

Internal Revenue Service  
TEGE Appeals Programs  
300 N. Los Angeles Street  
Los Angeles, CA 90012

Department of the Treasury  
**CERTIFIED**

Number: **201534020**  
Release Number: 8/21/2015

Date: **MAY 26 2015**

Redaction legend:

A=

B=

C=



**Taxpayer Identification Number:**

**Person to Contact:**

\*\*\*\*

Employee ID Number: \*\*\*\*

Tel: (\*\*\*\* Fax: \*\*\*\*

**Refer Reply to:**

\*\*\*\*

**In Re: Exempt status**

**Tax Years:**

**UIL Index:**

501.03-00

Dear :

This is a final adverse determination as to your application for exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reason(s):

You have not demonstrated that you are organized and operated exclusively for charitable, educational, or other purposes and that no part of your net earnings inure to the benefit of private shareholders or individuals as required by section 501(c)(3) of the Internal Revenue Code. Treas. Reg. § 1.501(c)(3)-1(a)(1). You appear to be operated primarily for the purpose of carrying on a trade or business of buying, rehabilitating and selling or leasing real property. Treas. Reg. § 1.501(c)(3)-1(e)(1). Your proposed customers are not limited to any charitable class. Further, you have not established that

your operations serve public rather than private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown above.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> (ninety-first) day after the date this determination was mailed to you. 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.

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.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or 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 final adverse determination of your exempt status, as required by Code section 6104(c).

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

Sincerely,

Nan Shimizu  
Appeals Team Manager

cc:



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Date: : May 06, 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

Corporation            =

Service                =

X                         =

Dear                 :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code (I.R.C.) § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

**FACTS**

You incorporated as a non-profit corporation under your State laws. Your Articles of Incorporation provide that your "specific and primary purpose . . . is to assist governmental agencies lessen the burden of government, reduce vacant, abandoned, blighted, and poorly maintained homes and to assist people to obtain housing and to erect, maintain and rebuild public buildings, monuments or works." Specifically, you intend to partner with banks, state and local government entities, and home owners associations (HOAs) to help reduce blighted properties, stabilize communities, and aid in the foreclosure process.

Activities

You state that you will perform the following activities:

- Purchase of real property;
- Rehabilitation of real property;
- Sale of real property;
- Lease of real property;
- Lien negotiation;

- Community liaison; and
- Education.

You state that you will spend 75 percent of your time and money buying, rehabilitating, selling, and leasing properties. You will hire independent contractors to rehabilitate your properties. Then, you will either sell or lease your properties. If you lease the properties, you state that you will provide renters with a portable lease option. You explain that, under this option, the renter "can transfer their accumulated 'hard equity' (extra payments above rent, but not property appreciation) during the course of a lease" to the lease or purchase of any of your other properties. You state that you will impose no restrictions on who may rent your properties but that you will give preference to low and moderate income families, first-time homebuyers, and veterans. You state that the maximum allowable rent for these individuals will be "30 [percent] of gross income or 55 [percent] of net income and non-taxable income will be grossed up by 120 [percent] in calculating eligibility." Otherwise, you state that you will set rental rates using a "capitalization rate formula with an [x percent] maximum cap rate and a brokers price option to determine market value." If you sell the properties, you do not state whether you will sell at, above, or below market value. However, you state that all of your income "is derived from appreciated values received from the sale or rent of rehabilitated properties."

Furthermore, you state that you will spend 5 percent of your time and money negotiating liens on your properties. You state that you "can foreclose on approved vacant properties while negotiating priority lienholder forgiveness and beginning the process of blight resolution." Specifically, you state that you will work with local code enforcement officials to develop a plan to bring the property into compliance and to reach an agreement on the mitigation of code enforcement liens on candidate properties.

Finally, you state that will spend 5 percent of your time and money educating the public. However, you also state that you "will not offer HOA's educational program[s]." You describe no other educational activities.

#### Relationships with Other Organizations

You state that you are an "affinity partner" with the Corporation. The Corporation identifies properties for purchase and then provides you with a customized list of vacant and foreclosed properties. Additionally, you leverage the Corporation's banking relationships to help acquire bank owned properties. In exchange, you encourage municipalities to use the Corporation's services, including Service.

You describe your relationship with the Corporation as being "arm's length" but failed to provide a copy of your partnership agreement or contract with the Corporation. You describe yourself as "a highly marketable solution and potentially a very profitable opportunity for [the Corporation]." Additionally, you state that you will "grow the [Corporation] model" and "increase [the Corporation's] scope of services . . . further distancing [the Corporation] from potential competition and assisting [the Corporation] in [its] marketing of new sales opportunities." Finally, you state that if you fail to acquire a property at auction, "then [the Corporation] will still make a small profit via the passed on research and preparation document costs."

Additionally, you state that you anticipate having relationships with other organizations and government entities but that no such relationships currently exist.

