

§ 168 (h) Tax-exempt use property.

(1) In general. For purposes of this section--

(A) Property other than nonresidential real property. Except as otherwise provided in this subsection, the term "tax-exempt use property" means that portion of any tangible property (other than nonresidential real property) leased to a tax-exempt entity.

(B) Nonresidential real property.

(i) In general. In the case of nonresidential real property, the term "tax-exempt use property" means that portion of the property leased to a tax-exempt entity in a disqualified lease.

(ii) Disqualified lease. For purposes of this subparagraph, the term "disqualified lease" means any lease of the property to a tax-exempt entity, but only if--

(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a) [26 USCS § 103(a)] and such entity (or a related entity) participated in such financing,

(II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an option,

(III) such lease has a lease term in excess of 20 years, or

(IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

(iii) 35-percent threshold test. Clause (i) shall apply to any property only if the portion of such property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property.

(iv) Treatment of improvements. For purposes of this subparagraph, improvements to a property (other than land) shall not be treated as a separate property.

(v) Leasebacks during 1st 3 months of use not taken into account. Subclause (IV) of clause (ii) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).

(C) Exception for short-term leases.

(i) In general. Property shall not be treated as tax-exempt use property merely by reason of a short-term lease.

(ii) Short-term lease. For purposes of clause (i), the term "short-term lease" means any lease the term of which is--

(I) less than 3 years, and

(II) less than the greater of 1 year or 30 percent of the property's present class life.

In the case of nonresidential real property and property with no present class life, subclause (II) shall not apply.

(D) Exception where property used in unrelated trade or business. The term "tax-exempt use property" shall not include any portion of a property if such portion is predominantly used by the tax-exempt entity (directly or through a partnership of which such entity is a partner) in an unrelated trade or business the income of which is subject to tax under section 511 [26 USCS § 511]. For purposes of subparagraph (B)(iii), any portion of a property so used shall not be treated as leased to a tax-exempt entity in a disqualified lease.

(E) Nonresidential real property defined. For purposes of this paragraph, the term "nonresidential real property" includes residential rental property.

(2) Tax-exempt entity.

(A) In general. For purposes of this subsection, the term "tax-exempt entity" means--

(i) the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing,

(ii) an organization (other than a cooperative described in section 521 [26 USCS § 521]) which is exempt from tax imposed by this chapter [26 USCS § 1 et seq.],

(iii) any foreign person or entity, and

(iv) any Indian tribal government described in section 7701(a)(40) [26 USCS § 7701(a)(40)].

For purposes of applying this subsection, any Indian tribal government referred to in clause (iv) shall be treated in the same manner as a State.

(B) Exception for certain property subject to United States tax and used by foreign person or entity. Clause (iii) of subparagraph (A) shall not apply with respect to any property if more than 50 percent of the gross income for the taxable year derived by the foreign person or entity from the use of such property is--

(i) subject to tax under this chapter [26 USCS § § 1 et seq.], or
(ii) included under section 951 [26 USCS § 951] in the gross income of a United States shareholder for the taxable year with or within which ends the taxable year of the controlled foreign corporation in which such income was derived.

For purposes of the preceding sentence, any exclusion or exemption shall not apply for purposes of determining the amount of the gross income so derived, but shall apply for purposes of determining the portion of such gross income subject to tax under this chapter [26 USCS § § 1 et seq.].

(C) Foreign person or entity. For purposes of this paragraph, the term "foreign person or entity" means--

(i) any foreign government, any international organization, or any agency or instrumentality of any of the foregoing, and
(ii) any person who is not a United States person.

Such term does not include any foreign partnership or other foreign pass-thru entity.

(D) Treatment of certain taxable instrumentalities. For purposes of this subsection, a corporation shall not be treated as an instrumentality of the United States or of any State or political subdivision thereof if--

(i) all of the activities of such corporation are subject to tax under this chapter [26 USCS § § 1 et seq.], and
(ii) a majority of the board of directors of such corporation is not selected by the United States or any State or political subdivision thereof.

(E) Certain previously tax-exempt organizations.

(i) In general. For purposes of this subsection, an organization shall be treated as an organization described in subparagraph (A)(ii) with respect to any property (other than property held by such organization) if such organization was an organization (other than a cooperative described in section 521 [26 USCS § 521]) exempt from tax imposed by this chapter [26 USCS § § 1 et seq.] at any time during the 5-year period ending on the date such property was first used by such organization. The preceding sentence and subparagraph (D)(ii) shall not apply to the Federal Home Loan Mortgage Corporation.

(ii) Election not to have clause (I) apply.

(I) In general. In the case of an organization formerly exempt from tax under section 501(a) [26 USCS § 501(a)] as an organization described in section 501(c)(12) [26 USCS § 501(c)(2)], clause (i) shall not apply to such organization with respect to any property if such organization elects not to be exempt from tax under section 501(a) [26 USCS § 501(a)] during the tax-exempt use period with respect to such property.

(II) Tax-exempt use period. For purposes of subclause (I), the term "tax-exempt use period" means the period beginning with the taxable year in which the property described in subclause (I) is first used by the organization and ending with the close of the 15th taxable year following the last taxable year of the applicable recovery period of such property.

(III) Election. Any election under subclause (I), once made, shall be irrevocable.

(iii) Treatment of successor organizations. Any organization which is engaged in activities substantially similar to those engaged in by a predecessor organization shall succeed to the treatment under this subparagraph of such predecessor organization.

(iv) First used. For purposes of this subparagraph, property shall be treated as first used by the organization--

(I) when the property is first placed in service under a lease to such organization, or
(II) in the case of property leased to (or held by) a partnership (or other pass-thru entity) in which the organization is a member, the later of when such property is first used by such partnership or pass-thru entity or when such organization is first a member of such partnership or pass-thru entity.

(3) Special rules for certain high technology equipment.

(A) Exemption where lease term is 5 years or less. For purposes of this section, the term "tax-exempt use property" shall not include any qualified technological equipment if the lease to the tax-exempt entity has a lease term of 5 years or less. Notwithstanding subsection (i)(3)(A)(i), in determining a lease term for purposes of the preceding sentence, there shall not be taken into account any option of the lessee to renew at the fair market value rent determined at the time of renewal; except that the aggregate period not taken into account by reason of this sentence shall not exceed 24 months.

(B) Exception for certain property.

(i) In general. For purposes of subparagraph (A), the term "qualified technological equipment" shall not include any property leased to a tax-exempt entity if--

(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a) [26 USCS § 103(a)],

(II) such lease occurs after a sale (or other transfer) of the property by, or lease of such property from, such entity (or related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease, or

(III) such tax-exempt entity is the United States or any agency or instrumentality of the United States.

(ii) Leasebacks during 1st 3 months of use not taken into account. Subclause (II) of clause (i) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).

(4) Related entities. For purposes of this subsection--

(A) (i) Each governmental unit and each agency or instrumentality of a governmental unit is related to each other such unit, agency, or instrumentality which directly or indirectly derives its powers, rights, and duties in whole or in part from the same sovereign authority.

(ii) For purposes of clause (i), the United States, each State, and each possession of the United States shall be treated as a separate sovereign authority.

(B) Any entity not described in subparagraph (A)(i) is related to any other entity if the 2 entities have--

(i) significant common purposes and substantial common membership, or

(ii) directly or indirectly substantial common direction or control.

(C) (i) An entity is related to another entity if either entity owns (directly or through 1 or more entities) a 50 percent or greater interest in the capital or profits of the other entity.

(ii) For purposes of clause (i), entities treated as related under subparagraph (A) or (B) shall be treated as 1 entity.

(D) An entity is related to another entity with respect to a transaction if such transaction is part of an attempt by such entities to avoid the application of this subsection.

(5) Tax-exempt use of property leased to partnerships, etc., determined at partner level. For purposes of this subsection--

(A) In general. In the case of any property which is leased to a partnership, the determination of whether any portion of such property is tax-exempt use property shall be made by treating each tax-exempt entity partner's proportionate share (determined under paragraph (6)(C)) of such property as being leased to such partner.

(B) Other pass-thru entities; tiered entities. Rules similar to the rules of subparagraph (A) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

(C) Presumption with respect to foreign entities. Unless it is otherwise established to the satisfaction of the Secretary, it shall be presumed that the partners of a foreign partnership (and the beneficiaries of any other foreign pass-thru entity) are persons who are not United States persons.

(6) Treatment of property owned by partnerships, etc.

