Exempt Organizations Technical Guide

TG 2: Single-Parent Title-Holding Corporations – IRC Section 501(c)(2)

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Technical Guide Revision Date: 2/1/2025

Publication 6055 (2-2025) Catalog Number 95545G Department of the Treasury **Internal Revenue Service** www.irs.gov

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I. Overview

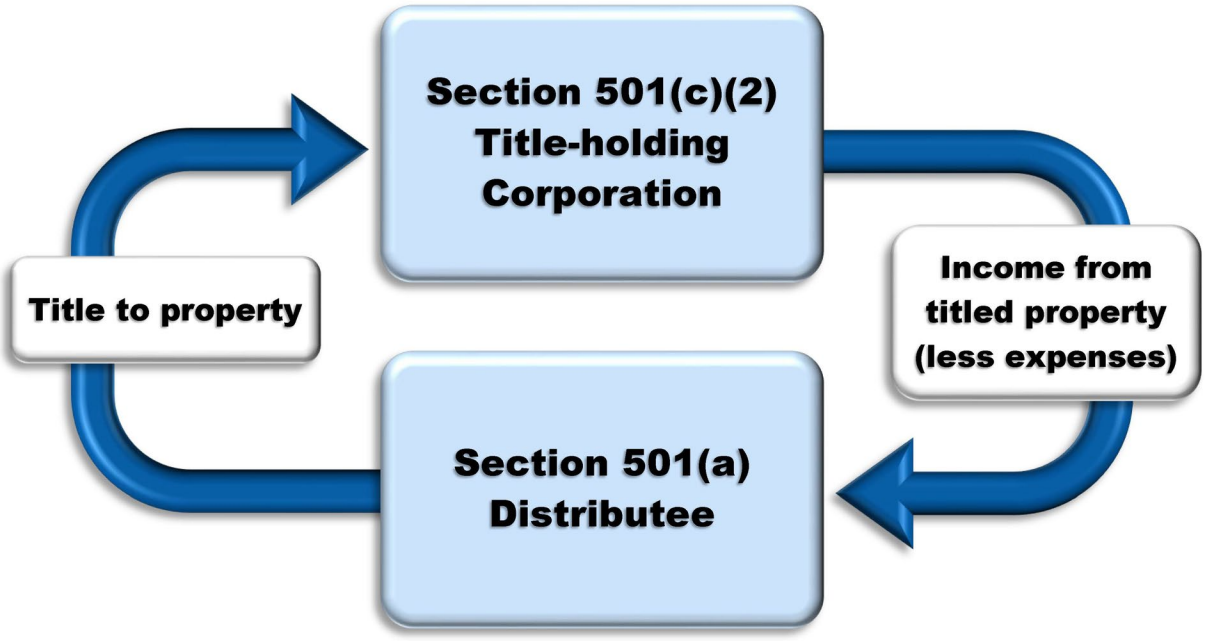
(1) This Technical Guide discusses exemption qualification for title-holding corporations described under Internal Revenue Code Section 501(c)(2).

(2) Generally, tax-exempt title-holding organizations provide a practical means for exempt organizations to transfer title to property in order to address legal considerations outside of exemption, such as limiting liability exposure, enhancing borrowing ability, or complying with state law requirements. Two types of title-holding organizations are exempt under the Code:

   a. Single-parent title-holding corporations, described under Section 501(c)(2)

   b. Multiple-parent title-holding corporations and trusts, described under Section 501(c)(25)

(3) Section 501(c)(2) corporations are 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 which itself is exempt under Section 501(a).



Diagrammatic Overview of Section 501(c)(2) Operations

A. Background / History

(1) Originating in Section 11(a) Twelfth of the Revenue Act of 1916, the Statutory provision exempting title-holding corporations has remained substantially the same through successive enactments.

(2) The legislative history surrounding the original enactment of the provision makes no specific reference to the provision or to the purpose it was intended to serve. The general observation is made, however, that organizations given exemption in the 1916 Act were difficult to secure returns from, and that the Treasury collected little or no revenue from them. See H. Rep. No. 922, 64th Cong., 1st Sess.

(3) The statute has always authorized the turning over of income by title-holding corporations to any organization exempt under Section 501(a) (or its predecessors). The provision for the exemption of a title-holding corporation related to an exempt organization recognizes the existence of a number of factors that might lead an exempt organization to segregate its investments and property in separate corporations. These factors include:

a. Limitation of liability from potential damage suits;

b. Enhancement of ability to borrow;

c. Limitations imposed on gifts and bequests to exempt organizations that effectively require such gifts to be kept in separate entities;

d. Clarity of title;

e. Accounting simplification; and

f. Limitations imposed by various state laws on organizations that would be recognized as exempt under the federal revenue laws.

(4) Beginning with the earliest interpretations of the statutory provision, only companies acting as investment and holding companies, as opposed to operating companies, have been exempt under this section. Where the active operation of any business other than the rental of real estate has been involved, exemption has consistently been denied.

(5) Regulations under Section 501(c)(2) were first written in response to the Revenue Act of 1950, which imposed the unrelated business income tax (UBIT) on these organizations. The Congressional Record states, “[S]ince these organizations are presently limited to holding title to property, collecting income from it and turning the proceeds over to other exempt organizations, the only trade or business in which they can engage is the rental of property.” See the 81st Congress Congressional Record: 96 Congressional Record 15602 (1950).

Thus, the rental of real property was clarified as being a permissible activity, which preserved the exemption from tax for those title-holding corporations already in existence that engaged in the rental of real property by excluding

them from the feeder provisions of Section 502. Other types of investments are also permissible, including stocks, bonds, etc.

(6) In 1980, Treasury Regulation (Treas. Reg.) 1.501(c)(2)-1(a) was amended 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 unrelated business taxable income (UBTI)) in cases where they have certain enumerated types of unrelated business taxable income.

(7) The Tax Reform Act of 1986 (Pub. L. 99-514) enacted Section 501(c)(25), which provides for the tax exemption for multiple-parent title-holding companies. Additionally, Section 501(c)(2) adopts a provision in Section 501(c)(25) that, under certain conditions, allows a title-holding corporation to earn income incidentally derived from holding real property.

(8) Congress ascertained that Section 501(c)(2) (and Section 501(c)(25)) title-holding organizations commonly hold real property assets such as shopping centers, office buildings, and apartment buildings. These real estate investments typically generate rental income, which generally is not considered unrelated business taxable income, but may also generate small amounts of income which could be treated as unrelated business taxable income (for example, money collected from laundry machines used by tenants, or from vending machines offered as a convenience to the patrons of a shopping center). Thus, Congress determined tax-exempt title-holding organizations should not lose their exemption merely because they receive small amounts of unrelated business taxable income that is incidentally derived from the holding of real property. As a result, in 1993, the Omnibus Budget Reconciliation Act of 1993, Pub. L. 103-66, August 10, 1993, 107 Stat 312, added paragraph (G) to Section 501(c)(25), and amended Section 501(c)(2) to reference that paragraph for single-parent title-holding organizations, as well. Section 501(c)(25)(G) allows a Section 501(c)(2) (or Section 501(c)(25)) title-holding organization to receive unrelated business income of up to 10% of its gross income, if that the unrelated business income is incidentally derived from the holding of real property. Additionally, if the amount of unrelated business income incidentally derived from the holding of real property is more than 10%, the organization may avoid disqualification if it establishes to the satisfaction of the Secretary that the excess was inadvertent and the organization is correcting the situation.

