

**Internal Revenue Service**

Appeals Office  
2525 Capitol Street, Suite 201  
Fresno, CA 93721

**Department of the Treasury**

**Employer Identification Number:**

**Person to Contact:**

Number: **201446028**  
Release Date: 11/14/2014

Employee ID Number:  
Tel:  
Fax:

August 20, 2014

**UIL: 504.50-00**

**Certified Mail**

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code.

Our adverse determination was made for the following reason(s):

You failed to establish that you operate exclusively for one or more exempt purposes as required by section 501(c)(3) of the Code. Additionally, you operate for a substantial, non-exempt, commercial purpose of providing residential construction services.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions for the return. For further instructions, forms, and information please visit [www.irs.gov](http://www.irs.gov).

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

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

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write

to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also 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 matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit [www.irs.gov/advocate](http://www.irs.gov/advocate) for more information.

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

Sincerely Yours,

Acting Appeals Team Manager

Enclosure: Publication 892 and/or 556



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: Aug 20, 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

P = state  
R = date

**UIL:**

501.36-01

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 fail to qualify for exemption from federal Income tax under section 501 (c)(3) of the Internal Revenue Code due to the commercial nature of your activities? Yes, for the reasons described below.

Do you fail to qualify for exemption from federal Income Tax under Section 501 (c)(3) of the Internal Revenue Code as your activities constitute a substantial non-exempt purpose? Yes, for the reasons described below.

**Facts**

You were incorporated in P on R. Your Articles of Incorporation state you are formed for charitable purposes within the meaning of 501(c)(3) of the Internal Revenue Code and to engage in any lawful act or activity for which corporations may be organized under the non-profit corporation law of your state. You will provide affordable residential construction services to the lower economic strata.

Letter 4036 (CG) (11-2011)  
Catalog Number 47630W

You refer to yourself as a non-profit residential construction company. You primarily provide carpentry services, but also offer other construction related trades, including the following:

- framing
- insulation
- drywall installation and finish
- painting(interior)
- interior trim
- window installation
- door installation (interior/exterior)
- flooring
- cabinet manufacture and/or installation
- hardware installation
- siding
- appliance installation
- incidental shoring
- pier and cement work
- weatherization services
- demolition and site cleanup
- incidental landscaping
- attic ventilation work
- mechanical work
- substantial concrete and foundation work
- roofing
- consulting services

You will contract primarily with other non-profits to provide construction services on pre-approved projects for which they are requesting bids. If selected, you enter into a contract with the organization and complete the work. You have bid for, accepted and completed dozens of these types of jobs over the last one to two years, and routinely bid for additional ones.

You estimate 90% of your work is dedicated towards these types of jobs. In describing your marketing plan you state you are able to compete and undercut regular contractors due to using a less experienced workforce, smaller infrastructure, no profit motive, and paying lower compensation.

In describing criteria used to determine projects working with non-profits, many have already been pre-qualified in terms of need. You further evaluate if the financial resources from the non-profit are available, and since bids are placed, this often is not an issue, as you are bidding the job to get the work and provide a service. You also

evaluate if you support the overall mission of the organization you will work with.

The remaining 10% of your work is done with private homeowners. These are small jobs contracted privately to supplement income. You have listed criteria used in evaluating potential clients of this nature, including economic status, resources, age or disability, the type of work and if you have the resources to complete the job. You indicated informal discussions were held with these clients about financing, with most being elderly and/or minority. You provided a listing of these types of jobs that you have completed to date. This list shows jobs included individuals with relations to members of your board and staff, including a former colleague, a neighbor and an acquaintance.

Your long term goal is to build capacity and eventually be able to buy and rehabilitate homes using financing obtained directly, rather than subcontracting work, as well as build new homes.

You have paid employees performing services at prevailing rates. You subcontract out some mechanical work, such as plumbing and electrical, that you either do not have the license or expertise to complete sufficiently. Your labor rates equal the employee salary plus a 50% markup for business overhead. There is a 10% project management markup on material and subcontractor bids which has been waived on certain occasions. You do provide some pro-bono and donated work. The majority of your income will come from fees charged for your services, with the remainder expected from gifts, grants and contributions.

