

Internal Revenue Service

Appeals Office

4330 Watt Avenue SA 7890

Sacramento CA 95821-7012

Date: OCT 26 2017

Number: 201803010

Release Date: 1/19/2018

Department of the Treasury

Employer Identification Number:

Person to Contact:

Employee ID Number:

Tel:

Fax:

UIL: 501.04-00, 501.04-07

Certified Mail

Dear :

This is a final adverse determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Code section 501(c)(4).

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

Your organization does not qualify for exemption under Section § 501(c)(4) of the Code because your organization under Treasury Regulation 1.501(c)(4)-1(a)(ii)(2)(ii) operates for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public similar to organizations operated for profit. Your organization does not meet the three requirements of Revenue Ruling 74-99.

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.

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 and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

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.

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 matter 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 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



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

Date: NOV 21 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

X = Date of formation

Y = State

Z = City

UIL:

501.04-00

501.04-07

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)(4) 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)(4) of the Code? No, for the reasons stated below.

Facts

You were incorporated on X in the State of Y to function as a homeowners' association. Your Articles of Incorporation, in part, states that you were formed to provide for the maintenance and preservation of the properties and to promote the health, safety and welfare of the residents, including maintaining the common facilities.

You maintain a residential development with approximately single family units located on approximately 70 acres in the city of Z. You do not maintain the exterior of any of the residences. You indicate that you provide a substantial social benefit to the community, the city of Z, and the world-at-large.

Owners of each and every lot within the subdivision shall automatically be, and must at all times remain, your members in good standing. Class A members shall include all owners of residential lots and shall be entitled to one vote per lot owned. Class B members shall be the owner or owners of the office tract and shall be entitled to cast that number of votes equal to % of the votes which Class A members are entitled to cast.

Your Bylaws state that each and every owner of a residential lot in good standing with you shall have a non-exclusive right and easement of enjoyment in and to the Tract A and Tract B Common Properties. It further states that if the owner or owners of the Office Tract is or are in good standing with you, shall have a non-exclusive right. All Residents in good standing with you shall have a non-transferable, non-exclusive privilege to use and enjoy all common properties for so long as they are Members in good standing.

Your Bylaws also indicate that the Tract A Common Properties shall be used exclusively by the owners of residential lots and their guests and invitees and access thereto shall be prohibited to any other person. Access to the Tract A Common Properties may be restricted by gating and fencing to all other persons. The owners of the residential lots shall be responsible for all assessments associated with the costs of the maintenance (including landscaping where applicable) of (i) the streets and alleys situated within the Development Tract, (ii) manned and unmanned gated areas serving the Development Tract accessible by the owners residential lots only, (iii) the creek easement areas, as hereinafter defined, and (iv) the balance of the Tract A Common Properties, including amenities constructed or installed in the Tract A Common Properties accessible only by owners of the residential lots, such as pools, hike and bike trails, fountains and other amenities located within the Tract A Common Properties.

Likewise, your Bylaws state that the Tract B Common Properties shall be subject to the use and enjoyment of residential lot owners and their guests and invitees and the employees, guests and invitees of the owner or owners of the Office Tract. The Board shall have the right to restrict the usage of the Common Properties by the owners of the residential lots and the office tract; however any restriction shall be imposed on a uniform basis on the owners of residential lots and the owner or owners of the Office Tract. Access to the Tract B Common Properties may be restricted by gating and fencing to all other persons. The owners of residential lots and the owner or owners of the Office Tract shall be responsible for all assessments relating to or associated with the Tract B Common Properties, including the Access Road Easement Area and the maintenance (including landscaping where applicable) of (i) the Tract B Common Properties (including the streets located within the Access Road Easement Area), (ii) the perimeter screening wall (in the buffer area) along certain streets, (iii) the screening walls constructed along the common property lines between the Office Tract, the Development Tract and the Common Properties, (iv) landscaping in the buffer area and medians along certain streets (as required by the Zoning Ordinance), (v) amenities, such as hike and bike trails, tennis courts, exercise stations, fountains and other amenities, constructed and installed within the Tract B Common Properties accessible to both the owners of residential lots and the owner or owners of the Office Tract, and (vi) manned and unmanned gated entries, if any, serving both the Development Tract and the Office Tract.

You provide manned gatehouses that provide a level of security for the community; safe, clean, groomed and visually appealing public areas of the neighborhood; adequate lighting in the recreation areas and street lights to enhance the security and safety of the community; water for irrigation to the common areas to maintain the physical attraction of the community; upkeep and maintenance of the common areas including community wide extermination help prevent the increase in mosquitoes and other pests. All of these services are to areas that are within the gated community and can only be accessed by members, guests and employees of the owner of the office tract.

You indicated that % of your time and revenue is expended for the purposes of security and management. Your on-site manager and a management company are responsible for the oversight and compliance of contractors as well as the bookkeeping of the financial records. This allows you to fulfill your obligations to maintain the public areas of the neighborhood. Security is provided by the gate staff.

An additional % of your time and revenue involves landscaping and grounds maintenance. You employ, by contract, a landscaping service to provide periodic landscape and tree trimming services to all public area within the community. Sprinkler system repair and costs associated with irrigation of the public areas are included in this category. The community, in total, consists of approximately acres of park-like grounds filled with

winding creeks, lakes and waterfalls. The employment of landscaping services allows you to provide safe, clean, groomed and visually appealing public areas of the neighborhood.

You expend another % of your time and revenue on utilities. Electricity and water are needed to maintain the common areas in the community. Adequate lighting is provided in the recreation areas and street lights enhance the security and safety of the community. Water is used for irrigation to the common areas to maintain the physical attraction of the community.

Additionally, % of your time and revenue involves many amenities that are maintained and serviced by specialized professionals. The amenities include the almost acres of the park-like grounds, expansive green space, walking and jogging trails, a dog park, swimming center with pools and pavilion, tennis courts and picnic areas. Contractors are used to provide safety and services to these amenities and the surrounding area. The upkeep and maintenance of the common areas enhances and beautifies the community. It is necessary to maintain these areas for public safety and health reasons. The maintenance is performed by specialized contractors that are supervised by you. Community-wide extermination is also provided to help prevent an increase in mosquitoes and other pests. This is a benefit not only to the community, but also to the surrounding areas.

The final % of your time and revenue is expended for activities that contribute to your daily and periodic operations and fulfillment of your purposes. These costs include social expenses, newsletter publication, and other professional fees. You also have periodic book clubs, poker clubs and wine clubs. The annual holiday decorations attract the community and another holiday party is open to anyone that RSVPs for the event. You allow employees of the office building located in the Office Tract, a Class B member, to use any facility and amenity, except for the pool, due to liability concerns.

Approximately % of your revenue is received from the assessment of dues of your members. The remaining % of your revenue is categorized as other income and interest income.

You submitted a map and photographs of the development which show that the property is fenced-in and there are gate houses located at each access point. gates have manned gate houses and one is a sliding gate. Individuals that are not guests are not allowed to enter. To gain entrance, individuals must prove they are a resident, guest of an owner, employee of the owner of the office tract, or a contractor working on the property.

Law
Section 501(c)(4) of the Code provides for the exemption of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Treasury Regulation Section 1.501(c)(4)-1(a)(2)(i) provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one that is operated primarily for the purpose of bringing about civic betterments and social improvements.

In Rev. Rul. 72-102, 1972-1 C.B. 149, an organization that was formed to preserve the appearance of a housing development and to maintain streets, sidewalks and common areas for use of the residents in the development was determined to qualify for exemption under Section 501(c)(4) of the Code.

Rev. Rul. 74-99, 1974-1 C.B. 131, modified Rev. Rul. 72-102 and held that a homeowners association, in order to qualify for exemption under Section 501(c)(4) of the Code, must, in addition to otherwise qualifying for exemption under Section 501(c)(4), satisfy the following requirements: (1) It must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof; (2) It must not conduct activities directed to the exterior maintenance of private residences; and (3) It owns and maintains only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

Rev. Rul. 80-63, 1980-1 C.B. 116, clarifies Rev. Rul. 74-99, 1974-1 C.B. 131, and provides answers to specific questions as to whether the conduct of certain activities will affect the exempt status under Section 501(c)(4) of the Code of otherwise qualifying homeowners' associations. The ruling states that:

- 1) the term 'community' does not embrace a minimum area or a certain number of homeowners,
- 2) a homeowners' association may not receive an exemption if it represents an area that is not a community and it restricts the use of its recreational facilities to only members of the association,
- 3) an affiliated recreational organization operated totally separate from the homeowners' association may be exempt so long as there is no benefit flowing back to any member, and
- 4) a homeowners' association cannot own and maintain parking for the sole use of its members if it is not a community.

In Commissioner v. Lake Forest, Inc., 305 F.2d 814 (1962), the case involved a nonprofit membership housing cooperative that provided low cost housing to its members. In denying exemption, the court stated that the organization was not organized exclusively for the promotion of social welfare. The court found that although its activities were available to all citizens eligible for membership, "its contribution is neither to the public at large nor of a public character." The court looked to the benefits provided and not to the number of persons who received benefits through membership.

In Lake Petersburg Association v. C.I.R., T.C. Memo 1974-55, 33 T.C.M. (CCH) 259, T.C.M. (P-H) P 74,055, 1974 PH TC Memo 74,055 (1974), the Association was an idea presented by the Petersburg Chamber of Commerce to help stimulate the economy in the surrounding area. A group of businessmen contributed capital and acquired capital from other sources such as the City, the Chamber and two banks, to obtain funding to purchase property and develop it. They formed an association, which required prospective owners to become dues-paying members. The dues helped finance the development of the lake and recreational facilities on said property. Use of the assets was limited to members and their guests. The Association's basis for their argument is that the organization was created to stimulate the economy and make it a better place to live, thereby fulfilling the requirement of a social welfare organization under Section 501(c)(4). The respondent argued that it was operated primarily for the benefit of its members and therefore did not qualify. The Court found that regardless

of the original intent, the actual benefit went to the members and any economic benefits to the Petersburg citizens were "indirect and remote." Exemption was denied.

In Rancho Santa Fe Association v. United States, 589 F. Supp. 54 (S.D.Cal.1984), the court held that a homeowners' association representing property owners within an independent community was exempt under Section 501(c)(4) of the Code despite closing certain recreational facilities for use by the general public. The Association existed to enforce protective covenants designed to preserve the character of the community of Rancho Santa Fe. The property contained in the development consisted of 6,100 acres. The Association owned 600 acres outright; the remainder was owned by the individual members. Of the 600 acres owned by the Association, 300 acres are dedicated to parkland and open space, 165 acres are improved as playgrounds, athletic fields, a public parking lot, a community clubhouse, and hiking and bridle trails. The remaining 135 acres comprise an 18-hole golf course and eight tennis courts. Of the lands directly under the ownership of the Association, the parklands and open space, playgrounds and athletic fields, public parking lot, community clubhouse, and the commercial areas are open to the public. The golf course and tennis courts are less freely accessible; they may be used by the general public only to the extent that members of the public are guests of the privately-owned Inn located in Rancho Santa Fe, otherwise only members of the Association may use these facilities. Rancho Santa Fe has its own post office and zip code.

In Flat Top Lake Association v. United States, 868 F.2d 108 (4th Circuit 1989), the Court confirmed the denial of Section 501(c)(4) status to a homeowners' association that maintained a private lake accessed by a private road, open only to lot owners in a 375-lot residential subdivision surrounding the lake. Citing Rev. Rul. 74-99, the Court stated that "Clearly Congress believed that an organization cannot serve social welfare if it denies its benefits to the general public ... Wholly private activity, however meritorious, confers no such benefit which would render [exemption] appropriate."

In Indian Lake Property Owners Association v. Director of Revenue, 813 S.W.2d 305 (1991) the Supreme Court of Missouri held that: (1) homeowners' association that enforced subdivision covenants, maintained subdivision roads, and provided security and trash collection services to residences within subdivision was not a "civic organization" entitled to sales and use tax exemption, and (2) to qualify as a "civic organization," the organization's purposes and functions must be concerned with and relate to citizenry at large. Further, the judge discusses Flat Top Lake within the text, stating, "Clearly Congress believed that an organization cannot serve social welfare if it denies its benefits to the general public. Implicitly Congress recognized that a true "community" functions within a broader national fabric. Service to such a community thereby furthers the national interest by expanding potential, by opening opportunities to all citizens who may find themselves within the bounds of that particular community." Exemption denied (affirmed).

Application of law

You are not described under Section 501(c)(4) of the Code because you are not operated exclusively for the promotion of social welfare. Rather, you were formed to provide maintenance of common areas in a residential development, whose use is strictly limited to members and their guests.

You do not meet the requirements of Treas. Reg. Section 1.501(c)(4)-1(a)(2)(i) because your primary purpose is not that of social welfare, but rather for the operation of a homeowners' association for the benefit of your members. Although you claim to be open to the general public, all of your common areas and facilities such as roadways, parklands, sidewalks and street lights are enclosed within the gated community. Access to the property and all of the amenities are restricted to members of the association, their guests, and the employees of

the owner or owners of the Office Tract. Manned gate houses prevent the general public from accessing the grounds.

You are not like the organization described in Rev. Rul. 72-102 because you are not serving a "community" by maintaining streets, sidewalks, and other common areas that used only by your members and their guests. Also, you are distinguished from this case because your housing development is gated and access is strictly limited to members and their guests.

You are not a "community" as described in Rev. Rul. 74-99 and Rev. Rul. 80-63. In these rulings the general public significantly benefited from the organizations operations. The housing development that you maintain, which consists of a few hundred homes and less than acres of open space, does not bear a recognizable relationship to an area ordinarily identified as a governmental subdivision. Also, the enjoyment of your public area is not extended to the members of the general public as evidenced by the gates preventing access by non-members. Your Bylaws confirm your assertion that the use of the common property is strictly for the enjoyment of your members and their guests.

As discussed in Commissioner v. Lake Forest, when public benefit is insignificant it may warrant a loss in exempt status. Similarly, your benefit to the general public is insignificant. You do not provide any access to roads, trails, parks, recreation equipment, or the like, to the general public beyond your members and their guests. You are similar to Flat Top Lake Association, Indian Lake Property Owners Association, and Lake Petersburg Association where the general public did not significantly benefit from the activities of the organizations.

The association in the court case Rancho Santa Fe Association was found to operate according to the exempt purpose of a Section 501(c)(4) organization. Rancho Santa Fe provided vast amounts of parkland, open space, facilities and equipment to the public. In contrast, you only provide the usage of your facilities, parks and roads to members and guests. Your housing development is not open, in any way, to the general public.

Your position

You indicated that with nearly homes located on almost acres of land, you are a community within yourself as in the case of Rancho Santa Fe Association. Restrictions must be placed in order to maintain and promote the safety and welfare of the residents. It is not feasible for your amenities to be available and provided to the world-at-large. You indicated you are a quasi-governmental entity and provide a multitude of city-like services in the same manner that a city would (i.e. landscape, street maintenance, parks and playgrounds, swimming pool and trails).

You indicated that only members and guests of members are permitted to use the massive amount of amenities in your development. You believe you qualify as a Section 501(c)(4) entity because you benefit the community. As in the case of Rancho Santa Fe Association, it was established that the concept of community did not include the benefit to the world-at-large. You believe that you closely resemble Rancho Santa Fe Association in that you do benefit the community, even though there is restricted access. As described in this case, unlimited access to the amenities beyond the community it serves to the world-at-large in order to obtain the exemption at issue is a neither necessary nor mandated condition. To impose such a requirement would defeat the statutory purpose of the exemption which encourages the provision of services to communities, in that requiring unlimited access to these facilities would necessarily lessen the benefit to the community which you represent. Congress did not require that, in order to obtain this exemption, an association must serve an entire city, or even

several communities; service to a single community was viewed as sufficient. Rancho Santa Fe Association, by serving well their community, was entitled to this exemption.

Our response to your position

Unlike Rancho Santa Fe Association, all of your amenities are not available to the neighborhood community beyond your members and their guests. You have gates to the community that do not allow anyone except for members and their guests to enter and use the property. While Rancho Santa Fe Association served the community by loaning out its facilities free of charge to various public service organizations as well as to the schools, you did not provide any information that you had any similar type committees or participate in any similar activities to serve the community outside of the residents.

The court also determined that Rancho Santa Fe Association was not the ordinary residential grouping of tract homes, but was an independent community separated geographically from the central area of the city of San Diego of which Rancho Santa Fe was a sub-part. Rancho Santa Fe had its own post office and zip code. The information you provided does not support that you are an independent community that comprises a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof. All of your amenities are within the gated area and none of your amenities are open to the general public. Accordingly, you are not operated for social welfare purposes because you do not benefit the community as a whole and you operate for the private benefit of your members.

Conclusion

Based on the facts presented above, you are not operated for the promotion of social welfare. Accordingly, you do not qualify for exemption under Section 501(c)(4) 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.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892

cc: