



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Number: **201640022**
Release Date: 9/30/2016

UIL: 501.03-00, 501.32-01, 501.33-00

Date: July 7, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear _____ :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) 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 the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date: May 11, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date of incorporation

C = State

x dollars = Amount

UIL:

501.03-00

501.32-01

501.33-00

Dear _____ :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under Section 501(c)(3) of the Code? No, for the reasons stated below.

Facts

You incorporated on B in the State of C. You are formed as a sweat equity housing cooperative association as defined in the State of C's Code. Your precept is to preserve and rehabilitate rural properties of historic value that serve simultaneously as family businesses and family homes. Your mission is to seek, preserve, restore and promote these almost extinct hubs of business, social and home-life by re-gentrifying these historical structures, encouraging a new generation of entrepreneurship and preserving a living legacy to the pioneers and settlers of the state.

Your Articles of Incorporation also state that dissolution will occur 10 years after the January 1st following incorporation date. However, the dissolution date may be extended by a majority of director's action of shortened as governed by the state code. You attested that you would add to your Articles of Incorporation the provision that upon dissolution your assets would be distributed exclusively for Section 501(c)(3) purposes.

All five of your Officers/Directors are also your board members. They are all related and were selected by your Secretary. Your Bylaws state that all members, including the elected board members, shall be entitled to one vote. Each member shall be entitled to receive a membership certificate which shall be issued by the board. Each member shall have a possessory interest in one of your cooperative residential units and possessory interest in common with other members of real and personal property not constituting residential units. This possessory interest shall constitute a legal relationship of landlord and tenant between you and each member. Each member must contribute equally for the buy-in of your stock, outlined below, for the Sweat Equity Partners Committee ("SEPC") and Advisory Committee ("AC").

Your Bylaws state that a SEPC shall be formed which will be comprised of all your members who meet the definition of "low-income" as defined by state law. The SEPC holds twenty-five percent of your stock and the AC holds seventy-five percent of your stock. Your SEPC and AC committees will include tradespersons, volunteers, business educators, financial advisors, etc. When we asked about these committees you said the SEPC consists of three related board members and the AC contains the remaining related board members.

Your Bylaws state that a dividend or distribution of assets among members shall not be made until you dissolve. Members holding less than eight and four tenths percent initial capital investment interest at the time of dissolution shall forfeit any interest in tangible property and distribution of dividends of assets to a member shall be in cash proportional to that member's initial capital investment percentage. In the event a SEPC membership is terminated your board shall determine a member's settlement based on the member's sweat equity contribution.

The real estate you own shall be taxed in your name and each member shall pay their proportionate share of the tax. The share they pay will be computed by taking the total real estate tax due multiplied by the percentage of each member's initial capitalization as set forth in your Bylaws.

You are set up under the guidance of a specific section of the State of C's Code. Your focus is on re-gentrification of the small town and rural historical structures with above storefront housing. You will take possession of a property, either by gift or purchase, that meets your criteria and you will then rehabilitate it. You said the possibility exists that an individual or other entity may wish to gift a specific structure and the land it sits on, or gift a physical structure that would need to be moved off-site in order to be rehabilitated. Your role will be to solicit bids for the restoration, renovation or rehabilitation of property, then use those bids in support of seeking grants or funding. You have not received any donations of property since your inception.

The intended use of the property restored, renovated, or rehabilitated, would need to include providing housing in the upper story (originally the store owner's living quarters). The original "business" portion of the building would be utilized as needed, based on consultation with county elected officials, township trustees, mayors, city councils and appointed economic development officials. The increased valuation of the properties will also add additional property tax base to the local governmental entities. You will seek funds to restore some of the targeted structures to their former grandeur, while at the same time utilizing local labor and contractors.

All monies raised, less other expenses, will be allocated to property purchases, upgrades, rehabilitation, and construction for the sweat equity housing cooperative association investors, as governed by C's law. You will work with the county's elected officials, as well as trustees, mayors, city councils, and appointed economic development officials to identify a project (or projects) that will be of the most benefit to the citizens of the rural portion of the county or the municipalities within the county.

Your initial application stated that all funds you raise, less expenses, will be given to a local housing authority. You also stated that proceeds raised and donated to a local housing authority will not only serve to establish rural housing, but rehabilitated storefronts will hopefully provide new business opportunities. When we asked about this, you said that this statement is not accurate and you can find no written references in your application to these statements. Rather, you state that money raised will be allocated to property purchases, upgrades, rehabilitation, and construction for the sweat equity housing cooperative investors, as governed by C's law.

You provided general demographic details for one county in C in which you intend to initially work, as well as one city. Median income level was included but no information on the low or very low income levels of these areas was provided relative to housing.

You hope to receive funding from a local housing authority. The rehabilitation plan shall contain provisions for transfer of stock from the AC to the SEPC. The transfer of stock shall occur when the rehabilitation plan is completed. You further state that the rehabilitation of the targeted structures can be accomplished for less than x dollars each year.

Law

Section 501(c)(3) of the Code describes corporations organization and operated exclusively for charitable purposes no part of net earnings of which inures to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) states 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.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) 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 regarded if more than an insubstantial part of its activities in not in furtherance of an exempt purpose.

Treas. Reg. Section 1.501(c)(3)-1(c)(2) 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.

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) provides that an exempt organization must serve a public rather than a private interest. The organization must establish that it is not organized or operated to benefit 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."

Rev. Rul. 69-175, 1969-1 CB 149 states that when a group of individuals associate to provide a cooperative service for themselves, they are serving a private interest. By providing bus transportation for school children, the organization enables the participating parents to fulfill their individual responsibility of transporting their children to school. Thus, the organization serves a private rather than a public interest. Accordingly, it is not exempt from federal income tax under Section 501(c)(3) of the Code.

Rev. Rul. 71-395, 1971-2 C.B. 22 states that a cooperative art gallery was formed by a group of artists to exhibit and sell their works. Additional artists were admitted to membership only on approval of existing members. All works displayed at the gallery could be purchased by the public and many could also be rented. The gallery retained a commission from the sales and rentals to cover its cost of operation. In concluding that the art gallery was not entitled to recognition of exempt status, the ruling emphasized that the gallery was a vehicle for advancing the careers of its members and for promoting the sale of their work. As such, it "serves the private purposes of its members, even though the exhibition and sale of paintings may be an educational activity in other respects."

In Amalgamated Housing Corp. v. Comm'r, 37 B.T.A. 817 (1938), affirmed, 108 F.2d 1010 (2nd Cir. 1940), the Board of Tax Appeals considered whether a limited dividend housing corporation organized under New York law was exempt under the predecessor statute to section 501(c)(4) of the Code. The working class tenants owned all the common stock of the corporation, and non-tenants owned the preferred stock. State law declared limited dividend housing corporations to be “agencies and instrumentalities of the state.” Such corporations were closely supervised by, and conducted projects authorized by, the State Board of Housing. Dividends could not exceed a certain percent, and stock could not be sold in excess of par value plus accrued dividends. The court held that the organization was not exempt, reasoning that it was operated, in part, for profit, even though limited.

In Better Business Bureau of Washington, D.C. Inc. v. United States, 326 U.S. 179 (1945), 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.

The court case Commissioner v. Lake Forest, Inc., 305 F. 2d 814 (4th Cir. 1962), describes a corporation organized by World War II veterans for the purpose of purchasing a government housing project and converting it to cooperative nonprofit housing for members. Individuals become members in the housing unit and the number of members was limited to the number of units. The court held that the organization did not qualify under Section 501(c)(4) of the Code because its activities were of the nature of an economic and private cooperative undertaking. The organization did not promote social welfare because it furnished housing to only a certain group of individuals as opposed to the community as a whole. It was a public spirited but a private endeavor that only provided incidental public benefit.

In Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash. 1963), the court held that even a small amount of private inurement is fatal to a Section 501(c)(3) exemption.

Application of law

In order to qualify for exemption under Section 501(c)(3) of the Code you must be both organized and operated exclusively for exempt purposes as described in Treas. Reg. Section 1.501(c)(3)-1(a)(1). You are formed for the non-exempt purpose of purchasing or receiving donations of property, using grants to fund the rehabilitation of the property, with your members holding an equity interest in those properties. Although restoring historical property could be a charitable activity, the manner in which you are operating is not charitable. Because you are not operating exclusively for an exempt purpose, as described in Treas. Reg. Section 1.501(c)(3)-1(c)(1), you are not exempt.

You are also not operated exclusively for exempt purposes if your net earnings inure in whole or in part to the benefit of private individuals. Your governing body members are also stock/equity holders, causing your net earnings to inure to their benefit. Because your earnings inure to their benefit, you are precluded from exemption, as described in Treas. Reg. Section 1.501(c)(3)-1(c)(2).

An organization does not serve a public rather than a private interest if any of its assets or earnings inure to the benefit of any insiders. You are operating for the benefit of your creators, who are also all family members, which precludes exemption, as described in Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii).

Like the organizations described Rev. Rul. 69-175 and 71-395, you were formed for the private purposes of your members, not for public purposes. You have a substantial non-exempt purpose of operating a

cooperatively owned property rehabilitation organization, which destroys your claim for exemption. Better Business Bureau.

Like the organization described in Amalgamated Housing, you have stock which is owned by individuals. Even though the State supervised the projects, it was found to be non-exempt because it was operated, in part, for profit, even though limited.

You are like the organization that failed to qualify under Section 501(c)(4) of the Code as described in Commissioner v. Lake Forest. The purpose of that organization was to purchase a housing project and convert it into a cooperative for members. Although you do not provide housing for your members, you are operating a cooperative with equity rights, which primarily benefits a select few individuals, who are all related and members of your governing body. The fact that the cooperative members are also your board members causes your earnings to inure to their benefit. Inurement, no matter how small the amount, precludes tax-exempt status under Section 501(c)(3). See Spokane Motorcycle Club.

Your position

You state that you are a charitable vehicle to enhance the rehabilitation of housing in financially distressed areas and your activities are combatting community deterioration. You cited Rev. Ruling 68-14, which states that a non-profit organization formed to preserve and develop the beauty of a city is exempt under Section 501(c)(3) of the Code since the effect of its activities is to combat community deterioration and lessen the burdens of government.

You also cited Rev. Rul. 70-585, which, in Situation 3, indicates that an organization which formulates plans for the renewal and rehabilitation of an area of a city where the median income in one section is lower than other sections and the housing is old and deteriorated, and which sponsors a renewal project in that area of the city is exempt under Section 501(c)(3) of the Code. This ruling indicates that the amount of private benefit must be incidental to the overall public interest in both nature and quantity.

In addition, you cited Rev. Rul. 74-587. If financial benefit is derived from an individual's participation in an activity which furthers exempt purposes, the benefit may be characterized as merely incidental to the public purposes served. This benefit may be a necessary byproduct of an organization's permitted use of the specific individuals as vehicles by which public purposes are served. In this connection, an exempt organization may confer direct financial benefits on people who are not themselves recipients of charity if these activities further public purposes. Rev. Rul. 70-186. This is essentially a weighing test which must be applied to the interest served to weigh the private interest as opposed to the public interest and then determine how necessary these private interests are. Incidental financial benefit accruing to an individual solely because of that person's participation in an activity that furthers the organization's exempt purposes will not affect the organization's exemption. The fact that an owner of a recognized historic residence in a depressed area received a loan at a favorable interest rate in order to restore the home may not affect the exemption of the organization providing the loan an arm's length transaction.

You state that your activities are charitable and the private benefit to sweat equity holders is insignificant and does not exceed your charitable purposes.

You submitted a copy, in pertinent part, of the State Code of C that discusses these types of cooperatives. It indicates that the cooperative association shall establish criteria for the reimbursement of a partner terminating membership in the association, in accordance with the partner's sweat equity contribution.

You also stated that numerous other entities have received exemption for conducting this activity and denying you would not only be in contravention to those rulings but place those organizations in jeopardy.

Our response to your position

Even if you are conducting some charitable activities that are beneficial to the community or the local government, the manner in which you operate disqualifies you from exemption under Section 501(c)(3) of the Code. The charitable activities you may conduct are insubstantial compared to the private benefit and inurement the board members will receive from cooperatively owning the property that will be rehabilitated. Additional private benefit is received by members upon dissolution when they receive a distribution of their equity held. Further, while you cited numerous instances where precedent demonstrated incidental private benefit, you did not provide actual evidence or reasoning as to why the benefits to your members will be incidental.

To address previous rulings, each organization is independently evaluated and each ruling is made on its own merits of those particular facts and circumstances. This ruling is not an interpretation that C's Code does not allow for charitable entities, nor is C's Code justification that charitable activities must be present. An organization will not necessarily qualify for exemption because it is eligible to participate in a particular state program. You said that the private benefit to sweat equity holders is insignificant and does not exceed your charitable purpose; however, your earnings inure to the benefit of your governing body. Any amount of inurement is fatal to exemption, as discussed above, and specifically illustrated in Spokane Motorcycle Club.

Conclusion

Based on the above facts and analysis, you do not qualify for exemption under Section 501(c)(3) of the Code because you are not operated exclusively for exempt purposes. In addition, your earnings inure to the benefit of your governing body members. Accordingly, you do not qualify for exemption under Section 501(c)(3).

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative

- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

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

For authorized representatives:

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

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

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

Street address for delivery service:

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

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892