#### **Law**

Section 501 (c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of 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 states 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 or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations states 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.

Rev. Rul. 69-528, 1969-2 C.B. 127 states that an organization formed to provide investment services on a fee basis exclusively to organizations exempt from federal

income tax under section 501(c)(3) of the Code is not exempt under 501(c)(3) of the Code.

In Revenue Ruling 72-369, 1972-2 CB 245, an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. The ruling found that providing managerial and consulting services on a regular basis for a fee was a trade or business ordinarily carried on for profit. The fact that the services in this case were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish an activity as charitable.

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

In B.S.W. Group, Inc. v. Commissioner, 70 I.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501 (c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. The Tax court Stated: We must agree with the Commissioner that petitioner's activities constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test under section 501(c)(3). Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. The case noted that among the major factors that courts have considered in assessing commerciality are competition with for-profit entities, pricing policies, the extent and degree of below cost services provided and the reasonableness of financial reserves. Additional factors include whether the organization uses commercial promotional methods (such as advertising) and the extent to which the organization receives charitable donations.

### **Application of Law**

You are not operated exclusively for charitable, educational, or religious purposes consistent with Section 501(c)(3) of the Code nor Section 1.501(c)(3)-1(a) of the Income Tax Regulations and therefore fail to meet the operational test. Specifically, the facts above indicate that you are not operated for exempt purposes but that you are operated in a commercial manner. You charge fees that are not substantially below cost, but are

instead set to cover costs. Your expenses include overhead and employee compensation, paying wages at prevailing rates. You offer services to private individuals at market rates. Your jobs are secured through a competitive bid process alongside other similar companies. As a result, your services are not distinguishable from any commercial construction company.

You are not described in section 1.501(c)(3)-1(c)(1) of the regulations because you are not primarily engaged in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. You are primarily engaged in a business indistinguishable from a commercial operation.

Similar to the organizations denied exemption in Revenue Rulings 69-528 and 72-369, you are operated similar to a trade or business ordinarily carried on for profit. Even though you are serving mostly non-profit entities, furnishing services in the manner described lacks the donative element to be considered charitable. You are involved in a competitive bid process to win jobs, and charge fees that are substantially above cost.

As noted in B.S.W. Group and Airlie Foundation, operations which have a commercial undertone are excluded from exemption under section 501(c)(3) of the Code. You have received little, if any, any contributions from private or public sources. Your primary source of income is from fees for services received for subcontracted work. While you intend on providing some services at a reduced price or free, this does not change the commercial manner in which you operate. Your operations are distinguishable from other for-profit construction companies only in that you charge slightly lower fees. You conduct business with private individuals and derive income from those sources, price your services accordingly, have a compensated staff, are in direct competition with other for-profit companies and even note your ability to under bid them. These factors are all indicative of commercial operations.

Since your operations are commercial in nature, they are distinguishable from an exclusively charitable and educational program, which would be exempt in nature. This underlying commercial motive is similar to what caused denial of exemption in Better Business Bureau of Washington D.C. Although elements of your proposed operations are aimed at helping those in need through some volunteer and pro-bono work, your substantial services are comparable to and are in direct competition with other local for-profit construction firms. This precludes exemption under section 501(c)(3) of the Code.

### **Conclusion**

Based on the facts and information provided, you are not organized or operated exclusively for exempt purposes. You fail the operational test, and you are operated for substantial non-exempt commercial purposes.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns. Contributions to you are not deductible under section 170.

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, How to Appeal an IRS Decision on Tax Exempt Status.

*Types of information that should be included in your protest can be found on page 1 of Publication 892, under the heading Filing a Protest. The statement of facts (item 4) must be accompanied by the following declaration:*

*"Under penalties of perjury, I declare that I have examined this protest statement including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts, and such facts are true, correct, and complete."*

*The declaration must be signed by one of your officers or trustees with personal knowledge of the facts.*

*Your protest will be considered incomplete without this statement.*

*If your representative submits a protest, a substitute declaration must be included stating that the representative prepared the protest and accompanying documents; and whether the representative knows personally that the statements of facts contained in the protest 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](http://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,

Kenneth Corbin  
Acting Director, Exempt Organizations  
Rulings And Agreements

Enclosure: Publication 892