(9) To date, Treas. Reg. 1.501(c)(2)-1(a) has not been updated to reflect the Section 501(c)(25)(G) statutory amendment.

B. Relevant Terms

(1) **Holding title:** Owning, as in having ownership of, an asset. In the case of a tax-exempt title-holding organization, the title is commonly transferred without monetary consideration.

(2) **Multiple-parent title-holding organization:** An entity that allows certain types of unrelated tax-exempt organizations, such as pension trusts and Section 501(c)(3) organizations, to pool investments and invest in real property through a title-holding organization with up to 35 shareholders or beneficiaries.

(3) **Personal property:** An asset other than real property. It is movable and not permanently fixed to one place. It is also sometimes called *personalty*.

(4) **Real property:** Real estate (including land, buildings upon it, landscape, water, and subterranean oil and minerals) plus the owner's property rights. Treas. Reg. 1.856-10 defines *real property* as land and improvements to land, which are inherently permanent structures and their structural components.

(5) **Single-parent title-holding corporation:** An organization tax-exempt under Section 501(a) that transfers title to property to a related corporation. Such a transaction might be employed to address legal considerations outside of exemption, for instance limiting liability exposure, enhancing borrowing ability, or complying with state law requirements.

(6) **Trade or business:** As described in Section 513(c), any activity carried on for the production of income from the sale of goods or the performance of services.

(7) **Unrelated trade or business:** As described in Section 513(a), any trade or business the conduct of which is not substantially related (aside from the need for income) to the performance by such organization of its purpose constituting the basis for its exemption, unless the trade or business meets one of the exceptions, including:

   a. Substantially all the work in carrying on such trade or business is performed for the organization without compensation;

   b. The trade or business is carried on by the organization primarily for the convenience of its members, such as items sold through vending machines or by snack bars;

   c. The trade or business consists of selling merchandise, substantially all of which the organization received as gifts or contributions; or

   d. Other exceptions specifically named in Section 513.

(8) **Unrelated business taxable income:** As described in Section 512(a)(1), generally, the gross income derived by any organization from any unrelated trade or business (as defined in Section 513) it regularly carries on, 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 Section 512(b).

C. Law / Authority

(1) **Section 501(c)(2) of the Internal Revenue Code** describes, as a category exempt from federal income tax under Section 501(a):

> 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 which itself is exempt under this section. Rules similar to the rules of subparagraph (G) of paragraph (25) shall apply for purposes of this paragraph.

(2) **Section 501(c)(25)(G)** states:

(i) An organization shall not be treated as failing to be described in this paragraph merely by reason of the receipt of any otherwise disqualifying income which is incidentally derived from the holding of real property.

(ii) Clause (i) shall not apply if the amount of gross income described in such clause exceeds 10 percent of the organization's gross income for the taxable year unless the organization establishes to the satisfaction of the Secretary that the receipt of gross income described in clause (i) in excess of such limitation was inadvertent and reasonable steps are being taken to correct the circumstances giving rise to such income.

(3) **Treasury Regulations Section 1.501(c)(2)-1** provides:

(a) A corporation described in section 501(c)(2) and otherwise exempt from tax under section 501(a) is taxable upon its unrelated business taxable income. For taxable years beginning before January 1, 1970, see section 1.511-2(c)(4). Since a corporation described in section 501(c)(2) cannot be exempt under section 501(a) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in section 512 other than income which is treated as unrelated business taxable income solely because of the applicability of section 512(a)(3)(C); or debt financed income which is treated as unrelated business taxable income solely because of section 514; or certain interest, annuities, royalties, or rents which are treated as unrelated business taxable income solely because of section 512(b)(3)(B)(ii) or (13). Similarly, exempt status under section 501(c)(2) shall not be affected where certain rents from personal property leased with real property are treated as unrelated business taxable income under section 512(b)(3)(A)(ii) solely because such rents attributable to such personal property are more than incidental when compared to the

total rents received or accrued under the lease, or under section 512(b)(3)(B)(i) solely because such rents attributable to such personal property exceed 50 percent of the total rents received or accrued under the lease.

(b) A corporation described in section 501(c)(2) cannot accumulate income and retain its exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is itself exempt from tax under section 501(a).

II. Exemption and UBTI Considerations

(1) Section 501(a) of the Code exempts from federal income tax organizations described in Section 501(c), 501(d), or 401(a), unless such an organization is denied under Section 502 or 503.

(2) Section 501(b) provides that an organization exempt from taxation under Section 501(a) is still subject to tax on unrelated business income (UBI) and certain other activities.

(3) Section 501(c)(2) describes, as a category exempt from federal income tax under Section 501(a), 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 which itself is exempt under Section 501(a).

(4) Section 502 states that, in general, 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 basis that all of its profits are payable to one or more organizations exempt from taxation under Section 501.

(5) Section 511 imposes tax on income of a tax-exempt organization when the income is generated by a trade or business not substantially related to the organization's exempt purpose.

(6) Treas. Reg. 1.501(c)(2)-1 states that a Section 501(c)(2) organization will not qualify for exemption if it has unrelated business taxable income, other than the specified permissible types described thereunder.

A. Form of Organization

(1) Section 501(c)(2) refers to "corporations" organized for the exclusive purpose of holding title to property and collecting income. A corporation, as defined in Section 7701(a)(3), also includes associations.

B. Organizational Requirements

(1) The Code establishes organizational requirements for organizations to qualify as tax-exempt under Section 501(c)(2). Specifically, such organizations must be 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 which itself is exempt under Section 501(a).

The term *organized* refers to requirements for the form and content of organizing documents. If the organizing documents state purposes and powers that go beyond holding property and collecting income by empowering the organization to engage in other business, this is evidence that the corporation was not organized for the "exclusive purpose" required by the Code.

(2) Many courts have considered the organizational requirements for Section 501(c)(2) organizations. As discussed in the cases below, the courts have ruled that the term *organized*, as used in the Code, means that an organization's charter powers must be limited to those described under Section 501(c)(2).

(3) In Sun-Herald Corp. v. Duggan, 73 F.2d 298 (2d Cir. 1934), the United States Circuit Court of Appeals ruled that the Sun-Herald Corporation, a newspaper publishing corporation, was not organized for the exclusive purpose of holding title to property, and, thus, did not qualify for exemption under what is now Section 501(c)(2). The owner of all the Sun-Herald Corporation stock bequeathed it to the Metropolitan Museum of Art, and all of the stock was turned over to Museum Estates, Inc., a tax-exempt holding company formed for the sole purpose of taking over, holding, and liquidating the residuary estate of the owner. The Sun-Herald Corporation had already discontinued all its business and publishing activities, and its only remaining assets were outstanding notes. The debtors made payments on the outstanding notes to Sun-Herald (and not Museum Estates). Under protest, Sun-Herald paid income taxes on the interest income it received on these notes.

Initially, the District Court found for Sun-Herald. The District Court asserted that the term *organized* used in Section 103(14) of the Revenue Act of 1928, the predecessor to Section 501(c)(2), related to the activities of Sun-Herald, which were limited during the periods in question to holding title to property and collecting income therefrom and turning over the entire amount to Museum Estates. Additionally, the District Court asserted that the term *organized* did not relate to the charter powers of that corporation. In effect, the lower court treated the term *organized* as meaning 'operated.'

