



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201202039**
Release Date: 1/13/2012

Date: October 6, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.03-00; 501.32-00; 501.33-00

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.

Since 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.

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, you should 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.

Letter 4038 (CG) (11-2005)
Catalog Number 47632S

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 Lerner
Director, Exempt Organizations

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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: August 16, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

UIL #;s
501.03
501.32
501.33

Legend:

B = CEO
C = Board member
D = Previous board member
E = Board member
F = Board member
G = Board member
H = Individual
M = For-profit company
N = For-profit company
O = For-profit company
P = City
Q = County
R = State
S = Date
t = Number
u = Number
v = Number
w = Number
x = Number
y = Number

Dear :

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code ("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.

Issues

1. Are you organized exclusively for 501(c)(3) purposes? No, for the reasons described below.
2. Are you operated exclusively for 501(c)(3) purposes? No, for the reasons described below.
3. Have you established that your operations do not inure to the benefit of private individuals, including the person who created you? No, for the reasons described below.
4. If you were organized and operated exclusively for 501(c)(3) purposes, would you meet the requirements of section 501(q) of the Code? No, for the reasons described below.

Facts

You were incorporated on date S as a non-profit corporation under the laws of state R. Your Charter or Articles of Incorporation ("Articles") state, in pertinent part that your purposes are to:

1. Increase affordable housing to the special needs population.
2. Increase the affordable homeownership and/or housing to the special needs population who meet certain income criteria.
3. Offer multiple housing options:
4. Housing counsel services
5. Connection with down payment assistance programs
6. Case management services that will improve health and human services
7. Referral services

Regarding your board of directors:

- B is also your Chief Executive Officer (CEO), Incorporator and Registered Agent
- C is unemployed
- D was re-placed by G during the application process
- E co-owns N
- F is a day-care operator
- G is a licensed mental health counselor

Your application for exemption states that "during the first five years (you) will focus on acquisition and rehabilitation of single family and multifamily homes. During the first and third year (you) will focus on supportive housing-permanent and transitional. The third year a new construction group home is planned to house 15-30 residents". B, hereinafter referred to as the CEO, will provide supervisory duties and oversight of the acquisition and rehabilitation of facilities.

Your case managers will "help residents with referral services, act as liaisons for residents, provide documentation as the residents well being, providing assessments, helping with food and clothing (if residents need), referrals to health services". Some of your services will be contracted out to other organizations.

In year one you will purchase four to ten single family homes for those in need of less restrictive care. In year two you will purchase three to four multi-family homes with at least 10 units each. After the second year you will continue to add group homes, single family homes and multi-family homes. In year six physically handicapped services will be offered and in year ten a skilled nursing home for the elderly. Joint ventures will help you achieve a goal of 1,000 units and 100 group home beds within 20 years.

Your initial property will be leased from the CEO. You plan to lease other properties from the CEO. A copy of a "Development/Management/Transfer of Property/Lease/Sales" agreement between you and the CEO regarding the lease of the initial property was submitted with your application. It indicated, in part, that the CEO will, subject to your approval, "serve as the primary agent" in overseeing the project, help you devise a development plan and budget, receive a fee for her services, prepare loan and grant applications and negotiate contracts or loans in her name or your name for the benefit of the project. You will provide the CEO with "full information" and "not unreasonably withhold approval of proposed contracts, plans and actions that have been negotiated, prepared or undertaken" by the CEO.

Other planned services include housing for the homeless, helping other non-profits rehabilitate, construct, lease and operate housing and construction for people with physical handicaps. You intend to apply for US Housing and Urban Development (HUD) section 811 (Disabled Housing), 202 (Elderly Housing) and 221d (multi-family) grants.

You plan to offer housing counseling. Your counseling will "give individuals knowledge about the home buying process, maintaining their home, what to do if financial problems...may prevent them from keeping their homes". You "will address th(ese) issues by providing guidance and establishing policies and procedures within state and federal guidelines to help people keep their homes". You will "act as an advocate or representative for the homebuyer and educat(e) the homebuyer about predatory lending". You will also assist people with down payment assistance programs.

You plan to create a "development division." This division will advise other non-profits, expand into rural areas, help with overall funding and offer services to the for-profit housing sector. However, outside development consultants will initially be used to oversee construction projects. You state that you "will be a real estate development corporation that is specifically marketed to a low-income population and or people with special needs".

Your definition of special needs includes: women who are pregnant, the elderly, mentally or physically handicapped, people with children, etc.

The CEO oversees operations and will:

- Handle all day to day operations

- Govern essential staff
- Control fundraising
- Oversee financial aspects and provide financial reporting
- Directly enter into contracts on your behalf
- Develop policies and procedures
- Hire and fire employees
- Over see all supportive housing projects
- Interview all housing clients
- Serve as spokesperson
- Appoint committees
- Supervise the program director
- Oversee all planning and goal-setting
- Initially, will supervise group home
- Handle all legal matters
- Handle consultation with developers and consultants

In order to raise funds for operations you will hold an annual ball and a golf tournament, sell movie tickets and gas/store cards, sell named bricks and catalog items, and hold food socials. Raffles, auctions and other fundraisers will be considered. Regarding the food socials, which will be held monthly, you "will obtain appropriate food and liquor licenses through the state (in which) the event will be held. These events will showcase local vendors in an effort to increase their business and our corporate supports w(h)ere applicable".

You will hire a development consultant to serve as lead project manager. The project manager will assist the CEO with developing and coordinating projects. H, who has substantial construction experience, is being considered for the position. You will also hire a financing consultant to help with loans. For-profit general contractors, hired by the development consultant, will actually construct, build and/or renovate the housing units.

You plan to conduct joint ventures. You will maintain at least 51% control and abide by IRS guidelines. Joint ventures may include a development firm, management company and maintenance company. The joint ventures will offer services to your properties and to unrelated for-profit entities and private individuals. You hope to qualify for low income housing tax credits.

You stated that "(u)pon the successful purchase of a property to be used by (you), through any director or board member...the ownership will remain with" the director or board member. The director or board member would "be the cosigner of all loans and will have the responsibility to pay all indebt(ed)ness on the property". Properties purchased from directors or board members must "have a deed restriction clause for specific use by (you). Covenants and restrictions will become part of the real estate transaction and will specify that (you) will have unlimited rights and use to the property...". A lease will be agreed upon between you and the specific director or board member who owns the property.

A one-time nonrefundable fee will be charged to a potential client to offset your cost of a criminal background and credit checks. Clients will be obtained from referrals from governmental and other agencies and advertising.

Financial projections submitted for your first three years of operations shows, contribution revenue of more than \$1.5 million, investment income of more than \$500,000, and gross receipts from sales of more than \$100,000. Your projected expenses are almost \$20,000 in fundraising expenses, officer/director compensation of more than \$220,000, other wages of about \$750,000, occupancy expense of over \$400,000, professional fees of approximately \$20,000 and other expenses totaling more than \$300,000.

To clarify your initial application and subsequent, sometimes conflicting responses, we sent you four letters. Your responses indicated, in part, the following:

Board Related Responses

Board members are "unpaid at this time" and "work in (an) advisory capacity (on) an as needed basis and will help the CEO make sound decisions".

The CEO and D were removed from the board. You will fill the three vacant board positions resulting in seven board members. The CEO and/or board will not sign in their personal capacities as previously indicated.

H is no longer being considered as a development consultant. However, she will help the board find a consultant..

You filed a form with R indicating you intended to transact business in R under the name of M. You also filed an amendment to your Charter.. Although the CEO was removed from the board prior to the filings, she filed both forms with R as your Incorporator. In fact, the amendment stated that it was filed without member approval by the Incorporator, CEO, as such member approval was not required. The twenty five page amendment indicated, in part, the following:

- The principal officer and incorporator is the CEO.
- You will have a director that will also serve as the CEO (this contradicts the alleged removal of the CEO from the board)
- No changes were made to your purpose as stated in your original Charter
- No employee, except the CEO, COO (Chief Operating Officer) and certain board members can approve spending
- The CEO will be appointed by the Incorporator
- In cases of emergency lines of succession can be modified and "notice of a meeting of the board of directors need be given only to those directors who in practicable manner" can be contacted. At least one director must be present at the meeting. "The board may deem to be directors as members for a meeting, in order of rank and within the same rank in order of seniority, as necessary to achieve a quorum". All action taken during an emergency meeting binds the corporation.
- You are a membership organization. You will "establish conditions for admission to membership, admit members, and issue memberships".

- Members are chosen by the board.
- You registration agent is the CEO.
- Only the Incorporator can change your registration office.
- Board members are appointed by the chief officers.
- If a board member resigns, their resignation is forwarded to the Incorporator who will officially announce the resignation at the next board meeting.
- The board will approve CEO compensation and review and approve contracts over \$5,000
- A quorum, for the purpose of the corporation, shall consist of four members of the board
- Directors are "prohibited from having any financial interest in any contract in connection with the rendition of services, the provision of goods or supplies, procurement of furnishings or equipment, construction of the project, procurement of the site or any other matters whatsoever, except with respect to management or supportive service contracts entered into by the Owner with the Sponsor or its nonprofit affiliate".
- The Incorporator or registered agent shall have final decision for the change of the charter.
- Bylaws can be amended in a special meeting by the board "with approval from (the) incorporator". Any amendments may be changed by the executor or incorporator.
- The CEO "shall hold in his/her possession...the official and amended bylaws and charters.
- Sale of assets "in the regular course of activities" shall be approved by 2/3 of the board.
- Sale of assets "other than in (the) regular course of activities...can only be approved through the incorporators and board of directors".

We asked for a statement, signed by each board member, that they would be active in the operation and oversight of your organization. In your response, the CEO indicated that "I have emailed the board members requesting the information in question 7, but have not yet received any responses back from the four board members". To date, we have not received any statements from the current four board members.

A copy of an email from the CEO to the existing four board members included the following statements:

"I believe it is time to take (the organization) further and start with fundraising and actually following through with the mission of providing housing".

"After some research to determine w(h)ere housing for low income individuals with disabilities will head, the goal of starting with the group home may have to be placed on a hiatus. Recent lawsuits...are driving the housing market to Supportive Living and Single Room Occupancy with a focus on increased services...and more independent living".

"I am still in need of 3 additional board members. I will be working to fill at least two of the slots over the next month. The board will need to schedule a meeting sometimes before the end of October to vote on several issues including the Conflict of Interest Policy, Compensation Packages, Fundraising amongst other issues. If everyone can please email at least 3-4 dates that are convenient, I will try to schedule something around those dates. As always I will be flexible. If you have questions please do not hesitate to call".

No evidence exists in the file that any of the four board members have been involved in any decision or activity of the organization. The CEO, who is also the Incorporator and Registered Agent, did all of the following:

- signed the initial and revised Form 1023
- signed and filed the articles
- signed and filed the amendment to the articles
- signed and filed the document regarding an assumed name
- signed all responses
- signed your HUD application

Housing Counseling Related Responses

You will not conduct housing counseling in your first two years. At that time, the board and CEO will hire someone to run the counseling program. The new program coordinator and CEO will take numerous housing counseling courses.

You will apply for approval as a housing counseling service through HUD. The CEO will hire a housing counselor or contract the service work to another agency. The housing counselor will conduct the following activities:

- Provide direct client-counselor and counselor-group activities
- Interview clients to obtain information about the client and their housing needs
- Identify resources (agency, community, etc...) to address the client's needs
- Design a counseling plan (not limited to debt management)
- Help the client save or attain a down payment or rental assistance
- Help the client through the loan process
- Monitor the client's progress

Fees charged to counseling clients will be inline with HUD Housing Counseling Program Handbook (7610.1) Chapter 6. Housing topics to be covered include:

- Housing selection
- Fair Housing Laws
- Qualifying for HUD subsidies
- Budgeting for Mortgage and Rent Payment
- Money Management
- Housing Maintenance and Care
- Referrals to Community Resources
- Pre-purchase issues
- Pre-rental issues

- Mortgage default
- Rent delinquency

An actual fee schedule was provided:

- Housing selection, referrals, pre-rental orientation (if renting from you), displacement and relocation consultation are at no charge.
- Home improvement and rehabilitation counseling are \$t per session.
- Homebuyers education (pre & post purchase and money management) is \$u per session (must complete three sessions)
- Mortgage and rent default and rent delinquency are \$v per session

No evidence of a policy providing for the waiver of fees in certain situations was submitted with the fee schedule. The revised Form 1023 did indicate some clients would receive free services. However, no specific guidelines were submitted.

Mortgage default counseling will include:

- "Determination of whether the mortgagor, with the assistance of the counseling agency, might bring the account current within a time period and payment plan acceptable to the mortgagee.
- Working out repayment plans with the mortgagor's other creditors
- Follow up counseling
- If the mortgagee decides to foreclose, determining if the mortgager is eligible for HUD's assignment program
- Foreclosure
- Alternatives to foreclosure (sale, deed-in-lieu, etc...)
- Mortgage rate reduction program
- Home equity conversion mortgage program

A one-page "Homebuyers education agenda" was provided. It indicated there is a three day, twelve hour course. No actual educational materials were provided. You indicated that "after course completion the client will demonstrate an understanding of homeownership preparation, budgeting/finances, credit management, home financing, home selection, home maintenance and avoiding delinquency and foreclosure". Once the twelve hours are completed, a certification will be granted.

The revised Form 1023 attachment summarized your housing counseling, in part, as follows:

"The purpose of the housing counseling services offered through [you] is to provide education on proper home buying procedures for residents who believe when they are ready, to buy a home. Housing counseling services will be offered to the general public as well as residents of [you]. Housing counselors will be trained and certified through Neighborhood Works. The housing counselor will also have the task of connecting individuals with down payment assistant programs for example through P or Q or R (city, county and state agencies).. The criteria for housing counsel services will be set by the HUD, Neighborhood Works, and the national industry standard for homeownership education and counseling. The targeted market will be people who wish to buy a home."

"The housing counsel[ing] staff will initiate contact with the service recipient through referrals, walk in, or solicitations from real estate agents, mortgage brokers, etc. The service recipient will have an intake with the housing counselor to determine needed services. The housing counselor will then schedule the recipient for needed classes or follow up sessions. A case file will be kept on all persons who seek services from [you]. The file will include an application for services and all necessary contact information. Housing counselors will educate client's on pre and post home buying procedures, money management, foreclosure prevention, maintaining and owning a home, housing selection, fair housing laws, helping residents qualify for housing subsidies w[h]ere applicable, and pre-rental orientation (your] residents only), and displacement and relocation assistance. This furthers the mission of the organization by keeping vacancy rates down and by increasing the number of homeowners within the community. Individuals participating in the housing counsel[ing] services will receive free or reduced housing counsel[ing] services based on a sliding fee scale. Once the organization begins housing counsel[ing] services with funds from HUD housing counsel[ing] services (pre and post purchasing counseling) will be offered free. All other services will be in accordance with previous submissions. The housing counselor will "build a network of vendors (mortgage lenders, real estate agents, loan originators, appraisal companies, etc.) to help individuals with obtaining loans. The target audience is people who have special needs."

Responses Related to Housing Sales and Rentals

Property sales will differ due to the requirements of various programs (R, HUD, etc...). Your board will determine if you will use N (which is co-owned by E) to handle your real estate deals. All profit from home sales will be used for "down payment assistance, administration cost, purchase and rehabilitation" and other programs. You will place restrictive covenants on properties, including:

- You must be informed if the house is placed on sale
- You will authorize the sale, mortgagor, etc...
- The home must be "affordable" for at least 10 years
- If a home is sold during the first 10 years of ownership, a "prorated amount plus a portion of the gains from the property" will be paid to you

We asked how "women with children" and "pregnant women" have "special needs". You stated that each client will be qualified based on income, past violent relationships, referrals (hospitals, treatment centers, etc...), and danger of homelessness.

Your initial project, the group home, will need financing assistance. Your CEO will be responsible for seeking the financing. You will serve as "primary borrower or secondary to the loan". The CEO will receive a salary and no fees. The CEO will enter into contracts, loans and grant agreements in her name on behalf of you in order to "move [you] along." Initially, the CEO will be the group home manager (40 hours per week) and provide oversight of the acquisition and rehabilitation of facilities. In year three the program director will be hired to relieve the CEO of some duties.

No housing unit has been leased or purchased at this time. However, you indicated that the initial group home would be leased from the CEO, stating that "the board has to approve the lease or purchase of the house from the CEO". However, she "will not benefit" and once you become "financially stable, the group home will be paid off and all interest of the CEO relinquished without any further liabilities". Any purchase or lease will be made at fair market value. Any capital improvements to the property will be made before a lease or purchase agreement is signed. Your initial lease will be one year with indefinite renewal rights.

A "sample lease agreement" between you as lessee and the CEO as lessor was submitted. The lease contained no actual terms but did indicate that any leasehold improvements would, unless provided for in a separate written agreement, become the property of the lessor. However, your last response contradicted your previous statements indicating that the "CEO does not own a personal property that is being considered for group home activities".

If funds are available, you will offer down payment assistance. Regarding this possible assistance:

- Your program will not be seller funded
- The applicant must be a first-time homebuyer
- The home price cannot exceed \$w
- You will use HUD and FHA low-income standards
- The applicant must have the income and employment history to qualify for a mortgage
- The applicant must attend housing counseling
- A "homebuyer can ask the seller to make a contribution to (you) after the (sale), but (it) is not a standard procedure"
- Homebuyers must live in the house for 10 years. If the home is sold before the 10 year period ends, a pro-rated amount of the down-payment is "recaptured"
- You will also connect clients to City, State and County down-payment assistance programs

You will acquire houses through foreclosure or donation which will provide housing to people with "special needs". You stated that the income criteria will be based on HUD guidelines and that the maximum income for a one person household will be \$x and for a household of eight or more persons, \$y per year.

You will also build housing units. You will offer the units at below market rates to people with "special needs". You did not indicate what construction management company would be used to actually build the units.

Regarding your home sales, you will pay closing costs only if the buyer was your tenant, attended your counseling classes, meets your low-income criteria and contributes 1% of the closing costs and/or down payment.

We asked for details regarding relationships with for-profit entities (construction companies, developers, etc...), future joint ventures and individuals/companies that would provide services to your organization. You failed to provide any details indicating "there are no for

profit entities that are being considered at this time”, “the board has not developed a list of entities” regarding joint ventures and “there are not individuals or entities that have provided or are projected to provide services to the organization”.

The revised application you submitted indicated you will purchase goods and/or services from directors and that someone else will develop your facilities. However, no details were provided.

Responses Related to Possible Future Activities

You stated “it has not been decided” whether you will provide debt management and liquidation services. You will not, in your initial two years, offer elderly housing. You have not selected a for-profit investor to participate in a joint venture. If you do enter into a joint venture, you provided an example; “a housing development agreement (where you) retain...management rights and 51% ownership in a housing development”. You will not operate a donor advised fund at this time. You will inform the Service when you begin debt management services, liquidation services, elderly housing, donor advised funds and joint ventures. Your foreclosure mitigation activity was removed from the application.

Responses Related to Financial Information

You provided more information regarding your fundraising. Your ongoing monthly fundraiser, Q, will be conducted by the board and CEO. “Tickets will be sold to the public for the event or vendors must pay for booth space. The board of directors and CEO will solicit local companies to participate in the fundraiser. A space will be rented to hold the event. The board will work with vendors to determine the services provided for each fundraiser. For example, the chocolate social may have vendors such as local or national chocolatiers and candy makers/sellers. They will pay a predetermined booth fee, and sell their goods to participants”. You may also “sell tickets and offer food services to the public. The vendors will receive a pre-negotiated amount for services or letter acknowledging donated services”.

New financial projections submitted with the revised application indicated for your first three years of operations, contribution revenue of more than \$1.5 million, gross receipt revenue over \$500,000, fundraising expenses of approximately \$15,000, no board/officer compensation (this contradicts previous financial information and numerous assertions regarding CEO compensation), other wages in excess of \$800,000, occupancy expense of almost \$500,000, professional fees over \$25,000 and other expenses over \$85,000.

Law

Section 501(c)(3) of the Code provides that corporations may be exempted from tax if they are organized and operated exclusively for charitable or educational purposes and no part of their net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (“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)(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 the words "private shareholder or individual" in section 501 of the Code to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization must 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)(3)(i) of the regulations provides that the term "educational," as used in section 501(c)(3) of the Code, relates to:

- (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
- (b) The instruction of the public on subjects useful to the individual and beneficial to the community.

Section 501(q) of the Code provides that organizations which provide "credit counseling services" as a substantial purpose shall not be exempt from taxation under section 501(a) unless they are described in sections 501(c)(3) or 501(c)(4) and they are organized and operated in accordance with the following requirements:

- (A) The organization--
 - (i) provides credit counseling services tailored to the specific needs and circumstances of consumers,
 - (ii) makes no loans to debtors (other than loans with no fees or interest) and does not negotiate the making of loans on behalf of debtors,
 - (iii) provides services for the purpose of improving a consumer's credit record, credit history, or credit rating only to the extent that such services are incidental to providing credit counseling services, and
 - (iv) does not charge any separately stated fee for services for the purpose of improving any consumer's credit record, credit history, or credit rating.
- (B) The organization does not refuse to provide credit counseling services to a consumer due to the inability of the consumer to pay, the ineligibility of the consumer for debt management plan enrollment, or the unwillingness of the consumer to enroll in a debt management plan.
- (C) The organization establishes and implements a fee policy which--
 - (i) requires that any fees charged to a consumer for services are reasonable,
 - (ii) allows for the waiver of fees if the consumer is unable to pay, and

(iii) except to the extent allowed by State law, prohibits charging any fee based in whole or in part on a percentage of the consumer's debt, the consumer's payments to be made pursuant to a debt management plan, or the projected or actual savings to the consumer resulting from enrolling in a debt management plan.

- (D) At all times the organization has a board of directors or other governing body--
- (i) which is controlled by persons who represent the broad interests of the public, such as public officials acting in their capacities as such, persons having special knowledge or expertise in credit or financial education, and community leaders,
 - (ii) not more than 20 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees or the repayment of consumer debt to creditors other than the credit counseling organization or its affiliates), and
 - (iii) not more than 49 percent of the voting power of which is vested in persons who are employed by the organization or who will benefit financially, directly or indirectly, from the organization's activities (other than through the receipt of reasonable directors' fees).

Section 501(q)(4)(A) of the Code defines, for purposes of section 501(q), the term "credit counseling services" to mean (i) the providing of educational information to the general public on budgeting, personal finance, financial literacy, saving and spending practices, and the sound use of consumer credit; (ii) the assisting of individuals and families with financial problems by providing them with counseling; or (iii) a combination of the activities described above.

Rev. Proc. 2010-9; 2010 IRB states, in part, that exempt status may be recognized 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.

- (1) A mere restatement of exempt purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement.
- (2) 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.
- (3) Where the organization cannot demonstrate to the satisfaction of the Service that it qualifies for exemption pursuant to the section of the Internal Revenue Code under which exemption is claimed, the Service will generally issue a proposed adverse determination letter or ruling.

Rev. Rul. 61-170, 1961-2 CB 112, described an association composed of professional private duty nurses and practical nurses which supported and operated a nurses' registry controlled by

the members primarily to afford greater employment opportunities for its members. Public participation in the management and support of the organization was negligible. Due, in part, to the limited control of the organization, it was not exempt under section 501(c)(3) of the Code.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for an exempt purpose. As the court stated:

Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia*, whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In Church by Mail, 765 F. 2d 1387 (9th Cir. 1985), affg. TCM 1984-349, Tax Court concluded that the extent of the integration between the operations of a non-profit entity and related for-profit entities controlled by the non-profit directors precluded exemption. Furthermore, the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated that the "critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church".

In International Postgraduate Medical Foundation v. Commissioner, T.C.M. 1989-36, the court held that an organization that had the substantial nonexempt purpose of benefiting a related for-profit travel agency, from which it purchased travel services, did not qualify for exemption under IRC 501(c)(3).

Operating for the benefit of private parties constitutes a substantial nonexempt purpose. Old Dominion Box Co. v. United States, 477 F. 2d 340 (4th Cir. 1973), cert. denied 413 U.S. 910 (1973).

In Solution Plus, Inc. v. Commissioner, T.C. Memo. 2008-21, the Tax Court held that a credit counseling organization was not exempt under section 501(c)(3) because it was not organized and operated exclusively for educational or charitable purposes and impermissibly served private interests. The organization was formed by an individual with experience selling debt management plans ("DMPs"). The founder and his spouse were the only

members of the organization's board of directors. The organization did not have any meaningful educational program or materials to provide to people who contacted the organization, and its financial education seminars for students constituted an insignificant part of the organization's overall activities.

Application of Law

You are not described in section 501(c)(3) of the Code because you are not organized and operated exclusively for charitable or educational purposes and your net earnings inure to the benefit of B.

You are not in compliance with Section 1.501(c)(3)-1(a)(1) of the regulations because you fail both the organizational and operational tests.

In order to meet the organizational test under this section, an organization's organizing document must properly limit its purposes to exclusively 501(c)(3) purposes and it must state that all assets will be distributed for 501(c)(3) purposes upon dissolution. Your purpose clause in your Articles of Incorporation is very broad and does not limit you exclusively to 501(c)(3) purposes. Your dissolution clause is also inadequate in that it allows for the distribution of assets to "a(n) estate of a person" or "per the R Code Annotated." Therefore, you do not meet the organizational test.

You also fail the operational test because you have not proven that your activities are exclusively charitable or educational, and you also operate in a commercial manner for the benefit of your CEO.

Your application indicated you would provide housing counseling. However, when asked for specific details, no details or examples of an actual substantial educational program were provided. You did indicate the broad topics the counseling would cover and that no counseling would be conducted during your first two years of operations. However, you did not provide evidence of a substantial educational program. For example, a one-page "Homebuyers education agenda" was provided. It indicated a three day, twelve hour course. However, no actual educational materials were provided. You indicated that "after course completion the client will demonstrate an understanding of homeownership preparation, budgeting/finances, credit management, home financing, home selection, home maintenance and avoiding delinquency and foreclosure" and be granted certification. No material regarding your course was submitted. You have not shown a substantial educational purpose as defined in section 1.501(c)(3)-1(d)(3)(i) of the regulations. Like the organization in Solution Plus, T.C. Memo. 2008-21, you did not provide evidence that you help clients develop an understanding of the cause of their financial problems or a plan to address their financial problems.

You conduct many of your activities, which are normally carried on by commercial enterprises for a profit, in the same commercial manner and in direct competition with commercial businesses, like the organization in Airlie Foundation, 283 F. Supp. 2d 58 (D.D.C. 2003). This is evidenced by the fact that you charge fees that are consistent with

market rates for counseling. You also plan to sell and rent homes at market rates. These activities are indistinguishable from other commercial entities.

Your ongoing monthly fundraiser, O, will include for-profit entities paying for booth space. You may also sell tickets and offer food services to the public. You did not provide evidence that the monthly fundraiser served a public interest and that the benefit to the for-profit entities was incidental. These benefits to unrelated for-profit entities are a substantial non-exempt purpose similar to the operations of the organizations in Better Business Bureau of Washington, D.C., Inc. v. United States, International Postgraduate Medical Foundation v. Commissioner and Old Dominion Box Co. v. United States.

Even though you have four board members, it is apparent that your organization is not controlled by the board, but is controlled by your CEO. No evidence exists in the file that any of the four board members have been involved in any decision or activity of the organization. You stated that the four board members "work in (an) advisory capacity (on) an as needed basis and will help the CEO make sound decisions". This implies the CEO will make final decisions.

You filed an amendment to your Articles of Incorporation with R. Your CEO filed as your incorporator. In fact, the amendment stated that it was filed without member approval by the Incorporator, the CEO, as such member approval was not required. The amendment indicates control of your organization by the CEO in that:

- The principal officer and incorporator is the CEO.
- You will have a director that will also serve as the CEO (this contradicts the alleged removal of the CEO from the board)
- The CEO will be appointed by the Incorporator
- In cases of "emergency" (not defined) lines of succession can be modified and the CEO can make binding decisions by herself.
- Only the Incorporator can change your registration office.
- Board members are appointed by the chief officers. The only "chief officer" at this time is the CEO.
- If a board member resigns, their resignation is forwarded to the Incorporator who will officially announce the resignation at the next board meeting.
- The Incorporator or registered agent shall have final decision for the change of the charter. Both offices are held by the CEO.
- Bylaws can be amended in a special meeting by the board "with approval from (the) incorporator". Any amendments may be changed by the executor or incorporator.
- The CEO "shall hold in his/her possession...the official and amended bylaws and charters.

When we asked for a statement, signed by each board member, that they would be active in the operation and oversight of your organization, our request was forwarded by the CEO to each board member. None of the board members responded to our request.

A copy of an email from the CEO to the existing four board members confirms our assertion regarding the control of the CEO and includes the following statements from the CEO:

"I believe it is time to take (the organization) further and start with fundraising and actually following through with the mission of providing housing".

"After some research to determine w(h)ere housing for low income individuals with disabilities will head, the goal of starting with the group home may have to be placed on a hiatus."

"I am still in need of 3 additional board members. I will be working to fill at least two of the slots over the next month."

Note that the CEO, and not the board, decided to begin fundraising and put the group home on hiatus and will select the new board members.

All of these facts are evidence that you are similar to the organization described in Revenue Ruling 61-170 where the board served the private interests of its membership and not the general public.

The Form 1023 and responses indicated you would lease your first group home from the CEO. In fact, a sample lease agreement was submitted between you and the CEO. Your last response contradicted your previous statements indicating that the "CEO does not own a personal property that is being considered for group home activities". However, the last response also appeared to contradict itself. Page 4, item 7a, of the revised Form 1023 indicated you will purchase goods and/or services from directors (no details were provided). Regardless, looking at all of the facts, it appears you will conduct business with the CEO in her personal capacity. Her control over you presents an inherent conflict of interest. This is not in compliance with section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Your relationship with the CEO in her personal capacity is a substantial non-exempt purpose similar to the operations of the organizations in Better Business Bureau of Washington, D.C., Inc. v. United States, International Postgraduate Medical Foundation v. Commissioner and Old Dominion Box Co. v. United States.

Considering the overwhelming control, related party transactions, and compensation to your CEO, you have not substantiated that your net earnings do not inure to the benefit of your CEO through compensation and purchased services. This is not in compliance with section 1.501(c)(3)-1(c)(2) of the regulations.

It is unnecessary for us to determine that you make payments to the CEO in her personal capacity or that such payments are unreasonable (see Church by Mail). Your entire enterprise is carried on in such a manner as to substantially benefit the CEO in her personal capacity.

Even if you did otherwise satisfy the requirements to be exempt under section 501(c)(3) of the Code, you still would not qualify for exemption because you fail the requirements of section 501(q) of the Code. You are providing "credit counseling services" within the meaning of section 501(q)(4)(A) of the Code. You stated that counseling fees charged to

clients will be in line with HUD guidelines. An actual fee schedule was provided that shows you charge \$0 to \$30 per session. You did not submit evidence to show that you have a policy providing for the waiver of fees in certain situations. The revised Form 1023 you submitted did indicate some clients would receive free services. However, no specific guidelines were submitted. Therefore, you have not established that you have a fee waiver policy in accordance with section 501(q)(c)(ii) of the Code.

You currently have four board members that include an unemployed individual, the co-owner of a real estate agency, a day-care operator, and a licensed mental health counselor. None of these individuals are public officials, have special knowledge regarding financial counseling or have been established as a "community leader". This is not in compliance with section 501(q)(d)(i) of the Code.

In effect, since the four board members are not involved in the decision-making for the organization, you have a one-person governing body consisting of the CEO. Your one person governing body is not in compliance with section 501(q)(d)(i).

The initial Form 1023 and responses indicated the CEO will be compensated. Although your revised Form 1023 states no officer or director compensation, this contradicts numerous previous statements. Because your CEO controls you and is responsible for your day to day operations, it is likely your CEO will be compensated as either an officer or any employee. Such an arrangement does not comply with section 501(q)(d)(ii) of the Code.

Some of the activities initially mentioned in your application were changed to "possible" activities. You have not yet decided whether you will provide debt management services, debt liquidation services, elderly housing, joint ventures, donor advised funds, foreclosure mitigation, etc. Even the activities that you definitely plan to conduct have changed several times and you have submitted several contradictory statements. You have not demonstrated to the satisfaction of the Service that you are organized and operated exclusively for charitable or educational purposes and that your net earnings do not inure to the benefit of private individuals. Therefore, you do not meet the requirements of Revenue Procedure 2010-9 that indicates proposed activities must be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption.

Applicant's Position

You declined to submit any additional information to support your request for tax exempt status.

Conclusion

The facts and law show three separate reasons, any one of which standing alone, is cause for denial of exemption:

1. You fail the organization test because your purposes are broader than permitted and your assets are not dedicated exclusively to 501(c)(3) purposes upon dissolution.

2. You fail the operational test because you have failed to establish your operations are within the meaning of section 501(c)(3). Your operations are only vaguely described, but it is apparent you are conducting activities in a commercial manner as your prices are at market rate. You are not exclusively educational or charitable. Even your fundraisers result in more than an insubstantial private benefit.
3. It is apparent you were formed specifically to further the interests of your CEO and not the general public or the poor and distressed. In fact, your entire method of operating provides for substantial private benefit to your CEO. Since your CEO is an "insider," this constitutes inurement.
4. Even if you did otherwise meet the requirements to be exempt under section 501(c)(3), you would not qualify for exemption because you do not meet the requirements of section 501(q). This is because you are controlled by your CEO, your CEO will likely be compensated either as an officer or as an employee, and your counseling activities have not been substantiated as educational.

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.

Appeal Rights

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:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
550 Main Street,
Cincinnati, OH 45202

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,

Lois Lerner
Director, Exempt Organizations

Enclosure: Publication 892