## **LAW**

I.R.C. § 501(a) provides that an organization described in § 501(c) shall be exempt from taxation under this subtitle unless such exemption is denied under § 502 or § 503.

I.R.C. § 501(c)(3) describes corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in I.R.C. § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) 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 I.R.C. § 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.

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more of exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, 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.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in I.R.C. § 501(c)(3) in its generally accepted legal sense and includes, among other things, lessening the burdens of government, relief of the poor and distressed or of the underprivileged, advancement of education or science, erection or maintenance of public buildings, monuments, or works, and promotion of social welfare by organizations designed to accomplish any of the above purposes, or to defend human and civil rights secured by law.

Rev. Rul. 68-17, 1968-1 C.B. 247, held that an organization formed to conduct a model demonstration housing program for low-income families and disseminate information about the results of the program qualified for recognition under § 501(c)(3). The organization's

membership consisted of other nonprofit institutions, neighborhood groups, and individuals. The object of the demonstration program was to test the feasibility, cost, procedural and financial aspect of providing housing for low-income families through the acquisition, rehabilitation, and resale or lease of residential structures in a deteriorating neighborhood. Local government officials and departments cooperated in the program by preparing renewal plans and transferring properties taken through tax foreclosure to the organization at cost. The organization sold or leased homes rehabilitated by the organization in the model demonstration program to low-income or displaced families on a nonprofit basis. The organization did no new construction. A grant from the Department of Housing and Urban Development (HUD) provided part of the financing for the organization's project. The organization obtained supplemental financing from public contributions and the sale of interest-bearing obligations. The ruling held that the organization performed charitable activities because its demonstration program combated community deterioration.

Rev. Rul. 70-585, 1970-2 C.B. 115, held generally that an organization formed for charitable purposes and accomplishing those purposes through a program of providing housing for low and, in certain circumstances, moderate income families qualifies for recognition under § 501(c)(3).

Situation 1 involved an organization formed to provide new home construction and the renovation of existing homes for sale to low income families on long-term, low-payment plans. It purchases homes for renovation and lots for building new homes throughout the city in which it is located. It builds new homes for sale to low income families who qualify for loans under a Federal housing program and who cannot obtain financing through conventional channels. It also aids financially those families eligible for the loans that do not have the necessary down payment. Rehabilitated homes are made available to families who cannot qualify for any kind of mortgage loan. The cost of these homes is recovered, if possible, through very small periodic payments. The organization derives its operating funds through Federal loans and contributions from the general public. Where possible, renovations are made with volunteer help. The organization performed charitable activities because it relieved the poor and distressed by providing homes for low income families who otherwise could not afford them.

Situation 2 involved an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open occupancy basis. Housing units were sold at or below cost to low or moderate income families or rented, with options to purchase, to families who could not afford to purchase. Preference was given to families previously located in ghetto areas. The organization was financed by contributions from the general public and by funds obtained under Federal and State housing programs. The ruling held that the organization engaged in charitable activities because its activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions.

Situation 3 involved an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. Studies of the area showed that the median income levels in the area were lower than in other sections of the city and the housing located in the area is generally old and badly deteriorated. The organization's membership was composed of the residents, businesses, and community organizations in the area. The organization cooperated with the local redevelopment authority in providing residents of the

area with decent, safe, and sanitary housing without relocating them outside the area. The organization is supported by Federal funds, membership fees, and contributions. The ruling held that the organization engaged in charitable activities because its activities combated community deterioration by assisting in the rehabilitation of an old and run-down residential area.

Situation 4 involved an organization formed to build new housing facilities for the purpose of helping families to secure, decent, safe, and sanitary housing at prices they can afford. Its membership is composed of community organizations that are concerned with the growing housing shortage in the community. A study of the area shows that because of the high cost of land, increased interest rates, and the growing population, there is a shortage of housing for moderate income families in the community. The organization planned to erect housing that would be rented at cost to moderate income families. The organization is financed by mortgage money obtained under Federal and State programs and by contributions from the general public. The ruling held that the organization did not perform charitable activities because the organization's program was not designed to provide relief to the poor or to carry out any other charitable purpose.

Rev. Proc. 96-32, 1996-1 C.B. 717, sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable under § 501(c)(3) for relieving the poor and distressed, and describes the facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed. It also clarifies that housing organizations may rely on other charitable purposes to qualify for recognition of exemption. The safe harbor requires that the housing be affordable to the charitable 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. In the case of homeownership programs, this requirement will ordinarily be satisfied by the adoption of a mortgage policy that complies with government-imposed mortgage limitations or otherwise makes the initial and continuing costs of purchasing a home affordable to low and very low-income residents. Facts and circumstances that demonstrate relief of the poor may include, but are not limited to, the following:

- (1) A substantially greater percentage of residents than required by the safe harbor with incomes up to 120 percent of the area's very low-income limit.
- (2) Limited degree of deviation from the safe harbor percentages.
- (3) Limitation of a resident's portion of rent or mortgage payment to ensure that the housing is affordable to low-income and very low-income residents.
- (4) Participation in a government housing program designed to provide affordable housing.
- (5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization's operations.

- (6) The provision of additional social services affordable to the poor residents.
- (7) Relationship with an existing § 501(c)(3) organization active in low-income housing for at least five years if the existing organization demonstrates control.
- (8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.
- (9) Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.
- (10) Existence of affordability covenants or restrictions running with the property.

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 private benefit, if substantial in nature, will destroy an organization's tax-exempt status regardless of the organization's other charitable purposes or activities.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court determined that the American Campaign Academy, a training program for political campaign professionals, operated for the private benefit of the Republican party because the its curriculum was tailored to Republican interests. The Tax Court defined private benefit as "nonincidental benefits conferred on disinterested persons that serve private interests." Private benefits included "advantage; profit; fruit; privilege; gain; [or] interest." However, "[o]ccasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefit."

## **ANALYSIS**

An organization seeking tax-exempt status under § 501(c)(3) must be organized and operated exclusively for charitable or other exempt purposes with no part of its net earnings inuring to the benefit of any private shareholder or individual. Treas. Reg. § 1.501(c)(3)-1(a)(1). The presence of a single non-exempt purpose, if substantial in nature, will destroy exemption under § 501(c)(3) regardless of the number or importance of any other exempt purposes. Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945); see Treas. Reg. § 1.501(c)(3)-1(c)(1). Based on the information and supporting documentation, you do not qualify for recognition under § 501(c)(3) because you operate for one or more substantial nonexempt purpose.

Your primary activity is buying, rehabilitating, selling, and leasing properties. In certain circumstances, this activity may be a charitable activity within the meaning of § 501(c)(3). See Treas. Reg. § 1.501(c)(3)-1(d)(2); Rev. Rul. 70-585 (Situations 1 through 3); Rev. Rul. 68-17. However, your housing rehabilitation program fails to combat community deterioration, eliminate prejudice and discrimination, lessen neighborhood tensions, or provide relief to the poor and distressed or underprivileged. First, you do not target any specific areas in your State for

rehabilitation, including areas with actual or potential deterioration or in which prejudice and discrimination exist. Second, you do not intend to use volunteers to rehabilitate your properties. Third, you intend to sell your properties at market rates. Market rates may be at or below cost, but you provide no information about your anticipated purchase prices or rehabilitation costs. Whether you will profit from the sale your rehabilitated properties is unknown. Fourth, you do not intend to provide financial assistance. Finally, your primary source of income will be from the sale of properties.

Furthermore, the facts and circumstances do not establish that your activities relieve the poor and distressed. See Rev. Proc. 96-32. First, you do not indicate how you will choose purchasers for your rehabilitated properties. Second, you indicate that you will only limit some, not all, renters' monthly payments. The individuals receiving discounted rent do not necessarily comply with definition of "low-income" or "very low-income" describe in Rev. Proc. 96-32. Third, you do not indicate whether purchasers' mortgage payments will be limited in order to ensure that the housing is affordable to low-income residents or whether you will impose any affordability covenants or restrictions that will run with the land. Fourth, you do not participate in any government housing programs designed to provide affordable housing or homeownership programs designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing. Fifth, you failed to establish that you operate through a community-based board of directors. Finally, you do not have any relationships with existing § 501(c)(3) organizations active in low-income housing for at least five years. For these reasons, your housing rehabilitation activity is not a charitable activity within the meaning of § 501(c)(3). You spend 75% of your time and money conducting your housing rehabilitation activities. Accordingly, you are not operated exclusively for one or more exempt purpose.

Additionally, 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 or if it serves a public rather than private interest. Treas. Reg. §§ 1.501(c)(3)-1(c)(2) & (d)(1)(ii). The organization seeking recognition bears the burden of establishing that it is not operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). The courts also define private benefit as "nonincidental benefits conferred on disinterested persons that service private interests." American Campaign Academy, 92 T.C. 1053. "Prohibited private benefit may include an 'advantage; profit; fruit; privilege; gain; [or] interest.'" Id.

You failed to establish that you are not operated for the benefit of private interests. You describe your relationship with the Corporation as being "arm's length" but the facts and circumstances indicate otherwise. You appear to operate for the Corporation's benefit by "increase[ing] the Corporation's] scope of services," "further distancing [the Corporation] from potential competition," and "assisting [the Corporation] in [its] marketing of new sales opportunities." Furthermore, the Corporation may profit from your operations. Accordingly, your operations may benefit private interests.

## CONCLUSION

Based on the above, we have determined that you fail to meet the requirements necessary to be recognized as a tax-exempt organization under § 501(c)(3). 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.

Your protest statement should 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 the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. For more information about representation, see 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 protest 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 this address:

Internal Revenue Service

1111 Constitution Ave, N.W.  
Washington, DC 20224

You may also 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,

Michael Seto  
Manager, EO Technical