However, the Court of Appeals reversed the lower court's ruling, stating, "We think it clear that 'organized' means incorporated and not 'operated.'" The Appeals Court noted the income from the notes did not accumulate in the tax-exempt holding company, but rather in the Sun-Herald Corporation, a business corporation organized to conduct newspaper publishing. Thus, the Sun-Herald (a) was the recipient of the income, and (b) was not organized for the limited purposes of a tax-exempt title-holding corporation. Summarizing, the court

stated, “To obtain an exemption, the taxpayers claiming it must come precisely within the terms of the statute and has not done this in the present case.”

In 1935, the United States Supreme Court declined to accept the petition for writ of certiorari. See Sun-Herald Corp. v. Duggan, 294 U.S. 719, 55 S. Ct. 546, 79 L. Ed. 1251 (1935). And, in 1936, Sun-Herald Corporation amended their claim of facts, and the Court of Appeals again held its prior judgement. See Sun-Herald Corp. v. Duggan, 62 F. Supp. 372 (S.D.N.Y. 1945), supplemented, (S.D.N.Y. Mar. 21, 1946), and aff’d, 160 F.2d 475 (2d Cir. 1947).

(4) Courts have found that the organizational requirements set forth in Section 501(c)(2) were not fulfilled in multiple other cases where the charters permitted powers broader than those stipulated in the Code. The following cases, among others, relied on the meaning of the term *organized* as held in Sun-Herald, 1934 (supra):

   a. Citizens Water Works, Inc. v. Comm’r, 33 B.T.A. 201 (1935)

   b. Gagne v. Hanover Water Works Co., 92 F.2d 659 (1st Cir. 1937)

   c. Roche’s Beach, Inc. v. Comm’r, 35 B.T.A. 1087 (1937), rev’d sub nom. Roche’s Beach v. Comm’r of Internal Revenue, 96 F.2d 776 (2d Cir. 1938)

   d. Roche’s Beach v. Comm’r of Internal Revenue, 96 F.2d 776 (2d Cir. 1938)

   e. Banner Bldg. Co. v. Comm’r, 46 B.T.A. 857 (1942)

   f. Santa Cruz Bldg. Ass’n v. United States, 411 F. Supp. 871 (E.D. Mo. 1976)

(5) In Rev. Rul. 58-566, 1958-2 C.B. 261, a corporation that was organized with charter powers too broad (and that also operated with business purposes far beyond the scope necessary) for a holding company was determined to not be exempt under Section 501(c)(2).

(6) A stock corporation with capital stock was found to qualify for exemption under Section 501(c)(2) in Rev. Rul. 68-222, 1968-1 C.B. 243. The corporation was organized and operated for the purpose of holding title to a chapter house of a Section 501(c)(7) college fraternity. The capital stock of the corporation was owned by members of the fraternity who, importantly, had no rights to receive profits, either in the form of dividends or in liquidating distributions. The ownership of the stock by the members, rather than by the fraternity, did not disqualify the corporation from exemption under Section 501(c)(2), provided that the stockholders could not receive any dividends or profits and that all the income from the property, less expenses, would be paid over to the exempt organization.

(7) A subsidiary of a Section 501(c)(2) title-holding corporation qualified for its own Section 501(c)(2) exemption in Rev. Rul. 76-335, 1976-2 C.B. 141. An organization incorporated as a subsidiary of an exempt title-holding corporation. The subsidiary’s exclusive purpose was holding title to investment property, collecting the income therefrom, and turning over such income, less expenses,

to its parent, a title-holding company exempt under Section 501(c)(2), which, in turn, distributed to its Section 501(c)(3) parent organization.

C. Permissible Activities

(1) The exclusive permissible activity of an organization exempt under Section 501(c)(2) is to hold title to property and turn the net income over to its exempt distributee. Under Section 501(c)(2), only certain types of property are permissible holdings that will not jeopardize exemption. Additionally, a Section 501(c)(2) organization may only have unrelated business taxable income from specified sources without jeopardizing its exemption, and that income is generally still subject to tax.

C.1. Permissible Holdings and Sources of Income

(1) **Specified permissible types of income.** Treas. Reg. 1.501(c)(2)-1(a) stipulates that an organization will not qualify for exemption under Section 501(c)(2) if it has UBTI under Section 512, other than a few specified exceptions. While nonetheless subject to unrelated business income tax, the following are those permissible types of income:

a. **Section 512(a)(3)(C)** – Special rules on non-member income when the distributee is exempt under Section 501(c)(7), 501(c)(9), or 501(c)(17);

b. **Section 514** – Income from debt-financed property;

c. **Section 512(b)(3)(B)(ii)** – Rents based on the income or profits derived by any person from the leased property, other than fixed percentage or percentage of receipts;

d. **Section 512(b)(13)** – Interest, annuities, royalties, and rents;

e. **Section 512(b)(3)(A)(ii)** – Rents from personal property leased with real property when the rents from personal property are more than an incidental amount of the total rents; and

f. **Section 512(b)(3)(B)(i)** – Rents from personal property leased with real property when the rents from personal property exceed 50% of the total rents.

(2) **Exception for excess income incidentally derived from holding title.** If a title-holding company has income incidentally derived from holding title to real property that exceeds 10% of its gross income for a taxable year, it will not lose its exemption if the company can establish that the receipt of the excess disqualifying income was inadvertent, and they are taking reasonable steps to correct the circumstances causing the excess income. See Section 501(c)(25)(G), as referenced in Section 501(c)(2). For a more detailed discussion, see section “Income incidental to holding title” in “Prohibited Holdings and Sources of Income,” below.

(3) **Passive income.** Section 501(c)(2) organizations may hold title to passive investments and collect the income they yield.

a. **Rent from real property.** Rent from real property is a common source of income for title-holding companies. Also, Section 501(c)(2) does not specifically prevent Section 501(c)(2) organizations from renting their real property to the general public.

Regarding this issue of exemption, Rev. Rul. 69-381, 1969-2 C.B. 113, discusses a title-holding corporation that holds title to a building containing offices and derives income from renting the offices to the general public. Based on the facts, the organization qualified for exemption under Section 501(c)(2). The ruling underscores that there is nothing in Section 501(c)(2) that prohibits renting real property to the general public, and that a Section 501(c)(2) organization may have rental income from real property.

Similarly, a corporation that has a leasehold interest in an office building, derives all its income from subleasing the building's space to the general public, and turns over its net rents to its exempt parent, qualifies for exemption under Section 501(c)(2) in Rev. Rul. 81-108, 1981-1 C.B. 327. While a leasehold of real property is generally classified as personal property, income derived from subleasing an office building is treated as income derived from the rental of real property under Section 512(b)(3). Such income is similarly treated as rental income from real property for purposes of Section 501(c)(2).

Regarding taxability of rent from real property, under Section 512(b)(3), generally, rent from real property is excluded from the calculation of unrelated business taxable income, unless an exception in Section 512(b)(3)(B) applies.

Additional considerations when an organization leases the real property it holds include:

- Income incidental to holding real property. See "Prohibited Holdings and Sources of Income," below, for a discussion of potentially disqualifying income earned incidental to holding real property.
- Leasing personal property *with* real property. See "Leasing personal property *with* real property," below, for a discussion on the effects of a title-holding company leasing personal property with real property.

b. **Leasing personal property with real property.** Certain rents from personal property leased with real property will not cause an organization to be disqualified under Section 501(c)(2). However, the rents are subject to UBIT. See Treas. Reg. 1.501(c)(2)-1(a).

In calculating UBTI, Section 512(b)(3)(A)(ii) states, generally, rents from personal property will only be excluded from unrelated business taxable income when the personal property is leased with real property, and 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. Additionally, Section 512(b)(3)(B) states that personal property rents are not excluded from unrelated business taxable income under Section 512(b)(3)(A) if either:

(i) More than 50% of the total rent received or accrued under the lease is attributable to the personal property described in Section 512(b)(3)(A)(ii), or

(ii) 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. **Passive investments.** Generally, investment in stocks and bonds is a non-jeopardizing source of income under Section 501(c)(2). It is not proscribed by the Regulations and is not prohibited by the restrictions on income from a trade or business (as a primary purpose) imposed on feeder organizations by Section 502. Thus, a Section 501(c)(2) organization may invest in stocks and bonds and passively collect the income from those investments. However, permissible passive investment activities must be distinguished from the non-permissible active trade or business of securities trading.

d. **Oil or mineral production payments.** Holding the right to receive oil or mineral production payments is a common investment for title-holding corporations in some parts of the country. With these arrangements, it might become necessary to distinguish between passive investment income and participation in a business venture.

In Rev. Rul. 66-295, 1966-2 C.B. 207, an organization was not precluded from exemption under Section 501(c)(2) when it acquired oil and gas production payments for properties in which it owned no working interests.

Generally, holding a royalty interest in such property, as opposed to an active working interest, would be a permissible source of income because it falls within the Section 512(b)(2) exclusion from unrelated business taxable income. On the other hand, holding a working interest in such property would not fall within the Section 512(b)(2) royalties permissible under Treas. Reg. 1.501(c)(2)-1. Instead, it would be an impermissible source of unrelated business income for a Section 501(c)(2) title-holding corporation. This could result in loss of exempt status under Treas. Reg. 1.501(c)(2)-1(a).

e. **Acquisition with borrowed funds.** There are certain transactions, sometimes referred to as ABC transactions, in which a 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. Oil and gas production payments from properties in which there is no ownership of working interest, and which are acquired with borrowed funds, are considered property to which a Section 501(c)(2) organization may hold title, as referenced in Rev. Rul. 66-295, 1966-2 C.B. 207. 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 Section 501(c)(2) because debt-financed income treated as unrelated business taxable income solely because of Section 514 is one of the permissible income types provided in Treas. Reg. 1.501(c)(2)-1(a). However, that income would still constitute unrelated business taxable income under Section 514, as debt-financed property income.

(4) **Interorganizational indebtedness vs. acquisition indebtedness.** In Rev. Rul. 77-72, 1977-1 C.B. 157, the tax-exempt parent of a wholly owned subsidiary, a Section 501(c)(2) title-holding company, advanced funds to the title-holding company so the subsidiary could buy two office buildings, to which the subsidiary would hold title and turn over the income therefrom to the parent. The only indebtedness the subsidiary owes is to the parent for this advance, which they call *interorganizational indebtedness*. This interorganizational indebtedness owed to the parent by its subsidiary is not acquisition indebtedness within the meaning of Section 514(c).

C.2. Prohibited Holdings and Sources of Income

(1) An organization will not qualify for exemption under Section 501(c)(2) if it holds title to property that generates unrelated business income, other than as specifically permitted by the Code and Regulations.

(2) **Income incidental to holding title.** The Code stipulates that an organization will not qualify as a title-holding company if it has income that exceeds 10% of its gross income for a taxable year which is incidentally derived from holding title to real property, *unless* the company can establish that the receipt of the excess disqualifying income was inadvertent, and they are taking reasonable steps to correct the circumstances causing the excess income. See Section 501(c)(25)(G), as referenced in Section 501(c)(2).

The House Report on the Omnibus Budget Reconciliation Act of 1993, which introduced the Section 501(c)(25)(G) provision, provides background on what is considered to be *income incidentally derived from holding title to real property*:

> For example, income generated from parking or operating vending machines located on real property owned by a title-holding company generally would qualify for the 10-percent de minimis rule, while income derived from an activity that is not incidental to the holding of real property (e.g., manufacturing) would not qualify. In cases where unrelated income is incidentally derived from the

holding of real property, receipt by a title-holding company of such income (up to the 10-percent limit) will not jeopardize the title-holding company's tax-exempt status, but nonetheless, will be subject to tax as UBTI.

For the House Report, see Omnibus Budget Reconciliation Act of 1993, 1993-3 C.B. 167 (I.R.S. 1993).

(3) **Leasing *only* personal property.** The leasing of personal property, unless leased with real property, has consistently been treated as the conduct of a trade or business, and is not exempt under Section 501(c)(2). Treas. Reg. 1.501(c)(2)-1(a) states that because an organization described in Section 501(c)(2) cannot be exempt under Section 501(a) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in Section 512 other than certain specified, permissible types of income. Thus, leasing *only* personal property is considered to be a trade or business and is not exempt under Section 501(c)(2).

In Rev. Rul. 69-278, 1969-1 C.B. 148, the leasing of trucks (personal property) is held to be engaging in a trade or business that precludes recognition as an organization described in Section 501(c)(2). It was not material that the renters were responsible for fueling, maintaining, and insuring the trucks. Nor was it 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 real property.

Note: Treas. Reg. 1.501(c)(2)-1(a) states that an organization's exempt status is not in jeopardy solely because it might have unrelated business taxable income from leasing personal property with real property. See "Leasing personal property with real property," above, in "Permissible Holdings and Sources of Income" for a discussion on exemption and calculation of unrelated business taxable income.

(4) **Operating a trade or business.** See "Operating a Trade or Business," below, for a discussion of organizations that do not qualify because their activities include business other than the limited activities described in Section 501(c)(2).

C.3. May Not Operate a Trade or Business

(1) Treas. Reg. 1.501(c)(2)-1(a) states that an organization described in Section 501(c)(2) is not exempt if it engages in any business other than that of holding title to property and collecting income therefrom. Additionally, a Section 501(c)(2) organization cannot have UBTI as defined in Section 512, *other than* certain, specified exceptions. See "Permissible Holdings and Sources of Income," above, for a discussion of those exceptions.

(2) As described in Section 513(c), a *trade or business* is any activity carried on for the production of income from the sale of goods or the performance of services.

(3) While many organizations have attempted to operate with activities broader than those described in Section 501(c)(2), there is ample legal precedent that underscores that an organization described in Section 501(c)(2) cannot participate in activities outside the scope of those permitted by Section 501(c)(2). Additionally, the legal precedent provides examples of activities that have been deemed to be operating a business.

