



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: March 27, 2007

Number: **200746021**
Release Date: 11/16/2007

Legend:
ORG= Name of Organization
NUM= EIN Number

Person to Contact:
Identification Number:

UIL: 501.03-01

In Reply Refer to: TE/GE Review Staff

ORG

EIN: NUM

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: _____

Dear _____ :

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

Our adverse determination was made for the following reasons:

Exemption from income tax is a matter of legislative grace and taxpayers have the burden of establishing their entitlement to exemptions. Section 6033 requires organizations exempt from tax to keep such records and render such statements as are required by such rules and regulations as the Secretary may prescribe. Treasury Regulations section 1.6033-2 (h)(2) requires organizations exempt from tax to submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into the organization's exempt status.

You have not filed information returns Form 990 and have remained inactive since Date1. Based on the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code retroactively to Date1.

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.

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 writing to: Internal Revenue Service, Taxpayer Advocates Office , Local Office.

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,

Martha A. Ramirez
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

ORG

Taxpayer Identification Number:

Form:

990

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.

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:

Taxpayer Advocate
Local Office

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,

Martha Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule
Explanation of Items		
Name of Taxpayer		Year/Period Ended
EIN:		

Legend:

ORG =Name of Organization
DATE1= Effective Date of Revocation
Date2= Date of incorporation
Manager1=Name of manager of Organization
ForProfit=Name of For-Profit successor
State= Name of State

ISSUE 1: Is Organization (ORG) operating exclusively for charitable purposes with no part of its net earnings inuring to the benefit of any insiders or other private persons?

ISSUE 2: Should the Section 501(c)(3) exemption ruling issued to ORG be revoked because it failed to observe the record keeping and annual filing of information returns (Forms 990) as required from organizations exempt under Internal Revenue Code (IRC) 501(c)(3)?

OVERVIEW:

ORGANIZATION. (hereinafter "ORG") incorporated in STATE on Date2. The articles provided that ORG will be organized and operated exclusively for charitable purposes within the meaning of 501(c)(3).

The specific charitable purposes for which ORG incorporated were:
to raise the economic, educational and social level of STATE minority community who are underemployed and or below federal poverty level;
to expand opportunities available to said people to obtain low-cost housing accommodation by constructing, rehabilitation and relieving the poor and distressed by providing them decent shelter, thus lessening the burden of government and promoting social welfare, and provide said people with opportunities to have ownership and control of their housing accommodations;
to expand opportunities to said persons to own and operate business enterprises in economically depressed area and assist them in developing entrepreneurial skills.

ORG's Articles dedicated its property to charitable purpose and provided that no part of its net income or assets shall ever inure to the benefit of any director, officer or member thereof or to the benefit of any private person. Upon the dissolution of the corporation the assets were to be distributed to another qualified organization which has established its exemption under 501(c)(3).

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule
Name of Taxpayer		Year/Period Ended
EIN:		

ORG received exemption and public charity status under Internal Revenue Code (IRC) Sections 501(c)(3) and 509(a)(1).

The U.S. Department of Housing and Urban Development (HUD) accepted ORG as an approved non-profit and invited it to purchase HUD acquired properties at a discount. During certain years, ORG acquired 9 properties, some directly from HUD, and some from other sellers. As a HUD approved 501(c)(3) agency, ORG was able to buy properties at a discounted price from HUD and received favorable financing that included no down-payment and FHA mortgages.

HUD considered nonprofit agencies to be important and active partners in developing affordable housing. Among other things, HUD supported this by permitting eligible nonprofit agencies to obtain insured financing under the same favorable terms as owner occupants. To be eligible as a mortgagor under FHA's programs and obtain the same insured financing percentage as owner-occupants, the nonprofit had to be a tax-exempt organization, and have a voluntary board whose members do not personally benefit.

HUD's acceptable affordable housing programs included two categories: Homeownership and Long-Term Rentals. Nonprofit that appeared to have taken on the role of a traditional, market rate landlord for cash-flow and income purposes without redistributing those funds back into its housing efforts would not have had its program approved because Nonprofits were expected to fulfill their commitment to low- and moderate-income families.

ORG long-term rental program was managed by MANAGER. He also was in charge of ORG's finances and had signatory authority and custody of ORG's bank records and finances.

MANAGER obtained properties for ORG, leased them, collected the monthly rental fees and paid the mortgages. The lessees were offered lease-purchase agreements and were promised that their lump-sum deposit will be applied towards the purchase price of the properties they leased. Additionally, they were promised that their monthly rental fee will be set at ORG's monthly mortgage payment for the property (which included the escrow funds for property tax and insurance) plus 10% to cover administration. Similarly, they were to purchase the property at ORG's purchase price plus 10%.

Some of the lease-purchase agreements that MANAGER executed for ORG failed to include the part dealing with the subsequent purchase. Missing were stipulations determining the purchase price, the required down-payment, the purchase date, etc. No provisions provided for refund of the deposit if the purchase will not materialize. When some of the agreements were executed, previously agreed terms were changed. MANAGER changed the rental fee that was previously agreed upon and raised it over the promised fee; he also raised the required deposit above what was initially

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule
Explanation of Items		
Name of Taxpayer		Year/Period Ended
EIN:		

agreed. These renters nevertheless signed the contracts, partly due to ORG promises and status as a HUD approved affordable housing provider. Some of the rental fees MANAGER collected were paid to him in cash without him issuing written receipts to the tenants. Two of ORG properties were leased to the daughters of ORG's chairman and a third property was leased to ORG board member. The property was leased to relatives. A third ORG owned property was leased to relatives.

The Chairman of the board, terminated MANAGER's services for charges of misconduct and mismanagement, including the failure to: pay contractual obligations, submit reports to the board of all significant business matters, afford board access to the books and bank records, account for funds and donations, and for using ORG accounts for his personal purposes.

Further, to rectify the situation, ORG board resolved in March to sell and transfer all of ORG's affordable housing properties and operations to FOR PROFIT. FOR PROFIT received the title to the properties' and was also responsible to pay the outstanding mortgages. After the transfer of the properties, ORG no longer conducted affordable housing programs and it became inactive. ORG stopped filing the annual statement of officers with the Secretary of State. The State Franchise Tax Board suspended ORG Corporation's status and powers including the power to defend itself against any suit that is brought against it in State.

FOR PROFIT or FOR PROFIT Paralegal Services were names used by the business. FOR PROFIT has not established its own exempt status with IRS. After the properties were transferred, disposed of the properties and evicted some of the tenants, including those holding the lease-purchase agreements with ORG. Since some of the tenants did not hold contracts with purchase stipulations they had no enforceable rights to purchase the leased properties at any stipulated price. Although FOR PROFIT offered to sell them these properties, he asked for a higher price than that was promised by ORG.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule
Name of Taxpayer		Year/Period Ended
EIN:		

LAW:

ISSUE 1: Requirements for Exemption

a. Requirement for Exemption under IRC 501(c)(3)

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations that are 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 describes the purposes specified in section 501(c)(3) to include: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals

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 is engaged primarily in activities that 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(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(c)(3)-1(d)(ii) of the regulations states that an organization is not organized or operated for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, shareholders, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(a)-1 (c) "Private shareholder or individual" defined. The words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

b. Cases: Existence of a Substantial Single Non-Exempt Purpose, can Destroy Exemption under 501(c)(3)

Better Business Bureau v. United States, 316 U.S. 279 (1945), holds that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption under section 501(c)(3). An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such purposes.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule
Name of Taxpayer		Year/Period Ended
EIN:		

c. Cases Where Exemption under 501(c)(3) Was Revoked Due to Inurement or Private Benefit

In Lowry Hospital Association, Petitioner v. Commissioner of Internal Revenue, 66 TC 850, Filed August 12, 1976, The tax court found that the hospital did not qualify as charitable organization under section 501(c)(3), because some of its net earnings inured to the benefit of the physician who was the organization's founder, and who also had his privately owned clinic located at the hospital building.

In its opinion the court said: "our concern extends beyond these specifically identifiable instances of private inurement. Where a doctor or group of doctors dominate the affairs of a corporate hospital otherwise exempt from tax, the courts have closely scrutinized the underlying relationship to insure that the arrangements permit a conclusion that the corporate hospital is organized and operated *exclusively* for charitable purposes without any private inurement. See *Harding Hospital, Inc. v. United States*, *supra*; *Maynard Hospital, Inc.*, [Dec. 29,751], 52 T.C. 1006 (1969); *Sonora Community Hospital*, [Dec. 28,053], 46 T.C. 519 (1966), *affd.* [68-1 USTC ¶9528] 397 F.2d 814 (9th Cir. 1968); *Lorain Avenue Clinic*, [Dec. 23,219], 31 T.C. 141 (1958).

In Wendy L. Parker Rehabilitation Foundation, Inc. v. Commissioner TC Memo. 1986-348, 52 TCM 51, Filed August 4, 1986 the tax court concluded that a not-for-profit corporation organized for the purpose of providing care and treatment for coma victims in stages of recovery was not exempt, because a child of the founder and chief operating officer of the foundation was a substantial beneficiary of the services provided by the organization. This constituted inurement for the benefit of a private individual which is prohibited under the qualifications for exemption.

ISSUE 2. Requirement to Maintain Records to Retain and Support the Organization's Exempt Status

Section 6033(a)(1) of the Code provides, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Section 1.6033-1(h)(2) of the regulations provides that every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the district director for the purpose of enabling him to inquire further

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule
Name of Taxpayer		Year/Period Ended
EIN:		

into its exempt status and to administer the provisions of subchapter F (section 501 and the following), chapter 1 of the Code and section 6033.

Rev. Rul. 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

GOVERNMENT POSITION:

ISSUE 1:

The government contends that ORG was not operating exclusively for charitable and public purposes with no part of its net earnings inuring to the benefit of any insiders or other private persons in 1998, because about 37% of its activities served the interest of private shareholders. As explained in Better Business Bureau v. United States, the existence of substantial non-exempt purpose precludes exemption under 501(c)(3).

Further, ORG failed the operational test under 501(c)(3) because it failed to comply with REGS, §1.501(c)(3)-1(d)(1)(ii) when it failed to establish 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."

On the contrary, the record shows that ORG activities benefited private individuals and inured to private share holders who are defined in Section 1.501(a)-1 (c) as persons having a personal and private interest in the activities of the organization. ORG operated in a way that benefited the daughters of its Chairman and its board member, this is comparable to the situation in Wendy L. Parker Rehabilitation Foundation, where the organization was found to be non-exempt because substantial part of its operations were to benefit the daughter of the founder and officer of the organization.

Chairperson's daughters, were substantial beneficiaries of ORG's activities, because they occupied three properties out of the total of eight properties ORG owned.

The government contends that although ORG Articles dedicated its assets to charitable purposes, when ORG transferred ownership of its assets, (who claimed to be a non-profit exempt organization called FOR PROFIT . Inc.), it breached the requirements of IRC 501(c)(3) because its activities no longer served public and charitable purposes; thus, it no longer complied with Section 1.501(c)(3)-1(c)(1) of the regulations that states that organization will be regarded as "operated exclusively" for one or more exempt purposes

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule
Name of Taxpayer		Year/Period Ended
EIN:		

only if it is engaged primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3).

When ORG board resolved to transfer or sell the properties to FOR PROFIT Inc. it ceased operating the affordable housing program or any other charitable programs. Since ORG ceased its charitable operations, it no longer conducted activities that qualify for exemption under 501(c)(3). Therefore, its exemption should be revoked effective DATE1

ISSUE 2:

The government contends that the Section 501(c)(3) exemption ruling issued to ORG should be revoked because it failed to observe the record keeping and annual filing of information returns (Forms 990) as was required under Section 6033(a)(1).

ORG has not filed annual information returns Forms 990 past 199512. It was required to file such return if its gross receipts were \$25,000 or more. It owned 8 properties each with an estimated rental of \$1,000/mo or \$12,000/year. Therefore, its annual gross receipts exceeded \$25,000 and it should have filed Form 990.

Additionally, ORG was unable or unwilling to provide essential records such as the lease purchase agreements, rental receipts etc. for the properties it leased under its affordable rental program. Such records were needed in order to document how its rental programs were conducted and establish that they were conducted in a charitable manner. As provided under Rev. Rul. 59-95, the failure or inability to file the required information return or otherwise to comply with the provisions of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of such organization.

TAXPAYER'S POSITION:

On IRS letter, the Taxpayer was requested to sign Form 6018 as an indication of acceptance of the proposed revocation, or if in disagreement, to provide a written rebuttal to the government's proposed revocation, including pertinent documentation. Taxpayer signed Form 6018, agreeing with the revocation.