

Nonprofits and Real Estate: A Focus on Cost Savings

Presented by

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I. Ownership of Real Estate – Opportunities to Save

Real Estate Tax Exemption

- Depends on state, sometimes county law
- Generally only available for 501(c)(3)s, though it's not automatic
 - Other types of nonprofits (c4,c6) generally not eligible



Real Estate Tax Exemption, cont.

- In DC – several specific categories: art galleries “open to the public,” organization of “public” charity, educational organizations that “embrace the concept of teacher/student” (DC Code 47-1002)
- In MD – “actually used exclusively for a charitable or educational purpose” is the most broad category (MD Code Tax-Property 7-202)
- In VA – limited categories: religious organizations, colleges and “institutions of learning,” museums (VA Code 58.1-3606)

Real Estate Tax Exemption, cont.



- Explore partial exemption
- Explore legislative exemption based on economic benefits your organization provides to your local economy

Sales Tax Exemption

- Utilities: affirmatively apply to the utility. It is not automatic upon ownership.
- Tenant improvement (carpet, drywall) exempt if paid for by Tenant
 - In VA/MD, must be fixtures
 - In VA, nonprofit buys the material and turns over to contractor for installation
 - In DC, add provision to construction contract granting use of exemption

Tax-Exempt Bonds

- UNCF has been the beneficiary of two bond issuances by the DC Government: 2010-\$26 mill, 2015-\$33 mill (advance refunding) for acquisition and construction of a new HQ building right on top of Shaw/Howard Metro Station
- IRS publication 4077 provides an overview

Tax-Exempt Bonds, cont.

Tax-exempt bonds typically offer advantageous rates.

- Basic structure of a tax-exempt deal:
 - Bonds are issued by the municipality (issuer) for a particular project
 - Bonds are sold by issuer to an underwriter or a bank
 - The proceeds of the bonds are loaned to the non-profit
 - There's a loan agreement between the non-profit and the issuer (UNCF & DC)
 - Loan agreement sets repayment and other terms
 - Collateral and liens (often there is a deed of trust/mortgage)
 - Maintaining financial ratios
 - Reporting requirements

Tax-Exempt Bonds, cont.

There are only certain uses for which a non-profit can use tax-exempt bonds:

- Capital expenditures – land, buildings, infrastructure owned by the nonprofit (IRC 145(a)(1)) and not used in a manner that constitutes unrelated trade or business (IRC 513(a))/the use must be consistent with your nonprofit purpose
- Refinancing prior debt (has to be something that would have qualified for tax-exempt bonds in the first place)
- Reimbursing prior capital expenditures (with some limitations)
- Working capital (with some limitations)
- Financing costs (with some limitations)

Tax-Exempt Bonds, cont.

