Subparagraph (A) shall not apply --

(i) if more than 50 percent of the total rent received or accrued under the lease is attributable to personal property described in subparagraph (A)(ii), or

(ii) if the determination of the amount of such rent depends in whole or in part on the income or profits derived by any person from the property leased (other than an amount based on a fixed percentage or percentages of receipts or sales).

(C) There shall be excluded all deductions directly connected with rents excluded under subparagraph (A).

(4) Notwithstanding paragraph (1), (2), (3), or (5), in the case of debt-financed property (as defined in section 514) there shall be included, as an item of gross income derived from an unrelated trade or business, the amount ascertained under section 514(a)(1), and there shall be allowed, as a deduction, the amount ascertained under section 514(a)(2).

(5) There shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than --

(A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or

(B) property held primarily for sale to customers in the ordinary course of the trade or business.

There shall also be excluded all gains on the lapse or termination of options, written by the organization in connection with its investment activities, to buy or sell securities (as defined in section 1236(c)). This paragraph shall not apply with respect to the cutting of timber which is considered, on the application of section 631, as a sale or exchange of such timber.

(6) The net operating loss deduction provided in section 172 shall be allowed, except that --

(A) the net operating loss for any taxable year, the amount of the net operating loss carryback or carryover to any taxable year, and the net operating loss deduction for any taxable year shall be determined under section 172 without taking into account any amount of income or deduction which is excluded under this part in computing the unrelated business taxable income; and

(B) the terms "preceding taxable year" and "preceding taxable years" as used in section 172 shall not include any taxable year for which the organization was not subject to the

provisions of this part.

(7) There shall be excluded all income derived from research for (A) the United States, or any of its agencies or instrumentalities, or (B) any State or political subdivision thereof; and there shall be excluded all deductions directly connected with such income.

(8) In the case of a college, university, or hospital, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(9) In the case of an organization operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public, there shall be excluded all income derived from research performed for any person, and all deductions directly connected with such income.

(10) In the case of any organization described in section 511(a), the deduction allowed by section 170 (relating to charitable etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or business), but shall not exceed 10 percent of the unrelated business taxable income computed without the benefit of this paragraph.

(11) In the case of any trust described in section 511(b), the deduction allowed by section 170 (relating to charitable etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or business), and for such purpose a distribution made by the trust to a beneficiary described in section 170(b)(1)(A) and (B) determined with reference to the unrelated business taxable income computed without the benefit of this paragraph (in lieu of with reference to adjusted gross income).

(12) Except for purposes of computing the net operating loss under section 172 and paragraph (6), there shall be allowed a specific deduction of \$1,000. In the case of a diocese, province of a religious order, or a convention or association of churches, there shall also be allowed, with respect to each parish, individual church, district, or other local unit, a specific deduction equal to the lower of --

(A) \$1,000, or

(B) the gross income derived from any unrelated trade or business regularly carried on by such local unit.

(13) Notwithstanding paragraphs (1), (2), or (3), amounts of interest, annuities, royalties, and rents derived from any organization (in this paragraph called the "controlled organization") of which the organization deriving such amount (in this paragraph called the "controlling organization") has control (as defined in section 368(c)) shall be included as an item of gross income (whether or not the activity from which

such amount are derived represents a trade or business or is regularly carried on) in an amount which bears the same ratio as --

(A) (i) in the case of a controlled organization which is not exempt from taxation under section 501(a), the excess of the amount of taxable income of the controlled organization over the amount of such organization's taxable income which if derived directly by the controlling organization would not be unrelated business taxable income, or

(ii) in the case of a controlled organization which is exempt from taxation under section 501(a), the amount of unrelated business taxable income of the controlled organization, bears to

(B) the taxable income of the controlled organization (determined in the case of a controlled organization to which subparagraph (A) (ii) applies as if it were not an organization exempt from taxation under section 501(a)), but not less than the amount determined in clause (i) or (ii), as the case may be, of subparagraph (A), both amount computed without regard to amount paid directly or indirectly to the controlling organization. There shall be allowed all deductions directly connected with amount included in gross income under the preceding sentence.

(14) Repealed. Pub.L. 101-508, Title XI, (Section) 11801(a) (23), Nov. 5, 1990, 104 Stat. 1388-521.

(15) Except as provided in paragraph (4), in the case of a trade or business --

(A) which consists of providing services under license issued by a Federal regulatory agency,

(B) which is carried on by a religious order or by an educational organization described in section 170(b) (1) (A) (ii) maintained by such religious order, and which was so carried on before May 27, 1959, and

(C) less than 10 percent of the net income of which for each taxable year is used for activities which are not related to the purpose constituting the basis for the religious order's exemption,

there shall be excluded all gross income derived from such trade or business and all deductions directly connected with the carrying on of such trade or business, so long as it is established to the satisfaction of the Secretary that the rates or other charges for such services are competitive with rates or other charges charged for similar services by persons not exempt from taxation.

(c) Special rules for partnerships. --

(1) In general. -- If a trade or business regularly carried on by a partnership of which an organization is a member is an unrelated trade or business with respect to such organization,

such organization in computing its unrelated business taxable income shall, subject to the exceptions, additions, and limitations contained in subsection (b), include its share (whether or not distributed) of the gross income of the partnership from such unrelated trade or business and its share of the partnership deductions directly connected with such gross income.

(2) Special rule for publicly traded partnerships. -- Notwithstanding any other provision of this section --

(A) any organization's share (whether or not distributed) of the gross income of a publicly traded partnership (as defined in section 469(k)(2)) shall be treated as gross income derived from an unrelated trade or business, and

(B) such organization's share of the partnership deductions shall be allowed in computing unrelated business taxable income.

(3) Special rule where partnership year is different from organization's year. -- If the taxable year of the organization is different from that of the partnership, the amount to be included or deducted in computing the unrelated business taxable income under paragraph (1) or (2) shall be based upon the income and deductions of the partnership for any taxable year of the partnership ending within or with the taxable year of the organization.