



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200847018**
Release Date: 11/21/2008

Date: August 27, 2008

501.33-00
501.36-01

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

SE:T:EO:RA:T:1

Dear _____ :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. 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.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

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,

Lawrence M. Brauer

Robert Choi
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

Date: July 22, 2008

501.33-00
501.36-01

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Dear :

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code. Based on the information provided, we have concluded that you do not qualify for exemption under section 501(c)(3) of the Code. The basis for our conclusion is set forth below.

FACTS

You are a non-profit corporation formed under applicable state law. Your purpose is to support certain section 501(c)(3) organizations such as hospitals, academic medical centers, medical research organizations, homes for the aged, educational institutions and other organizations ("Supported Organizations") "by providing or facilitating low-cost financing of facilities and infrastructure for the Supported Organizations. . . ." Your articles of incorporation do not identify any of these Supported Organizations by name. Your articles of incorporation also state that your purposes include:

To own, operate and lease, as lessor or lessee, nonprofit healthcare, educational or other public facilities in a manner that will minimize the costs of financing and use thereof and thereby the costs to the public for the use of such facilities. . . .

and

To own, operate and lease, as lessor or lessee, public buildings, monuments, works or other public facilities in a manner that will minimize the costs of financing and use thereof and thereby the costs to the public for the use of such facilities. . . .

Your primary activity in furtherance of these purposes is facilitating the financing and construction of various infrastructure projects for the Supported Organizations. For each Supported Organization, you plan to form a wholly-owned, single member limited liability company ("LLC"). The LLC will then secure financing for the construction of a facility through the issuance of tax-exempt bonds by a local government, the proceeds of which will be loaned to the LLC. The LLC will then construct the facility and lease it to the Supported Organization. The LLC will use the rental payments from the Supported Organization to repay the bonds. The Supported Organization may also have the option to purchase the facilities the LLC constructs.

You state that you have chosen this structure in part because you expect that it will allow Supported Organizations to take advantage of financing through an LLC without having to record any of the debt on their balance sheets.

The Supported Organizations will pay for the expenses you and the LLCs will incur in providing these services. You have not stated that you will submit any reports to the Supported Organizations or to the surrounding community regarding the LLC's activities or operations. Currently, you have formed no LLCs and no leases have been entered into. You have not provided any draft agreements.

You will be governed by a board of three directors who will not be controlled, or subject to removal, by the Supported Organizations. Each LLC will have a board of managers, a majority of whom will be members of the public and not subject to control or removal by the Supported Organizations. At least 40 percent of the managers of the LLC will be selected by the Supported Organizations.

LAW

Section 501(c)(3) of the Code provides an exemption from taxation for organizations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 509(a)(3)(A) of the Code provides that an organization will not be a private foundation if it is organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations that are described in section 509(a)(1) or section 509(a)(2); and that it is either operated, supervised, or controlled by one or more organizations described in section 509(a)(1) or section 509(a)(2), supervised or controlled in connection with one or more such organizations, or operated in connection with one or more such organizations; and that it is not controlled by a disqualified persons as defined in section 4946.

Section 509(f)(1) of the Code requires, in part, that in order for an organization to be "operated in connection with" one or more of the organizations described in section 509(a)(1) or 509(a)(2) under section 509(a)(3)(B)(iii), it must meet the "responsiveness test" described in section 509(f)(1)(A).

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section

501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(i) of the regulations provides that an organization must be organized and operated exclusively for one or more of the specified purposes, including a charitable purpose. The organization must not be organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" includes, among others, lessening the burdens of government.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code 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 purposes of carrying on an unrelated trade or business.

Section 1.509(a)-4(b) of the regulations states that in order to qualify as a supporting organization under section 509(a)(3) of the Code, an organization must meet both an "organizational test" (described in section 1.509(a)-4(c)) and an "operational test." (described in section 1.509(a)-4(e)).

Section 301.7701-3(b) of the Procedure and Administration Regulations provides that for federal tax purposes, an organization that is not a corporation and that has only a single member is disregarded as an entity separate from its owner, unless it elects otherwise.

Rev. Rul. 67-217, 1967- 2 C.B. 181, recognizes an organization formed to provide housing and food service exclusively for students and faculty of a section 501(c)(3) university lacking such facilities as exempt under section 501(c)(3) of the Code. The housing facility was constructed by the organization on land near the university and made available to the students of the university at rates comparable to those offered by the university in its own facilities. The facility was managed by a commercial firm in accordance with the university's rules and regulations. Any surplus from operations was donated to the university and the university had an option to purchase the facility at any time for an amount equal to the outstanding indebtedness. Providing the housing under these circumstances served to advance education within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.

In Rev. Rul. 71-529, 1971-2, C.B. 234, a nonprofit organization that provides assistance in the management of the endowment or investment funds of its member colleges and universities for a charge that is less than 15 percent of its total operating costs qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that

the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable for purposes of section 501(c)(3) of the Code. The ruling concluded that "Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable."

Rev. Rul. 76-336, 1976-2 C.B. 143, describes an organization formed by community leaders to provide housing for students of a particular college in response to studies by the college showing that it lacked suitable housing to meet the needs of students. The college was financially unable to provide housing. Additionally, many of the students in its primary service area lived at such a distance that daily commuting was not reasonably possible. The organization operated a housing facility for students adjacent to the college campus. Charges to students for the housing approximated costs, including debt retirement. The organization was not controlled by the student residents or by the college. However, the college and the organization consulted and cooperated to ensure that the needs of the college and its students were served by the operation of the housing facility. The organization was governed by a board of directors composed of community leaders. The ruling holds that the organization was both helping the college to fulfill its educational purposes and aiding the students in attaining an education. Therefore, the activities of the organization were advancing education within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.

Rev. Rul. 85-1, 1985-1 C.B. 177, applied the criteria set out in Rev. Rul. 85-2, *infra*, for determining whether an organization's activities lessen the burdens of government. In this ruling, the organization was created to assist a county's law enforcement agencies in policing illegal narcotics traffic more effectively. The organization provided funds that allowed the county's agents to engage in certain activities for which funds were not otherwise available. This ruling concluded that by funding activities that the county treats as an integral part of its Program to prevent the trafficking of illegal narcotics, the county demonstrated that it considered these activities to be its burden. Thus, the organization was lessening the burdens of the county by enabling it to augment its law enforcement activities.

Rev. Rul. 85-2, 1985-1 C.B. 178, states that to determine whether an activity is a burden of government, the question is whether there is an objective manifestation by the government that it considers such activity to be part of its burden. The fact an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Similarly, the fact that the government or an official of the government expresses approval of an organization and its activities is also not sufficient to establish that the organization is lessening the burdens of government. A close interrelationship between the government and the organization is evidence that the organization is actually lessening the burdens of the government. To determine whether the organization is actually lessening the burdens of government, all the relevant facts and circumstances must be considered.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and also services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed *arguendo* that the organization had an educational purpose. However, it held that it had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and therefore was not entitled to be regarded as exempt.

In B.S.W. Group, Inc. v. Commissioner of Internal Revenue, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. The Tax Court stated, "We must agree with the Commissioner that petitioner's activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit..." 70 T.C. at 358.

In Columbia Park and Recreation Assoc. v. Commissioner, 88 T.C. 1 (1987), aff'd without published opinion, 838 F.2d 465 (4th Cir. 1998), the court of appeals upheld the decision of the Tax Court that the organization did not lessen any burden of government and thus, was not exempt under section 501(c)(3) of the Code. The organization provided a wide range of services and facilities to the residents of Columbia, Maryland. The organization contended that if it did not provide these services and facilities the local or state government would have to provide them. The Tax Court stated that this assertion does not mean that the organization's activities are, in fact, a burden of government. Instead, the organization must demonstrate that the State of Maryland or the county accepts the organization's activities as their responsibility and recognize the organization as acting on their behalf. In addition, the organization must establish that its activities actually lessen the burden of the state or local government.

In Easter House v. U.S., 12 Cl. Ct. 476 (1987), aff'd in an unpub. opinion, 846 F. 2d 78 (Fed. Cir. 1988), cert. den., 488 U.S. 907 (1988), the organization, in exchange for a fee, provided adoption services to parents seeking to adopt a child, including services to pregnant women who intended to place their newborns for adoption. These fees were the organization's sole source of income. The Claims Court concluded that the organization's business purpose of operating an adoption service, not the advancement of educational and charitable activities, was its primary goal. It competed with other commercial organizations providing similar services. Thus, "[p]laintiff's competition provides its activities with a commercial hue." 12 Cl. Ct. at 486. Accordingly, the organization did not qualify for exemption under section 501(c)(3) of the Code.

In Airlie Foundation v. I.R.S., 283 F.Supp. 2d 58 (D.D.C. 2003), the District Court found that the organization was formed principally to organize, host, conduct, and sponsor educational and other charitable functions on its facilities. The organization paid advertising and promotional expenses and derived substantial income from weddings and special events held at its conference center. The court determined that the organization's activities competed with a number of commercial, as well as non-commercial entities, which strongly evidenced a commercial nature and purpose. The court concluded that although the organization carried out a number of charitable and educational activities, these were incidental to its primary activity of operating a for-profit conference center. The court stated, "While plaintiff's organizational

purpose is exempt and the foundation operates, in important respects, in an exempt fashion, there is a distinctive "commercial hue" to the way Airlie carries out its business. 283 F.Supp.2d at 65.

ANALYSIS

To qualify as an organization described in section 501(c)(3) of the Code, an organization must be organized and operated exclusively for one or more exempt purposes, such as religious, charitable, or educational purposes. See section 1.501(c)(3)-1(a)(1) of the regulations. An organization is operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more such exempt purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. See section 1.501(c)(3)-1(c)(1). In addition, the organization must not be organized or operated for the benefit of private interests, such as its creators, designated individuals or organizations controlled by such private interests.

You are organized and operated for the benefit of certain section 501(c)(3) organizations to provide financing services to these organizations. The financing services will enable the organizations to use tax-exempt bonds for the construction of major facilities in such a manner so that they can avoid having to report this debt on their balance sheets. You will provide these services through single-member LLCs of which you will be the sole member. Under section 301.7701-3(b) of the regulations, a single-member LLC is disregarded as an entity separate from its owner. Therefore, unless you elect otherwise, the LLCs of which you are the sole member are disregarded and you are treated as carrying on their activities.

Providing financing services to tax-exempt organizations, in the manner described above, does not further a tax-exempt purpose within the meaning of section 501(c)(3) of the Code or section 1.501(c)(3)-1(a)(1) of the regulations. Rather, these activities further a non-exempt commercial purpose, obtaining advantageous financing for construction projects.

You are similar to the organizations described in American Institute for Economic Research, supra; B.S.W. Group, supra; Easter House, supra; and Airlie Foundation, supra, because your primary purpose is to provide services that are essentially commercial, rather than charitable. Although an organization's activities may indirectly benefit the public generally, it does not qualify for exemption under section 501(c)(3) of the Code unless its activities further one or more of the purposes specified in section 501(c)(3) and section 1.501(c)(3)-1(d) of the regulations.

Providing goods and services at cost and solely to tax-exempt organizations does not further a tax-exempt purpose. See Rev. Rul. 72-369, supra. Therefore, simply because you provide financing services to organizations that are tax-exempt under section 501(c)(3) does not mean you further a tax-exempt purpose within the meaning of section 501(c)(3) of the Code.

An organization that provides commercial services for free or at substantially below its cost to a charitable class is operated for a charitable purpose. See Rev. Rul. 71-529, supra. However, you are not providing your services to tax-exempt organizations for free and you have not demonstrated that you will be providing services at substantially below your cost.

You are unlike the organization described in Rev. Rul. 67-217, supra, because you have not demonstrated that you will have a close relationship with a specific section 501(c)(3) organization for which you will be providing services like the organization in this ruling had with the university, nor will you donate any surplus you may derive to the Supported Organizations. You are also distinguishable from the organization described in Rev. Rul. 76-336, supra, because you have not demonstrated that you will consult and cooperate with a specific section 501(c)(3) organization, nor are you governed by leaders of a specific community.

Charitable purposes include lessening the burdens of government. See section 1.501(c)(3)-1(d)(2) of the regulations. An organization lessens the burdens of government within the meaning of this regulation if a governmental unit considers the organization's activities to be its burden and the organization's activities actually lessen such burden. An activity is a burden of the government if there is an objective manifestation by the governmental unit that it considers the activities of the organization to be its burden. Whether the organization is actually lessening the burdens of government is determined by considering all of the relevant facts and circumstances. See Rev. Rul. 85-2, supra; Rev. Rul. 85-1, supra.

Factors that may be considered in determining whether an organization lessens a burden of government include: whether there is a close interrelationship between a governmental unit and the organization; whether the organization is funded by the government, and whether the government controls the organization. Rev. Rul. 85-1; Rev. Rul. 85-2.

You have not presented any evidence to show that a government entity considers your activities to be its burden. None of your board members are appointed by government agencies or are government officials acting in an official capacity. Although the LLCs formed to finance and construct facilities for governments may have board members appointed by a government entity, the LLCs will not be controlled by the government. In addition, neither you nor the LLCs will receive funding from a government entity. Merely asserting that the government would conduct your proposed activities itself if you did not is not sufficient to establish that you are lessening the burdens of government within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations. See Columbia Park and Recreation Assoc. v. Commissioner, supra. You have not established that a government entity considers your activities to be its responsibility and recognizes you as acting on its behalf. Therefore, you are not operated exclusively to lessen the burdens of government within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations.

To qualify as a supporting organization under section 509(a)(3) of the Code, an organization must meet an "organizational test" and an "operational test" as described in section 1.509(a)-4(b) of the regulations. In addition, it must establish that it meets one of three defined relationships with the supported organization or organizations, as described in section 1.509(a)-4(f). To be "operated in connection with" one or more of the organizations described in section 509(a)(1) or 509(a)(2) under section 509(a)(3)(B)(iii), the supporting organization must meet the "responsiveness test" described in section 509(f)(1)(A). You have not established that you satisfy these requirements. Therefore, even if you qualify as an organization described in section 501(c)(3) of the Code, you do not qualify as a supporting organization under section 509(a)(3) of the Code.

CONCLUSION

For the reasons set forth above, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements