



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

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Date: January 18, 2007
UIL Code: 501.03-01

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN:

**LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: Date 1**

Dear :

This is a Final Adverse Determination Letter as to the Org.'s exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

Your exempt status as an organization described in section 501(c)(3) is being revoked effective **Date 2**. You did not operate exclusively for exempt purposes as required for an organization to be recognized as exempt pursuant to section 501(c)(3). In this regard, your primary activities did not accomplish charitable or other exempt purposes as required by Treas. Reg. 1.501(c) – 1(c)(3)(1) and more than an insubstantial part of your activities did not further exempt purposes. Your operations also served private interests more than insubstantially. You have consented to this revocation by executing Form 6018, Consent to Proposed Action – Section 7428.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending **Date 3** and for all years thereafter. You have already furnished these forms to the IRS for **YE Date 3** and **Date 4**.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling XXX- or writing to: Internal Revenue Service, Taxpayer Advocates Office, TAO.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Marsha Ramirez
Director, EO Examinations

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer Org. . (EIN: N)		Year Ended Date 1

ISSUE:

Has the **Org.** met the requirements to qualify for tax exempt status under section 501(c) (3) of the Internal Revenue Code?

FACTS:

Org. was incorporated in July and recognized as a tax exempt organization under 501(c) (3) of the Internal Revenue Code in July of . In its Articles of Incorporation, **Org.** stated, "this corporation is a nonprofit public benefit corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Public Benefit Corporation Law for public and charitable purposes. The specific purpose of this corporation is to buy distressed real estate and then to rehabilitate it and sell or lease the real estate at no profit, to individuals who are qualified to receive low cost housing assistance."

During the year under examination, **Date 1**, the organization bought four rental apartment buildings (two buildings have four units each, one has three units and one has two units) through real estate agents in the city of . After evicting the tenants and rehabilitating the properties, the organization sold these properties to individuals through real estate agents. Per discussions with **Name**, the founder and the president of the organization, rental apartment units cannot be sold separately and the buyer must purchase the building all together. The buyers usually occupy one unit and rent out the remaining other units for rental income. Per **Name**, all four properties sold to low or moderate income buyers, but the organization failed confirm the buyer's financial information to verify that the buyers are qualified as a charitable class. It did not mention the buyers' income requirement on the contract agreements with the listing real estate agents to sell the rental apartment building. The organization did not provide documentation establishing that the buyers were qualified at low or moderate income.

Name 2, Incorporated (**Name 2, Abrev.**) is a for profit property management company located in city of **Name 3**. The organization does not have a written contract or agreement with **Name 2** for services provided by **Name 2**. Per **Name 1**, the verbal agreement with **Name 2** was follows: For each property purchased by the organization and managed by **Name 2**, the organization would receive a developer fee (good faith deposit) from **Name 2** . **Name 2** would arrange loans, rehabilitate each property, and lay out funds related to the rehabilitation and the holding of each property. **Name 2** would collect the rents and would evict tenants when necessary in order to properly rehabilitate each property. **Name 2** would also manage the selling process. At close of escrow to the new buyer, **Name 2** would send the organization an invoice for the rehabilitation of each property. **Name 1** stated the organization selected from other companies before choosing **Name 2**, but the organization does not have documentation to prove the selection from other companies.

Name 2 paid **Org.** a developer fee averaging \$1,500 per property and total of \$6,000 for the four properties. **Name 2** arranged loans to purchase these properties. Per the statement from **Name 1**, two

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loans borrowed from **Name 4** in the last quarter of 2002 at a 13% interest rate and the other two loans were arranged by **Name 2** and the organization does not have any details. Based on the escrow documents, the four properties loans borrowed from **Name 4**.

Name 2 managed the properties by collecting rents and evicting tenants before rehabilitating the properties. **Name 2** sent the rents to the organization and in turn, the organization issued a check for the full amount of the rents to **Name 2**. **Name 2** is responsible for rehabilitating the properties and managing the selling process of these properties.

Upon close of escrow, **Name 2** sent an invoice to the organization including management fees, insurance expenses, legal fees, interest payments, utilities, and cost associate with the rehabilitation. The organization sent all the proceeds from escrow account to **Name 2**.

There is no written contract or agreement for services between **Org.** and **Name 2**. **Name 2** billed the interest expenses, rehabilitation fees, insurance, utilities, management fees and all misc. expenses at the same amounts as the proceeds from the escrow to the organization upon the escrow closing.

Name 2 is a corporation incorporated in California. **Name 2** has not filed federal income tax return for years **Date 1** and **Date 2**.

Org. is a proxy of **Name 2** because **Name 2** is the party who performs these transactions and benefits from these transactions.

Summary of the property transactions

Property Address	Address 1	Address 2.	Address 3.	Address 4
Purchase price	\$	\$	\$	\$
Price Sold	\$	\$	\$	\$
Gross profit	\$	\$	\$	\$
Proceeds from Escrow	\$	\$	\$	\$
Invoice from Name 2 for rehabilitation	\$	\$	\$	\$
Management cost by Name 2	\$	\$	\$	\$

Per the summary of the four properties above, **Name 2** billed to the organization for rehabilitation cost at the amount equal to the proceeds from escrow accounts.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
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LAW:

Section 501(c) of the Internal Revenue Code provides that an organization described in section 501(c) (3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the 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 section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Income Tax Regulation 1.501(c) (3)-1(c) (1) states, "Primary Activities. 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."

Income Tax Regulation 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. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization. The term "private shareholder or individual" is defined in regulation section 1.503(a)-1(c).

An organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of 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." Treas. Reg. § 1.501(c) (3)-1(d) (1) (ii). Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

In Better Business Bureau v. United States, 326 U.S. 279 (1945) the court held that regardless of the number of truly exempt purposes, the presence of a single substantial non exempt purpose will preclude exemption under section 501(c)(3) of the code.

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. est of Hawaii v.

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Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the “est” body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant’s activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization’s rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization “was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations.”

GOVERNMENT POSITION:

The organization stated that its purpose is to purchase distressed real estate properties and to rehabilitate those properties for sell or lease the properties at no profit, to individuals who are qualified to receive low cost housing assistance. The organization is not organized for the private gain of any person. The organization purchased four multiple units rental apartment buildings and sold them at market price to the individuals at a profit. There is no documentation to prove the buyers are low or moderate income qualified individuals. Individuals who purchase rental properties with the intention for rental income is for investment purpose more than for releasing distress purpose. The organization that purchased the rental properties and resells them for profit is for profit purpose and not for charitable purpose.

The organization’s activities were not for charitable purpose, thus, not exempt from federal income tax. All four transactions for the year under examination and subsequent years are a proxy of **Name 2**, a for profit corporation (**Name 2**). **Name 2** arranged the processes of these transactions from purchasing to reselling of these properties. **Name 2** paid to the organization total of \$6,000 developer fees for the four properties purchased under the organization’s name. Upon the close of the sell, the proceeds from escrow account paid to **Name 2**. The transactions are directly benefit the for profit corporation, **Name 2**..

Org. has not operated exclusively for tax exempt purpose and the proceeds from the transactions have been benefit of private individual. Therefore, it does not qualify for exemption from Federal income tax under section 501(c) (3) of the code. The organization should file Form 1120 effective on **Date 1**..

TAXPAYER’S POSITION:

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
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Org. agreed with the revocation of its exempt status and signed the Form 6018 on October 05, 2005. **Org.** prepared and submitted Forms 1120 for years **Date1 and Date 2.**

CONCLUSION:

Org. has not operated exclusively for tax exempt purpose and the proceeds from the transactions have been benefit of private individual. Therefore, it does not qualify for exemption from Federal income tax under section 501(c) (3) of the code. **Org.** filed Forms 1120 for years **Date 1 and Date 2..**

Legend for 30 Day Letter

Name = Org
EIN = N
Tax Period Ended = Date1
Address of Site of Taxpayer Advocate= TAO

Legend for 90 Day Letter

Name = Org
EIN = N
Last Date for Filing = Date1
A Petition w/Tax Court
Effective Date of = Date2
Revocation
YE Date For = Date3
Forms 1120
Address of Site of Taxpayer Advocate= TAO



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
300 N. Los Angeles Street, MS 7300
Los Angeles, CA 90012

Org..

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear _____:

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "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 its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

TAO

Telephone:

Fax:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO E xaminations

Enclosures:

Publication 892

Publication 3498

Report of Examination