(A) In general. For purposes of this subsection, if--

(i) any property which (but for this subparagraph) is not tax-exempt use property is owned by a partnership which has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, and

(ii) any allocation to the tax-exempt entity of partnership items is not a qualified allocation, an amount equal to such tax-exempt entity's proportionate share of such property shall (except as provided in paragraph (1)(D)) be treated as tax-exempt use property.

(B) Qualified allocation. For purposes of subparagraph (A), the term "qualified allocation" means any allocation to a tax-exempt entity which--

(i) is consistent with such entity's being allocated the same distributive share of each item of income, gain, loss, deduction, credit, and basis and such share remains the same during the entire period the entity is a partner in the partnership, and

(ii) has substantial economic effect within the meaning of section 704(b)(2) [26 USCS § 704(b)(2)].

For purposes of this subparagraph, items allocated under section 704(c) [26 USCS § 704(c)] shall not be taken into account.

(C) Determination of proportionate share.

(i) In general. For purposes of subparagraph (A), a tax-exempt entity's proportionate share of any property owned by a partnership shall be determined on the basis of such entity's share of partnership items of income or gain (excluding gain allocated under section 704(c) [26 USCS § 704(c)]), whichever results in the largest proportionate share.

(ii) Determination where allocations vary. For purposes of clause (i), if a tax-exempt entity's share of partnership items of income or gain (excluding gain allocated under section 704(c) [26 USCS § 704(c)]) may vary during the period such entity is a partner in the partnership, such share shall be the highest share such entity may receive.

(D) Determination of whether property used in unrelated trade or business. For purposes of this subsection, in the case of any property which is owned by a partnership which has both a tax-exempt entity and a person who is not a tax-

exempt entity as partners, the determination of whether such property is used in an unrelated trade or business of such an entity shall be made without regard to section 514 [26 USCS § 514].

(E) Other pass-thru entities; tiered entities. Rules similar to the rules of subparagraphs (A), (B), (C), and (D) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

(F) Treatment of certain taxable entities.

(i) In general. For purposes of this paragraph and paragraph (5), except as otherwise provided in this subparagraph, any tax-exempt controlled entity shall be treated as a tax-exempt entity.

(ii) Election. If a tax-exempt controlled entity makes an election under this clause--

(I) such entity shall not be treated as a tax-exempt entity for purposes of this paragraph and paragraph (5), and

(II) any gain recognized by a tax-exempt entity on any disposition of an interest in such entity (and any dividend or interest received or accrued by a tax-exempt entity from such tax-exempt controlled entity) shall be treated as unrelated business taxable income for purposes of section 511 [26 USCS § 511].

Any such election shall be irrevocable and shall bind all tax-exempt entities holding interests in such tax-exempt controlled entity. For purposes of subclause (II), there shall only be taken into account dividends which are properly allocable to income of the tax-exempt controlled entity which was not subject to tax under this chapter [26 USCS § 1 et seq.].

(iii) Tax-exempt controlled entity.

(I) In general. The term "tax-exempt controlled entity" means any corporation (which is not a tax-exempt entity determined without regard to this subparagraph and paragraph (2)(E)) if 50 percent or more (in value) of the stock in such corporation is held by 1 or more tax-exempt entities (other than a foreign person or entity).

(II) Only 5-percent shareholders taken into account in case of publicly traded stock. For purposes of subclause (I), in the case of a corporation the stock of which is publicly traded on an established securities market, stock held by a tax-exempt entity shall not be taken into account unless such entity holds at least 5 percent (in value) of the stock in such corporation. For purposes of this subclause, related entities (within the meaning of paragraph (4)) shall be treated as 1 entity.

(III) Section 318 to apply. For purposes of this clause, a tax-exempt entity shall be treated as holding stock which it holds through application of section 318 [26 USCS § 318] (determined without regard to the 50-percent limitation contained in subsection (a)(2)(C) thereof).

(G) Regulations. For purposes of determining whether there is a qualified allocation under subparagraph (B), the regulations prescribed under paragraph (8) for purposes of this paragraph--

(i) shall set forth the proper treatment for partnership guaranteed payments, and

(ii) may provide for the exclusion or segregation of items.

(7) Lease. For purposes of this subsection, the term "lease" includes any grant of a right to use property.

(8) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.