Dear Mary:

In a memorandum to you dated February 16, 2000, we provided an analysis of certain federal income tax consequences arising from the rental of church steeples by local United Methodist churches to cellular telephone companies. One conclusion was that rents received by a church from a lease of its steeple and other real property to a cellular phone company should not be taxable as long as the leased property was not “debt-financed property” under section 514 of the Internal Revenue Code. The basis for this conclusion was that the church steeple (and other property leased to the phone company) would constitute “real property,” rather than personal property or other tangible property used as an integral part of furnishing communication services (“special use property”). As you know, rents from real property—but not other property—generally are excludible from unrelated business income.

The analysis of this issue included a discussion of Private Letter Ruling 98-16-107 (Jan. 20, 1998), in which the Internal Revenue Service (“IRS”) concluded that the leasing of space by a university to a paging service company on a separate antenna tower located on the university’s property qualified for the exclusion for rents from real property. The IRS reasoned that, since the tower was permanently affixed to the real estate on which it was located, the rental payments received by the university were rents from real property. We noted that the ruling did not consider whether the tower should be classified as special use property.

The IRS, in Private Letter Ruling 200104031 (published Jan. 26, 2001), has now revoked the 1998 ruling and ruled instead that the tower is indeed special use property, rather than real property; therefore, receipts attributable solely to the rental of the broadcasting tower constitute unrelated business taxable income.

The definition of special use property was described in our memorandum (at pages 4-5) as follows:
Special use property, in the context of providing communications services, includes broadcasting towers and telephone poles, as well as other depreciable tangible property used as an integral part of providing communications services, but excludes buildings and structural components. Treas. Reg. §§ 1.1245-3(c)(1), 1.48-1(d). A “building” does not include a structure which houses special use property if the use of the structure is so closely related to the use of the special use property that the structure can be expected to be replaced when the property it initially houses is replaced. Factors indicating that a structure is closely related to the use of the special use property that it houses include (1) the fact that the structure is specifically designed to provide for the stress and other demands of the special use property and (2) the fact that the structure could not be economically used for other purposes. Treas. Reg. § 1.48-1(e)(1).

Unlike the separate antenna tower involved in the IRS rulings, a church steeple normally is not a freestanding broadcasting tower that is constructed solely or even primarily for use in providing communication services. Rather, as indicated in our memorandum (at page 5), it may be viewed as a building (or a component of the overall church structure) that encloses a space within its walls, has uses other than for telecommunications, will not be replaced or removed when the communications property inside the steeple is replaced or removed, and is not specifically designed to provide for the stress and demands of the communications property (except perhaps in cases where a new steeple is constructed with funding from a phone company).

In our memorandum (at page 5), we stated that the 1998 IRS letter ruling was “helpful in suggesting that typical church leases to cellular phone companies would not produce taxable income to the church.” Obviously, the revocation of that ruling and the new contrary ruling are not helpful to churches on this issue. While, as indicated above, they have still good arguments for treating the steeples as real property and the rental income therefrom as excludible from unrelated business income, the recent IRS ruling increases the chances that the issue could be raised if a church with such income were audited.

Please call if you have any questions or would like to discuss any additional followup on this issue.

Warmest regards,

Michael A. Lee
Memorandum

To: Mary K. Logan, Esq.
General Counsel
General Council on Finance and Administration
The United Methodist Church

From: Michael A. Lee

Date: February 16, 2000

Re: Rental of Church Steeples to Cellular Phone Companies-Tax Consideration

This memorandum is in response to your request for an analysis of certain federal income tax consequences arising from the rental of church steeples by local United Methodist churches to cellular telephone companies. In particular, we have reviewed two issues: (1) whether such rentals generate unrelated business taxable income to a church that engages in this activity; and (2) whether such activity may jeopardize the federal income tax exemption of such a church if it generates more than half of the church’s income. While we provide a general analysis of these issues below, this analysis is not intended to constitute a formal legal opinion, which could be provided only with reference to the particular facts and circumstances of a specific transaction or series of transactions.

I. CONCLUSIONS

Under the assumed facts described in Part II below:

- Rents received by a church from a lease of its steeple and other real property to a cellular phone company should be excludible from unrelated business income as long as the leased property is not “debt-financed property” (as defined at pages 3-4 below) and

- The rental activity should not jeopardize a typical church’s tax exemption even if the rental income received by the church constitutes more than half of its total income.
II. ASSUMED FACTS

We understand that, in recent years, a growing number of United Methodist churches have entered into agreements allowing cellular telephone companies to use church steeples as antennae in providing cellular phone service to their customers. This has occurred as the phone companies have encountered difficulties in finding sites or obtaining permits for the construction of towers in some localities. In some cases, churches have leased their steeples to more than one phone company.

You have indicated that the typical agreement is structured as a long-term lease to the phone company (e.g., 10 years with a number of five-year renewal options). The rent payable by the phone company is a flat amount, with periodic increases to reflect inflation, and is not contingent upon the revenues of the phone company from its use of the church property.

The lessee is permitted to use the leased premises only for the purpose of constructing, installing, maintaining and operating a communications facility, including antenna equipment, cable wiring, backup power sources (including generators and fuel storage tanks) and related fixtures. The lessee must avoid interfering with use of the steeple by other phone companies. The lease may include not only part of the church steeple, but also a small amount of space in the church building and an area on the site for placement of an emergency generator. In addition, the church may grant the phone company an easement for the installation and maintenance of wires, cables, conduits and pipes running across church property.

The phone company is responsible for providing all equipment needed for its operation and for building out any space needed to house the equipment. The church provides no personal property and no services to the lessee. The phone company is required to maintain the leased premises, to pay for all utility services that it uses, to insure its equipment and other property placed in the leased space, and to pay any real property taxes that may be imposed because of the phone company’s use of the property. The church is required to maintain and insure only the church buildings and the steeple itself. Upon termination of the lease, the phone company is required to remove its equipment, personal property and all readily removable fixtures from the leased premises.

III. UNRELATED BUSINESS INCOME

While a church is generally exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code of 1986 (the “Code” or “I.R.C.”), the church is subject to the unrelated business income tax (“UBIT”) imposed by section 511.1 For this purpose, an exempt organization’s “unrelated trade or business” is any trade or business that is regularly carried on if the conduct of the business is not substantially related to the organization’s exempt purposes. I.R.C. § 513(a). For UBIT purposes, the

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1 All section references are to the Code unless otherwise indicated.
organization’s need for money or the use it makes of the profits derived from the business will not make the business activity related to exempt purposes.

Although the leasing of real property by an exempt organization to unrelated parties normally is viewed as an unrelated trade or business activity, pursuant to a statutory exemption the rents derived from such leases are not subject to tax under most circumstances. I.R.C. § 512(b)(3). However, this favorable exclusion is not available (and the rents become taxable in whole or in part) in the following situations:

- If more than 50 percent of the total rent received or accrued under the lease is attributable to personal property, rather than real property;²
- If the determination of the amount of rent depends in whole or in part on the income or profits derived by any person from the property leased;³
- If the lessor provides services to the occupant of the real property that are primarily for the occupant’s convenience and go beyond the services customarily rendered in connection with the rental of space for occupancy only;⁴
- If the rent is received from an organization that is considered “controlled” by the lessor under Code section 512(b)(13); or
- If the leased property is “debt-financed property,” which is property held to produce income and with respect to which there is “acquisition indebtedness.”⁵

I.R.C. §§ 512(b)(4), 514(b)(1). If substantially all⁶ of the use of property is

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² Rent from personal property itself is excluded from taxation if the personal property is leased with the real property and the rents attributable to the personal property are an incidental amount (not more than 10 percent) of the total rents received or accrued under the lease, determined at the time the personal property is placed in service. I.R.C. § 512(b)(3)(A)(ii); Treas. Reg. § 1.512(b)-1(c)(2)(ii)(b).

³ The rent may, however, be based on a fixed percentage of receipts or sales, as opposed to income or profits. I.R.C. § 512(b)(3)(B)(ii).

⁴ Permissible services include furnishing heat and light, cleaning common areas and collecting trash. Treas. Reg. § 1.512(b)-1(c)(5).

⁵ “Acquisition indebtedness” is the unpaid amount of (A) debt incurred by an exempt organization in acquiring or improving property; (B) debt incurred before the acquisition or improvement of property if the debt would not have been incurred but for the acquisition or improvement; and (C) debt incurred after the acquisition or improvement of the property if the debt would not have been incurred but for such acquisition or improvement and incurring the debt was reasonably foreseeable at the time of the acquisition or improvement. I.R.C. § 514(c)(1).

⁶ In general, this “substantially all” test is met if at least 85 percent of the use of the property is devoted to the organization’s exempt purposes. The extent to which property is used for a particular purpose is determined based on all the facts and circumstances, including (where appropriate) (a) a comparison of the portion of time the property is used for exempt purposes with the total time such property is used, (b) a comparison of the portion of space that is used for exempt purposes with the portion of such property that is used for all purposes, or (c) both of these comparisons. Treas. Reg. § 1.514(b)-1(b)(1)(ii).
substantially related to the performance of the organization’s exempt purposes or functions, the property is not treated as debt-financed property even if debt is incurred to acquire or improve such property. I.R.C. § 514(b)(1)(A)(i).

Under the assumed facts described in Part II above, the rent charged for use of the steeple and other church property does not depend on the phone company’s income or profits; the church does not provide non-customary services to the lessee; and the lease is not to an organization controlled by the church. If the leased property is not “debt-financed property,” then the church should be able to avoid tax on the rental income if the steeple and other leased property are considered real property under applicable Code sections and Treasury Regulations (the “Regulations”).

For this purpose, “real property” includes land, buildings and structural components, and excludes (a) personal property and (b) other tangible property used as an integral part of furnishing certain kinds of services, including communications services (hereafter called “special use property”). I.R.C. §§ 512(b)(3)(A), 1250(c), 1245(a)(3)(B); Treas. Reg. §§ 1.1250-1(e)(3), 1.1245-3(b). Each of these categories is defined further as follows:

• A “building” generally means any structure or edifice enclosing a space within its walls and usually covered by a roof. Treas. Reg. §§ 1.1250-1(e)(3), 1.1245-3(c)(2), 1.48-1(e).

• “Structural components” include such parts of buildings as walls, partitions, floors and ceilings, as well any permanent coverings therefor; windows and doors; heating and air conditioning components; plumbing and plumbing fixtures; electric wiring and lighting fixtures; chimneys; stairs, escalators and elevators; sprinkler systems; fire escapes; and other components relating to the operation or maintenance of a building. Id.

