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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201411037**
Release Date: 3/14/2014
Date: **December 18, 2013**

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.00-00; 501.03-00; 501.03-20; 501.00-00

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.

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,

Kenneth Corbin
Director, Exempt Organizations

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

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: **October 25, 2013**

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = Officer
C = $$
D = $$
M = Address
O = State
P = Date

UIL:

501.00-00
501-03-00
501.03-20
503.00-00

Dear :

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

Issues

1. Do your earnings inure to the benefit of B, therefore disqualifying you from exemption under section 501(c)(3) of the Code? Yes, for the reasons described below.

Facts

You were formed as a corporation on date P in the State of O. You filed Form 1023 requesting recognition of exemption under section 501(c)(3) of the Code as a church under sections 509(a)(1) and 170(b)(1)(A)(i). You indicated that your purpose is to operate a religious congregation. You hold daily prayer services, weekly worship services, and services on holy days. Your members also study religious law every day, using the same space as a study hall. You stated you have 40 members.

You lease a building located at M, which is owned by B who is an officer/president. You intend to use this building as a facility where you will regularly conduct your activities. You do not currently have services at M; rather, your services are held at B's private residence. There is no indication that you considered any buildings other than the building at M to serve as your facility.

You have been renting the facility located at M for over a year in the amount of $C per month. The rental amount increased by 20% after the first year. The rental amount will continue to increase annually; approximately 17% the second year and 14% the third year. Furthermore, the current annual rent is greater than the yearly rent as projected in an appraisal of the facility you submitted that anticipates considerable capital improvements. Your rental agreement will terminate five years after the lease commenced. You state that the reason why the rental amount is increasing annually despite the fact that the building is unusable is because market value rents generally increase.

The lease requires you to have a substantial amount of liability insurance. You also are required to pay all utilities.

The facility located at M is a one story brick warehouse. It is currently unusable and will require substantial renovations totaling $D. You submitted a contractor's cost estimate for proposed renovations to the approximately 30% of the current square footage of the facility that will be used for your purposes. The cost for the improvements is broken down and includes: interior framing, insulation, sheet rock, painting, flooring, windows and doors, electric work and fixtures, HVAC, plumbing and fixtures, tile, roof repair, brick pointing, cement, filing and permits, and insurance. You are raising funds to make capital improvements to the building.

You submitted an appraisal of the facility located at M. The appraisal states that there is ample deferred maintenance present rendering the building unfit for warehouse use in its current condition. There are broken exterior windows, several of the garage doors are broken and sections of the concrete slab floor are pitted and gouged. The brickwork needs pointing; the ceiling is missing in sections and needs to be replaced. The structural integrity of the roof is unknown. Some of the plumbing is inoperative. The interior heat is provided by several mounted space heaters, but it is unknown if they are operative. The property located at M was used as a public garage and later a motor vehicle repair shop. The appraisal assumes that the current lease is for the entire building. Furthermore, it states that the determination of the prospective market rent for the renovated facility assumes that a new lease will be executed to include only the portion of the facility that is being renovated. Additionally, the appraisal states that concessions may be made in the new lease that incorporate some level of rebate on your overall expense in renovating the property. However, no specific provisions of such a new lease were provided beyond these speculations.

The financial data you provided indicates that during your first year of operations 81% of your revenue was used to pay for occupancy expenses. During your second year of operations you anticipate your occupancy expenses will consist of 86% of your total revenue.

Law

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

Section 1.501(c)(3)-1(a)(1) of the regulations 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.

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) defines the words "private shareholder or individual" in section 501 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 is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

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.

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

In Western Catholic Church v. Commissioner, 73 T.C. 196 (1979), the Tax Court held that although separate requirements, the "private inurement" test and the "operated exclusively for exempt purposes" test often overlap substantially.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the court found that although the organization did serve religious and charitable purposes, it existed to serve the private benefit of its founders, and thus failed the operational test of section 501(c)(3). Control over financial affairs by the founder created an opportunity for abuse and thus the need to be open and candid, which the applicant failed to do.

In New Dynamics Foundation v. United States, 70 Fed.Cl. 782 (2006), the petitioner brought suit to challenge the denial of its application for exempt status. The court found that the administrative record supported the Service's denial on the basis that the organization operated for the private benefit of its founder, who had a history of promoting dubious schemes. The organization's petition claimed that the founder had resigned and it had changed. However, there was little evidence of change other than replacement of the founder with an acquaintance who had no apparent qualifications. The court resolved these questions against the petitioner, who had the burden of establishing it was qualified for exemption. If the petitioner had evidence that contradicted these findings, it should have submitted it as part of the administrative process. "It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant".

Application of Law

You are currently leasing an unusable facility from your president. A substantial portion of your revenue is used to pay the rent, insurance and utilities on this facility. In addition, you intend to make significant capital improvements to this building. You did not consider any other alternative locations for your facilities. There is no evidence that the facility was selected only after you completed a comparative review of available facilities in the relevant marketplace. The terms of your lease were not made at arm's length. Such a benefit to a private individual or shareholder is inconsistent with operation exclusively for an exempt purpose as described in section 1.501(c)(3)-1(c)(2) of the regulations. .Although the lease agreement states that the current lease amount is reasonable, this cannot be substantiated or justified. The inherent value of a lease is contingent upon the lessor's ability to make use of the property they are leasing. The facility is not usable; therefore, you are not realizing any benefit by paying for it. Because the building would be unrentable were it not for you, you are benefiting B by providing a source of revenue that otherwise would not exist. B is receiving a substantial benefit by gaining revenue for an unusable building. The current amount of rent received by B exceeds the amount projected in the appraisal after completion of the capital improvements. In addition, B will benefit from the increase in property value resulting from the significant capital improvements made to the facility which B owns. The decision in Old Dominion Box Co. v. United States established that operating for the benefit of private parties constitutes a substantial non-exempt purpose. Furthermore, this substantial benefit demonstrates that you are serving the private interests of B rather than a public interest as required by section 1.501(c)(3)-1(d)(1)(ii) of the regulations. You are not operating exclusively for one or more purposes specified in section 501(c)(3) of the Internal Revenue Code or section 1.501(c)(3)-1(a)(1) of the regulations.

As indicated in Better Business Bureau, supra, 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. Your lease and planned improvement of M is a substantial, non-exempt purpose, which precludes you from qualifying for exemption.

As in Western Catholic Church v. Commissioner, supra, although separate requirements, the "private inurement" test and the "operated exclusively for exempt purposes" test often overlap substantially. Likewise, in Basic Bible Church v. Commissioner, it was determined that even if an organization serves exempt purposes, it will fail the operational test if it serves the private benefit of its founders. In your case, you hold religious services in B's home. However, by paying B to lease a facility that is unusable, you are serving the private interests of your founder, and thus fail the operational test of section 501(c)(3).

You were formed for the private benefit of B through your lease and through planned substantial capital improvements to the building owned by B. Although you may conduct some exempt functions, as in the above-cited case of New Dynamics Foundation v. United States, you have not demonstrated that your operations exclusively further exempt purposes.

Applicant's Position

You intend to enter into a long term lease for approximately 30 or 40 years. You will not enter into such lease until the project is completed. You stated by the time you finish your long lease the depreciated value of the improvement would be zero, therefore causing no private inurement.

Service Response to Applicant's Position

Although you indicated you might enter into a 30 to 40 year lease, you have not yet entered into such lease. You do not plan on entering into such lease until the renovations you will pay for are completed. You did not provide the terms or rental fees of the planned lease agreement. You indicated that the 30 to 40 year lease would depreciate the value of the improvements to zero. However, because of the current state of the building and the value of the proposed renovations, it is impossible to say that the owner will not benefit from the improvements when the proposed lease expires or terminates. The terms of your current lease indicate the amount you pay B exceeds the appraised value including reductions for capital improvements. Because the owner of the property is also your President, B, the payments constitute inurement to B.

Conclusion

Based on the above facts and law, you do not qualify for exemption under section 501(c)(3) of the Code. Your net earnings inure to the benefit of B, causing you to be precluded from exemption under section 501(c)(3) of the Code. You failed to demonstrate that you meet the operational test as you do not operate exclusively for an exempt purpose under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office.
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.*

Types of information that should be included in your appeal can be found on page 1 of Publication 892, under the heading "Filing a Protest". The statement of facts must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative,* if you have not already done so. You can find more information about representation in 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 appeal 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 the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance

You may 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,

Kenneth Corbin
Acting Director, Exempt Organizations
Rulings and Agreements

Enclosure: Publication 892