

**Internal Revenue Service**  
Appeals Office

**Department of the Treasury**

**Employer Identification Number:**

**Date:** MAR 04 2016

**Person to Contact:**

Number: **201622035**  
Release Date: 5/27/2016

Employee ID Number:  
Tel:  
Fax:

**UIL: 501.03-05**

**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 effective July 1, 2011.

Our revocation was made for the following reason(s):

You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). More than an insubstantial part of your activities was not in furtherance of an exempt purpose.

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 of 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,

Appeals Team Manager

Enclosure: Publication 892 and/or 556

**Internal Revenue Service  
Tax Exempt and Government Entities Division**

**Department of the Treasury**

**Date: FEB 13 2015**

**Taxpayer Identification Number:**

**Form:**

**Tax Year(s) Ended:**

**Person to Contact/ID Number:**

**Contact Numbers:**

Telephone:

Fax:

**Manager's name/ID number:**

**Manager's Contact Number:**

**Response due date:**

**Certified Mail – Return Receipt Requested**

Dear :

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service  
Office of the Taxpayer Advocate  
300 N. Los Angeles St., Room 5109, Stop 6710  
Los Angeles, CA 90012

Phone#: (213) 576-3140

**For additional information**

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer  ORG	Tax Identification Number	Year/Period ended 6/30/20XX, 6/30/20XX, 6/30/20XX

**Issue**

Whether ORG ("ORG") was operated exclusively for charitable or educational purposes within the meaning of Internal Revenue Code ("IRC") section 501(c)(3).

**Facts**

ORG incorporated on January 28, 19XX in State and is currently in active status according to the State State Secretary of State.

ORG states that it is currently in the process of dissolving but has not filed articles of dissolution with the State of State nor a final return tax return with the IRS.

Per the Articles of Incorporation, ORG is organized exclusively for charitable and educational purposes within the meaning of IRC section 501(c)(3). ORG's purpose is to promote social welfare of City and City by fostering business development likely to benefit low and moderate-income people in the City and City areas.

With Form 1023 dated November 30, 19XX, ORG applied for exemption under IRC section 501(c)(3) to:

1. Create new jobs, promote business growth, and promote economic revitalization in the economically depressed area of City, State,
2. Provide access for small businesses to financing and business consulting,
3. Target businesses that create employment opportunities for low to moderate income families, especially minority and women-owned businesses,
4. Acquire a building and rent low-cost space to small businesses and entrepreneurs,
5. Provide low cost on-site management services,

The IRS issued Letter 1050 in October 19XX recognizing ORG as an exempt organization described in IRC section 501(c)(3) and a public charity described in Code section 170(b)(1)(A)(vi).

Per its amended bylaws, adopted on March 3, 19XX, ORG is to:

1. Promote social welfare by fostering business development, providing financial and managerial services, providing educational and technical services to enhance the survival and development of entrepreneurship and businesses likely to benefit low and moderate income people,
2. Organize and manage a small business incubator,
3. Secure financing to build or rent a facility to house companies, which may seek to do business within this incubator.

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The following table compares ORG's revenues and expenses reported on the Form 990's under examination and shows the organization incurred a loss in each year.

	GROSS REVENUES			% of Total Revenue		
	Form 990 20XX	Form 990 20XX	Form 990 20XX	20XX	20XX	20XX
Contributions: Gov't Grants	0		0	0%	0.0%	0%
Contributions: All Other	0	0		0%	0.0%	0%
Program Service Revenue (1): Rental Income	0	0	0	0%	0.0%	0%
Program Service Revenue (2): DSL Income	0	0		0%	0.0%	0%
Program Service Revenue (3): Misc.	0	(0)	0	0%	-0.0%	0%
Program Service Revenue (4): Service Support	0			%	0.0%	0.0%
Miscellaneous Revenue: All Other:			0	0.0%	0.0%	0.0%
<b>TOTAL REVENUE</b>	<b>0</b>	<b>0</b>	<b>0</b>			

	EXPENSES			% of Total Revenue		
	Form 990 20XX	Form 990 20XX	Form 990 20XX	20XX	20XX	20XX
Compensation of current officers			0	0.0%	0.0%	0%
Fees: Legal:			0			0%
Fees: Accounting:	0	0	0	0%	0.0%	0%
Fees: Fundraising:	0			0%	0.0%	0%
Fees For Services: Other:	0	0	0	0%	0.0%	0%
Advertising And Promotion:				0%	0.0%	0%
Office Expenses:	0	0	0	0%	0.0%	0%
Interest:	0	0	0	0%	0.0%	0%
Depreciation, Depletion, Amortization:	0	0	0	0%	0.0%	0%
Insurance:	0	0	0	0%	0.0%	0%
Other Expenses (1): Utilities	0	0	0	0%	0.0%	0%
Other Expenses (2): Property Taxes	0	0	0	0%	0.0%	0%
Other Expenses (3): Janitor	0	0	0	0%	0.0%	0%
Other Expenses: All Other:	0	0	0	0%	0.0%	0%
<b>TOTAL EXPENSES</b>	<b>0</b>	<b>0</b>	<b>0</b>			

ORG owns a 0 sq. ft. commercial office building and an adjacent parking lot located at Address, City, State that is debt-financed with acquisition indebtedness. The commercial building has approximately 0 offices and cubicles available to rent at below market rates by the public.

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ORG's tenant selection process consists of:

1. Completing a standard lease obtained from the American Industrial Real Estate Association
2. Providing rental history, employment history, credit info,
3. Providing a brief description of their business.

ORG's largest tenants from July 1, 20XX to June 30, 20XX, were:

- Law Offices (6),
- Marketing Firms and Special Event Staffing (5),
- Exempt Organizations (3),
- Real Estate (2),
- Financial Service Providers (2),
- Hospice and Assisted Living Providers (2),
- Communication Businesses (2)

During the 12-month period ended June 30, 20XX, ORG offered two online one-day seminars on QuickBooks and using social media for marketing. The President stated ORG did not have the capacity to conduct an extensive amount of charitable or educational activities.

ORG's day-to-day operations and property management activities were performed by:

1. Volunteers, and
2. Independent contractors

### Law

Code section 501(c)(3) provides exemption from federal income taxes of organizations organized and operated exclusively for charitable and educational purposes....

Code section 511(a)(1) imposes a tax on the unrelated business taxable income of organizations described in section 501(c).

Code section 512(a)(1) defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions which are directly connected with the carrying on of such trade or business.

Code section 512(b) provides that all **rents** from real property are excluded from the term "unrelated business taxable income" except in the case of amounts derived from debt-financed property (as defined in section 514).

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Code section 513(a) provides that the term "unrelated trade or business" means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Code section 514(b)(1) defines "debt-financed property" as any property that is held to produce income and with respect to which there is an acquisition indebtedness at any time during the taxable year.

Code section 514(b)(1)(A)(i) provides that the term "debt-financed property" does not include any property substantially all the use of which is substantially related (aside from the need of an organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

Regulation section 1.501(c)(3)-1(a) 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 test or the operational test, it is not exempt.

Regulation section 1.501(c)(3)-1(b) **Organizational test--(1)** In general. (i) An organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities, which in themselves are not in furtherance of one or more exempt purposes.

Regulation section 1.501(c)(3)-1(c) **Operational test--(1) Primary activities.** 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.

Regulation section 1.501(c)(3)-1(d)(i) **Exempt purposes--** An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for purposes such as:

- (a) Charitable,
- (b) Educational

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Regulation section 1.501(c)(3)-1(d)(ii) provides an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest.

Regulation section 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. The term includes: relief of the poor and distressed or of the underprivileged; lessening of the burdens of Government; and promotion of social welfare. The Service has long held that poor and distressed beneficiaries must be needy in the sense that they cannot afford the necessities of life. See Rev. Proc. 96-32, 1996-1 C.B. 717, section 2.01

Regulation section 1.501(c)(3)-1(d)(3) provides that the term "educational" refers to: (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) The instruction of the public on subjects useful to the individual and beneficial to the community.

Regulation section 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3).

In Revenue Ruling 76-419, 1976-2 C.B. 146, a nonprofit organization was formed with the objectives of the relief of poverty, dependency, chronic unemployment, and underemployment, and the reduction of community tensions in an economically depressed community. In furtherance of these purposes the organization encouraged industrial enterprises to locate new facilities in the economically depressed area in order to provide more employment opportunities for low-income residents. The organization purchased blighted land in the depressed area and converted it into an industrial park. Lots in the industrial park were leased to industrial enterprises on terms sufficiently favorable to attract tenants to the area. Tenants were required by their lease with the organization to hire a significant number of presently unemployed persons in the area and to train them in needed skills. The organization in selecting tenants for the industrial park, considered only those industrial enterprises whose hiring policies conformed to current fair employment law. Enterprises that had initial requirements for low skill workers were favored over those with initial high skill job requirements, since the former were of greater immediate benefit to the surrounding depressed community. The area in which the organization was active had been identified by

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governmental authorities as having a high ratio of unemployed and underemployed low-income people.

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. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352, 357-358 (1978), the Tax Court held that when considering whether an organization qualifies for exemption under section 501(c)(3) the critical inquiry is whether petitioner's primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for petitioner. Factors such as the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits are relevant evidence of a forbidden predominant purpose.

### Government's Position

An organization may be held exempt only if its primary purpose is to engage in the type of activity prescribed in the Code section under which it claims exemption. If it is found that an organization's primary purpose is the conduct of a business of a type ordinarily carried on for profit, and not the furtherance of an exempt purpose, exemption cannot be established

ORG's Articles of Incorporation, Form 1023, and Amended Bylaws establish it was organized for charitable and educational purposes:

1. Promoting economic revitalization in an economically depressed area serves a charitable purpose and benefits a charitable class of people.
2. Creating employment opportunities for the poor, distressed, or underprivileged serves a charitable purpose and benefits a charitable class of people.
3. Offering seminars and technical training to entrepreneurs serves an educational purpose

Based on the interview of ORG's President and the examination of operational and financial records it cannot be established ORG was operated for charitable and educational purposes because the organization only carried out a marginal amount of activities that further an exempt purpose. The only educational activities conducted during the year ended June 30, 20XX were two seminars on QuickBooks and social media. ORG did not provide any financial assistance to small businesses or non-profits as stated in the Articles of Incorporation.

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There is no evidence ORG promoted economic revitalization in an economically depressed. ORG's commercial building was not located in a blighted area as described in Revenue Ruling 76-419. Per www.bestplaces.net, City, State has maintained a strong job market and employment growth compared to the rest of the United States.

Economy	City, CA	United States
<u>Unemployment Rate</u>	0%	0%
<u>Recent Job Growth</u>	0%	0%
<u>Future Job Growth</u>	0%	0%
<u>Sales Taxes</u>	0%	0%
<u>Income Taxes</u>	0%	0%
<u>Income per Cap.</u>	\$0	\$0
<u>Household Income</u>	\$0	\$0
<u>Family Median Income</u>	\$0	\$0

All of ORG's resources were devoted to managing the building and rental activities. From July 1, 20XX to June 30, 20XX, 0% of ORG's gross revenues were from rental income.

From July 1, 20XX to June 30, 20XX, there was an insubstantial amount of expenditures that furthered an exempt purpose:

- 0% of ORG's gross expenses were related to interest for the building and parking lot,
- 0% of ORG's gross expenses were depreciation,
- 0% of ORG's gross expenses were utilities,
- 0% of ORG's gross expenses were property taxes,
- 0% of ORG's gross expenses were related to janitorial services

ORG contracted a property manager to execute leases, collect rent, manage the building, and oversee major repairs. The property manager did not have a criteria used to select tenants. ORG provided office space to anyone that could afford it without any consideration given to whether the tenant was in a charitable class or would provide relief to a charitable class. Renting office space to the public does not further an exempt purpose.

Because the building is debt-financed property" as defined by Code section 514(b)(1), the rental activity is an unrelated trade or business as provided by Code section 513(a).

Based on the fact that the majority of resources used by ORG are related to the rental activities, and the absence of activities which further an exempt purpose, ORG fails the operational test provided in §1.501(c)(3)-1(c)(1) of the Regulations and is not entitled to exemption under §501(c)(3) of the Code. Similarly to *Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945)*, the presence of a single **non-exempt purpose**, substantial in nature, disqualifies the organization from exemption.

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**Taxpayer's Position**

The Assigned Agent presented the facts, law, and government's position to the taxpayer and is awaiting their response.

**Conclusion**

ORG's primary purpose was to maintain a commercial office building and rent office space to the public. The tenants were not a charitable class of individuals and renting office space at below market rates did not serve an exempt purpose. ORG was not operated exclusively for charitable or educational purposes within the meaning of IRC section 501(c)(3).

Accordingly, ORG's exempt status should be revoked effective July 1, 20XX. Contributions will no longer be deductible under section 170 of the Internal Revenue Code. Form 1120 returns should be filed for all tax periods ending on or after June 30, 20XX.