



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201149045**

Release Date: 12/9/2011

Date: September 16, 2011

UIL Code: 501.32-00

501.01-00

501.33-00

501.35-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

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.

Letter 4038(CG) (11-2005)
Catalog Number 47632S

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,

Lois Lerner
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: August 1, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = individual

C = individual

D = individual

L = date

M = state

N = business

O = product

P = city

R = city

S = homes

UIL:

501.32-00

501-32-01

501.33-00

501.35-00

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

Do you meet the operational test for exemption under section 501(c)(3) of the Internal Revenue Code?

Facts

You were incorporated on L in the state of M exclusively for charitable, scientific or

Letter 4036(CG)(11-2005)
Catalog Number 47630W

educational purposes, and in part to:

Assist in the development, testing, creation and promotion of S, specifically designed to remove sewers and septic systems, reduce water intake costs, promote smart energy thereby reducing costs and promoting homes that exceed Leeds agencies standards; promote building of smart homes in areas where they are currently deemed unbuildable; promote fundraising to enable new products and services to be incorporated into future builds for beta testing to ensure public safety and to promote the implementation of such builds across the nation in an effort to support our builders; to aid, support and assist rehabilitations of homes with the intent of rebuilding communities stricken by economic or other factors for the purpose of contributing to Section 8 housing or other alternative affordable housing for families....

Your Articles of Incorporation and Bylaws state that you have capital stock, your directors are elected by your stockholders, and distributions may be made upon the capital stock. You have indicated that you may issue stock in the future.

You anticipate support from grants, including grants from governmental units, and private contributions. However, you were not responsive to our requests when asked to provide complete projections of your revenues and expenditures.

Your primary program will consist of performing "beta testing" on green, that is, environmentally benign, residential housing products. You have defined "beta testing" as field testing of a product for the purpose of working out the defects in it so as to make it ready for market. Beta-testing involves incorporating the green product in buildings which are actually occupied. The product is used by the residents on a day to day basis; problems with the product are observed and reported by you to the manufacturer; the manufacturer's fix is implemented at the beta-testing site, and you assess its efficacy. One aspect of the testing program is designed to help the product meet state requirements for certification as posing no safety hazard, a major hurdle to getting some products to market. The purpose of "beta testing" is to shorten the time it takes for an environmentally benign product designed for use in residential building projects to reach the market.

The first product to be tested is the "Q", a kind of dry toilet that dispenses with the need for sewer systems and disposal. Q is only the first of the environmentally friendly building products that you expect to test. Beta testing of Q will have to be carried out in each state where the product is to be marketed, to meet that state's specific regulatory requirements. This will be the case whenever you do beta-testing of a new product.

There is no relationship between your officers and directors and the manufacturer of Q or its owners. The costs of the testing are not to be defrayed by the manufacturer or any

commercial entity which would benefit if the product reached the market. The program of beta testing will be supported by grants and contributions. Your principal expenses will be, in order of importance, management fees, purchase of the product to be tested, and training in its installation and servicing.

You are the successor to a C-corporation, N. Prior to your incorporation, B incorporated N in M as a for profit to build and sell green homes. Your directors, B and D, were also directors and officers of N. N's green development projects never got beyond the planning stage, and N was dissolved shortly before you were incorporated.

Your application narrative and your website contain various statements that you too would engage in building, rehabbing or resale of housing incorporating the products you have tested. For example, from your "About Us" web page --

We do more than just build homes. Constructing a home begins with creating a distinctive home design that fits the unique terrain and lifestyle of the community. Our Personal Touch method of walking the client through the entire process is what sets us apart from other builders. Our in-house staff of Quality Home Designers will carefully listen to the client's needs and desires, and interpret those concepts into a comprehensive design that is harmonious with the surroundings. The client is further treated to a comprehensive evaluation of all financial options to expedite the escrow process reducing any anxiety associated with building their dream home. When we present the keys to our clients, the relationship does not end there. Because we expect the most, all of the estates come with a full satisfaction guarantee. In addition, we are a multi-state, licensed real estate broker and offer our clients all traditional real estate services.

and

We also believe it is just as important to build a solid foundation with our clients, communities, and cities as it is to construct a solid foundation in every home. To master these objectives, we have assembled a high caliber team of diverse professionals to not only construct the highest quality home, but also exceed the expectations of our clients, cities and neighbors.

When questioned, you represented that you will not engage in those activities. However, the statements on your website indicating that you will develop and sell housing have not been expunged or modified.

You represented in your response to our first letter that you would train other professionals on the installation and maintenance of green products which you have beta-tested. However, you subsequently represented that you will not conduct training programs for builders and technicians. Some of your Board members will be trained to

install and service the products you have tested, but you represent that neither you nor they will engage in the business of installing or servicing the products, or training and certifying other builders and technicians to do so.

Your inaugural project, the R Project, will retrofit a house in R with the Q system for the beta testing. Your current President, C, resides with his spouse B, your former Director and Secretary, in this house, which is your current address of record. You have not paid for the necessary rehabilitation of the house, but only the expenses of retrofitting it with Q. You explained the choice of the house in terms of its suitability: The State of M requires that the system be tested as to its safety to persons undergoing chemotherapy, and C, as it happens, is receiving chemotherapy for cancer. The management fees that are your primary expense item will be used to contribute to the mortgage of the home, which is owned by C's uncle.

Law

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax corporations, and any community chest, fund, or foundation, organized and operated exclusively for, charitable, scientific, or testing for public safety, among other purposes. It expressly forbids the inurement of net earnings to the benefit of a private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that an organization that fails either the organizational test or the operational test is not exempt under Section 501(c)(3) of the Code.

Reg. 1.501(c)(3)-1(c)(1) provide that an organization is operated exclusively for exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3). It is not so operated if more than an insubstantial part of its activities do not further those purposes.

Reg. 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private individuals.

Reg. 1.501(c)(3)-1(d)(1)(ii) states that to be charitable, an organization must serve a public rather than a private interest. The organization must demonstrate 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. The private benefit restriction is not limited to benefits provided to insiders. Rather, the restriction applies to benefits provided to any individual, whether or not the individual is in a position to control or influence the organization. The private benefit restriction operates against all parties who receive a benefit not accorded the public as a whole.

Reg. 1.501(c)(3)-1(d)(4) defines the term testing for public safety, as used in section 501(c)(3), as including the testing of consumer products, such as electrical products, to determine whether they are safe for use by the general public.

Reg. 1.501(c)(3)-1(d)(5)(i) provides that a scientific organization, as with other organizations described in IRC 501(c)(3), must be organized and operated in the public interest. This means that organizations that primarily pursue business purposes or that serve substantial private interests are not entitled to exemption under IRC 501(c)(3). Hence, scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations such as the inspection of products or the designing of equipment. Reg. 1.501(c)(3)-1(d)(5)(ii).

Rev. Rul. 65-61, 1965-1 C.B. 231, held that an organization engaged in establishing safety standards for pleasure boats, and testing boats and boating equipment for safety is exempt under IRC 501(c)(3). The organization was incorporated for the purpose of testing for public safety in the field of pleasure boating. Its charter provides that it shall accept for inspection, testing, and safety evaluation, products intended for use on, in or in connection with, small boats, primarily pleasure boats, including hulls and entire boats, and shall report and circulate the results of such inspection, tests, and evaluations to the public and other interested parties by attaching labels or certificates to such products, or by other appropriate means. The organization's facilities are available for safety testing to all manufacturers of products and accessories used on pleasure craft, who wish to have their products evaluated under the organization's standards.

Clinical testing of drugs for pharmaceutical companies is not testing for public safety. The organization described in Rev. Rul. 68-373, 1968-2 C.B. 206, tests drugs before marketing to enable the companies to comply with Food and Drug Administration rules. Until a drug is approved for marketing by the Food and Drug Administration, it is not a 'consumer product,' available for general use by the public. The clinical testing of a drug for safety and efficacy in order to enable the manufacturer to meet FDA requirements for marketing is not 'testing for public safety' but is merely a service performed for the manufacturer. Such testing principally serves the private interest of the manufacturer rather than the public interest. Furthermore, the clinical testing is an activity ordinarily carried on as an incident to a pharmaceutical company's commercial operations. Therefore, such testing does not constitute scientific research within the meaning of section 1.501(c)(3)-1(d)(5)(i) of the regulations.

Rev. Rul. 78-426, 1978-2 C.B. 175, relates to an organization whose activities include the inspection, testing, and safety certification of cargo shipping containers. The usefulness of containers to manufacturers and shippers in international trade is greatly diminished without the safety certification of this organization. As in Rev. Rul. 68-373, the testing and certification serve the private interests of container and other

manufacturers and shippers by facilitating their operations in international commerce, and only incidentally serve the public interest. In addition, the safety and efficiency of shipping containers are closely allied to successful commercial operations, since manufacturers and shippers must protect themselves against losses due to spoilage, leakage, delays in transit, and employee injuries. The Revenue Ruling also noted that the organization is not organized and operated for the purpose of testing for public safety, as the products tested are not consumer products utilized by the general public.

An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single non-charitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. See Better Business Bureau of Washington, D. C., Inc. v. United States, 326 U.S. 279 (1945) which held activities that were in part aimed at promoting the prosperity and standing of the business community were held to serve a substantial non-exempt purpose.

In The Church of the Living Tree v. Commissioner, T.C. Memo 1996-291 (1996), the Tax Court upheld the Service's determination that the organization, whose secondary purpose was promotion of the (hand) papermaking industry, was not described in IRC 501(c)(3). The organization also provided rent-free facilities to the founder, although the founder received no compensation for his work with the organization. The Service had determined that promotion of the papermaking industry was a substantial non-exempt purpose and that the organization provided private benefit to the founder. The court ruled that the organization had not carried its burden of proof to show the Service's determination was erroneous.

Application of Law

Your Articles of Incorporation and Bylaws authorize you to issue capital stock and to make distributions to stockholders. As a result your net earnings are set to inure to private individuals. The holding of stock by any private individual that entitles that individual to any part of your assets or income constitutes inurement prohibited under Section 501(c)(3). Because your organizing documents are structured in this manner you do not meet the organizational test. Also, because you are operating for commercial purposes and in furtherance of private, rather than public, purposes, you do not meet the operational test (Section 1.501(c)(3)-1(a)(1)) and therefore do not qualify for exemption under 501(c)(3).

You are similar to the organizations described in Revenue Rulings 68-373 and 78-426. Your beta-testing of products is testing of a kind incidental to commercial operations. It confers a direct benefit on the businesses that manufacture the products by helping them to bring the products to market more quickly and inexpensively. Any benefit to the public from this activity is indirect. In addition, by charging the businesses nothing for your services you are in effect providing them with a subsidy.

Because the testing is of a kind that is normally incident to commercial operations, you are not operated exclusively in the public interest, and consequently are not operated exclusively for scientific purposes (Regs. 1.501(c)(3)-1(d)(5)(i) and (ii)).

You do not, therefore, meet the requirements of Reg. 1.501(c)(3)-1(d)(1)(ii) because you serve private interests, namely, the business interests of the manufacturers of the products, more than incidentally. You also serve the private interests of the businesses that will install and service these products. In Revenue Ruling 78-426 the benefit from the organization's testing and certification program to the shippers who used the containers was no less an issue than the benefit to the manufacturers. Your stated purposes in making selected products market ready is to provide a stimulus to the residential construction industry.

You do not meet the requirements of Reg. 1.501(c)(3)-1(c)(1) because more than an insubstantial amount of your activities are furthering non-exempt purposes. Your operations benefit private parties, namely, private businesses that manufacture, install and service the green products you test. You have acknowledged one of your goals in making selected products market ready is to provide a stimulus to business start-ups such as Q, and to the residential construction industry. You are similar to the organization in Better Business Bureau of Washington, D. C., Inc. v. United States, in that you have a substantial purpose to help businesses to become successful and prosperous, an activity which is not in furtherance of any exempt purpose within the meaning of Section 501(c)(3).

You do not meet the requirements of Reg. 1.501(c)(3)-1(d)(4). You are not organized and operated exclusively to test products for public safety or to test consumer products to determine whether they are safe for use by the general public. While you test products that at a later time may be sold to consumers, the testing is more in the nature of a field trial than a series of standard tests made in a laboratory setting and is for the purpose of completing their development and satisfying the regulatory requirements in each of the states where they have been tested, as necessary preconditions to unrestricted commercial distribution in those venues. The testing you do is therefore not exclusively with respect to the safety of the product.

Moreover, like the organization described in Revenue Ruling 68-373, until your course of beta-testing is completed, a product may be available for distribution but is not a 'consumer product,' available for general use by the public. Thus, you are distinguished from the organization described in Revenue Ruling 65-61 which established safety standards for pleasure boats, and tested boats and boating equipment for safety. That organization evaluated all pleasure boat related consumer products submitted to it by the public solely in regard to its safety. You, on the other hand, conduct beta-testing only on products that you have selected as meriting your services and the testing you conduct is not exclusively with regard to the products' safety for consumer use.

In accordance with Section 1.501(c)(3)–1(c)(2) of the Regulations, you are not operated exclusively for exempt purposes because your net earnings inure to the benefit of private individuals. You are paying the mortgage of the house selected as the site of the beta-test, owned by C’s uncle and used as their primary residence by B and C. The provision of living facilities rent-free to an officer was held to constitute inurement in The Church of the Living Tree v. Commissioner, above.

Your Position

Your activities promote conservation and protection of natural resources as they promote practices that lessen the adverse impact of residential construction on the natural environment. You seek to bring ecologically beneficial products to the end user quicker and at lower prices by helping their manufacturers make them market ready. The Q product would be especially valuable on P, where it was originally to have been tested, because of the island’s “water issues” and would also help conserve water in arid parts of the country.

Service Response to Your Position

While it is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public constitute a charitable purpose, any benefit to the public from your program would be indirect. The direct and primary beneficiaries would be the businesses which would be in a position to manufacture, market, install and maintain the green products. For this reason, even though portions of your activities may be serving conservation purposes, you are more than insubstantially serving private interests. The existence of one non-charitable purpose that is substantial in nature is cause for denial of exemption. Furthermore, an organization will not qualify for exemption if it is operated for a mixture of exempt and non-exempt purposes.

Conclusion

You do not qualify for exemption under Section 501(c)(3) of the Code because you serve private rather than public interests, more than an insubstantial part of your activities are in furtherance of non-exempt purposes, and your net earnings inure to the benefit of private individuals.

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, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) 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
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

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,

Lois Lerner
Director, Exempt Organizations

Enclosure, Publication 892