



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

Release Number: **201641027**  
Release Date: 10/7/2016

Date: July 14, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.33-00, 501.36-01

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,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

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  
P.O. Box 2508  
Cincinnati, OH 45201

Date: May 26, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = State  
C = Date  
D = Location  
F = Name  
G = Name  
H = Name  
J = Name  
K = Name  
L = Name  
M = Name  
N = Organization Name  
Q = Organization Name  
R = County  
S = County  
v = Number  
w dollars = Amount  
x dollars = Amount  
y dollars = Amount  
z dollars = Amount

**UIL:**

501.33-00  
501.36-01

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 explained below.

## **Facts**

You incorporated in the State of B on C. Your Articles of Incorporation state:

“Said corporation is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501 (c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code.”

According to your Bylaws, your specific objective and purpose shall be: “(a) to provide a centralized location to provide care to the underserved population in rural D area in Southern B; (b) to continue to advance and include more services at the needs of the populace.”

Your governing body is composed of F, G, H, J, K, L and M. F and G are husband and wife, as are H and J and K and L. F is the daughter of H and J. F, J and K are owners/partners of N. M is an employee of N.

The partners at N have a common goal to further assist the residents of their community by creating a safe and convenient place for those residents to obtain quality patient care on a broad scale. You stated the South D area is underserved and that an industry analysis shows the area is considered both rural and a healthcare professional shortage area. You will achieve your goal by providing a centralized location where the majority of the patients’ healthcare needs are met. This would include, but is not limited to, primary care, pharmacy, physical therapy, alternative medicine, mental health counseling, and imaging services.

Since your goal is to provide the community with increased access to healthcare, you will only lease space to organizations and individuals in the healthcare industry. You state that as a charitable corporation, you “will require the least amount of compensation for rent as possible while still collecting enough revenue to maintain operation, security, and basic supplies.” All spaces will be leased at an equal price per square foot to all tenants and the revenue you collect from lease payments will be used to pay for the general expenses for the building. Any additional grants or donations will be used for expansions and/or charities as approved by the Board of Directors.

Your market will only be towards companies that are in the healthcare industry and whose values align with your own. These companies will provide medical care and services to patients located in a Health Professional Shortage Area established by the US Department of Health and Human Services. You will be able to offer your business partners and their patients access to close medical care since the closest medical office other than N is six miles north of N. Based on your research, you feel you will be a viable and thriving business investment in current and future markets.

Your long-term goal consists of building a v square foot brick and mortar building in Southern D proper. You have identified two occupants thus far, N and Q, both of which are for-profit companies. Q already has a large business to business pharmaceutical establishment, but would like to branch out into retail pharmacy. The owners of N will also lease a substantial amount of space, enough to support 4 to 5 staff members.

In order to secure occupants, you plan to offer each company a service they cannot get anywhere else. You stated that while you aim to be a non-profit corporation, you still have to operate with the economic principles of supply and demand. You therefore need to create a supply that other medical industries want to demand.

In addition to the physical facility, you will offer the following services: advertisement, conference room, landscaping, security and maintenance, power, internet, office supplies, elevator, and trash and recycling services. You can also offer customized services based on actual client needs versus what you think the client wants. These customized service plans will help create long-term clients and ultimately help the public. You will place signs on nearby roadways that will post the names of the businesses located at your facility. You will also advertise through your website, in newspapers, on the radio and possibly through flyers. Your website will have basic business information and links to your clients' businesses.

Your business plan will provide solutions to those looking for better healthcare services. It will also provide options for you to prioritize which services are in higher demand; this will help you maintain a competitive edge when selecting which companies to affiliate with.

In the beginning, your operations will consist of fundraising and obtaining grants and donations to build the facility that will house all the necessary care facilities. You also hope to secure signed contracts and commitments from a majority of the business partners that will operate out of the new building in order to help you obtain any necessary building loans. You have spoken with different contractors and expect the building to cost approximately y dollars. Once the building has been constructed, you will continue to oversee the operation and maintenance of the building. Your financial strategy focuses on paying down the loan required to build the new facility. You will make a small profit until the maturity date of the loan in 27.5 years.

Once the building is complete, you will rely on the rents from tenants to continue to offer your services. You expect that you will need to bring in z dollars per month to break even. This would result in a charge of over x dollars per square foot to your occupants. You anticipate that the monthly rental payments could be reduced considerably with the receipt of grants and donations. This would allow each individual company to pass the savings onto their clients. Your proposed pricing plan allows enough income to pay for the services offered and pay the loan for the building. As your business expenses decrease over time, your profitability rises. You stated that it is important to make sure the rents you receive are more than the expenses, but not too high to cause your renters to vacate. While your price per square foot is higher than the average paid in southern B, it is made up for in the amenities you offer to your clients. You stated that while there are other options in R and S counties for other companies to lease space, none will offer the level of comfort, convenience, and confidence that you will offer.

You have evaluated the competitive market and found that there are two main companies that pose a competitive risk to you. You have also determined that there are three main market divisions which impose a competitive risk to you: government non-profits, independent non-profits, and for-profit facilities. Government non-profits and independent non-profits pose the greatest competitive risk to you. However, while all of the competitors offer services similar to yours, you will maintain several advantages over your competition including the fact that you are a local company that understands the needs of local individuals and the fact that you will have a new facility that will offer multiple types of services. You also state that your services will be better than the competition because the services are everyday needs that a business has, the prices will be competitive but affordable, and a personalized plan is available.

## **Law**

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of organizations organized and operated exclusively for charitable or educational purposes, provided that no part of their net earnings inures to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(a)-1(c) defines "private shareholder or individual" to mean persons having a personal and private interest in the activities of the organization.

Treas. Reg. Section 1.501(c)(3)-1(a)(1) 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.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) states 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). 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. Section 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. Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated exclusively for one or more 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. Section 1.501(c)(3)-1(d)(2) defines the term "charitable" as used in section 501(c)(3) of the Code. It includes the relief of the poor and distressed, lessening the burdens of government, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, eliminate prejudice and discrimination or combat community deterioration and juvenile delinquency.

Rev. Rul. 69-545, 1969-2 C.B. 117, held that since the purpose and activity of a hospital, apart from its related educational and research activities and purposes, are providing hospital care on a nonprofit basis for members of its community, it is organized and operated in furtherance of a purpose considered 'charitable' in the generally accepted legal sense of that term. The promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community. By operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, the hospital is promoting the health of a class of persons that is broad enough to benefit the community.

Rev. Rul. 69-572, 1969-2 C.B. 119, held that a nonprofit organization, created to construct and maintain a building for the exclusive purpose of housing and serving exempt member agencies of a community chest, may be exempt under section 501(c)(3) of the Code. The organization's building was erected on city land that is the subject of a long-term lease under which the organization pays only a nominal rental and is committed to use the premises for the exclusive purpose of housing and otherwise serving the community chest agencies.. Office space in the building is leased to member agencies at a rate that makes the organization's rental income approximately equal to its total annual operating costs without any allowance for depreciation. This results in a rental rate that is substantially less than commercial rates for comparable facilities.

Rev. Rul. 73-313, 1973-2 C.B. 174, held that an organization formed and supported by residents of an isolated rural community to provide a medical building and facilities at reasonable rent to attract a doctor who would provide medical services to the entire community is exempt under section 501(c)(3) of the Code. The community represented by the organization is a relatively isolated rural area. For a number of years there had been no medical practitioners located in the area, and the nearest regular practicing doctors were located a considerable distance away. To correct the deficiency and to assist in inducing a doctor to locate in the area, the organization erected a building suitable for use as a doctor's office. Funds for this purpose were raised by contributions from members of the community. The building contained office space, treatment rooms, and the basic equipment generally necessary for housing a modern medical practice. Using the availability of the building on a reasonable rental basis as an inducement, the organization entered into an arrangement with a doctor to locate in the community. In these circumstances, any personal benefit derived by the doctor (the use of the building in which to practice his profession) does not detract from the public purpose of the organization nor lessen the public benefit flowing from its activities and is not considered to be the type of private interest prohibited by the regulations.

In Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes. The activities of the organization in Better Business Bureau of Washington, D.C., Inc v. United States were in part aimed at promoting the prosperity and standing of the business community and were held to serve a substantial non-exempt purpose.

In Old Dominion Box Co. v. United States, 477 F. 2d 340 (4th Cir. 1973), cert. denied 413 U.S. 910 (1973), the Fourth Circuit held that operating for the benefit of private parties constitutes a substantial nonexempt purpose.

B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978) describes an organization whose sole activity was to provide consulting services for a fee to nonprofit organizations. It provided qualified persons to perform research projects for its clients. The fees charged by the organization were set at or close to cost but were not less than the organization's full cost of providing its service. The organization was denied exemption because it operated in a commercial, nonexempt manner. The provision of managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The court held that the organization was not operated exclusively for charitable, educational or scientific purposes within the meaning of section 501(c)(3) of the Code.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the Sixth Circuit court found that although the organization did serve religious and charitable purposes, it existed to serve the private benefit of its founders, and thus failed the operational test of section 501(c)(3). Control over financial affairs by the founder created an opportunity for abuse.

In Airlie Foundation v. Internal Revenue Service, 283 F. Supp. 2d 58 (D.D.C., 2003), the district court relied on the "commerciality doctrine" in applying the operational test. The operational test requires both that an organization engage "primarily" in activities that accomplish its exempt purpose and that not more than an "insubstantial part of its activities" further a non-exempt purpose. 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 court stated:

Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.

In Asmark Institute, Inc. v. Commissioner of Internal Revenue, 486 Fed. Appx. 566. T.C. Memo 2011-20, the appeals court upheld the tax court decision that Asmark Institute is not entitled to exempt status under section 501(c)(3) of the Code because the institute's operations were commercial rather than charitable. Its activities consist mainly of compliance services for a fee.

### **Application of law**

You are not described in section 501(c)(3) of the Code and Treas. Reg. Section 1.501(c)(3)-1(a)(1). You fail the operational test for exemption under 501(c)(3) because you will operate in a commercial manner.

In the general law of charity, promotion of health is a charitable purpose. Rev. Rul. 69-545. Therefore, assisting an isolated community lacking medical care to secure such care by reasonably necessary means is a method of promoting health in the legal sense of the term in the law of charity and, therefore, a charitable purpose. However, your purpose is not inherently charitable as defined in Treas. Reg. Section 1.501(c)(3)-1(d)(2). You are similar to the organization in Rev. Rul. 73-313 in that you were formed to bring medical facilities to a rural area. However, unlike Rev. Rul. 73-313, you were not formed by residents of the community. Additionally, while you plan to locate in a rural area, N is already located in that area so medical care is already present and the next closest facility is six miles from N. You were formed by the owners of a for-profit medical practice, N, that plans to lease space in the facility. The owners of N are on your board. Also unlike the organization in Rev. Rul. 73-313, your activities will result in substantial private benefit and inurement. While there may be some public benefit derived from building a facility that will contain multiple medical specialties, your activities are commercial in nature and the benefit to the for-profit businesses outweighs any public benefit. Like the organization in Basic Bible Church you will serve the interests of your founders by constructing a building from which their for-profit business will operate.

Your fee based service activities show that you are similar to the organizations in B.S.W. Group, Inc., Airlie Foundation, and Asmark Institute and you have a substantial non-exempt commercial purpose. You will provide services to your for-profit clients in the form of leasing office space and providing related services. You stated that in order to secure occupants, you plan to offer each company a service they cannot get anywhere else. You also stated that while you aim to be a non-profit corporation, you still have to operate with the economic principles of supply and demand. You therefore need to create a supply that other medical industries want to demand. You indicated that based on your research, you feel you will have a viable and thriving business investment in current and future markets. Like a regular commercial business, you evaluated the competitive market to find the companies that pose a competitive risk to you. You determined that there are three main market divisions which impose a competitive risk to you: government non-profits, independent non-profits, and for-profit facilities. You indicated that you will maintain several advantages over your competition including the fact that you are a local company that understands the needs of local individuals and the fact that you will have a new facility that will offer multiple types of services. You also stated that your services will be better than the competition because the services are everyday needs that a business has, the prices will be competitive but affordable, and a personalized plan is available. In addition to the physical facility, you will offer the following services: advertisement, conference room, landscaping, security and maintenance, power, internet,

office supplies, elevator, and trash and recycling services. You can also offer customized services based on actual client needs. You will advertise your clients' businesses through your website, signs, and other means. Your rental rate will be set at an amount to cover your costs and make a profit. These facts demonstrate a commercial and substantially non-exempt purpose inconsistent with section 501(c)(3) of the Code and Treas. Reg. Section 1.501(c)(3)-1(c)(1).

You are similar to Better Business Bureau of Washington, D.C. Inc. and Old Dominion Box Co. because you operate for the benefit of private business interests. You operate for the private interests of your client businesses for whom you provide various services for a fee. You also operate for the private interest of your founders, as all are either owners or employees of, or related to the owners of, N, a business you will provide services to. Therefore, you are not organized or operated exclusively as described in Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii). As a result of expending funds to advertise the business of N, you are conferring a benefit to them. Additionally, you anticipate that the monthly rental payments from the for-profit businesses could be reduced considerably with the receipt of grants and donations. This would result in private benefit to the for-profit businesses. Since the owners of N are insiders as defined in Treas. Reg. Section 1.501(a)-1(c), this would result in inurement to them as referenced in Treas. Reg. Section 1.501(c)(3)-1(c)(2).

Your rental activities are not similar to those in Rev. Rul. 69-572. Your facility will be rented to for-profit organizations, not 501(c)(3) organizations. Therefore, your activities do not fulfill a charitable purpose and any reduction in rental rates to the for-profit entities through grants or donations would result in private benefit to the for-profit entities. They will also result in inurement to the owners of N who are also your board members.

#### **Your position**

You provided additional information in which you stated that while your primary activity may appear to have the characteristics of a trade or business, what sets you apart is the amount of charity given towards those businesses you associate with. You indicated that many businesses in the local area can rent or lease space anywhere for x dollars – w dollars per square foot; on the other hand, you will only collect enough rents or lease payments to cover necessary expenses. With non-profit status, you would be able to raise enough funds to construct the building while incurring limited, if any, loans. This would in turn allow for lower monthly payments from each associated business.

Your goal is to incentivize businesses in the healthcare industry to provide care to those in need. Rural R county in B is listed as a Health Professional Shortage Area. You stated that you are taking up the torch to bridge the gap to community members in need and you will pave the way while other industry businesses have agreed to follow if you construct the centralized building to house them.

#### **Our response to your position**

While your goal is to increase healthcare services to those in need, you are not providing these services yourself. Instead, you are building a facility in which your related for-profit, N, among other for-profit businesses, will operate. You will provide these services to them in an amount high enough to not only cover costs but to produce a profit. You anticipate that the monthly rental payments from the for-profit businesses could be reduced considerably with the receipt of grants and donations. The fact that you will provide the facility to for-profit companies at a reduced rate as well as advertise for the businesses and provide other services to them shows that you have a more than insubstantial purpose of benefiting the for-profit businesses. You are operating in a commercial manner and providing substantial private benefit to these businesses. Since the majority of your governing body are also owners or related to the owners of N, your earnings are also inuring to the benefit of insiders.

## **Conclusion**

Based on the above facts and analysis, you do not qualify for exemption under section 501(c)(3) of the Code because you are not operated exclusively for a 501 (c)(3) purpose. The facts show you operate for a substantial non-exempt commercial purpose as well as for the benefit of for-profit businesses and the owners of N which results in inurement. Accordingly we conclude you do not qualify for exemption under section 501(c)(3).

## **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](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure:  
Publication 892