

February 23, 2001  
From: ARNOLD & PORTER  
To: Mary K. Logan, Esq.  
General Council on Finance and Administration  
The United Methodist Church  
1200 Davis Street  
Evanston, IL 60201-4193

**Re: Rental of Church Steeples**

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.

Regards,  
Michael A. Lee