



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Release Number: **201519033**
Release Date: 5/8/2015
UIL Coe: 501.03-30
501.32-00
501.33-00

Date: 2/11/2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) 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, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Tamera Ripperda
Director, Exempt Organizations

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date:

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

M =

N =

O =

P =

Q =

\$r =

\$t =

\$x =

UIL:

501.03-30

501.32-00

501.33-00

Dear

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons described below.

Does your inability to adequately establish operations as exclusively charitable preclude you from exemption under section 501(c)(3) of the Code? Yes, for the reasons described below.

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

Facts

You were created as a charitable trust that was funded on P. The trust document states that you were organized and operated exclusively for charitable purposes and your primary purposes consist of providing low-income housing, preserving holiday traditions, providing volunteer support for charitable community events, environmental protection, and land preservation.

Your founders, who also serve as your trustees, are husband and wife. They do not receive compensation from you.

Your primary activity will be the operation of a two hundred unit apartment complex for low income housing. You will not participate in government housing programs but will follow HUD Guidelines to determine the low-income housing income limits and maximum rents that may be charged.

You own M, a 200 unit apartment complex in N where your low income housing activities will take place. The building was donated to you by O, a limited liability company owned by your trustees. The building has an estimated gross value of \$t. There is a \$r loan on the building that you assumed along with other associated liabilities such as utilities, insurance, and property maintenance. You declined to provide a certified appraisal for the value of the apartment building at the time of transfer due to cost. You did not provide any documentation on the value of the building or on its transfer. Your other estimated operating expenses to be \$x. That amount includes maintenance, repairs, and supplies, general property expenses, payroll expenses, general turnover costs such as renovation, cleaning, and repairs, utilities, advertising, taxes, insurance, and administrative expenses.

You stated that it is illegal to break a lease, so you will honor the existing lease contracts that were in place at the time the building was transferred. Once those units vacate, you will place qualified tenants in the units. You did not provide any detail on the number of residents of the apartment building who are currently low income tenants.

Your other activities include:

- Helping families identify and cope with apraxia,
- Acquiring land for the development of affordable housing,
- Coordinating exempt activities with the community activities of Q, and
- Conducting Christmas activities to keep the Christmas spirit alive.

Your Christmas activities are held on private property owned by your trustees that includes a living Christmas tree farm with a 100 foot Santa balloon. The trustees will not charge you for use of the property to promote the Christmas spirit. You will coordinate with local vendors to provide Christmas activities that will include a train ride through a Christmas tree farm, arts and crafts workshops, apple cider and hot chocolate, pony rides, and petting zoos. A small fee will be charged to the public by each of the participating vendors for the activities with prices ranging from \$ to \$. There is no obligation that visitors purchase any goods or services to enjoy the festivities and holiday lights.

Law

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, educational, scientific, or other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(b)(1)(iii) of the Income Tax Regulations provides, generally, that an organization described in section 501(c)(3) of the Code shall submit a detailed statement of its proposed activities as part of its application for exemption.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order for an organization to be exempt under 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 Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. 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 Income Tax 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(a)-1(c) defines the words "private shareholder or individual" in Code section 501 as referring to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes under Code section 501(c)(3) unless it serves a public rather than a private interest. Thus, 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 or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Revenue Ruling 70-585 held that an organization providing housing to low-income families is exempt under section 501(c)(3) of the Code.

Revenue Ruling 76-441 described two situations in which a for-profit entity was converted to a non-profit entity. In situation 1 the organization was granted exemption because it established the conversion from for-profit to non-profit served a public and not a private interest. In situation 2 the organization was denied exemption because the founders benefitted from the transfer of the property to the non-profit entity because the non-profit entity assumed the liabilities of the for-profit entity.

Revenue Procedure 96-32, 1996-1 C.B. 717, sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable as described in section 501(c)(3) of the Internal Revenue Code because they relieve the poor and distressed. The revenue

procedure also describes the facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed. An organization must establish that at least (a) 75 percent of its units are occupied by low-income families, and (b) either 20 percent of the units are also occupied by very low-income residents or 40 percent of the units are occupied by residents whose incomes do not exceed 120 percent of the area's very low income limit. In addition, the housing is affordable to beneficiaries. In the case of rental housing, this requirement will ordinarily be satisfied by the adoption of a rental policy that complies with government-imposed rental restrictions or otherwise provides for the limitation of the tenant's portion of the rent charged to ensure that the housing is affordable to low-income and very low-income residents. The organization may not further the private interests of individuals with a financial stake in the project resulting from real property sales, development fees or management contracts.

Section 4.03 of Revenue Procedure 2014-9, provides, in part, as follows:

Exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. (1) A mere restatement of purposes will not satisfy this requirement. (2) The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures. (3) Where the organization cannot demonstrate to the satisfaction of the Service that it qualifies for exemption pursuant to the Section of the Internal Revenue Code under which exemption is claimed, the Service will generally issue a proposed adverse determination letter or ruling.

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

In Kenner vs. Commissioner, 318 F.2d 632 (7th Cir. 1963), and Cleveland Chiropractic Practical College vs. Commissioner, 312 F. 2d 203, 206 (8th Cir. 1963) the conditional language of section 501(c)(3) of the Code and the burden of proof placed upon the taxpayer is considered. In general, an organization that applies for recognition of exemption has the burden of proving that it clearly meets all the requirements of the particular section of the Code under which it has applied. The taxpayer must clearly demonstrate its right to exemption.

New Dynamics Foundation v. United States, 70 Fed. Cl. 782 (2006), the organization failed to establish an administrative record that showed it was operated for exclusively exempt purposes. The court held that exemption from federal income tax is not a right; it is a strictly interpreted matter of legislative grace and the burden rests with the applicant to prove that it is entitled to exempt status.

In Founding Church of Scientology v. United States, 412 F.2d 1197, 1200, 1202, 188 Ct. Cl. 490 (Ct.Cl 1969), the organization has the burden of providing sufficient documentation or other substantive information regarding its activities and operations, which would establish entitlement to tax exempt status, including establishing that its net earnings will not inure to the benefit of private individuals and that it will not serve private interests.

In Mercantile Bank & Trust Company v. United States, 441 F.2d 364 (8th Cir. 1971), the court stated that "Special benefits to taxpayers, such as tax exemption status, do not turn upon general equitable considerations but are matters of legislative grace. The taxpayer has the burden to show that it comes within the statutory provision allowing the deduction or exemption comes squarely within the terms of the laws conferring the benefit sought."

In Salvation Navy v. Commissioner, T.C.M. 2002-275 (2002), the Tax Court found that one of the reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that it was not organized to serve the private interests of its founder.

Application of Law

Section 501(c)(3) of the Code sets forth two main tests for an organization to be recognized as exempt. Section 1.501(c)(3)-1(a)(1) of the Regulations provides that in order for an organization to be exempt under section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. You have failed the operational test because you did not provide information to show that you are operated exclusively for 501(c)(3) purposes.

In order to establish its exemption, an organization must submit a detailed statement of its proposed activities as a part of its application for exemption. See Section 1.501(a)-1(b)(1)(iii) of the Regulations. You failed to provide the following items that are material to a determination of whether you satisfy the standards for exempt status:

- Details to determine if your housing is currently operating as low income and fulfills a charitable purpose.
- Details and documentation regarding the transfer of property to you that demonstrates the transaction did not lead to inurement to your trustees.
- Details to determine if your Christmas activities further an exempt purpose under Section 501(c)(3) of the Code.

The IRS has statutory and regulatory authority to inquire about an applicant's proposed activities and other subjects material to its determination of whether the applicant meets the standards for exempt status. Rev. Proc. 2014-9. Accordingly, gaps in the administrative record may be resolved against you. See Rev. Proc. 2014-9, Section 4.03. Despite our request, you failed to respond to questions that were material to determining whether you satisfy the standards for exempt status. Your exemption request is similar to Kenner vs. Commissioner, and Cleveland Chiropractic Practical College vs. Commissioner, above. Here, the court held that an organization has the burden of proving that it clearly meets all the requirements of the particular section of the Code under which it has applied. Your application and response lacked sufficient information to show that you meet the requirements to be classified as an exempt organization under Section 501(c)(3) of the Code. Like the organization in New Dynamics Foundation v. United States, you failed to show that you are operated exclusively for exempt purposes.

Though providing low income housing may fulfill an exempt purpose under Section 501(c)(3) of the Code, you have not shown that you engage primarily in activities that accomplish an exempt purpose. See Section 1.501(c)(3)-1(c)(1) of the Regulations. You are unlike the organizations described in Rev. Rul. 70-585. You did not provide information to show that the residents of your apartment building are low income and meet the guidelines set forth in Rev. Proc. 96-32. When your apartment building was transferred to you, there were already current tenants residing in the building. You did not provide information on the income levels of the tenants or how many units were occupied by low income residents. You only stated that it is illegal to break a lease so you have to honor the existing lease contracts that were in place at the time the building was transferred. Once those units vacate, you will place qualified tenants in the units. As stated above in Mercantile Bank & Trust Company v. United States, the burden of proof that the requirements for tax exemption are met falls upon you. By failing to provide information about the current residents of your apartment building, you have not carried your burden to demonstrate that your activities are exclusively in furtherance of exempt purposes.

You also failed to provide details and documentation regarding the transfer of property to you that demonstrates the transaction did not lead to inurement to your trustees. Your apartment building was donated by an LLC controlled by your founders who are also your trustees. The apartment building has a liability attached to it. You are unlike the organization in Situation 1 of Rev. Rul. 76-441. Your board is composed of the former owners of the apartment building. In that respect, you are similar to the organization in Situation 2 of Rev. Rul. 76-441. However, it is unclear whether the transfer of assets and liabilities was similar to that of Situation 2 since you declined to provide a qualified appraisal or other documentation on the property so we could determine if the assets transferred were greater than the liabilities. You only provided a statement indicating the value of the building and the outstanding loan amount. Charitable organizations cannot be operated to benefit insiders such as officers or directors. Per Section 1.501(c)(3)-1(c)(2) of the Regulations, 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. Like the organizations in Salvation Navy v. Commissioner and Founding Church of Scientology v. United States, you did not provide information to prove that you were not organized to serve the private interests of your founders who are also your trustees.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes under Code section 501(c)(3) unless it serves a public rather than a private interest. Thus, 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 or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. By not providing documentation about the transfer of the apartment building, you did not establish that you are not operated for the benefit of your trustees.

Per Section 1.501(c)(3)-1(c)(1) of the Regulations, 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) of the Code. You stated that your Christmas activities include train rides, arts and crafts workshops, pony rides, and petting zoos. These activities are social and recreational in nature, not

charitable or educational. Like in Better Business Bureau of Washington, D.C., Inc. v. United States, your Christmas activities do not fulfill an exempt purpose under section 501(c)(3) of the Code.

Conclusion

You do not meet the requirements under Section 501(c)(3) of the Code because you failed to establish your activities are exclusively charitable and that you do not operate for the private interest of your founders. Accordingly, you do not qualify for exemption as an organization described in Section 501(c)(3) of the Code.

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I 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.

For authorized representatives:

Under penalties of perjury, I declare that I prepared 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.

Your representative (attorney, certified public accountant, or other individual enrolled to practice

before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. 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*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

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

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Director, Exempt Organizations

Enclosure:
Publication 892