• “Personal property” includes both tangible and intangible personal property, and “tangible personal property” means any tangible property except land and improvements thereto (such as buildings, other inherently permanent structures and structural components of such buildings and structures). Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. Treas. Reg. §§ 1.1245-3(b), 1.48-1(c).

• Special use property, in the context of providing communications services, includes broadcasting towers and telephone poles, as well as other depreciable tangible property used as an integral part of providing communications services, but excludes buildings and structural components. Treas. Reg. §§ 1.1245-3(c)(1), 1.48-1(d).

• A “building” does not include a structure which houses special use property if the use of the structure is so closely related to the use of the special use property that the structure clearly can be expected to be replaced when the
property it initially houses is replaced. Factors indicating that a structure is closely related to the use of the special use property that it houses include (1) the fact that the structure is specifically designed to provide for the stress and other demands of the special use property and (2) the fact that the structure could not be economically used for other purposes. Treas. Reg. § 1.48-1(e)(1).

Under these definitions, the church steeple (and other property leased to the phone company) should qualify as real property, rather than personal property or special use property. The steeple is not a freestanding broadcasting tower that is constructed solely for use in providing communications services. Rather, it should be viewed as a building (or portion of the overall church structure) that encloses a space within its walls, has uses other than for telecommunications, will not be replaced or removed when the phone company’s communications property inside the steeple is replaced or removed, and is not specifically designed to provide for the stress and demands of the communications property (except perhaps in cases where a new steeple is constructed with funding from a phone company).

In Private Letter Ruling 98-16-017 (Jan. 20, 1998), the Internal Revenue Service concluded that the leasing of space by a university to a paging service company on a separate antenna tower located on the university’s property qualified for the exclusion for rents from real property. The tower was used to hold broadcast antennae, dishes and similar communications equipment used in the operation of the university’s own radio station and had capacity to house additional antennae for radio signal transmission. The lease to the paging company included space on the antenna tower and a right of way on the tower premises for the installation, operation and maintenance of the lessee’s equipment. Equipment was also installed in the broadcast station building owned by the university. The rent was for a monthly fee, adjusted for inflation. The tower lease agreement contained the usual provisions of a real estate lease, including the obligation to utilize space without interference with other tenants on the tower. The IRS reasoned that, since the transmission tower was permanently affixed to the real estate on which it was located, the rental payments received by the university were rents from real property and thus were not taxable.

The facts described in Part II above regarding typical church leases are similar in many respects to those in the above ruling. Although IRS private letter rulings do not constitute precedent that may be relied upon by anyone other than the party to whom it is addressed, the ruling discussed above is helpful in suggesting that typical church leases to cellular phone companies would not produce taxable income to the church.

Accordingly, based on the foregoing analysis, rents received by a church from a lease to a cellular phone company under the assumed facts described in Part II should be

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7 In one respect, the facts in the IRS ruling were less favorable, since the leased property there was a separate antenna tower that might have been classified as special use property, rather than real property, for purpose of the rental exclusion from UBIT. The IRS ruling did not address that issue.
excludible from unrelated business income as long as the leased property is not “debt-financed property” (as defined on pages 3-4 above).

IV. TAX-EXEMPT STATUS

In some cases, the rental of a church’s steeple to one or more cellular phone companies could generate more than half of that church’s total income for one or more years of the lease term. You have asked us to consider whether a church’s tax-exempt status may be jeopardized in such circumstances.

The issue of how much unrelated business activity may be conducted by a section 501(c)(3) organization has generated much uncertainty and confusion. Although many practitioners have advised charitable organizations not to derive more than half of their revenue from unrelated business activities, such a limitation may be unduly restrictive, at least in some circumstances. As discussed below, the amount of income earned from an activity, by itself, is not dispositive. Other key factors also must be considered, including (1) the purpose of the activity, (2) the magnitude of the activity in relation to exempt activities of the organization and (3) the nature of the activity — e.g., whether it involves the active conduct of a commercial business enterprise involving the production of goods or performance of services or merely a passive investment or rental activity.

A. Legal Framework

To qualify under section 501(c)(3), an organization must be organized and operated exclusively for charitable, religious, educational or certain other exempt purposes. The Regulations provide that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages “primarily” in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3), and that an organization will not be so regarded if more than an “insubstantial part” of its activities is not in furtherance of an exempt purpose. Treas. Reg. § 1.501(c)(3)-1(c). The Regulations also state:

An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization’s exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. Treas. Reg. § 1.501(c)(3)-1(e)(1).
These two regulations may appear to be inconsistent. Regulation section 1.501(c)(3)-1(c) could be construed to prohibit any substantial nonexempt activity, while section 1.501(c)(3)-1(e) permits the operation of a trade or business as a substantial part of an organization’s activities (or possibly even its primary activity) so long as the operation of such activities is in furtherance of an exempt purpose. Treas. Reg. § 1.501(c)(3)-1(e)(1).

B. Purposes vs. Activities

To resolve the ambiguity in the regulations, it is necessary to distinguish between the purpose of an activity and the activity itself. The Supreme Court has stated that the presence of a single nonexempt purpose, if substantial in nature, will destroy exemption regardless of the number or importance of truly exempt purposes. Better Business Bureau v. United States, 326 U.S. 279, 283, 66 S. Ct. 112, 114 (1945). The Court did not say a single substantial nonexempt activity will destroy exempt status. Moreover, the Tax Court has stated that a single activity may further both exempt and nonexempt purposes. B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978).

According to the IRS and a number of court cases, an unrelated business activity may serve exempt purposes if the income from such activity is used for exempt purposes. Thus, the IRS has stated in its internal training materials that the intent behind Regulations section 1.501(c)(3)-1(e) “was to permit charities to carry on substantial unrelated businesses so long as such businesses are in furtherance of exempt purposes. The latter purpose is accomplished by using the profits from the businesses for charitable purposes.” IRS Exempt Organizations CPE for 1983, at 90.

The IRS employed this approach, which we refer to as the “destination rule,” in Revenue Ruling 64-182, 1964-1 C.B. 186, in which a section 501(c)(3) organization’s principal source of income was the rental of space in a commercial office building owned and operated by the organization. The rental income was used to support grants to other charitable organizations. The IRS ruled that the organization met the primary purpose test of Regulations section 1.501(c)(3)-1(e)(1) and qualified for exemption where it carried on a “charitable program commensurate in scope with its financial resources through the grants to other charitable organizations.”

Revenue Ruling 64-182 did not limit the amount of rental activity or the income that could be derived from it as long as the commensurate test was met. The absence of any such limits was confirmed in General Counsel Memorandum 34,682 (Nov. 17, 1971).

The IRS has continued to rely on or acknowledge the position stated in Revenue Ruling 64-182. See, e.g., Rev. Rul. 73-128, 1973-1 C.B. 222; Gen. Couns. Mem. 38,742

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8 This revenue ruling was based on General Counsel Memorandum 32,689 (April 27, 1964), which concluded that the primary purpose of an organization engaged in trade or business activities would be considered charitable where the organization carried on a charitable program reasonably commensurate with its resources.

[An organization’s] exemption is not jeopardized merely because it conducts an unrelated business as a substantial part of its total activities, as section 1.501(c)(3)-1(e)(1) of the regulations indicates. The key issues are the reason why the business is carried on and the organization’s primary purpose. A purpose to raise funds to support the organization’s exempt functions is a legitimate reason for an organization to conduct a business, although it would have to pay tax on any unrelated business taxable income derived from a business not otherwise substantially related to its performance of its exempt purposes. As long as the conduct of such business is not the organization’s primary purpose, as determined by the facts and circumstances, the organization may conduct such business consistent with section 501(c)(3).

Use of the “destination rule” to determine exempt status has been supported by court decisions since 1924. That rule “states that where the only objective of an organization is charitable, a tax exemption will not be denied because an organization raises money for that objective by commercial activity.” Ohio Teamsters Educational & Safety Training Trust Fund v. Commissioner, 692 F.2d 432, 436 (6th Cir. 1982), aff’g, 77 T.C. 189 (1981). The rule was first articulated by the Supreme Court in Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578, 44 S.Ct. 204 (1924), when the Court stated that the predecessor of section 501(c)(3) “says nothing about the source of the income, but makes the destination the ultimate test of exemption.” 263 U.S. at 581. The Court explained:

[Exempt] activities cannot be carried on without money; and it is common knowledge that they are largely carried on with income received from properties dedicated to their pursuit. This is particularly true of many charitable, scientific and educational corporations and is measurably true of some religious corporations. Making such properties productive to the end that the income may be thus used does not alter or enlarge the purposes for which the corporation is created and conducted. Id.

9 For UBIT purposes, the destination rule does not apply. Code § 513(a) defines an “unrelated trade or business” as “any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its [exempt purpose or function].”
More modern cases following the destination rule include Scripture Press Foundation v. United States,\textsuperscript{10} 285 F.2d 800 (Ct. Cl. 1961), and Aid to Artisans, Inc. v. Commissioner.\textsuperscript{11} 71 T.C. 202 (1978).

C. **Magnitude of Nonexempt Activities**

Notwithstanding the foregoing authority for the destination rule, the IRS occasionally focuses on the magnitude of an organization’s nonexempt activity rather than the purpose of such activity or the use of funds therefrom for exempt purposes. Even in these cases, however, the receipt of large amounts of income from nonexempt activities, in itself, normally does not cause an organization to lose its tax exemption.

For example, in Technical Advice Memorandum 95-21-004 (Feb. 16, 1995), the Service ruled that an organization that operated a nonexempt travel agency business would not lose its tax exemption even though the business provided roughly one-half of the organization’s gross receipts, since most of the time spent by the organization’s employees was devoted to exempt activities. In Technical Advice Memorandum 95-50-001 (Aug. 23, 1995), which involved a section 501(c)(6) organization, the IRS looked at net revenues and functional expenses, in addition to time spent on nonexempt activities, in determining that the magnitude of such activities did not warrant revocation of the organization’s exemption.

In Technical Advice Memorandum 97-11-003 (Nov. 8, 1995), an organization was able to retain its tax exemption even though 98 percent of its gross income came from a bingo operation and one-half or more of the organization’s time and resources were devoted to that operation. In Private Letter Ruling 98-09-062 (Dec. 5, 1997), the Service ruled that, although an organization received large amounts of income from various unrelated business activities, the extent of those activities was insubstantial when compared to exempt activities. The IRS stated that, while close scrutiny is required to ensure that nonexempt activities are not more than an insubstantial part of the organization’s overall activities, “the amount of income received does not per se establish that an organization is operating to carry on nonexempt activities to more than an insubstantial degree.”

\textsuperscript{10} In Scripture Press the court ruled that an organization was not exempt because of the large gap between the amounts it spent to support religious educational programs and the amount of capital and surplus accumulated from its business of selling religious literature. 285 F.2d at 804-805.

\textsuperscript{11} In Aid to Artisans, the Tax Court stated:

In the instant case, petitioner’s primary activities are the purchase, import, and sale of handicrafts. All profit generated by the operations is earmarked for specific purposes; no profit earned by Aid to Artisans is to be retained. If we find that the purposes for which petitioner is to use the profit are exempt purposes, then we will be convinced that petitioner’s commercial activities are not an end unto themselves. 71 T.C. at 212.
One court case departed from the destination rule and found that the magnitude of an organization’s nonexempt business activities was sufficient to defeat its exemption. In *Orange County Agricultural Society, Inc. v. Commissioner*, 55 T.C.M. (CCH) 1602 (1988), aff’d, 893 F.2d 529, 532 (2d Cir. 1990), the Tax Court dealt with a section 501(c)(3) organization that had the stated exempt purpose of promoting agriculture and horticulture. One of its substantial activities was involvement in the operation of a related organization’s speedway. The organization eventually received all of the racing and concession revenues, which constituted 29 to 35 percent of its total revenues. The court held that the organization’s operation of the raceway through an alter ego was not in furtherance of its exempt purposes and constituted more than an insubstantial part of the organization’s total activity, causing loss of tax exemption. When the organization made an argument based on the destination rule, the Tax Court responded:

The Society further argues that the money that it received from the racing activities as ‘rent’ constitutes a ‘vital part of its cash flow,’ and if it did not receive such funds it could not continue to function. Again, these arguments miss the point. The fact that the racing activities provide the Society with substantial income does not make the racing activities substantially related to the Society’s exempt educational purpose. 55 T.C.M. at 1605.

While it did not address expressly the destination rule, the Second Circuit affirmed the Tax Court’s finding that the organization’s “involvement in the automobile racing activities exceeded the benchmark of insubstantiality.” 893 F.2d at 533. The Second Circuit relied on an earlier Tax Court case involving the “revocation of tax exemption [of a section 501(c)(6) organization] where approximately 30 percent of revenues derived from non-exempt activity.” *Id.* at 533, citing *Associated Master Barbers & Beauticians of America, Inc. v. Commissioner*, 69 T.C. 53, 68-69 (1977).

**D. Nature of Nonexempt Activity**

In addition to the purpose and magnitude of an organization’s nonexempt activity, the nature of such activity may influence its potential effect on the organization’s tax exemption. A very substantial nonexempt activity involving the production of goods or the performance of services—especially if the activity competes with for-profit companies—is more likely to cause a problem than a substantial passive activity that

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12 The court also found that the organization conferred impermissible private benefit on parties who received interest-free loans. This provided a separate and sufficient ground for loss of exemption, which could have allowed the court to avoid its troublesome and misplaced reliance on the magnitude of the organization’s nonexempt activities.

13 The court thus erroneously applied the UBIT test to the issue of entitlement to tax exemption.

14 In that case, the measurement of nonexempt activity was based on time spent, revenue received and disbursements.
produces only rental or investment income. I am aware of no case or ruling that has revoked the tax exemption of a section 501(c)(3) organization because it earned too much rental income from real property (or too much interest, dividend or royalty income). If there were a percentage limit on the amount of passive income that could be earned by a section 501(c)(3) organization, it would affect not only churches wishing to rent their steeples to cellular phone companies, but also organizations such as large universities and private foundations that rely on investment income from large endowments. It also would make little sense to exclude real property rents, royalties, interest and dividend income from UBIT but then limit the amount of such income that may be earned by an organization without jeopardizing its tax exemption.

E. Conclusion on Tax-Exempt Status

Under all of the approaches discussed above, the rental of a church steeple to cellular telephone companies under the facts assumed in Part II logically should not jeopardize a church’s tax exemption even if the rental income accounts for more than half of the church’s total income:

- Under the destination rule, the church’s primary purposes should continue to be considered religious and charitable as long as rental income is used for the church’s exempt purposes and the church carries on a program of exempt activities reasonably commensurate with its financial resources;

- Because the rental activity should require only nominal expenditures of time and money by the church, the magnitude of the rental activity should be considered insubstantial in relation to a typical church’s exempt programs and activities; and

- The nature of the activity is passive, does not require the sale of goods or the performance of substantial services, and produces only a type of income (real property rents) that is excludible from UBIT.
February 25, 2000

NON-TAX LEGAL ISSUES ASSOCIATED WITH THE PLACEMENT OF WIRELESS COMMUNICATIONS EQUIPMENT ON CHURCH PROPERTY

With the exploding growth of the wireless communication industry, many congregations are being courted by wireless service providers (“providers”) to allow the placement of base stations and antennae on church premises. For the church, the chief benefit of entering into such an arrangement is obvious – it promises to supply a steady stream of income to the church, at minimal effort and cost to the church. There are, however, some serious risks and potential complications that need to be confronted and addressed by any congregation that is considering such a project. The purpose of this memorandum is to highlight those issues.

Two caveats are in order. First, this memorandum does not address the tax ramifications that may flow from receiving income from the placement or use of wireless communications equipment on church property. That issue is the subject of another memorandum that will be circulated by the General Council on Finance and Administration of The United Methodist Church. Second, no representation is made that this memorandum identifies all conceivable non-tax legal concerns associated with entering into contracts with the providers. The intent was to identify what seem to be the key areas of concern – to spot the kinds of issues that need to be addressed, without necessarily exhausting them all or treating each one comprehensively. In all cases, a congregation that is contemplating such an arrangement should retain experienced counsel to identify all legal issues that are pertinent to that congregation’s situation and to negotiate the best possible agreement with the provider.

Indemnity & Insurance

Indemnity and Insurance. Perhaps the most important thing is to ensure that the provider bears all, or nearly all, of the risks associated with the placement and use of the provider’s equipment on the church property. The provider should bear sole responsibility for securing all of the necessary insurance (e.g., casualty, fire, etc.) and should name the church as an additional insured on each policy. Thereafter, the congregation should be vigilant to ensure that the insurance remains in force by, among other things, annually requiring the provider to supply the congregation with a certificate of renewal of the policy for the upcoming period. (The adequacy of fire insurance should be examined closely, particularly if a structure higher than any that previously existed is erected to hold the antenna, since that might increase the risk of fire attributable to lightning.)
In addition, even if seemingly adequate insurance is secured, the church should require the provider to expressly indemnify the church from liability for all claims, losses, costs and damages (including defense costs and attorneys’ fees) associated with the construction, maintenance and operation of the project. The scope of risks covered should be comprehensive. At a minimum, the indemnity should cover the following:

- **Personal injury or bodily injury.** This should cover anyone, including parishioners, the provider’s employees, contractor employees, neighbors, church employees and anyone else that may use the premises. Please be aware that there is much being written and said about the possibility of adverse health effects being associated with microwave transmissions. Although many believe that exposure levels due to radio frequency emissions from transmitter facilities are well below the levels considered to be safe, the congregation needs to conduct its own inquiry into this issue, to be sure it is aware of all the risks. Whatever the outcome of that assessment, however, it would be advisable to have the indemnity extend not merely to actual bodily injury, but also to claims for increased risk of disease and to any alleged emotional distress that might accompany such risk. Furthermore, the agreement should make clear that the indemnity extends beyond the life of the agreement, covering both claims and injuries that may arise or surface after the arrangement expires.

- **Property damage.** This should cover the church’s own property, of course, but also all property belonging to the provider, any contractors, parishioners, neighbors, or anyone else. Coverage should also apply without regard to the cause of the damage or when it occurred (whether during construction, installation, operation, maintenance, dismantling of the equipment).

- **Damage arising even from the church’s own negligence.** Ideally, the indemnity should exclude only damages arising from the church’s own gross negligence or intentional misconduct.

- **Failure to obtain permits or licenses, or otherwise to comply with laws or regulations.** The provider must bear all costs arising out of any claimed failure to comply with relevant laws and regulations, including, but not limited to, zoning ordinances, construction permit requirements, and regulations promulgated by the Federal Communications Commission (“FCC”).

- **Claims/liens by contractors.** Obviously, the provider should be responsible for paying all contractors hired in connection with installing, maintaining or operating the equipment, and the provider should be required to cure any damage or loss the church may sustain if a contractor claims not to have been paid and asserts claims or liens against the church or its property.
Casualty loss. This would cover any claims or losses associated with any failures or shutdowns of the provider’s equipment for any reason, as well as for any other casualty loss, such as those that may be caused by frequency interference or power outages allegedly attributable to the operation of equipment.

Responsibility for Compliance with Laws and Regulations

As suggested by the indemnity discussion, the agreement between the church and provider should firmly place upon the provider the obligation to obtain all permits and licenses that may be needed to construct and operate the equipment, and to ensure that the entire operation otherwise complies with all relevant laws and regulations. In addition, the provider should expressly warrant that the structure will at all times be in full compliance with all applicable laws and regulations and that the provider has obtained all necessary clearances, certificates, and permits.

While obtaining these assurances provides protection for the congregation, government agencies may still consider it to be the church’s obligation to fulfill certain requirements. For example, the FCC distinguishes between “owners” and “licensees” of antennas and imposes distinct requirements on each. See Summary of FCC Requirements, below. Although the cost and labor associated with meeting those requirements should be transferred to the provider by agreement, the church may well remain exposed as far as the government is concerned, so the church and its counsel need to monitor the situation to ensure that all requirements are, in fact, satisfied.

Summary of FCC Requirements

The FCC regulates wireless antenna structures pursuant to the federal Telecommunications Act of 1996. The requirements imposed by the Act and by FCC regulations are diverse and should be reviewed closely with counsel at the time any arrangement with a provider is being considered. The requirements include, among other things, the following:

Registration. Subject to certain exemptions, the “owner” of an antenna structure (as distinct from the “licensee”/provider who is using the structure) may be required to register the structure with the FCC if the highest point of the structure is more than 200 feet above ground level, or even if the structure is not that high but is close to an airport. The regulations governing registration are complex and need to be examined closely during the design process. The owner is also responsible for amending the registration data as necessary (e.g., if the structure’s height is modified), and for displaying the registration number in a conspicuous place so that it is readily visible near the base of the antenna structure.

The owner is responsible for maintaining the structure in accordance with any specifications and conditions found in the registration (such as painting or lighting requirements imposed to ensure visibility by aircraft pilots).
The Telecommunications Act precludes local authorities from enforcing regulations that (1) discriminate among providers of functionally equivalent services, (2) prohibit or have the effect of prohibiting wireless services altogether, or (3) impose restrictions based on environmental effects of radio frequency emissions that are more strict than those imposed by comparable federal regulations. 47 U.S.C. § 322(c)(7)(B)(i), (iv).

The structure must comply with federal regulations governing the environmental and health effects of radio frequency emissions, which can be found at 47 CFR §§ 1.307, 1.310 and 2.1093.

The structure must comply with FCC rules (found generally at 47 CFR § 1.301 et seq.) implementing the National Environmental Policy Act of 1969, which require the preparation of an environmental assessment in certain cases, and which are of particular relevance to any structure located in a flood plain, or on or within an area or building that is listed or eligible for listing in the National Register of Historic Places.

There is a wealth of information available from the FCC regarding these issues. A good starting point is to visit the FCC’s web site at www.fcc.gov/wtb.

Other Potential Restrictions

Zoning. Although the Telecommunications Act of 1996 places some important constraints on the jurisdiction of local zoning authorities over such matters, local authorities generally retain the right to regulate the construction, modification and placement of wireless communications equipment. The church’s counsel should review the local zoning ordinances and any other applicable regulations (e.g., neighborhood land use agreements or restrictions) to ensure that the specific structure proposed would comply with them.

Charter or Deed Restrictions. There may be language in the church’s charter documents, organizational statutes, or property deed that restricts or prohibits it from putting such structures in place. These documents must be referenced to ensure that the placement of and use of income from these structures will not violate any of the restrictions they contain.

Property Tax Issues. Counsel for the church should also consider whether the placement of the equipment on the property, or the receipt of income from the arrangement, may effect the church’s status with property taxing authorities.

Responsibility for Costs and Added Expenses

The agreement between the church and the provider should also state that the provider shall bear all out-of-pocket costs associated with the project. Take care that this obligation is stated in comprehensive terms, to make clear that it extends to costs associated with every stage of the venture, including the initial construction/installation phase, maintenance and repair costs, whatever costs may be

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associated with actually operating the equipment, and any costs incurred if and when the equipment is removed or dismantled.

Utility costs will be a significant operating expense. To limit any squabbles over this issue, the church should insist that the provider install a separate electric meter dedicated to measuring the electricity consumed by the provider’s operations.

**Coordination Issues**

Problems will undoubtedly be minimized if the congregation and the provider take pains to account for issues that, without planning, might prove divisive, disruptive and costly. The key is to anticipate how each party’s operations might impact the other, and seek to identify ways in which problems can be avoided or resolved through coordination. Issues that might need this kind of attention include the following:

**Installation.** The installation of the structure could potentially disrupt church services or other church activities and may require additions or modifications to the existing building. The church should ensure that the structure will be installed at a time and in a manner that is acceptable to the church. To do so, the church may wish to secure an agreement in advance that covers the exact time and manner in which the equipment will be installed. This agreement could outline the location and properties (i.e., size, related noises, whether it requires use of the church’s electricity, potential health hazards, etc.) of all on-site equipment (including machinery and other equipment used during construction), the construction design (including any plans for rewiring or altering existing structures in any way), and the time and manner of construction (i.e., whether services will be affected, whether equipment will be stored on church property, etc.).

**Type/Design of structure.** While the provider should be solely responsible for the design and installation of the structure and for ensuring that the structure complies with all applicable laws and regulations, the church will want to conduct its own appraisal to ensure that equipment and its placement is minimally intrusive and aesthetically appropriate and safe, and that it poses no threat to the soundness of the existing structures. To do this, the church should seek detailed plans and specifications from the provider, and condition commencement of installation on approval from the church’s own architect and/or engineer. It would also be a good idea for the church to conduct periodic inspections (once a year, at a minimum) to ensure that the structure and equipment have not damaged or compromised the building over time.

**Access rights.** The church should make itself aware of any rights to access that the service provider would require to install, operate, inspect or otherwise maintain the equipment. If the provider’s presence on the property would disrupt church services or other church activities, then the church may seek to limit the provider’s access rights during those periods. In addition, the church should be aware of any other access rights that may correspond with the agreement, such as a public utility easement (e.g., where a utility has a legal or contractual right to read an electrical meter or inspect the equipment) or governmental right of
access (e.g., where a government agency requires access to the structure in order to determine if it complies with the applicable regulations).

Maintenance and repairs. Although the agreement should require the provider to maintain the structure in good condition, the church should seek to include provisions that allow it to compel the provider to make any necessary repairs or modifications to the structure or equipment if necessary. The agreement should include a manner in which the church will notify the provider should repairs become necessary, the length of time in which the provider is required to respond, and the consequences if the provider fails to respond or refuses to make the necessary repairs.

Burdens on the Church’s use or development of the property. The church and the provider need to be very clear on the extent to which any church activities may be limited by the arrangement. The provider may seek to limit or prohibit church personnel from accessing the area in which the equipment is located. The church will need to consider whether any such restrictions will compromise its ability to maintain the property or fulfill any of its functions or missions. The agreement should also address procedures for dealing with situations in which making repairs or improvements to the property impacts the operation of the provider’s equipment. For example, will the agreement allow the church to remodel or expand if doing so would require the equipment to be moved or temporarily shutdown? If so, which party bears the costs associated with moving or shutting down the equipment?

Removal of Equipment Upon Termination. The agreement should clearly provide for the disposition of the structure and equipment upon termination of the agreement. The agreement should either expressly require the provider to remove the equipment, or cut-off the provider’s rights to the equipment upon termination, so that the church can make any appropriate disposition of the equipment on its own. If the burden of removal is placed on the provider, the agreement should specify the length of time that the provider has to remove the equipment, the consequences if the provider fails to comply, and an indemnification provision that requires the provider to bear all costs and risks associated with removal.

Form, Terms and Duration of Agreement

Form. Agreements between churches and providers typically take the form of a lease. The church’s counsel may consider whether some other form has any particular advantage (e.g., a license, which is a privilege to go on another’s real property for a particular purpose, but does not confer any title, interest or estate in the property), but the lease form is so commonly used that one might expect providers to be reluctant to adopt a different format.

Compensation. There are several mechanisms by which the church may be compensated under an agreement with a provider, including lump sums and monthly or yearly payments, among other arrangements. While the church can boost its cash flow with a lump sum or one-time payment, doing so may cause the church to forgo potentially greater revenue in the future, should the value of the arrangement increase (e.g., due to increased property values). Compensation arrangements can provide for increasing
payments over time and should cover any instance in which the agreement terminates before the end of a pay period. To ensure that the congregation’s compensation is competitive, an effort should be made to determine the structure and amount of payments that others are receiving from providers in the same area.

Payment arrangements can be creative. For example, we are aware of an instance in which a church without a steeple had one erected at the provider’s expense, in exchange for which the church agreed to receive lower fees than it might have if the steeple had already been in place. Another congregation might compromise on compensation in exchange for the provider bearing the expense of making other improvements that increase the value of the property as a whole.

(Duration) The church will have to establish the duration of its agreement with the provider, as well any options to extend the agreement. In all likelihood, there will be a minimum period (i.e., a period before which the church will be unable to terminate the agreement), calculated by the provider to ensure a reasonable return in light of the capital outlay required to install the equipment. After negotiating that period, the agreement may allow for one or more optional or automatic extensions of shorter duration, and for early termination of any of those periods.

(Transferability) If the provider has the right to assign its lease to another provider, the church may be required to do business with a company that it would otherwise wish to avoid. If the church wishes to deal solely with the original provider, then its agreement with the provider should expressly provide that the provider's interest is non-transferrable. Alternatively, the church may wish to reserve a right to transfer its interest in the lease should the church ever decide to sell all or part of its property. Indeed, the provider itself may well want to ensure that result, by insisting that any sale or transfer of the property be subject to lease.

Compliance with the Book of Discipline

Insofar as the agreement with the provider will constitute an agreement respecting the church’s interest in real property, the congregation must also ensure that it complies with the local church property provisions of THE BOOK OF DISCIPLINE OF THE UNITED METHODIST CHURCH, which are set forth at ¶¶ 2524-2552. Special attention should be paid to ¶ 2540, which lists the steps that must be followed when any real property owned by the church is sold, mortgaged or leased – including obtaining approval by the charge conference at a duly-noticed meeting, obtaining the written consent of the district superintendent, and involving the district board of church location and building.

Property Issues

Ownership of the structure and equipment. The agreement should clearly specify who owns what. The church will, undoubtedly, wish to retain title to the steeple or any other pre-existing structure on which an antenna is placed, and to the area on which any of the provider’s other equipment may be placed or constructed. But the agreement should also clarify who holds title to any structure or other improvement
that is built or made to accommodate or support the equipment. In any case, the agreement should clearly establish the ownership of all property associated with the arrangement, including all pre-existing structures, any improvements and the equipment itself.

**Subordination Agreement.** The church may wish to include a provision in its agreement which requires or allows (at the church’s option) the agreement to be subordinated to any subsequent mortgage. Providers have agreed to such provisions, but sometimes on the condition that the mortgage recognize the validity of the agreement and the provider’s right to use the property after any foreclosure.

**Burden on Title.** Providers typically seek agreements that account for the possibility that the church may be sold to another congregation before the agreement expires. They will want the agreement to state that any such sale of the property shall be subject to the provider’s rights under the agreement. The church needs to consider, then, whether the arrangement will restrict the church’s ability to sell, transfer or encumber the property as it sees fit. Conversely, if the provider insists that the obligations of the agreement survive any sale of the church property, the congregation might insist that the obligations stay with the land – that is, that the congregation will have no further obligations under the agreement once it vacates the premises after selling the property.

**Sharing Tower Space, or “Collocation”**

The church may wish to bargain for the right to enter into similar agreements with other providers as a source of additional revenue. This option – sometimes called “collocation” – would allow other providers to make use of the structures already in place, provided that such would not interfere with any provider’s use of or access to the structure. There are limits to how many transmitters a single tower can hold and different tower structures have different limits. In addition, the providers are competitors and some may be unwilling to participate in such sharing arrangements. Other providers, however, may be inclined to allow for collocation from the outset, perhaps as a means of increasing the likelihood of obtaining zoning approval and spreading costs. One must also factor in the effect the additional equipment may have on compliance with radio frequency emission requirements or other potential environmental concerns. In all events, the sharing option should at least be considered.

Again, the foregoing is a summary of issues that need to be considered by a local church when it is considering leasing its premises to a wireless communications service provider. There are undoubtedly other issues that need to be addressed, and the ones discussed above need to be considered in light of the particular situation and any developments in the law. The legal ramifications are diverse and complex, acting with the advice of counsel is essential.
If you have any questions about this material, please call or write:

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