

SUBTITLE A. INCOME TAXES
CHAPTER 1. NORMAL TAXES AND SURTAXES
SUBCHAPTER F. EXEMPT ORGANIZATIONS
PART III. TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

IRC Sec. 514

Sec. 514. Unrelated debt-financed income.

(a) Unrelated debt-financed income and deductions. In computing under section 512 [26 USCS § 512] the unrelated business taxable income for any taxable year--

(1) Percentage of income taken into account. There shall be included with respect to each debt-financed property as an item of gross income derived from an unrelated trade or business an amount which is the same percentage (but not in excess of 100 percent) of the total gross income derived during the taxable year from or on account of such property as (A) the average acquisition indebtedness (as defined in subsection (c)(7)) for the taxable year with respect to the property is of (B) the average amount (determined under regulations prescribed by the Secretary) of the adjusted basis of such property during the period it is held by the organization during such taxable year.

(2) Percentage of deductions taken into account. There shall be allowed as a deduction with respect to each debt-financed property an amount determined by applying (except as provided in the last sentence of this paragraph) the percentage derived under paragraph (1) to the sum determined under paragraph (3). The percentage derived under this paragraph shall not be applied with respect to the deduction of any capital loss resulting from the carryback or carryover of net capital losses under section 1212 [26 USCS § 1212].

(3) Deductions allowable. The sum referred to in paragraph (2) is the sum of the deductions under this chapter [26 USCS §§ 1 et seq.] which are directly connected with the debt-financed property or the income therefrom, except that if the debt-financed property is of a character which is subject to the allowance for depreciation provided in section 167 [26 USCS § 167], the allowance shall be computed only by use of the straight-line method.

(b) Definition of debt-financed property.

(1) In general. For purposes of this section, the term "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year (or, if the property was disposed of during the taxable year, with respect to which there was an acquisition indebtedness at any time during the 12-month period ending with the date of such disposition), except that such term does not include--

(A) (i) any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 [26 USCS § 501] (or, in the case of an organization described in section 511(a)(2)(B) [26 USCS § 511(a)(2)(B)], to the exercise or performance of any purpose or function designated in section 501(c)(3) [26 USCS §

[501\(c\)\(3\)](#)), or (ii) any property to which clause (i) does not apply, to the extent that its use is so substantially related;

(B) except in the case of income excluded under section 512(b)(5) [[26 USCS § 512\(b\)\(5\)](#)], any property to the extent that the income from such property is taken into account in computing the gross income of any unrelated trade or business;

(C) any property to the extent that the income from such property is excluded by reason of the provisions of paragraph (7), (8), or (9) of section 512(b) [[26 USCS § 512\(b\)](#)] in computing the gross income of any unrelated trade or business;

(D) any property to the extent that it is used in any trade or business described in paragraph (1), (2), or (3) of section 513(a) [[26 USCS § 513\(a\)](#)]; or

(E) any property the gain or loss from the sale, exchange, or other disposition of which would be excluded by reason of the provisions of section 512(b)(19) [[26 USCS § 512\(b\)\(19\)](#)] in computing the gross income of any unrelated trade or business.

For purposes of subparagraph (A), substantially all the use of a property shall be considered to be substantially related to the exercise or performance by an organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 [[26 USCS § 501](#)] if such property is real property subject to a lease to a medical clinic entered into primarily for purposes which are substantially related (aside from the need of such organization for income or funds or the use it makes of the rents derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 [[26 USCS § 501](#)].

(2) Special rule for related uses. For purposes of applying paragraphs (1)(A), (C), and (D), the use of any property by an exempt organization which is related to an organization shall be treated as use by such organization.

(3) Special rules when land is acquired for exempt use within 10 years.

(A) Neighborhood land. If an organization acquires real property for the principal purpose of using the land (commencing within 10 years of the time of acquisition) in the manner described in paragraph (1)(A) and at the time of acquisition the property is in the neighborhood of other property owned by the organization which is used in such manner, the real property acquired for such future use shall not be treated as debt-financed property so long as the organization does not abandon its intent to so use the land within the 10-year period. The preceding sentence shall not apply for any period after the expiration of the 10-year period, and shall apply after the first 5 years of the 10-year period only if the organization establishes to the satisfaction of the Secretary that it is reasonably certain that the land will be used in the described manner before the expiration of the 10-year period.

(B) Other cases. If the first sentence of subparagraph (A) is inapplicable only because--

(i) the acquired land is not in the neighborhood referred to in subparagraph (A), or
(ii) the organization (for the period after the first 5 years of the 10-year period) is unable to establish to the satisfaction of the Secretary that it is reasonably certain that the land will be used in the manner described in paragraph (1)(A) before the expiration of the 10-year period,

but the land is converted to such use by the organization within the 10-year period, the real property (subject to the provisions of subparagraph (D)) shall not be treated as

debt-financed property for any period before such conversion. For purposes of this subparagraph, land shall not be treated as used in the manner described in paragraph (1)(A) by reason of the use made of any structure which was on the land when acquired by the organization.

(C) Limitations. Subparagraphs (A) and (B)--

(i) shall apply with respect to any structure on the land when acquired by the organization, or to the land occupied by the structure, only if (and so long as) the intended future use of the land in the manner described in paragraph (1)(A) requires that the structure be demolished or removed in order to use the land in such manner;

(ii) shall not apply to structures erected on the land after the acquisition of the land; and

(iii) shall not apply to property subject to a lease which is a business lease (as defined in this section immediately before the enactment of the Tax Reform Act of 1976 [enacted Oct. 4, 1976]).

(D) Refund of taxes when subparagraph (B) applies. If an organization for any taxable year has not used land in the manner to satisfy the actual use condition of subparagraph (B) before the time prescribed by law (including extensions thereof) for filing the return for such taxable year, the tax for such year shall be computed without regard to the application of subparagraph (B), but if and when such use condition is satisfied, the provisions of subparagraph (B) shall then be applied to such taxable year. If the actual use condition of subparagraph (B) is satisfied for any taxable year after such time for filing the return, and if credit or refund of any overpayment for the taxable year resulting from the satisfaction of such use condition is prevented at the close of the taxable year in which the use condition is satisfied, by the operation of any law or rule of law (other than chapter 74 [[26 USCS §§ 7121](#) et seq.], relating to closing agreements and compromises), credit or refund of such overpayment may nevertheless be allowed or made if claim therefor is filed before the expiration of 1 year after the close of the taxable year in which the use condition is satisfied.

(E) Special rule for churches. In applying this paragraph to a church or convention or association of churches, in lieu of the 10-year period referred to in subparagraphs (A) and (B) a 15-year period shall be applied, and subparagraphs (A) and (B)(ii) shall apply whether or not the acquired land meets the neighborhood test.