

Internal Revenue Service
Director, Exempt Organizations
Rulings and Agreements

Department of the Treasury
P.O. Box 2508 - EODQA Rm. 7008
Cincinnati, OH 45201

Date: [REDACTED]

Employer Identification Number:
[REDACTED]

Contact - I.D. Number:
[REDACTED]

Contact Telephone Numbers:

[REDACTED] Phone
[REDACTED] FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice

[REDACTED]

Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If 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. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgment or 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 we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

[REDACTED]

Director, Exempt Organizations

Enclosures: 3

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Facts

You were incorporated as a non-profit corporation in the State of [redacted] on [redacted]. Your Articles of Incorporation state that you were formed exclusively to develop, on a non-profit basis, a housing project for persons of low income.

You submitted a copy of the First Amended and Restated Agreement of Limited Partnership (the "Partnership Agreement"), and supplemental agreements of [redacted] (the "Partnership") that operates [redacted] affordable apartments for low-income seniors known as [redacted] (the "Project") at [redacted]. You state that all units will be rented to seniors whose income below [redacted] % of the area median income.

The Partnership Agreement shows the status, the percentage interest, and the capital contribution of each Partner as follows:

| <u>Names</u> | <u>Status</u> | <u>% Interests</u> | <u>Capital Contributions</u> |
|--------------|-----------------|--------------------|-------------------------------|
| [redacted] | General Partner | [redacted] % | \$ [redacted] or [redacted] % |
| [redacted] | Limited Partner | [redacted] % | \$ [redacted] or [redacted] % |
| [redacted] | Limited Partner | [redacted] % | \$ [redacted] or [redacted] % |
| Total | | [redacted] % | \$ [redacted] |

Section 1.06 of the Partnership Agreement states that, in part, it was formed for acquiring, owning, developing, constructing, rehabilitating, leasing, managing, operating, and selling property and operating [redacted] % of units in compliance with section 42 of the Code during the compliance period.

The General Partner is your wholly owned for-profit subsidiary. The

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Articles of Incorporation of your subsidiary state that, in part, it was formed to purchase, lease, rent, exchange, or otherwise acquire real estate property and any interest therein.

Neither the Articles of Incorporation of the General Partner nor the Partnership Agreement is limited to exclusively charitable purposes described under section 501(c)(3) of the Code.

[REDACTED] and [REDACTED] (" [REDACTED] ") referred to as the Limited Partners. The [REDACTED] (" [REDACTED] ") is the [REDACTED] Agent, which is also the general partner of [REDACTED] and [REDACTED].

[REDACTED] is the Developer, the Guarantor, and the Administrator of the Project. Your board members are either board members of [REDACTED] or are approved by [REDACTED]. The Property Manager is [REDACTED] (the "Manager"). The supportive service provider is [REDACTED] ([REDACTED]). [REDACTED], [REDACTED], and the Manager are covered by the [REDACTED], which holds a group exemption under section 501(c)(3) of the Code.

You purchased the property from [REDACTED] (the "Seller") for \$ [REDACTED]. The Seller granted you a Purchase Money Note and Mortgage for \$ [REDACTED]. The balance of \$ [REDACTED] was paid at the acquisition closing out of the first installment of capital contributions from the Limited Partners. You state, in your correspondence to the Service, that the General contribution of \$ [REDACTED] is comprised in part by a \$ [REDACTED] difference in the appraised value of the site and the \$ [REDACTED] actual sale price, and the remaining \$ [REDACTED] development fee that was pledged back to the Project to create Operating and Replacement Reserves.

You signed the Nominee Agreement and the Assignment and Assumption Agreement, transferring all beneficial and equitable interest to the Partnership.

The Nominee Agreement states, in part, the following:

- (1) You retain legal title of the Project as nominee solely for the benefit and on behalf of the Partnership.
- (3) The beneficial and equitable interest has been transferred to the Partnership.
- (4) You act solely as an agent on behalf of the Partnership in all acts with respect to the Partnership.
- (5) The Partnership is the beneficial and equitable owner of

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the Project.

(7) You agree to perform all acts reasonably requested by the Partnership in regard to or arising from ownership, management, or operation of the Project.

(8) You covenant and warrant that you are the legal owner.

The Assignment and Assumption Agreement shows that, in consideration of [REDACTED] dollars and other good and valuable consideration, you (the "Assignor") grant, bargain, sell, assign, and transfer unto the Partnership (the "Assignee") and the Assignee assumes all obligations under any notes, mortgages, leasehold interests and all documents executed by the Assignor in connection with the financing of the Project.

The Partnership Agreement shows that you have no role in the operation of the Partnership. You state, on page 8 of your application, that the Partnership undertakes all operations, and that you have no financial activity.

You state in the correspondence to the Service, that the structure of the Partnership has been established to take advantage of the maximum real estate tax abatement, under section 420(C) of the Real Estate Property Tax Law of the State of [REDACTED], that is available to low-income housing tax credit projects that are owned by a limited partnership. You also state that there is not much for you to do from the standpoint of operations as the sole owner of the General Partner, and that you are a separate organization and should be treated separately from the General Partner. You state, however, that you have the flexibility to act as needed and as such, all of your activities, income, and earnings should be exempt. You state to date you have not been requested to take any action on behalf of the Partnership, although you have covenanted and agreed to do so as requested, and such covenant remains in full force and effect.

You state that you maintain your corporate status as a not-for-profit corporation and a housing development fund corporation, and you will take all necessary steps to maintain a good standing status in order for the Project to qualify for the real estate exemption. You state that by enabling the Project to receive a real estate tax exemption, you are performing a charitable act.

Law

Section 501(c) (3) of the Code provides for the exemption from federal

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income tax of organizations organized and operated exclusively for charitable purposes.

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

In Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 438 (1943), the court holds that for federal income tax purposes, a parent corporation and its subsidiary are separate taxable entities so long as the purposes for which the subsidiary is incorporated are the equivalent of business activities or the subsidiary subsequently carries on business activities.

In Britt v. United States, 431 F. 2d 227, 234 (5th Cir. 1970), the court emphasizes that where a corporation is organized with the bona fide intention that it will have some real and substantial business function, its existence may not generally be disregarded for tax purposes.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, 283 (1945) the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, would destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

Discussion

Section 501(c)(3) of the Code sets forth two main tests for qualification for exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). You meet the organizational test; however, you must also satisfy the operational test. The key requirement is that an organization be operated exclusively for one or more exempt purposes.

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You seek exemption under section 501(c)(3) of the Code based on the activities of the Partnership that operates an elderly low-income housing project. You are not a partner in the Partnership. A for-profit corporation of which you own 100% of the interest is the General Partner in the Partnership.

The Service's main concerns are whether you conduct any charitable activity to qualify for exemption under section 501(c)(3) and whether your activity serves private benefits. The central question is whether acting as an agent for the Partnership to take advantage of the real estate exemption under section 420(C) of the Real Estate Property Tax Law of the State of [REDACTED] is considered a charitable activity under section 501(c)(3) of the Code. The next question is whether the activities of the General Partner can be considered your activities for purposes of determining your qualification for exemption under section 501(c)(3) of the Code.

You are organized for a single housing project. You signed the Nominee Agreement and the Assignment and Assumption Agreement to transfer all beneficial and equitable interest to the Partnership. You retain only the legal title to the property. The Nominee Agreement states that you act solely as an agent on behalf of the Partnership and agree to perform all acts reasonably requested by the Partnership regarding or arising from an ownership, management, or operation of the Project. However, the Partnership Agreement and the supplemental agreements reveal that you have no role in the operation of the Partnership.

Sponsoring a low-income housing project that meets the requirements under section 42 of the Code and the rent restriction alone does not necessarily satisfy section 501(c)(3) of the Code. Not all low-income housing projects qualify for exemption under section 501(c)(3) of the Code. Section 1.06 of the Partnership Agreement does not explicitly state that charitable purposes take precedence over profit motives. Unlike section 501(c)(3) of the Code, section 42 does not require that charitable purposes be met. As owners of a low-income housing tax credit project, the Partnership and its partners are obligated to meet the requirements under section 42, they, however, are not obligated to operate within the meaning of section 501(c)(3). The for-profit entities that own and operate the Project have economic goals strikingly different from, and often in conflict with, the charitable goal of providing low-income housing.

As demonstrated in Better Business Bureau, a single function may actually achieve more than one purpose. If one purpose is non-exempt and substantial in nature, it destroys the exemption regardless of the number and importance of exempt purposes. Regardless of the fact that you may cause the Partnership to provide housing to persons regarded as poor and distressed, obtaining a loan to acquire the property, transferring the property and the outstanding loan to the Partnership,

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holding nominal title to the property and acting as an agent on behalf of the Partnership, and serving as an owner of the General Partner are not exempt activities described within section 501(c)(3). This is so, even though you have a close relationship with other section 501(c)(3) organizations.

You are not a partner in the Partnership and have no managing authority over the affairs of the Partnership. You have not demonstrated that you conduct any charitable activity because you have no resources to carry out your charitable purposes; you are virtually a shell; you have no paid employees; and you conduct no activities yourself. Therefore, you have not established that you are operated exclusively for charitable purposes as defined in section 1.501(c)(3)-(1)(c)(1) of the Regulations.

A corporation is a separate entity, a legal being having an existence separate and distinct from that of its owner. For federal income tax purposes, a parent corporation and its subsidiary are separate taxable entities. As you agreed in the correspondence to the Service, you are a separate corporation and should be treated separately from the General Partner. The submitted information also establishes that the General Partner has a separate corporate existence and business purpose from you. Therefore, the General Partner's corporate existence may not be disregarded for federal income tax purposes and its activity cannot be attributed to you. Since you have no charitable activity of your own, you may not use activities of the Partnership, the General Partner, or to solely establish your basis of exemption as indicated in Moline Properties and Britt.

Conclusion

Under the facts presented, the Service concludes that you are not operated exclusively for charitable purposes because you do not have a charitable activity.

Accordingly, based on all the facts and circumstances, the Service concludes that you do not qualify for recognition of exemption from federal income tax as an organization described in section 501(c)(3) of the Code.

Department of the Treasury - Internal Revenue Service
Consent to Proposed Adverse Action
(All references are to the Internal Revenue Code)

Case Number

Date of Latest Determination Letter

Employer Identification Number

Date of Proposed Adverse Action Letter

Name and Address of Organization

I consent to the proposed adverse action relative to the above organization as shown below. I understand that if Section 7428, Declaratory Judgements Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

- Denial of exemption under IRC 501(c)(3)
- Revocation of exemption, effective.
- Modification of exemption from section 501(c)() to section 501(c)(), effective
- Classification as a private foundation described in section 509(a), effective ****
- Classification as an private operating foundation described in sections 509(a) and 4942(j)(3), effective for
- Classification as an organization described in section 509(a)(), effective
- Classification as an organization described in section 170(b)(1)(A)(), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgement under section 7428.

(Signature instructions on Back)

Name of Organization:

Signature and Title

Date

Signature and Title

Date