



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

Release Number: **202016028**
Release Date: 4/17/2020
UIL: **501.00-00, 501.03-30, 501.36-01**

Date: January 23, 2020

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.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Stephen A. Martin
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: November 14, 2019

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

- B = Organization
- C = State
- D = Date
- E = Name
- F = Date
- G = Number
- H = Number

UIL:

- 501.00-00
- 501.03-30
- 501.36-01

w dollars = Amount
 x dollars = Amount

Dear _____ :

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

Issues

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

Facts

B, which is an IRC Section 501(c)(3) corporation that develops affordable housing, and makes investments in low income communities, developed E. B owns the licensing rights to E, which is a cloud-based data collection and monitoring system platform for energy related investments. B subsequently formed you under the C nonprofit statute to operate E on D. Your purpose was then amended on F to read that you are organized and are to be operated exclusively for charitable and educational purposes within the meaning of Section 501(c)(3) of the United States Internal Revenue Code.

Your mission consists of collecting, monitoring, analyzing, and sharing energy data through E in order to:

- Reduce the environmental impact of housing,
- Decrease the cost of building and maintaining housing,
- Improve the operational efficiency,
- Develop scientific knowledge of best practices for energy efficiency and building systems operations.

To accomplish your mission, you will make E available to a network of members. E, which uses off-the-shelf hardware will be installed at your members' sites to acquire energy related data from your members' building management systems, HVAC components, electrical panels, and other energy devices. The data will be collected for each member in a single location so that an analyst employed by you can provide regular monitoring of the systems and help local staff identify and address system issues as well as help the member optimize building energy performance. Furthermore, your members will use the data to improve energy outcomes, control operating expenses, and plan new energy system investments in their portfolio. Through E, you will also help members use existing energy systems more effectively and efficiently to reduce overall energy costs while also reducing maintenance and replacement costs.

Per your bylaws, you will have two classes of members comprised of member institutions and associate members. Your initial member institution is B and membership institutions must generally be IRC Section 501(c)(3) organizations while associate members are other developers of affordable housing projects that include for-profit businesses. Furthermore, only developers of affordable housing projects that serve low-and moderate-income households that qualify for certain state programs and the Internal Revenue Code Section 42 low- income housing tax credit program will be eligible for your membership.

You will provide the following services to all members:

- Installation of E on-site hardware at their affordable housing developments;
- Web-based data collection and data analysis as well as monthly reports;
- Guidance of an energy analyst to assist the member understand the data gathered and implement cost-saving and efficiency-improving measures.

A paid staff will conduct your services in close contact with property managers and maintenance staff at your members' affordable housing developments. You will employ a team of analysts and support personnel who will work closely with the members to support the analysis of data as well as respond to system alerts.

You expect the cost to operate E be paid by members through an annual fee that includes a fixed amount and an amount based on the member's usage of E. The fixed amount of w dollars per year includes the license to use E and the service agreement as well as the ongoing cost of maintaining your software, organizational overhead costs and, field costs to troubleshoot issues. The fee based on usage will be a per site fee. A "site" is a development, which typically includes multiple housing units. The annual per site fee will start at x dollars for a site with G housing units, with no minimum number of sites. Furthermore, B will contribute E and related intellectual property to you in exchange for a note payable based on a determination of the fair market value of E based on the expected member fees you will collect for the use of E.

Membership fees will be your primary source of support although you have received one grant and plan to continue to apply for additional grants. Expenses consist of salaries, marketing expenses, and operational support.

You have a s -person board including B's legal counsel and H employees of B. You indicated that you will benefit from your relationship with B to connect with affordable housing developers and managers.

Moreover, you stated that the use of E will decrease the capital costs and maintenance costs associated with the construction and operation of affordable housing by reducing demand and stress on building systems, which increases the life span of those systems. This will then reduce the reliance on government support and subsidies to fund construction and management of affordable housing. Lower capital cost for existing affordable housing, in turn, makes more resources available to affordable housing developers for new affordable housing projects, by improving energy efficiency, E will also help reduce the environmental impact of affordable housing and make affordable housing more economically and environmentally sustainable.

Finally, you wrote that through the provision of E and related services, you will:

- Aid the poor and the distressed by making housing, a critical necessity of life, more affordable and available,
- Educate affordable housing developers, owners, operators and the general public about best practices in energy efficient operations using the data that results from the use of E.

Law

Internal Revenue Code Section 501(c)(3) provides for exemption for organizations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 513(a) of the Code describes an “unrelated trade or business” as any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under Section 501 Code.

Section 513(c) of the Code provides that a “trade or business” includes any activity which is carried on producing income from the sale of goods or the performance of services. Where an activity carried on for-profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

Treasury Regulations Section 1.501(c)(3)-1(a)(1) states that 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) states that in order to meet the operational test, an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. Section 1.501(c)(3)-1(e)(1) states an organization may meet the requirements of Section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in Section 513 of the Code. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under Section 501(c)(3) of the Code, even if it has certain religious purposes, its property is held in common, and its profits do not inure to the benefit of individual members of the organization.

In Rev. Rul. 72-369, 1972-2 C.B. 245, an organization was formed to provide managerial and consulting services for section 501(c)(3) organizations to improve the administration of their charitable programs. The organization enters into agreements with unrelated section 501(c)(3) organizations to furnish managerial and consulting services on a cost basis. This revenue ruling stated that:

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test,' the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for-profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court found that the "commercial hue" permeating the organization was reflected in its charter provisions, which was dedicated to the securing of "educational and scientific advancements of business methods" so that merchants might "successfully and profitably conduct their business." The organization's activities were largely animated by this commercial purpose. The Supreme Court held that the presence of a single nonexempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the organization's sole activity was to offer consulting services on rural-related policy and program development to limited-resource organizations for a fee. The organization did not limit its clientele to organizations which were themselves organizations described under Section 501(c)(3) of the Code, but only to organizations which were either nonprofit or exempt. The fees charged were set at or close to cost but were not less than its full cost of providing its services. The organization's financing did not resemble that of the typical organization described under Section 501(c)(3) of the Code. The organization had not solicited or received voluntary contributions from the public. Its only source of income was from fees for services, and those fees were set high enough to recoup all projected costs and to produce a net profit. It failed to show it would not be in competition with commercial enterprises. The provision of managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for-profit. The Court held that the organization's primary purpose was not educational, scientific, or charitable, but rather was the conduct of an ordinary commercial consulting enterprise in competition with other commercial firms. The organization was not operated exclusively for tax-exempt purposes within the meaning of Section 501(c)(3) of the Code.

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), gaff’s 12 Cl. Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under Section 501(c)(3) of the Code. The organization was operated for a substantial nonexempt purpose rather than for the exempt purposes of providing educational and charitable services to unwed mothers and children. The court stated that “adoption services do not in and of themselves constitute an exempt purpose.” The court found that the adoption agency was operated in a commercial manner. The agency’s operation was funded completely by the fixed fees charged to adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. Ultimately, the agency was not entitled to tax exempt status on basis that it was “not distinguishable from commercial adoption agency.” The court found that the adoption agency’s primary goal was furthering of a “business purpose” rather than the advancement of an educational or a charitable purpose.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the court of appeals upheld a Tax Court decision stating that the organization operated its restaurants and health food stores for a substantial commercial purpose, and it did not qualify for exemption under Section 501(c)(3) of the Code. The appellate court provided the factors that may indicate a substantial nonexempt commercial purpose. These factors include:

- Direct competition with other for-profit businesses
- Existence and amount of annual and accumulated profits
- Competitive pricing policies and lack of below-cost pricing
- Use of promotional materials to enhance sales
- Advertising of goods and services
- Lack of plans to solicit charitable contributions
- Hours of operation that are competitive with other commercial enterprises

In Airlie Foundation v. Internal Revenue Service, 283 F. Supp. 2d 58 (D.D.C., 2003), due to the commercial manner in which the organization conducted its activities, the court held that the organization was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. The court found that the organization operated its conference center in a manner consistent with that of a commercial business. “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.”

Application of law

You do not meet the requirements for recognition of tax exemption under IRC Section 501(c)(3) because you do not operate for a tax-exempt purpose under Section 501(c)(3). Your sole activity is the conduct of a trade or business for the production of income. You conduct no other activity aside from providing the right to use the monitoring system platform, E, and related services to your member clients to optimize energy usage for a fee in order for them to reduce energy costs. Your clients are comprised of affordable housing developers and organizations whether operated on a for-profit basis or a non-profit basis who are able and willing to pay your fees. Your fees include a fixed amount and an amount based on the member’s usage of E. Compensated employees conduct your operations on a regular and continuous basis. Based on Treas. Reg. Section 1.501(c)(3)-1(e)(1), you do not meet the requirements for recognition of tax exemption under Section 501(c)(3)

because you are operated for the primary purpose of carrying on an unrelated trade or business, as defined in IRC Section 513.

In addition, you do not meet the operational requirements for recognition of tax exemption under IRC Section 501(c)(3) and you fail the operational test as described in Treas. Reg. Section 1.501(c)(3)-1(a)(1). You are not operating per Treas. Reg. Section 1.501(c)(3)-1(c)(1) because you operate for a substantial nonexempt purpose because more than an insubstantial part of your activities is not in furtherance of an exempt purpose.

You are like the organization described in Rev. Rul. 72-369, 1972-2 C.B. 245 because you are operating in a commercial manner. The organization described in the revenue ruling was conducting commercial services only for organizations exempt under IRC Section 501(c)(3). Your activities consist of the provisions of E and related services to optimize energy usage to any individual or organization who is able to pay your fees. The facts that you believe you are improving energy efficiency in housing developments to reduce the environmental impact of housing, including affordable housing units, and making housing more sustainable, as well as educating housing developers, owners, operators, and the general public about best practices in energy efficient operations, are not sufficient to characterize the activity as charitable.

In Better Business Bureau of Washington, D.C., Inc., the United States Supreme Court provided that “the presence of a single [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes.” Since your primary purpose is the conduct of an unrelated trade or business for-profit, by providing the use of E and related services to members for a fee based on their consumption to optimize their energy usage, you serve a substantial nonexempt purpose, which precludes tax exemption under IRC Section 501(c)(3).

You are operated for a substantial nonexempt purpose similar to the organization described in Airlie Foundation v. Internal Revenue Service, supra. Applying the factors stated in Airlie Foundation as demonstrating a substantial nonexempt commercial purpose, your provision of E, which is a monitoring system platform, and related services for a fee directly competes with other providers of similar services. Like a commercial business, your services are generally available to any individual or organization who are affordable housing developers willing to pay your fees.

In addition, like the organization in Arlie, you do not limit members to organizations that are described under IRC Section 501(c)(3). Another factor considered in assessing the commercial manner of operations is the extent and degree of below cost services provided. You indicated that you provide services to members and that the cost to operate E is expected to be paid by members through an annual fee that includes a fixed amount and an amount based on the member’s usage of E. The fixed amount includes the license to use E, the service agreement as well as the ongoing cost of maintaining the software, organizational overhead costs and field costs to troubleshoot issues. In addition, the fee based on usage will be based on a per site fee and the more units there are, the higher the fee. Thus, you meet most of the factors indicated by the courts as operating for a substantial nonexempt purpose.

You are like the organization described in Living Faith, Inc. v. Commissioner, supra, where the court of appeals upheld a Tax Court decision stating that the organization operated its restaurants and health food stores for a substantial commercial purpose. You also meet most of the factors provided by the appellate court in Living Faith, Inc. as exhibiting a substantial nonexempt commercial purpose. Your provision of E and related services to member clients for a fee is in direct competition with other for-profit providers of similar services. The

financial data you submitted shows that your revenue is from fees for services rendered. You are not supported by gifts, grants and charitable contributions from the general public. Your expenses consist of salaries, marketing expenses, and operational support expenses for members. You are operated in a manner indistinguishable from a commercial enterprise. By operating in the manner described, you are furthering a substantial nonexempt purpose.

You are like the organization described in Easter House v. United States, supra, where the court determined that the organization was not exempt because its conduct of adoption services activity was in furtherance of a nonexempt commercial purpose. Similar to adoption services, your provision of E and related services to member clients for a fee do not in and of themselves constitute an exempt purpose. Your sole activity is to render services to your member clients in exchange for a fee. Your activities are not carried out to accomplish a tax-exempt purpose under IRC Section 501(c)(3).

You are comparable to the organization described in B.S.W. Group, Inc. v. Commissioner, supra, where the court indicated that the provision of managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for-profit. Your activities constitute the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for-profit. Like a for-profit business, your revenues are from fees paid by your member clients for the use of the monitoring system platform, E and related services. While charitable institutions often do provide services to individuals, the cost is generally subsidized by contributors who do not receive anything in return. You stated that you expect to be spending 100% of total time and resources on activities that are supported by the members' fees. This illustrates that your fees however, are set high enough to recoup all projected costs. Thus, based on the totality of the facts and circumstances, you are operated for the substantial nonexempt purpose.

Conclusion

Based on the facts, we conclude that you are not in compliance with the above stated laws and precedence. You do not meet the operational test under IRC Section 501(c)(3) because the manner in which you operate is commercial. Accordingly, you do not qualify for exemption as an organization described in Section 501(c)(3). Contributions to you are not deductible under IRC Section 170.

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.

If you don't agree

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

- Your name, address, employer identification number (EIN), and a daytime phone number
- A statement of the facts, law, and arguments supporting your position
- A statement indicating whether you are requesting an Appeals Office conference

- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization or your authorized representative
- The following declaration:

For an officer, director, trustee, or other official who is authorized to sign for the organization:
Under penalties of perjury, I declare that I have examined this request, or this modification to the request, including accompanying documents, and to the best of my knowledge and belief, the request or the modification contains all relevant facts relating to the request, 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 they haven'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 gave us a basis to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't given us a basis for reconsideration, we'll send your case to the Appeals Office and notify you. You can find more information 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 later because the law requires that you use the IRC administrative process first (IRC Section 7428(b)(2)).

Where to send your protest

Send your protest, Form 2848, if applicable, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Mail Stop 6403
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Mail Stop 6403
Cincinnati, OH 45202

You can also fax your protest 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 they received it.

You can get the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676). If you have questions, you can contact the person listed at the top of this letter.

Contacting the Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or if you've tried but haven't

been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements