

Debt-financed property; transfer to wholly owned subsidiary. The transfer, subject to an existing mortgage, of an appreciated apartment complex by a tax-exempt hospital to its wholly owned taxable subsidiary in exchange for additional stock in the subsidiary does not result in a gain with respect to which the hospital will be taxed under section 511 of the Code.

'Advice has been requested whether, under the circumstances described below, the transfer of appreciated debt financed property from an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 to its wholly owned taxable subsidiary as a contribution to the capital of the subsidiary will be subject to the tax imposed by section 511.

'A hospital exempt under section 501(c)(3) of the Code wishes to build a new hospital complex to replace its present old and obsolete facility. The most desirable location for the new hospital complex is a site occupied by an apartment complex. The hospital purchased the land and improvements comprising the apartment complex several years ago, taking title subject to a first mortgage already on the premises.

For valid business reasons, the hospital proposes to exchange the land and improvements comprising the apartment complex, subject to the mortgage on the property and in a manner that satisfies the requirements of section 351(a) of the Code, for additional stock in its wholly owned subsidiary.

'The hospital has asked whether, under the above circumstances, the transfer of the apartment complex to its wholly owned subsidiary will result in gain with respect to which the hospital will be taxed under section 511.

'Section 511 of the Code imposes a tax on the unrelated business taxable income earned by organizations that are exempt under section 501(c)(3).

'Section 512(b)(4) of the Code provides that in the case of debt-financed property, as defined in section 514, there shall be included, as an item of gross income derived from an unrelated trade or business, the amount ascertained under section 514(a)(1).

'Section 514(a)(1) of the Code provides that a percentage of the gross income derived from or on account of each debt-financed property shall be included in the computation under section 512 of unrelated business taxable income.

'Section 1.514(a)-1(a)(1)(v) of the Income Tax Regulations provides that, if debt-financed property is sold or otherwise disposed of, a percentage of the total gain (or loss) derived

from such sale or other disposition shall be included in the computation of unrelated business taxable income.

'Section 351 of the Code provides, in part, that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control of the corporation.

'Section 357(a) of the Code provides, in part, that if a taxpayer receives property which would be permitted to be received under section 351 without the recognition of gain if it were the sole consideration, and, as part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability, then such assumption or acquisition shall not be treated as money or other property, and shall not prevent the exchange from being within the provisions of section 351.

'Section 357(c) of the Code provides, with certain exceptions not relevant here, that in the case of an exchange to which section 351 applies, if the sum of the amount of the liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the exchange.

'Under the provisions of sections 351(a) and 357(a) of the Code, no gain would be recognized by the hospital as the result of the transfer to its wholly owned subsidiary of all assets relating to the apartment complex in exchange for additional stock of the subsidiary and the assumption by the subsidiary of the mortgage on the property to the extent that such mortgage does not exceed the adjusted basis of the property at the time of the transfer.

Section 514 of the Code and the regulations thereunder expressly recognize the applicability of other Internal Revenue Code provisions in determining gross income derived from or on account of each debt-financed property. See, for example, section 1.514(a)-1(b)(2) of the regulations. The legislative history and the regulations do not indicate that section 514 was intended to render taxable a transaction which would not be taxable by virtue of a nonrecognition provision of the Code if it were carried out by an entity which is not tax-exempt.

'Accordingly, the transfer of appreciated debt-financed property from the organization to its wholly owned subsidiary solely in exchange for stock will not result in gain with respect to which the exempt transferor-organization will be taxed under section 511.