**<u>Rental of a Bahá'í Facility</u>:**

This paper describes issues that a Local Spiritual Assembly or Registered Group should consider when deciding whether to rent local Bahá'í facilities to others. The issues below apply whether the facility is used as a Center, book store, school, meeting place or any other purpose.

Rental of a Bahá'í facility raises complex issues about Federal, State and possibly local income taxes, property taxes, zoning and insurance issues. **Before renting its facility, a Local Spiritual Assembly or Registered Group should consult on the issues described below with:**

- **An experienced local tax attorney or accountant on the tax issues;**
- **An experienced real estate attorney on the zoning issues; and,**
- **An experienced insurance broker or agent on the insurance issues.**

The following information will help the Assembly understand the complexity of the issues for its consultation with the selected professional advisors.

1. **<u>Federal Tax Issues</u>:**

a. **<u>Background on Nonprofit Tax Exemption</u>:**

Local Spiritual Assemblies are included under the National Spiritual Assembly's group exempt ruling from the Internal Revenue Service. The ruling letter holds that the National Spiritual Assembly and its subordinate organizations are exempt from federal income tax as organizations described in section 501(c)(3) of the Internal Revenue Code. The ruling letter further states that the National Spiritual Assembly and its subordinates are not private foundations because they are organizations of the type described in Section 509(a)(1) and 170(1)(b)(1)(A)(i).

b. **<u>Federal Unrelated Business Income Tax (UBIT)</u>:**

A nonprofit organization is taxed on its unrelated business income. Under Federal tax law, this is referred to as the Federal Unrelated Business Income Tax (UBIT).

i. **Trade or Business Not Substantially Related to the Organization's Exempt Purpose.**

One type of unrelated business income is income from a trade or business that is regularly carried on by the exempt organization that is <u>not substantially related</u> to the organization's exempt purpose.[1] Some types of unrelated business income, such as

[1] The IRS website and IRS Publication 598 further clarify what these terms mean. "Trade or business" generally includes any activity carried on for the production of income from selling goods or performing services. "Regularly carried on" indicates a frequency and continuity. "Substantially related" requires an examination of how the activity relates to a purpose which causes the Assembly to be a nonprofit

income from the sale of advertising in a newsletter, are not associated with Centers and are not analyzed in this statement.

Since a local Bahá'í Center's purpose is to serve the religious mission of the Faith, anything that tends to serve that mission would more than likely not be taxed. Some examples of income from Centers that would be permitted and not permitted as related income are given below:

| Related Income | Unrelated Income |
|---|---|
| Charging a fee for Center use by organizations with compatible service goals, such as Alcoholics Anonymous, Health for Humanity, etc. | |
| Fees for Bahá'í marriage ceremonies or an occasional non-Bahá'í marriage ceremony | Fees for regular non-Bahá'í marriage ceremonies |
| Occasional rental of Center parking lot | Regular rental of Center parking lot one day a week |
| Book stores selling books and materials related to the Faith. | |
| Cafeterias and coffees shops operated for the convenience of the organization's employees or members | |
| Vending machines for snacks and beverages for the benefit of employees and members | |

### ii. Income From a Center That is Debt-Financed.

Passive income, which includes rental from real estate and the gain from its sale, generally is not taxable. It becomes taxable if the Center is debt-financed. Debt-financing refers to debt incurred directly or indirectly in order to acquire or improve the property rented. Some exceptions to this general statement are the following:

| Not Taxable | Taxable |
|---|---|
| Property acquired by gift, bequest, or devise subject to a mortgage | Rental of personal property either by itself or real estate and personal property rented together |
| Substantially all (85% or more) of the use of any property is for exempt purposes | Rents based on income or profits derived by any person by any method unless on a fixed percentage of gross receipts or sales |

organization and if it contributes importantly to that purpose. The fact that an organization needs income to fund its related activities does not cause that income to become related income.

| | |
|---|---|
| The acquisition of real property with the intent of using it for exempt purposes in the future | Providing services not generally provided with the rental of real estate |
| The debt is an annuity obligation | Rent is received from a controlled organization |

These exceptions have many nuances.

### iii. Form 990-T Filing Does Not Affect Tax Exempt Status.

If the Local Spiritual Assembly's unrelated business income from all activities, before deductions, is $1,000 or more, it would need to file an annual form 990-T with the Internal Revenue Service. Deductions are allowed for direct and allocated expenses and depreciation. If the income less expenses exceed $1000, federal income taxes at corporate rates would be due.

Federal tax exempt status of the Local Spiritual Assembly is generally not jeopardized by paying tax on unrelated business income. The Local Spiritual Assembly remains tax exempt. Only in rare circumstances is tax-exempt status jeopardized. One example of a jeopardized tax-exempt status is if the primary purpose of the organization becomes to carry on an unrelated business, which would be determined by examining all circumstances.

### 2. State UBIT and Property Tax Issues.

States and some municipalities may also collect income tax on unrelated business income. Each State and locality will have its own rules, which may differ from the Federal rules described above, about what constitutes unrelated business income.

Aside from the income tax, an entirely different tax is the State and local property tax. For property tax purposes, some States require that a Center be used exclusively for religious purposes. However, many States allow an occasional or minimal use for other purposes. Depending upon the particular State, occasionally allowing other groups to use local Bahá'í facilities may not cause loss of the property tax exemption. Local taxing authority requirements should also be investigated. Failure to comply with State and local property tax requirements may jeopardize the tax exempt status of the property and subject it to full property tax.

### 3. Local Zoning Issues.

Rentals can also pose issues for the zoning and use status of a Center. An experienced real estate attorney should advise a Local Spiritual Assembly on these issues.

### 4. Insurance Issues.

Insurance issues can also be a challenge for rentals. The local insurance agent or legal advisor should determine if the Local Spiritual Assembly's insurance policies cover usage by renters and their clients and guests of the Center. If not, the Assembly will either need to get a separate insurance policy (or a rider to an existing policy) or the Assembly will need to have the renter buy insurance with the Assembly as an additional named insured and give the Assembly a copy.