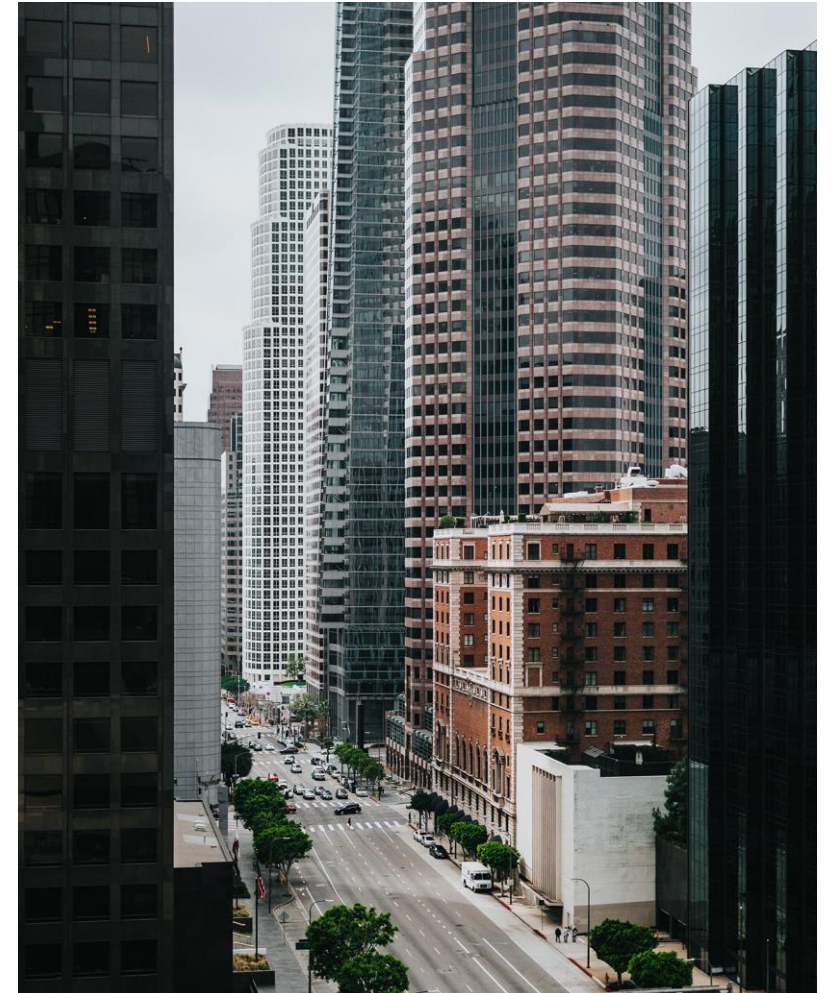
A portion of the project *can* be used by for-profit entities/purposes if:

- that portion can be allocated to financing sources other than the tax-exempt bonds (equity, taxable loan)
- that portion of the project used represents less than 5% of the proceeds of the tax-exempt bonds (IRC 145(a)(2))

UNCF employed this structure to allow a restaurant to have a bit of outdoor space.

Tax-Exempt Bonds, cont.

- The local approval process can involve a high political quotient, but certainly achievable
- High degree of reliance on outside counsel
 - If you're a corporate transactional lawyer, I think you'll find it fun.
 - If you're not, it can be overwhelming.



Additional Considerations

- Tax-exempt bonds are only available to 501(c)(3)s
- As mentioned, it may involve local political process
- There are ongoing tax compliance requirements – federal filings (for example on the Form 990, Part IV 24a and Schedule K), internal use monitoring

Additional Considerations, cont.

- Reduction in complexity – bank placements
 - Smaller-sized deals “work” now (more cost-effective structures)
- Leasehold improvements are eligible for tax-exempt financing (sometimes)
- Like-minded leasing can be used in tax-exempt-financed space

II. Leasing of Real Estate

Real Estate Tax Exemption Pass-Throughs

- DC: exempt landlord to exempt tenant
 - DC regulations do *not* recognize this except in school-to-school and charity-to-charity setting, but case law does (DCMR 322.1)
- VA and MD: not available





Sales Tax Exemptions

- DC leasehold improvements
 - Whether bought directly or through a contractor
- VA and MD only recognize direct purchases
- Sub-metered utilities
 - Available in DC

III. Common Mistakes in Federal Income Taxation

Common Mistakes in Federal Income Taxation

- Debt-Financed Real Estate – capital gains (IRC 513, 514)
 - Debt incurred in furtherance of exempt purposes excluded
 - Average look back basis vs. *highest* look back debt
- Debt-Financed Real Estate – leases (IRC 513, 514)
 - Like-minded lease exception
 - No tax even if debt financed
 - 15% exclusion
 - No tax even if debt financed

Common Mistakes in Federal Income Taxation, cont.



- Silo Rules for offsetting UBIT with losses from other UBIT activities
 - No longer able to shelter real estate UBIT with other losses (see 2017 Tax Act, 512(a)(6))

IV. Question & Answer Period

Further questions?

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