

INTERNAL REVENUE SERVICE
District Director

Department of the Treasury

915 Second Avenue, MSW 540
Seattle, Washington 98174

Date: JUL 03 1999

Employer Identification Number:

Case Number:

Person to Contact:

Telephone Number:

Dear Applicant:

We have considered your application for exemption for Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code.

FACTS:

The information submitted shows that you were incorporated under

Section Two of your Articles of Incorporation state that the specific purpose of your organization is "specializing in developing functional, and viable programs and projects in the areas of: Affordable housing development, Transitional living programs, Alternative living programs, Cultural arts/media communication and Affordable paralegal services." Section Four, subsection (a) indicates that the corporation is "organized and operated exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code."

The [redacted] states that the corporation is "dedicated primarily to the promotion of the general welfare and economic development of all income groups residing in [redacted]. Services to be provided to the community include tenant training and education, affordable housing, lease/rental, purchase options, default notice aide, FHAVA foreclosure prevention assistance, pre-approved FHAVA financing, down payment and loan closing cost assistance. Other activities will be providing Real Estate Management seminars, literacy programs, supervision of the rehabilitation of HUD properties (203k or 203B) and the promotion of new construction in deteriorated areas. Possible "clients" of the organization are listed as the "low, moderate and even high-income families to senior citizens, veterans, under employed, underprivileged, single parents, individuals with good incomes, but lack down payment or loan closing costs."

It is indicated that [redacted] with the individuals involved providing real estate services, mortgage services and loan processing services, etc.

The financial data provided indicates that the majority of organization income will come from Gross Investment Income. Your letter dated [redacted] states that "most of the real estate investment income is from the sale or control of the real estate that we purchase and then sell for a profit."

The organization had a number of properties (at least [redacted]) transferred to it from another corporation before the organization was an approved corporate entity.

ISSUE:

Does the organization qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code?

LAW:

Section 501(c)(3) of the Internal Revenue Code describes certain organizations exempt from income tax under section 501(a) and reads in part as follows:

" (3) Corporations, and any community chest, fund, or foundation 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 (but only if no part of its activities involve the provision of athletic facilities or equipment), no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on legislation, (except as otherwise provided in subsection (h), and which does not participate in, or intervene in (including publishing or distribution of statement), any political campaign on behalf of any candidate for public office."

Section 1.501(c)(3)-1(a)(1) of the income tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such sections. If any organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(2) defines "charitable" to include the relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations states 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). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(e)(1) of the Income Tax Regulations states that an organization that has as its primary purpose the carrying on of a trade or business may not be exempt.

Section 513 of the Internal Revenue Code defines a trade or business as "...any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) 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..."

In Better Business Bureau v. U.S. 279 (1945), the Supreme Court considered the qualifications for exemption of the Better Business Bureau of the District of Columbia as a charitable organization. Despite certain educational purposes, the organization did not qualify for exemption under Internal Revenue Code section 501(c)(3). "The presence of a single non-exempt purpose, ...substantial in nature will destroy the exemption regardless of the number of or importance of truly exempt purposes."

See Church of Boston v. Commissioner, (1978) 71 T.C. 102; Colorado State Chiropractic Society, (1989) 93 T.C. 487; Best Lock Corporation, (1959) 31 T.C. 1217; St. Louis Science Fiction

Limited v. Commissioner, T.C. Memo 1985-162 and Minnesota Kingsmen Chess Association Inc. v. Commissioner, T.C. Memo 1983-495; all of these court cases hold that the presence of a single non-exempt purpose and substantial non 501(c)(3) activities results in the loss of exemption despite the presence of other exempt purposes.

In Greater United Navajo Development Enterprises Inc., 74 T.C. 69, Dec. 36,890/Aaff'd CA-9 (unpublished opinion), 12-23-81. A corporation organized to assist the poor of the Navajo Nation did not qualify as an exempt organization because it was not operated exclusively for exempt purposes. Through its agent, a wholly owned subsidiary corporation, the corporation engaged in non-charitable, profit-motivated activities, leading to a finding that non-exempt business activities were more than an insubstantial part of the corporation's total activities.

In Make a Joyful Noise, Inc., 56 TCM 1003, Dec. 45,405 (M), T.C. Memo 1989-4, an organization did not satisfy its burden of proving that the Service's revocation of its tax-exempt status under Internal Revenue Code section 501(c)(3) was erroneous. The organization was not regarded as "operated exclusively" for one or more exempt purposes because it did not engage primarily in activities which accomplished an exempt purpose. Its primary activity was the management and operation of bingo games for other exempt organizations, a trade or business activity that did not qualify as an exempt activity under section 501(c)(3) of the Internal Revenue Code.

ANALYSIS:

Preceding Code sections, Regulation sections and court cases describe the criteria under which an organization may be exempt under section 501(c)(3) of the Internal Revenue Code. They also describe the basis for which organizations are denied exemption because they were not organized and operated exclusively for section 501(c)(3) purposes.

The organization is the [REDACTED] that provided real estate services to the public. The organization continues to provide the same variety of services (real estate, loan, ...) to the community at large. As indicated in the application, the organization "clients" are not limited to a charitable class. The provision of these real estate services in this instance could be considered as the operation of a trade or business.

In addition, your response dated [REDACTED] states that real estate is purchased and sold for profit. The proceeds from these sales as well as rental income constitute the main source of the organization income (gross investment income). The activity involved in the management and maintenance of these properties as well as the sales activities can also be considered as the operation of a trade or business.

These activities constitute a substantial portion of the organization's activities. Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations states that an organization must be both organized and operated exclusively for one or more exempt purposes to be an exempt organization. Section 1.501(c)(3)-1(e)(1) states that an organization that has as its primary purpose the carrying on of a trade or business may not be exempt. As such, it is not apparent that the organization is operated exclusively for exempt purposes but rather engaged in the operation of a trade or business.

Court cases such as Better Business Bureau, Church of Boston, Colorado State Chiropractic Society, Best Lock Corporation, St Louis Science Fiction Limited and Minnesota Kingsmen Chess Association all hold that the presence of a single non-exempt purpose and substantial non 501(c)(3) activities result in the loss of exemption despite the presence of other exempt purposes. Greater United Navajo Development Enterprises, Inc and Make a Joyful Noise both dealt with organizations engaged in the operation of a trade or business as their primary activity which the courts ruled did not qualify as exempt activity and therefore the organization did not qualify as an Internal Revenue Code section 501(c)(3) organization.

CONCLUSION:

The organization is not operating exclusively for an exempt purpose pursuant to sections 1.501(c)(3)-1(c)(1) and 1.501(c)(3)-1(e)(1) of the Income Tax Regulations.

It is the opinion of the Internal Revenue Service, based on the information submitted, that you do not meet the requirements for exemption as a charitable organization described in section 501(c)(3) of the Internal Revenue Code because you are not organized and operated exclusively for purposes within section 501(c)(3).

If you are in agreement with this proposed determination, we request that you sign and return the enclosed agreement, Form 6018 (Consent to Proposed Adverse Action). Please note the instructions for signing on the reverse side of the form.

If you do not agree with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for a hearing should include a written appeal giving the facts, law and any other information to support your position, as explained in the enclosed Publication 892. You will then be contacted to arrange a date for a hearing. The hearing may be held at the office of Regional Director of Appeals or, if you request, at a mutually convenient District Office. A self-addressed envelope is enclosed.

If we do not hear from you within 30 days from the date of this letter, and you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies and will then become our final determination.

Section 7428(b)(2) of the Internal Revenue Code provides in part that "declaratory judgment of decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



Steven A. Jensen
District Director

INTERNAL REVENUE SERVICE
District Director

Department of the Treasury

915 Second Avenue, MSW 540
Seattle, Washington 98174

Enclosure:
Publication 892
Form 6018
Envelope