



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Number: **200851033**  
Release Date: 12/19/2008

Date: September 25, 2008

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

SE:T:EO:RA:T:3

Uniform Issue List:

501.03-10

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,

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: March 18, 2008

Contact Person:

XXXXX  
XXXXX  
XXXXX

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:  
XXXXX

Uniform Issue List:  
501.03-10

Legend:

<u>A</u>	=	XXX
<u>B</u>	=	XXX
<u>C</u>	=	XXX
<u>D</u>	=	XXX
<u>E</u>	=	XXX
<u>i</u>	=	XXX
<u>k</u>	=	XXX
<u>l</u>	=	XXX
<u>m</u>	=	XXX
<u>n</u>	=	XXX
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<u>t</u>	=	XXX
<u>u</u>	=	XXX
<u>v</u>	=	XXX
<u>w</u>	=	XXX
<u>x</u>	=	XXX
<u>y</u>	=	XXX

Dear :

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

You are a nonprofit organization incorporated in A on j. Your Articles of Incorporation state that your purpose is to obtain, build, repair, maintain, and/or renovate housing for low income

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persons in areas located within the State of A to the extent that such purpose is within the meaning of section 501(c)(3) of the Internal Revenue Code.

You have five uncompensated directors. Two of these directors, B and C are husband and wife. B and C are also the sole owners of D, a for-profit general contracting and investment business.

You are the successor to an unincorporated organization of the same name that started in A in k. You have indicated that your predecessor mostly conducted seminars, led by B, which taught low income citizens how to apply for loans and mortgages and how to care for and maintain a home. You will continue to use virtually the same name as your predecessor.

You plan to focus your activities on the provision of housing to low income persons. You state in Schedule F of your Form 1023 application that the project will consist of approximately r units with a total of approximately s residents. Later in that same Schedule, you state that the project will consist of approximately t duplexes. Subsequently, you indicated, in an answer to a development letter, that you would be concentrating on property development of between u and v units.

To start this project, you propose to obtain a loan from the A Department of Housing and Community Affairs in your name and a donation of realty from the local government. You originally stated that your intention was to develop this project in E. However, in your correspondence dated l, you wrote that "[a]t present, no community has been identified" for your development.

You plan to hire a general contractor to handle the construction aspect of your project. In your Form 1023 application, you state that you anticipate entering into a joint venture with D for the construction in which you are the majority partner with income from the project to be distributed pro rata between the partners after loan obligations are satisfied. You state that D "is selected" because B began working on this project in his individual capacity as well as in his capacity as president of D in m. Additionally, you state that B and D have already invested a considerable amount of time and expense in this project. Later, in correspondence dated n, you state that you have no final or preliminary draft of a joint venture agreement, that such a draft will be made if you obtain tax exempt status, and that D and other non-related entities will be considered for the general contractor position. In your correspondence dated l, you state that purchasing of services, including development projects, will almost always be done using a three bid process. You also acknowledge that sole source purchasing may be used and deny the existence of any joint venture arrangement or plan to enter into any joint venture arrangement.

Upon completion of construction, you plan to manage or oversee management of the property. You may engage another entity to provide on-site management of the property. You have stated that any outside management provider will have no business or family relationship to any persons associated with you.

In your Form 1023 materials, you state that you anticipate owning "at least a majority of any housing facilities." In subsequent correspondence, you listed only yourself when asked to identify the owners of your facilities.

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You state, in correspondence dated n, that you plan to meet all federal, state, and local government standards and requirements concerning the qualification of residents for your low-income housing project. However, in your correspondence dated l, you indicate that only w-x% of the units in your project will meet local, state, and federal affordable housing guidelines.

You state that you will ensure that at least 75% of the units in your project are occupied by residents whose income does not exceed the low-income limits set by HUD for the county in which your project lies by complying with these standards. Additionally, you state that you will ensure that either at least 20% of the units in your project will be occupied by residents whose income does not exceed the very low-income limits set by HUD for the county in which your project lies or at least 40% of the units in your project will be occupied by residents whose income does not exceed 120% of the very low-income limits set by HUD for the county in which your project lies by complying with these same standards. However, you also state that you will strive to have at least y% of the units be occupied by residents whose income is at or below 120% of the area's very low-income limits set by HUD for the county in which your project lies. In addition, you indicate that you are uncertain of the exact percentage of residents who will have income levels at or below 120% of the area's very low-income limit.

You have no application form for potential residents. You have no residency or homeownership contracts or agreements. You state that you cannot provide a copy of any affordability covenants or restrictions running with the property until after the property is transferred to you.

You indicate that social services will be provided on-site to promote aging in place for the elderly. Subsequently, you state that no aging in place policy has been established for your project. In addition, you state that, while your housing will be open to elderly persons and will be made handicap accessible as required by law, you will not be designing units for those persons who can not live independent of direct services often required for elderly persons, such as those offered in retirement centers or nursing homes.

You plan to provide a home training course that will be free to the public every two to three months. You also plan to provide services to your residents, depending on organizational resources and resident interest, which may include programs such as GED classes, computer classes, senior activities, financial literacy training, food and clothing banks, job training and placement, counseling and referral services, English as a second language classes, health care services, nutrition activities, tutoring, meals on wheels, and neighborhood watch.

You plan to apply all income received from this project to the fulfillment of your loan obligations associated with the project and, after such obligations are satisfied, then to your own account and the accounts of any partners involved in the project, pro rata. All funds distributed to your account will be used to develop other housing projects and/or provide homebuyer, homeowner, or resident educational programs for low-income persons. You will not fundraise or apply for grants unless you are first given tax exempt status.

Section 501(c)(3) of the Internal Revenue 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.

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Section 1.501(c)(3)-1(c)(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, the organization must be one that is both organized and operated for one or more of the purposes specified in that section. Thus, an organization that fails to meet either the organizational or operational test 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 activities specified in section 501(c)(3). 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(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) of the regulations defines private shareholder or individual as a person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Therefore, to meet the requirement of this subsection, it is necessary for an organization to establish that it is not 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 defines the term "charitable" as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

Rev. Proc. 96-32, 1996-1 C.B. 717, sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable for relief of the poor and distressed, and described the facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed. It also clarified that housing organizations may rely on other charitable purposes to qualify for recognition of exemption. The safe harbor identifies those low-income housing organizations that will, with certainty, be considered to relieve the poor and distressed by requiring occupancy by significant percentages of both very low-income and low-income persons. The facts and circumstances that demonstrate relief of the poor by organizations falling outside of the safe harbor may include, but are not limited to, the following:

- (1) A substantially greater percentage of residents than required by the safe harbor with incomes up to 120 percent of the area's very low-income limit.
- (2) Limited degree of deviation from the safe harbor percentages.
- (3) Limitation of a resident's portion of rent or mortgage payment to ensure that the housing is affordable to low-income and very low-income residents.

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- (4) Participation in a government housing program designed to provide affordable housing.
- (5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization's operations.
- (6) The provision of additional social services affordable to the poor residents.
- (7) Relationship with an existing 501(c)(3) organization active in low-income housing for at least five years if the existing organization demonstrates control.
- (8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.
- (9) Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.
- (10) Existence of affordability covenants or restrictions running with the property.

Rev. Proc. 2008-9, 2008-2 I.R.B. 258, provides that exempt status may be granted in advance of the organization's operations if the proposed activities are described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption pursuant to the section of the Internal Revenue Code under which exemption is claimed. The organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures. A mere restatement of exempt purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement.

Rev. Rul. 67-138, 1967-1 C.B. 129 holds that a nonprofit organization created to provide instruction and guidance to low-income families in need of adequate housing and interested in building their own homes is exempt under section 501(c)(3) of the Code. The organization's training of low-income families on various aspects of house building and homeownership was educational. The activities related to assisting families find adequate housing was charitable as it provided relief to the underprivileged, lessened the burdens of government and was a means of combating community deterioration.

Rev. Rul. 79-18, 1979-1 C.B. 194 holds that an organization that provides specially designed housing to elderly persons at the lowest feasible cost and maintains the residence for those tenants subsequently unable to pay its monthly fees is an organization exempt from tax under section 501(c)(3). The organization in the ruling was formed to meet the housing needs of the elderly by building and operating an apartment rental complex designed especially for them. It was formed under the sponsorship of community leaders to meet a community need for such a facility. Its board of directors consists of civic leaders and other individuals with a particular

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interest in the problems of the elderly. The ruling holds that an organization operating in such a manner is relieving the major forms of distress to which the elderly are susceptible.

Rev. Ruls. 85-1 and 85-2, 1985-1 C.B. 178, provide a two-part test to determine whether an organization lessens the burdens of the government. The first part of the test requires that the organization establish that its activities are actually burdens of the government. The second part of the test requires that the organization actually lessen the burdens of the government.

Rev. Rul. 68-655, 1968-2 C.B. 213, holds that an organization operating to assist certain families purchase homes for the purpose of stabilizing an integrated neighborhood and to educate the public regarding integrated housing is charitable, in part, because it operates to eliminate discrimination and prejudice.

In Better Business Bureau of Washington, D.C. v. U. S., 326 U.S. 279 (1945), the court held that an organization was not organized and operated exclusively for charitable purposes. The court reasoned that the presence of a single nonexempt purpose, if substantial in nature, would destroy the exemption regardless of the number or importance of truly exempt purposes.

In KJ's Fund Raisers, Inc. v. Commissioner, 74 T.C.M. 669 (1997), the court held that a nonprofit organization, which sold lottery tickets on the premises of a for-profit business had a substantial non-exempt purpose to enhance the profits of the for-profit business. The owners of the for-profit business to purportedly raise funds for distribution to charitable causes formed the nonprofit organization. The nonprofit's lottery tickets were sold during the regular business hours by the owners and employees of the for-profit business. The owners of the for-profit initially controlled the board and later indicated that it would vest control in unrelated parties. The nonprofit opined that the organization "would fold without the original founders of the organization as officers." In finding that the nonprofit had a substantial nonexempt purpose, which was promoting the for-profit, the court reasoned that the identity of the for-profit owners and the officers of the nonprofit, placed the owners of the for-profit in a position to control the nonprofit. Additionally, the court found that the publicity received by the for-profit was a significant benefit.

In Redlands Surgical Services v. Commissioner, 113 T.C. 47 (1999), *aff'd*, 242 F.3d 904 (9th Cir. 2001), the appellate court affirmed the holding of the tax court and found that a nonprofit organization was not operated exclusively for exempt purposes under section 501(c)(3) of the Code where its sole activity was participating as co-general partner with a for-profit corporation in a partnership that was general partner of an operating partnership that owned and operated an ambulatory surgery center. The Tax Court reasoned that an organization's purposes might be inferred from its operations. To the extent that an organization cedes control over its sole activity to for-profit parties having an independent economic interest in the same activity and having no obligation to put charitable purposes ahead of profit-making objectives, the organization cannot be assured that the partnerships will in fact be operated in furtherance of charitable purposes. Based on the facts presented, the court determined that the nonprofit organization had ceded effective control over the operations of the partnerships and the surgery center to the for-profit partners and the management company. This, the court found was an impermissible benefit to private interests. The management contract between the operating partnership and the management company, an affiliate of the for-profit partner, gave the management company broad powers to contract, negotiate with third-party payors, and set



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patient charges. As the fees were a percentage of gross revenues, there was an incentive for the management company to maximize profits. Additionally, the partnership agreements restricted the partners and their affiliates from establishing competing centers or providing certain services to patients, thus detracting from community health to the benefit of the for-profit partners.

You have not proven that your operations will further a charitable purpose and that you will not be operated for a substantial nonexempt private purpose.

You have not proven that your operations will be charitable through relief of the poor and distressed. While you may deal exclusively with persons who are considered low-income, you have not proven that you will meet the safe harbor of Rev. Proc. 96-32 for dealing with "low-income" persons. You claim that you meet the requirements set forth in Rev. Proc. 96-32, but, when asked for specifics explaining how you will meet those requirements, your answers were either vague, contradictory, or lacking. Moreover, you failed to provide evidence of many favorable factors set forth in the facts-and-circumstances test, such as serving excess very-low-income persons, a limited degree of deviation from the safe harbor percentages, limitation of a resident's portion of rent to ensure affordability to low-income and very low-income individuals, a community-based board, and relationship with an existing 501(c)(3) organization.

Housing organizations may also be charitable through combating community deterioration. However, the mere redevelopment of blighted areas is not necessarily a charitable activity, as for-profit organizations often engage in such activity. You have not clearly provided facts and circumstances demonstrating a charitable endeavor here, such as the existence of any community participation and control of your board. In fact, you have not decided in which community you will locate your project. See, e.g., Rev. Rul. 70-585, 1970-2 C.B. 115.

You have not proven that you provide specially designed housing to elderly persons at the lowest feasible cost. In fact, you have stated that you will not specially design your housing for elderly persons.

You have also failed to show that you operate to lessen the burdens of the government. Specifically, you have provided no information that suggests that the government has made an objective manifestation declaring that your activities are its burden.

Additionally, you have not proven that you operate to eliminate discrimination and prejudice. You have provided no information that suggests the area in which you plan to operate suffers from prejudice and discrimination or racial tensions. Again, you have not selected a community in which to operate.

Furthermore, it is not clear that you will not be operated for the private benefit of B, C, and D. It is not clear that D will, in fact, be required to participate in an impartial bidding process before it is selected as the contractor for your project. Your responses to various questions posed by the Internal Revenue Service also suggest that you are dependent on the actions and expertise of B. In fact, you have stated that B has already made a personal investment of time and money in your proposed project. In addition, while you have indicated that you have no joint ventures at the present time, you have also stated that you anticipate entering into a joint venture, in which you would be a majority partner, with D for an indefinite period of time. These facts make your

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situation similar to those in KJ's Fund Raisers, Inc. and Redlands Surgical Services. The identity of the owners of D and your directors, your dependence on B and his previous work on this project in his capacity as president of D, and your plans for a joint venture will allow the owners of D to exercise constructive control over your operations. It is also unclear that you are not being operated to give D indirect access to government land and money that it would not otherwise be able to obtain. Since B and C are both members of your Board of Directors and owners of D, this situation constitutes inurement to the benefit of private individuals as well as a more than incidental amount of private benefit to D as a for-profit entity.

As Rev. Proc. 2008-9, 2008-2 I.R.B. 258, states that an organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures. Exempt status may only be granted in advance of the organization's operations if all of these activities are described in sufficient detail. If all of the organization's proposed activities are not described in sufficient detail, the Service will generally issue a proposed adverse determination letter or ruling. The descriptions that you provided of your housing activities were not sufficiently detailed enough to warrant a grant of tax exempt status.

Accordingly, 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.

Contributions to you are not deductible under section 170 of the Code.

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](http://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

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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