(4) In Von Baumbach v. Sargent Land Co, 242 U.S. 503, 37 S. Ct. 201, 61 L. Ed. 460 (1917), the United States Supreme Court held that corporations whose operations were broader than solely holding title to land and leasing the land were carrying on a business. John S. Pillsbury & Company was the owner of large tracts of lands used for timber and then leased for the extraction of the mineral deposits contained therein. Subsequently, three corporations were formed to own the leased lands. The lessors maintained the right to monitor the mining and measure the ore extractions to ensure they were paid adequately. Additionally, the corporations sold real estate and stumpage, held leases, and granted other leases.

The court stated that the corporations' operations constituted carrying on a business; it was not solely holding title to land and distributing the income therefrom. The court examined the findings of four cases for the meaning of *carrying on a business*:

a. A company organized to deal in real estate and engaging in the management and leasing of a certain hotel, and another company owning and leasing ore lands for the purpose of carrying on mining operations and receiving a royalty depending upon the quantity of ore mined, were both engaged in business, as held by Flint v. Stone Tracy Co., 220 U.S. 107, 31 S. Ct. 342, 55 L. Ed. 389 (1911).

b. A corporation that owned a piece of real estate it had leased for 130 years and whose articles limited its purposes to holding title to the property and to receiving and distributing the rental income was not engaged in doing business because the corporation had no other activities, as held by Zonne v. Minneapolis Syndicate, 220 U.S. 187, 31 S. Ct. 361, 55 L. Ed. 428 (1911).

c. A corporation that leased all of its property to another and was doing only what was necessary to receive and distribute that income among stockholders was not doing business, as held by McCoach v. Minehill & S. H. R. Co., 228 U.S. 295, 33 S. Ct. 419, 57 L. Ed. 842 (1913).

d. A corporation that distributed rent received from a single lessee was not doing business, as held by United States v. Emery, Bird, Thayer Realty Co., 237 U.S. 28, 35 S. Ct. 499, 59 L. Ed. 825 (1915).

(5) In Stanford Univ. Bookstore v. Comm'r, 29 B.T.A. 1280 (1934), aff'd sub nom. Stanford Univ. Book Store v. Helvering, 83 F.2d 710 (D.C. Cir. 1936), a cooperative bookstore whose profits were in part accumulated in a reserve for business needs and contingencies, and in part distributed as rebates to its

customers, including its members, was not held to be a tax-exempt title-holding corporation. The petitioner was organized for the purpose of carrying on a general mercantile business, for the accommodation of the students and faculty of a certain college. The bookstore actively engaged in business, and did not turn over its earnings, less expenses, to an exempt organization.

(6) In Gagne v. Hanover Water Works Co., 92 F.2d 659 (1st Cir. 1937), the Circuit Court of Appeals ruled that a water company organized to engage in, and that did engage in, the business activities of operating a water works plant for profit was not a tax-exempt holding company. Additionally, the company did not pay over its entire income, less expenses, and from year to year retained a part of its income and built up a substantial reserve fund.

(7) In Roche's Beach v. Comm'r of Internal Revenue, 96 F.2d 776 (2d Cir. 1938), the Circuit Court of Appeals found that a holding company that received title to, and took over operations of, an extensive bathing beach business was not a tax-exempt title-holding corporation because its powers were too broad. Additionally, the business's income was derived from bathhouse, suit, and towel rentals; concessions; rent from a portion of the beach occupied by a club; and rentals of the bathhouses and garage. The court stated, "To call the operation of a business of these proportions merely 'holding the title' and 'collecting income therefrom' would be a forced construction of the language of the statute."

(8) In Banner Bldg. Co. v. Comm'r, 46 B.T.A. 857 (1942), the United States Board of Tax Appeals ruled that a company that acquired, improved, and operated a building from which it collected rents and operated bowling alleys and a bar that received revenues from members of a fraternal beneficiary society and the general public, was not a tax-exempt title-holding corporation.

(9) In Rev. Rul. 58-566, 1958-2 C.B. 261, a corporation that operated with business purposes far beyond the scope necessary for a holding company (in addition to being organized with charter powers too broad) was determined to not be exempt under Section 501(c)(2).

(10) An organization regularly carrying on an investment service business, that would be an unrelated trade or business if carried on by any of the exempt organizations on whose behalf it operates, is not exempt under Section 501(c)(2). In Rev. Rul. 69-528, 1969-2 C.B. 127, an organization is formed to provide investment services on a fee basis exclusively to organizations exempt under Section 501(c)(3). The organization is free from the control of the participants and has the absolute discretion in the investment services. Providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The organization is not exempt under Section 501(c)(2) because it regularly carries on the business of providing investment services that would be an unrelated trade or business if carried on by any of the tax-exempt organizations on whose behalf it operates.

(11) In Santa Cruz Bldg. Ass'n v. United States, 411 F. Supp. 871 (E.D. Mo. 1976), the District Court held that a corporation organized to promote better relations among its members and to provide buildings and equipment for activities for members of a fraternal organization was not a tax-exempt title-holding corporation because (among multiple reasons) it engaged in activities of a broader scale than merely holding title. Its "dealings with the general public involved neither 'one-shot affairs', nor insubstantial amounts of money, nor activities distinguishable from those of profit-making organizations."

D. Turning Over Income

(1) Section 501(c)(2) requires organizations described therein to turn over the entire amount of income collected from holding title to property, less expenses, to an organization exempt under Section 501(a).

(2) Treas. Reg. 1.501(c)(2)-1(b) states that an organization described in Section 501(c)(2) cannot accumulate income and retain its exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is exempt from tax under Section 501(a).

(3) While neither the Code nor the Regulations specifies that the income must be turned over as soon as earned, the IRS has historically expected that the divestiture would occur at least annually. An abnormal delay in the distribution could create a hardship for the exempt recipient. It might also distort the income and, consequently, the public support tests under Section 509 for organizations exempt under Section 501(c)(3).

(4) In the following court cases, the organizations did not qualify as exempt title-holding corporations because they had both organizational and operational defects, including not turning over collected income, less expenses, to a Section 501(a) organization:

a. In Citizens Water Works, Inc. v. Comm'r, 33 B.T.A. 201 (1935), the water company performed activities other than those of an exempt title-holding corporation, did not collect income from property, nor did it turn the entire amount thereof, less expenses, to a tax-exempt organization.

b. In Gagne v. Hanover Water Works Co., 92 F.2d 659 (1st Cir. 1937), the water company did not pay over its entire income, less expenses. From year to year, it retained a part of its income and built up a substantial reserve fund.

c. In Banner Bldg. Co. v. Comm'r, 46 B.T.A. 857 (1942), the company's actual operations were not exclusively those of exempt title-holding corporations. Moreover, the company did not show it was under any legal obligation to turn over any of its funds to an exempt organization, nor did it, in fact, pay over any of its funds to an exempt organization.

d. In Santa Cruz Bldg. Ass'n v. United States, 411 F. Supp. 871 (E.D. Mo. 1976), the company accumulated income over the years, rather than

turning it over to an exempt organization. Further, the company did not operate at a loss, so it was not able to contend that income was retained to cover normal operational expenses, as described in what is now Rev. Rul. 77-429, 1977-2 C.B. 189.

(5) Rev. Rul. 77-429, 1977-2 C.B. 189, illustrates a circumstance where a Section 501(c)(2) organization may retain a portion of the income collected to lessen indebtedness on the property it holds for its exempt parent. By agreement with its exempt parent, a title-holding corporation was permitted to retain a part of the income it collected each year to apply it to the indebtedness it incurred on the property to which it holds title. This transaction was treated as if the income had been turned over to its exempt parent and the parent had used the income to make a capital contribution to the title-holding corporation, which, in turn, applied the contribution to the indebtedness. This transaction served an administrative convenience for both the title-holding corporation and its exempt parent; otherwise, the title-holding corporation would have been restricted in serving the needs of its parent in connection with the administration of property.

E. Distributee

(1) Section 501(c)(2) and Treas. Reg. 1.501(c)(2)-1(b) state that the income must be paid over to an organization exempt from tax under Section 501(a). The Section 501(a) organization is the distributee.

(2) Section 501(a) includes organizations described in Sections 501(c), 501(d) (religious and apostolic associations), and 401(a) (qualified pension, profit-sharing, and stock bonus plans).

(3) Rev. Rul. 68-371, 1968-2 C.B. 204, additionally clarifies that an exempt title-holding corporation will *not continue to qualify* for exemption if the organization to which it makes distributions of its income ceases to qualify for exemption under Section 501(a).

E.1. Relationship with Distributee

(1) The legislative and judicial history of Section 501(c)(2) demonstrates that title-holding corporations have traditionally been regarded as investment or property holding subsidiaries of an organization exempt under Section 501. That is, a relationship, such as that of a parent and subsidiary, or other form of effective control between the distributee organization and the title-holding company, is required.

a. In the Revenue Act of 1916, the statutory language for the term *title-holding corporation* referred to a corporation holding title to property, collecting the income therefrom and paying over the income, less expenses, to a distributee having an ownership interest in the corporation.

b. In Von Baumbach v. Sargent Land Co, 242 U.S. 503, 37 S. Ct. 201, 61 L. Ed. 460 (1917), and the cases cited therein, the Supreme Court determined that a *title-holding corporation* was a corporation not engaged in carrying on or doing business but merely holding title to investment assets, receiving the income therefrom and distributing it to its "stockholders" or parent.

c. In the dissent to the decision in Roche's Beach v. Comm'r of Internal Revenue, 96 F.2d 776 (2d Cir. 1938), Judge Learned Hand discussed exemption of title-holding companies in terms of a parent-subsidiary relationship.

d. In Banner Bldg. Co. v. Comm'r, 46 B.T.A. 857 (1942), the Board of Tax Appeals held that the petitioner had not shown that it was under any legal obligation to turn over any of its funds to Banner Council, an exempt fraternal beneficiary society, and its failure in this requirement precluded its classification as an exempt title-holding corporation.

(2) The distributee must maintain effective ownership and control over the title-holding corporation, otherwise, the title-holding corporation will not qualify for exemption. In Rev. Rul. 71-544, 1971-2 C.B. 227, a nonprofit corporation formed to hold title to securities and turn over its income to a selected exempt organization that had no control over the corporation was determined to not be an exempt title-holding corporation under Section 501(c)(2). In this ruling, the title-holding corporation was not owned, nor controlled, by the exempt organization to which it turned over its income. The title-holding corporation was independent of the distributee and had complete discretion as to the selection of the distributee. The ruling concluded that Section 501(c)(2) provides exemption for title-holding corporations only where there is effective ownership and control over the title-holding corporation by its distributee organization. Control may be evidenced, for example, by owning the voting stock of the title-holding corporation or possessing the power to select nominees to hold the voting stock.

(3) While a parent-subsidiary relationship commonly exists, that particular relationship is not required by the Statute. In Rev. Rul. 68-222, 1968-1 C.B. 243, the ownership of the stock of a title-holding corporation by the members of its distributee, rather than by the distributee itself, did not disqualify that corporation from exemption under Section 501(c)(2). Of note, the stockholders could in no case receive any dividends or profits, and all the income from the property, less expenses, was paid over to the exempt organization.

(4) The presence of a relationship between the title-holding corporation and its distributee will not in and of itself allow the title-holding corporation to qualify under Section 501(c)(2). It must still meet the specific requirements of the subsection. In Rev. Rul. 66-150, 1966-1 C.B. 147, a subsidiary, which held title to property of its exempt parent, did not qualify under Section 501(c)(2) because its activities, including operating social facilities for members, including

a bar, restaurant, and game room, located in the building, were outside the scope of Section 501(c)(2).

F. Adjunct Doctrine

(1) The adjunct doctrine, also sometimes called the integral part doctrine, is a judicial theory that an organization might be eligible for a derivative exemption from a related tax-exempt entity, where the organization (among other factors) provides a necessary and indispensable service solely to the tax-exempt organization, that the tax-exempt organization would otherwise have to perform for itself.

(2) In Knights of Columbus Bldg. Ass'n of Stamford, Connecticut, Inc. v. United States, 61 A.F.T.R.2d 88-1212, 88-1 USTC ¶ 9336 (D. Conn. 1988), the court stated that the adjunct doctrine could not be used to sidestep the specific requirements of the individual subsections under Section 501. Specifically, regarding Section 501(c)(2) organizations, the court stated, "The fact that Congress used the word "exclusive" in Section 501(c)(2) unequivocally precludes the title holding entity from doing anything but holding title."

The petitioner in the Knights of Columbus Building Association case unsuccessfully argued that they qualified for exemption under Section 501(c)(2) or Section 501(c)(8). The Service had revoked the petitioner's exemption under Section 501(c)(2) because it operated, on the behalf of a Section 501(c)(8) Knights of Columbus, a bar and buffet in its building, held a liquor license, and paid for all the utilities serving the building. These activities exceeded the permissible activities under Section 501(c)(2). Later, the petitioner applied for, and was denied, tax exemption under Section 501(c)(8) because they did not operate under a lodge system. Then, the petitioner asked the United States District Court to allow their request for exemption under Section 501(c)(8), arguing they were covered by the adjunct doctrine. The petitioner cited instances in which the Internal Revenue Service and the courts had recognized that organizations which furthered the purpose of another statutorily exempt organization were, themselves, exempt because they were "treated as one with the exempt organization."

The court rejected the petitioner's argument that the organization was described in Section 501(c)(8) as an adjunct to the fraternal organization:

> The issue becomes whether the adjunct doctrine, broadly stated, has general applicability. The court concludes that it does not. Section 501(c)(2) specifically exempts organizations that do largely what the Association does: hold title to property for exempt organizations. Because the Association cannot qualify under this section, it should not be entitled to skirt the prerequisites which title holding organizations must meet under the Code by asserting a nonstatutory basis for exemption. This would undermine the intent of Congress. The adjunct doctrine has developed in unique factual

> settings which when reconciled do not stand for a general principle capable of eroding the statutory limitations on exemptions for each of the 25 types of entities described in Sections 501(c)(1)-(24), (d).... The Association argues that it is so closely intertwined with the purposes of the exempt organization, primarily because it holds title for an exempt organization, that it is entitled to the same exempt status. This formulation would allow title holding entities to stray from their title holding purpose and, therefore, from Section 501(c)(2), yet retain tax exemption. This application of the adjunct doctrine would render Section 501(c)(2) meaningless. Because Congress has by implication specifically precluded this result in Section 501(c)(2), the court will not countenance an end run around that section by way of the adjunct doctrine.... [T]he adjunct cases involve fact patterns in which the adjunct performs a necessary and essential service to exempt organizations which the Code does not explicitly reach. In the present case the Association's central purpose is to hold title to real property for a Section 501(c)(8) organization, a function which in Section 501(c)(2) the Code recognizes with strictures that cannot be ignored.

(3) Similar to the Knights of Columbus Building Association case, the organization in Rev. Rul. 66-150, 1966-1 C.B. 147, did not qualify for exemption under Section 501(c)(2) because, even though it performed services to benefit its Section 501(c)(4) parent, the services were outside of the scope of those permitted in Section 501(c)(2). In that ruling, an organization which held title to a building that housed its exempt Section 501(c)(4) parent, maintained the building, and operated the social facilities for the members of the exempt parent, did not qualify for exemption under Section 501(c)(2) or Section 501(c)(4) because it operated outside the scope of both subsections. In contrast, based on the facts in the case, it did qualify under Section 501(c)(7), as a social club for members of the Section 501(c)(4) parent.

III. Other Considerations

A. Applying for Exemption

(1) An organization seeking recognition of exemption under Section 501(c)(2) must electronically file Form 1024, Application for Recognition of Exemption Under Section 501(a) or Section 521 of the Internal Revenue Code, including its Schedule A, with the correct user fee and all required supplemental documents through Pay.gov. See Rev. Proc. 2024-5, 2024-1 I.R.B. 262 (updated annually).

(2) Adverse rulings may be appealed. After December 2015, organizations described in Section 501(c)(2) may institute a declaratory judgment proceeding in court in response to an adverse ruling under the rules of Section 7428. See Section 9, Procedures for Adverse Determination Letters, and Section 10,

Declaratory Judgement Provisions of Section 7428, of Rev. Proc. 2024-5, 2024-1 I.R.B. 262 (updated annually).

B. Return Filing Requirements

B.1. Filing Requirements

(1) Organizations that are tax-exempt under Section 501(c)(2) are generally required to electronically file an annual Form 990-series return or notice (that is, Form 990, Return of Organization Exempt From Income Tax; Form 990-EZ, Short Form Return of Organization Exempt From Income Tax; or 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990EZ) to report certain information required by Section 6033.

The organization's gross receipts and its total assets determine which Form 990-series return it must file. Webpage "Form 990 Series - Which Forms Do Exempt Organizations File - Filing Phase In" on IRS.gov provides a chart on gross receipts and asset levels.

(2) Organizations with unrelated business taxable income must electronically file Form 990-T, Exempt Organization Business Income Tax Return, and electronically pay any required periodic estimated tax payments.

(3) The distributee organization of a Section 501(c)(2) title-holding company may file a consolidated Form 990-T with the Section 501(c)(2) organization, but not a consolidated Form 990.

Section 1501, which allows an affiliated group of corporations to file a consolidated income tax return. Section 1504(e) permits 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 . . . "

Section 511(c) provides that if a Section 501(c)(2) organization:

(1) pays any amount of its net income for a taxable year to an organization exempt 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) the Section 501(c)(2) organization and the Section 501(a) organization file a consolidated return for the taxable year,

the Section 501(c)(2) organization will be treated, for purposes of the tax imposed by Section 511(a), as being organized and operated for the same purposes as the Section 501(a) organization, in addition to the purposes described in Section 501(c)(2).

(4) Organizations with employees must file employment tax returns and unemployment tax returns and electronically pay any required periodic tax

deposits. See Publication 15 (Circular E), Employer's Tax Guide, for more information.

B.2. Automatic Revocation

(1) In 2006, Congress enacted a law that requires, with very limited exceptions, that all tax-exempt organizations file an annual return or notice with the IRS beginning with the 2007 tax year. The law also provides that any organization that fails to file a required annual return or notice for three consecutive years will automatically lose its tax-exempt status, effective as of the due date for the third missed return. This automatic revocation is by operation of law, and not by a determination made by the IRS.

(2) Section 501(c)(2) organizations are subject to automatic revocation.

(3) See webpage "Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions" on IRS.gov for more information.

C. Non-Deductibility of Contributions

(1) Contributions to Section 501(c)(2) organizations are not allowable as deductions under Section 170. Section 6113 requires certain tax-exempt organizations that are ineligible to receive tax deductible charitable contributions to disclose, in "an express statement (in a conspicuous and easily recognizable format)," the non-deductibility of contributions during fundraising solicitations. Section 6710 provides penalties for failure to comply with Section 6113 without reasonable cause. Organizations whose annual gross receipts do not normally exceed $100,000 are excepted from this disclosure requirement. See Notice 88-120, 1988-2 C.B. 454.

IV. Examination Techniques

(1) The information in this section is intended to guide the examiner in identifying and developing issues particular to Section 501(c)(2) title-holding corporations. These guidelines are meant to supplement the guidelines provided by IRM 4.70, TE/GE Examinations, and are not all-inclusive nor meant to limit the examiner in identifying issues nor using additional examination and legal resources (for example, CPE articles, examination tools and techniques, etc.) that are not included here.

A. Form of Organization

(1) A Section 501(c)(2) organization should be formed as a corporation. The term corporation in the Code includes associations. See Section 7701(a)(3). Ensure the organization is formed as an appropriate entity type.

B. Organizational Requirements

(1) Section 501(c)(2) refers to corporations “organized for the exclusive purpose” of holding title to property and collecting income.

(2) If an organization’s charter allows corporate purposes and powers beyond holding property and collecting income, then the corporation is not organized for the “exclusive purpose” of holding title to property required by the Code.

(3) When an organization’s history and activities point to acceptable Section 501(c)(2) operations, but its charter does not, the IRS will look favorably upon the organization’s offer to amend the charter to meet the organizational requirements under Section 501(c)(2).

(4) Refer to “Organizational Requirements” in “Exemption and UBTI Considerations,” above, for detailed technical information on whether an organization’s organizing document meets the qualification requirements under Section 501(c)(2).

C. Permissible Activities

(1) As a general rule, an exempt Section 501(c)(2) organization may only engage in the activity of holding title to property for an exempt parent and turning over the income, less expenses, to the parent. Generally, an exempt title-holding corporation may not have unrelated business income and would be revoked if it engaged in an unrelated trade or business. However, there are several exceptions to this general rule, discussed below.

C.1. Permissible Holdings and Sources of Income

(1) Under Treas. Reg. 1.501(c)(2)–1(a), a title-holding corporation may retain exemption if it has income that is treated as UBI solely because of:

a. Section 512(a)(3)(C)

b. Section 514

c. Section 512(b)(3)(B)(ii)

d. Section 512(b)(13)

e. Section 512(b)(3)(A)(ii), or

f. Section 512(b)(3)(B)(i).

(2) Another exception is that a title-holding company will not lose its exemption if it has income incidentally derived from holding title to real property (such as parking and vending machine income) that exceeds 10% of its gross income for a taxable year, if the company can establish that the receipt of the excess disqualifying income was inadvertent, and they are taking reasonable steps to correct the circumstances causing the excess income. See Section 501(c)(25)(G), as referenced in Section 501(c)(2).

(3) Certain sources of passive income, such as rent from the real property to which title is held, will not cause a title-holding company to lose its exemption. It is important to distinguish permissible passive investment activities from the non-permissible active trade or business of securities trading.

