



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **200615026**

Release Date: 4/14/06

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U.I.L. – 501.25-00 No Third Party Contacts

Date: January 18, 2006

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

1120

Tax Years:

ALL

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(25).

We made this determination for the following reason(s): You are not organized and operated exclusively for purposes described in section 501(c)(25) of the Code. You are engaged in a hotel business operation that is other than the business of acquiring and holding title to real property, and collecting income therefrom.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your

Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

SIN 501.25-00

Date: January 18, 2006

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

Trust =

LP =

Hotel =

Manager =

Corporation =

LLC =

Member 1 =

Member 2 =

X = .

M =

Year 1 =

A =

B =

x =

a =

Dear _____ :

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(25). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated on Year 1, as a nonprofit corporation under A. Section IV of your Articles of Incorporation provides that you are authorized to issue _____ shares of common stock, without par value. All stock shall be of the same class. It further provides that no person shall be a shareholder unless it is a pension or profit sharing trust qualified under section 401(a) of the Code, other nonprofit organization, or a subdivision, unit or agency of the United States or of a state or local government.

Your sole shareholder is Trust. Trust is a group trust described in Rev. Rul. 81-100. All participating trusts are described in 401(a).

You are the successor in interest of LP, a B limited partnership. As successor of LP's interest, you own the real property commonly known as Hotel. Hotel features x rooms, a restaurant and banquet facilities. Hotel is managed by Manager, a wholly-owned subsidiary of X, under a 25 year agreement. The Management Agreement between LP (referred therein as the First Party) and X was executed in a.

In an Assignment of Management Agreement dated April 30, a, X assigned its interests in the Management Agreement to Manager.

You are referred to as the First Party in the Management Agreement as LP's successor. Article III of the Management Agreement provides for the use and operation of Hotel and states--

"All activities of X in the management, use and operation of the Hotel shall be on behalf of and for the account of the First Party. The employees of the Hotel shall be employees of X. All contracts of employment and all leases and concessions, all purchase orders and agreements shall be executed in the name of the First Party by X as Manager. All bank accounts and other deposits shall also be in the name of the First Party but X shall have the sole power to designate the signatories on such bank accounts or other depositories. In no event shall any such bank accounts be intermingled with the bank accounts of any other X hotels."

Article IV of the Management Agreement provides for the management fee to X and payment to the LP as follows:

Section 1. Basic Management Fee. During the Operating Term, X shall be entitled to charge as an expense of the operation of the Hotel, and retain as its basic management fee, an amount equal to three percent (3%) of the Revenue, as defined in Article V.

Section 2. Incentive Fee. In addition to the basic management fee provided for in Section 1 of this Article, X shall be entitled to retain during the Operating Term, as an incentive fee, ten percent (10%) of the Gross Operating Profit, as defined in Article V.

Notwithstanding the foregoing, X's incentive fee for any fiscal year as calculated pursuant to the preceding paragraph shall be reduced if and to the extent that for such fiscal year the of sum of (a) the amount by the First Party for real estate taxes on Hotel; (b) the premiums paid by the First Party for insurance required to be maintained pursuant to Article VIII, Section 1; (c) the First Party's debt service payments... (d) the total amount repaid to X on account of advances it has made to the First Party pursuant to Section 5 of this Article; and (e) for each of the first six (6) full fiscal years following completion of the Refurbishment Program \$ _____, for the seventh full fiscal year following such completion \$ _____, and for each full fiscal year thereafter the product of \$ _____ and a fraction the numerator of which is the average level of the CPI for such fiscal year and the denominator of which is the average level of the CPI for the seventh full fiscal year following such completion, exceeds 90% of the Gross Operating Profit (as defined in Article V) for such fiscal year.

Section 3. Payments. Subject to the provisions hereinafter set forth, X shall during the Operating Term pay to the First Party ...the Gross Operating Profit after deduction of amounts payable to X for and on account of advances previously made by it pursuant to Section 5 of this Article and X's incentive fees...

Section 2 of Article V of the Management Agreement provides that the term "Gross Operating Profit" shall be computed as follows.

A. All revenues and income of any kind derived directly or indirectly from the operation of the Hotel by X, including rental or other payments from lessees and concessionaires (but not gross sales receipts of such lessees or concessionaires) (hereinafter called "Revenue"); it being understood that there shall be excluded from Revenue (to the extent the same re not in any event excluded in accordance with the Uniform Systems of Account) all gratuities to employees and all state and local taxes.

B. From the Revenue shall be deducted the entire cost and expense of maintaining, conducting and supervising the operation of the Hotel, including, without limiting the generality of the foregoing, the following:

- (1) X's basic management fee as provided for in Section 1 of Article IV;
- (2) The cost of all food an beverages and Operating Supplies as defined in Section 1 of Article VII, sold or consumed and the total payroll including taxes, applicable fringe benefits and severance and seniority payments or accruals;
- (3) The cost of replacement of or additions to Operating Equipment and Uniforms as provided for in Section 3 of this Article;

- (4) The cost of Group Services and Benefits provided by X in accordance with Section 2 of Article VII;
- (5) The cost of all other goods and services;
- (6) Out-of-pocket expenses incurred for the account of or in connection with the Hotel operation, including reasonable traveling expenses of employees and executives of X and its affiliates;
- (7) All costs and expenses of any advertising, business promotion, or personal training program of the Hotel, separate and distinct from other hotels of X or its affiliated companies;
- (8) All expenditures made by X for maintenance, repairs or decoration to keep the Hotel in good operating condition in accordance with Section 1 of Article VI;
- (9) The cost of alterations, addition, and improvements made in accordance with Section 2 of Article VI;
- (10) Premiums for insurance maintained in accordance with Section 2 of Article VIII (premiums on policies more than one year to be pro-rated over the period of insurance and premiums under blanket policies to be allocated among properties covered) and losses incurred on self-insured risks;
- (11) All taxes and fees or other charges payable to public authorities, other than income taxes, payable by or assessed against X with respect to the operation of the Hotel;
- (12) For fiscal year up to and including the fiscal year in which the Refurbishment Program is completed \$ _____, for the first full fiscal year following completion of such program five percent (5%), for the next full fiscal year six percent (6%), for the next full fiscal year seven percent (7%), for the next full fiscal year eight percent (8%) and for each full fiscal year thereafter ten percent (10%) of the original installed cost of the Furnishing and Equipment as defined in Article I, Section 2, paragraph B (a) and (b); provided, however, that whenever X shall, from time to time, determine that the replacement value of the Furnishings and Equipment has increased to a degree which makes it necessary to increase the said deduction in order to preserve the standards of the Hotel, X shall be entitled to obtain an independent appraisal, but no more frequently than annually, to determine the replacement value, the cost of which shall be an operating expense, and the amount of the deduction hereunder shall thereafter be fixed at the applicable percentage of the replacement value as so determined. The said deduction shall be made by a monthly

charge equal to one-twelfth of the annualized amount determined as above.

(13) Such reserve for bad debts as X shall determine in accordance with the operating budget and forecast delivered pursuant to Article VII, Section 4.A, it being understood that on occasion unforeseen circumstances may arise which make it necessary to exceed the budgeted amount.

In connection with the operation of Hotel, you entered into a lease agreement with Corporation as tenant of the premises located on one floor of a building situated at M. Section 1.1 of the lease agreement states --

"The Premises are to be used solely for operating, in a first class manner, a banquet and meeting facility, restaurant, bar, cocktail lounge, catering facility and office use which is specifically related to and incidental hereto, all in connection with and in support of the operation of the Hotel, which is currently owned and operated by the Tenant.

Corporation is an affiliate of Trust. Corporation is exempt under section 501(c)(25) of the Code.

You believe that you were organized and operated as an organization described in section 501(c)(25) of the Code since inception in Year 1 but due to an oversight you filed F-1120 and paid income taxes for all tax years from inception through . However, you indicated that this application for recognition of exemption under section 501(c)(25) is for tax years beginning

Your income tax returns for tax years through reported the following financial information:

_____	_____	_____	_____	_____	_____
Gross Receipts					
Cost of Sales					
Gross Profit					
Other income					
Total income					
Expenses					
Taxable income					
Tax					

The Cost of Sales consists primarily of expenses on rooms and for food and beverage. Expenses are primarily payments for management and incentive fees, other professional fees, insurance, taxes, and other administrative and operating expenses.

You made proposed amendments to your Articles of Incorporation. The amendments include providing for purposes described in section 501(c)(25), limiting your number of qualified shareholders to no more than 35 and providing such shareholders' rights for dismissal of

investment advisors and for termination of their interests in the corporation. You indicate, however, that such proposed amendments will be filed after our approval of your application.

In addition, you will enter into a lease agreement with LLC to lease Hotel. You indicate that the lease agreement has not been executed by the parties, which will be made after your receipt of approval of tax exemption. You submitted to us a copy of your proposed lease agreement LLC. The agreement provides LLC payment of a Base Rent and a Percentage Rent for leasing the Hotel. LLC will pay you a Base Rent of \$ _____, \$ _____, \$ _____ and \$ _____ in years _____, _____, and _____, respectively. In addition, LLC will pay you a Percentage Rent, which is based upon a percent of Hotel's graduated gross revenue during the fiscal year. The proposed agreement clarifies that the amount retained by the Manager under the Management Agreement shall constitute a portion of the Base Rent.

LLC is a B limited liability company. It was formed to be the lessee of Hotel under the proposed lease agreement, subject to the terms and conditions of the Management Agreement. LLC's members are Member 1 and Member 2. Each is also a B limited liability company. Member 1 is an affiliate of Trust and Member 2 is an affiliate of X.

Section 501(c)(25)(A) of the Code provides exemption to any organization or trust which has no more than 35 shareholders or beneficiaries, has only 1 class of stock or beneficial interest, and is organized for the exclusive purpose of acquiring real property and holding title to, and collecting income from such property, and remitting the entire amount of income from such property (less expenses) to one or more organizations described in 501(c)(25)(C).

Section 501(c)(25)(C) of the Code includes a qualified pension, profit sharing or stock bonus plan that meets the requirements of section 401(a).

Section 501(c)(25)(D) of the Code provides that a corporation or trust shall in no event be treated as described in subparagraph (A) unless such corporation or trust permits its shareholders or beneficiaries--

(i) to dismiss the corporation's or trust's investment adviser, following reasonable notice, upon a vote of the shareholders or beneficiaries holding a majority of interest in the corporation or trust, and

(ii) to terminate their interest in the corporation or trust by either, or both, of the following alternatives, as determined by the corporation or trust:

(I) by selling or exchanging their stock in the corporation or interest in the trust (subject to any Federal or State securities law) to any organization described in subparagraph (C) so long as the sale or exchange does not increase the number of shareholders or beneficiaries in such corporation or trust above 35, or

(II) by having their stock or interest redeemed by the corporation or trust after the shareholder or beneficiary has provided 90 days notice to such corporation or trust.

Section 501(c)(25)(F) of the Code provides that for purposes of subparagraph (A), the term "real property" includes any personal property which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property (determined under the rules of section 856(d)(1)) for the taxable year does not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such lease.

Section 501(c)(25)(G)(i) of the Code provides that an organization shall not be treated as failing to be described in this paragraph merely by reason of the receipt of any otherwise disqualifying income which is incidentally derived from the holding of real property.

Section 501(c)(25)(G)(ii) of the Code provides that clause (i) shall not apply if the amount of gross income described in such clause exceeds 10 percent of the organization's gross income for the taxable year unless the organization establishes to the satisfaction of the Secretary that the receipt of gross income described in clause (i) in excess of such limitation was inadvertent and reasonable steps are being take to correct the circumstances giving rise to such income.

Notice 87-18, 1987-1 C.B. 455, provides application requirements and procedures for an organization seeking exemption under section 501(c)(25) of the Code. Its articles of incorporation or trust document must contain provisions that clearly demonstrate meeting the requirements of sections 501(c)(25)(A) and (D).

Exemption under 501(c)(25) requires passing an organizational and operational test. The organizational test is met if the corporation's articles contain the required provisions under section 501(c)(25)(A) and (D) -- exclusive purpose, limitation on the number of qualified shareholders, and the specific rights given to shareholders. See also Notice 87-18.

Your Articles of Incorporation do not currently contain the required provisions under section 501(c)(25)(A) and (D). Therefore, you fail to meet the organizational test for exemption under 501(c)(25). This failure, however, would be corrected by your proposed amendments to your Articles.

We find, however, that you fail to meet the operational test. You are engaged primarily in operating a hotel, which is an ordinary trade or business. By engaging primarily in a trade or business activity, you are not operated exclusively for purposes under section 501(c)(25) of the Code. Rather, your hotel business operation is beyond the purpose of acquiring and holding title to real property, and collecting income from such property pursuant to section 501(c)(25). Also, the income you derived from hotel operations is not incidental to holding title of real property pursuant to section 501(c)(25)(G)(i) and (ii).

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(25) of the Code.

You propose to enter into an agreement with LLC for the latter to lease the Hotel from you. This proposal, if executed, will alter your activity from operating a hotel business into leasing real property, an activity in furtherance of section 501(c)(25) purposes. Such a change would allow us to recognize you as exempt under section 501(c)(25) effective the date of the lease.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If it is convenient, you may fax your reply using the fax number shown in the heading of this letter. If you fax your reply, please contact the person identified in the heading of this letter by telephone to confirm that your fax was received.

Internal Revenue Service
TEGE, T:EO:RA:T:3

1111 Constitution Ave, NW
Washington, D.C. 20224

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