(4) Refer to “Permissible Holdings and Sources of Income” in “Exemption and UBTI Considerations,” above, for detailed technical information on whether an organization’s holdings and sources of income meet qualification requirements under Section 501(c)(2).

C.2. Prohibited Holdings and Sources of Income

(1) Other than noted exceptions under Section 501(c)(25)(G) and Treas. Reg. 1.501(c)(2)-1(a), a Section 501(c)(2) title-holding company may not retain its exemption if it generates unrelated business income.

(2) Refer to “Permissible Holdings and Sources of Income” and “Prohibited Holdings and Sources of Income” in “Exemption and UBTI Considerations,” above, for detailed technical information on whether an organization’s holdings and sources of income meet qualification requirements under Section 501(c)(2).

D. Turning Over Income

(1) Although neither the Code nor the Regulations specify the actual timing of remittance, a Section 501(c)(2) organization should turn over its net income to its parent as soon as is practical.

(2) Refer to “Turning Over Income” in “Exemption and UBTI Considerations,” above, for detailed technical information on whether an organization’s income distribution practices meet the qualification requirements under Section 501(c)(2).

D.1. Accumulation Prohibition

(1) A corporation described in Section 501(c)(2) can’t accumulate income (Treas. Reg. 1.501(c)(2)-1(b)). It must turn over the entire amount of income, less expenses, to an organization, which is itself exempt under Section 501(a).

(2) Neither the Code nor Regulations specify that a 501(c)(2) corporation must turn over income as soon as earned. Distribution, however, shouldn’t be delayed beyond a period sufficient to allow the holding company to complete normal accounting and administrative actions.

(3) An abnormal delay in distribution could create a hardship for the exempt distributee. It might also distort the income and, therefore, the support test under Section 509 for organizations exempt under Section 501(c)(3).

D.2. Method of Payment

(1) The form of the distribution is not important, but payment must actually be made, not merely accrued. The income must be distributed to the exempt

organization. A mere obligation to use the income for the exempt parent's benefit, or parental control of the title-holding company, doesn't satisfy this requirement. Permissible forms of distribution, for example, do include allowing the exempt parent to use facilities rent-free, or paying a dividend on stock.

D.3. Deductible Expenses

(1) Expenses includes the operating costs that a taxable corporation could deduct, such as depreciation. Rev. Rul. 66-102, 1966-1 C.B. 133, affirms that when computing the amount required to be distributed, a title-holding corporation may deduct operating expenses that would be deductible by a taxable corporation. This includes a reasonable allowance for depreciation, according to Rev. Rul. 66-102, and payments to retire indebtedness, as discussed in Rev. Rul. 67-104, 1967-1 C. B. 120.

(2) The IRS 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, 1977-2 C.B. 189.

E. Distributee

(1) A Section 501(c)(2) title-holding corporation must turn over certain income to an organization that is exempt under Section 501(a), which includes pension trusts described in Section 401(a). So, a pension trust is an acceptable recipient for a title-holding corporation income.

(2) An organization incorporated as a subsidiary of an exempt title-holding corporation, organized and operated exclusively for Section 501(c)(2) purposes, itself qualifies for recognition under Section 501(c)(2). See Rev. Rul. 76-335, 1976-2 C.B. 141.

(3) Refer to "Distributee" in "Exemption and UBTI Considerations," above, for detailed technical information on whether an organization's relationship with its distributee meets the qualification requirements under Section 501(c)(2).

E.1.Relationship with Distributee

(1) An exempt organization that receives support from a title-holding company must exercise some control or ownership over it. See Rev. Rul. 71-544, 1971-2 C.B. 227.

(2) Some examples of the necessary control are:

a. Owning the voting stock of the title-holding company

b. Possessing the power to select nominees to hold the voting stock

c. Appointing directors, etc.

(3) The absence of control by the distributee over the title-holding corporation is fatal to the exemption.

(4) A parent-subsidiary relationship commonly exists, but that exact relationship isn't required. If the title-holding company is a stock corporation, the distributee doesn't need to hold its stock if both:

a. the stock confers no rights to dividends or liquidating distributions, and

b. the title-holding company pays all income from the property, less expenses over to the distributee. See Rev. Rul. 68-222 1968-1 C.B. 243.

E.2. Limitations Arising from Relationship

(1) Rev. Rul. 68-490, 1968-2 C.B. 241, describes a situation when a Section 501(c)(2) organization is subject to the unrelated business income tax imposed by Section 511, if its exempt parent organization is subject to such tax. Of note, Rev. Rul. 68-490 was promulgated prior to the release of Section 501(c)(25), which describes multiple-parent title-holding companies, and was enacted under the Tax Reform Act of 1986 (Pub. L. 99-514), effective for taxable years beginning after December 31, 1986.

(2) The fact that the relationship between the title-holding company and its distributee are very close doesn't mean that the title-holding company may carry on all the activities of its parent. Apply the strict limitations of Section 501(c)(2) and the Regulations, regardless of how the parent is organized and operated. See Rev. Rul. 66-150, 1966-1 C.B. 147.

F. UBTI

(1) UBI, other than the permissible types of named in Section 501(c)(25)(G) and Treas. Reg. 1.501(c)(2)-1(a), will cause a Section 501(c)(2) to lose its exemption.

(2) The permissible types of UBI are still subject to tax, according to the Code.

V. Exhibit

A. Chart: Comparison of Section 501(c)(2) and 501(c)(25) Requirements

Criteria	501(c)(2) Organization	501(c)(25) Organization
Form of Organization	Corporation (incl. Association)	Corporation (incl. Association) or Trust
Purpose	Holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under Section 501(a)	Acquiring real property and holding title to, and collecting income from, such property, and remitting the entire amount of income from such property (less expenses) to its shareholders or beneficiaries
Number of shareholders or beneficiaries (aka, parents, distributees)	1	1 to 35
Permissible shareholders or beneficiaries	Must be exempt under Section 501(a)	Must be: • a qualified pension, profit-sharing, or stock bonus plan that meets the requirements of Section 401(a); • a governmental plan described in Section 414(d); • the United States, any state or political subdivision thereof, or any agency or instrumentality of the foregoing; or • an organization described in Section 501(c)(3)
Permissible holdings and sources of income	Assets that produce passive income, such as: • Rent from real property • Personal property leased with real property (subject to limitations) • Passive investments • Oil or mineral production payments	Real property and: • Personal property leased with real property (up to 15%) • Options to purchase real property • Reasonable cash reserves

Criteria	501(c)(2) Organization	501(c)(25) Organization
Prohibited holdings and sources of income	Include: • Operating a trade or business • Leasing only personal property • Income incidental to holding title exceeding limits	Include: • Ordinary trade or business • Tenancy in common • Holding interests in partnerships or real estate investment trusts • Making mortgage loans • Options trading • Income incidental to holding title to real property exceeding limits
Unrelated business taxable income / Unrelated business income	Will not qualify for exemption if it has UBTI, other than a few specified exceptions	Will not qualify for exemption if it has UBI, other than a few exceptions
Related TG	TG 2: Single-Parent Title-Holding Corporations – IRC Section 501(c)(2) has more detailed information.	TG 25: Multiple-Parent Title-Holding Organizations – IRC Section 501(c)(25) has more detailed information.