



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities

Date:  
August 8, 2022  
Taxpayer ID number:

Number: 202304012  
Release Date: 1/27/2023

Form:  
Tax periods ended:

Person to contact:  
Name:  
ID number:  
Telephone:  
Fax:

UIL: 501.03-00

**CERTIFIED MAIL - RETURN RECEIPT REQUESTED**

Dear \_\_\_\_\_ :

**Why we are sending you this letter**

This is a final determination that you don't qualify for exemption from federal income tax under Internal Revenue Code (IRC) Section 501(a) as an organization described in IRC Section 501(c)(3), effective \_\_\_\_\_. Your determination letter dated \_\_\_\_\_, is revoked.

Our adverse determination as to your exempt status was made for the following reasons: Organizations described in IRC Section 501(c)(3) and exempt from tax under IRC Section 501(a) must be both organized and operated exclusively for exempt purposes and no part of the net earnings may inure to the benefit of any private shareholder or individual. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. You have not demonstrated that you are both organized and operated exclusively for charitable, educational, or other exempt purposes within the meaning of IRC Section 501(c)(3). You have not demonstrated that you satisfy the support test in IRC Section 509(a)(2). As such, you failed to meet the requirement of IRC Section 501(c)(3) and Treasury Regulations Section 1.501(c)(3)-1(a).

Organizations that are not exempt under IRC Section 501 generally are required to file federal income tax returns and pay tax, where applicable. For further instructions, forms and information please visit [www.irs.gov](http://www.irs.gov).

**What you must do if you disagree with this determination**

If you want to contest our final determination, you have 90 days from the date this determination letter was mailed to you to file a petition or complaint in one of the three federal courts listed below.

**How to file your action for declaratory judgment**

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of IRC Section 7428 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.

Please contact the clerk of the appropriate court for rules and the appropriate forms for filing an action for declaratory judgment by referring to the enclosed Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status. You may write to the courts at the following addresses:

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

U.S. Court of Federal Claims  
717 Madison Place, NW  
Washington, DC 20439

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 if you file a petition for declaratory judgment under IRC Section 7428.

**Information about the IRS Taxpayer Advocate Service**

The IRS office whose phone number appears at the top of the notice can best address and access your tax information and help get you answers. However, you may be eligible for free help from the Taxpayer Advocate Service (TAS) if you can't resolve your tax problem with the IRS, or you believe an IRS procedure just isn't working as it should. TAS is an independent organization within the IRS that helps taxpayers and protects taxpayer rights. Contact your local Taxpayer Advocate Office at:

Or call TAS at 877-777-4778. For more information about TAS and your rights under the Taxpayer Bill of Rights, go to [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov). Do not send your federal court pleading to the TAS address listed above. Use the applicable federal court address provided earlier in the letter. Contacting TAS does not extend the time to file an action for declaratory judgment.

**Where you can find more information**

Enclosed are Publication 1, Your Rights as a Taxpayer, and Publication 594, The IRS Collection Process, for more comprehensive information.

Find tax forms or publications by visiting [www.irs.gov/forms](http://www.irs.gov/forms) or calling 800-TAX-FORM (800-829-3676).

If you have questions, you can call the person shown at the top of this letter.

If you prefer to write, use the address shown at the top of this letter. Include your telephone number, the best time to call, and a copy of this letter.

Keep the original letter for your records.

Sincerely,



Lynn A. Brinkley

Acting Director, Exempt Organizations Examinations

Enclosures:

Publication 1

Publication 594

Publication 892

cc:



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities

Date:  
04/07/2021  
Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:  
Name:

Address:  
Manager's contact information:  
Name:  
ID number:  
Telephone:

Response due date:

**CERTIFIED MAIL – Return Receipt Requested**

Dear

**Why you're receiving this letter**

We enclosed a copy of our audit report, Form 886-A, Explanation of Items, explaining that we propose to revoke your tax-exempt status as an organization described in Internal Revenue Code (IRC) Section 501(c)(3)..

**If you agree**

If you haven't already, please sign the enclosed Form 6018, Consent to Proposed Action, and return it to the contact person shown at the top of this letter. We'll issue a final adverse letter determining that you aren't an organization described in IRC Section 501(c)(3) for the periods above.

**If you disagree**

1. Request a meeting or telephone conference with the manager shown at the top of this letter.
2. Send any information you want us to consider.
3. File a protest with the IRS Appeals Office. If you request a meeting with the manager or send additional information as stated in 1 and 2, above, you'll still be able to file a protest with IRS Appeals Office after the meeting or after we consider the information.

The IRS Appeals Office is independent of the Exempt Organizations division and resolves most disputes informally. If you file a protest, the auditing agent may ask you to sign a consent to extend the period of limitations for assessing tax. This is to allow the IRS Appeals Office enough time to consider your case. For your protest to be valid, it must contain certain specific information, including a statement of the facts, applicable law, and arguments in support of your position. For specific information needed for a valid protest, refer to Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status.

Fast Track Mediation (FTM) referred to in Publication 3498, The Examination Process, generally doesn't apply now that we've issued this letter.

4. Request technical advice from the Office of Associate Chief Counsel (Tax Exempt Government Entities) if you feel the issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS.

If you're considering requesting technical advice, contact the person shown at the top of this letter. If you disagree with the technical advice decision, you will be able to appeal to the IRS Appeals Office, as explained above. A decision made in a technical advice memorandum, however, generally is final and binding on Appeals.

**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 adverse determination letter.

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

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit [www.taxpayeradvocate.irs.gov](http://www.taxpayeradvocate.irs.gov) or call 877-777-4778.

**Additional information**

You can get any of the forms and publications mentioned in this letter by visiting our website at [www.irs.gov/forms-pubs](http://www.irs.gov/forms-pubs) or by calling 800-TAX-FORM (800-829-3676).

If you have questions, you can contact the person shown at the top of this letter.

Sincerely,

Director, Exempt Organizations Examinations

Enclosures:  
Form 886-A  
Form 6018

Form <b>886-A</b>	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
Name of Taxpayer	Tax Identification Number	Year/Period ended

**ISSUE:**

Can tax exempt status as a public charity described in IRC 501(c)(3) and 509(a)(2) be sustained when the majority of the organization's revenue comes from debt financed rental income from a , and the majority of assets are used exclusively by the ?

**FACTS:**

was formed in . In , the organization was granted exemption from income tax under IRC Sec. 501(c)(3) as a public charity described in Sec. 509(a)(2). The organizations purpose as described in its Form is as follows: "

As a Sec. 501(c)(3) organization, conducts an annual fundraiser, and grants each year. The organization also conducts cultural activities. Each year, on the weekend after the , the organization conducts a " " to promote including a with , food, dance, and . The organization receives entrance fees which allows patrons to enjoy performing in clothing, and is played by live bands. This activity is performed entirely by volunteers, as does not have any employees. The (a for-profit corporation) provides all of the food and available for purchase at the , and the holds the used for this

The also operates a , in the building owned by . The , payments from the are the largest source of income for the public charity. Per the , the also conducts a number of annual events celebrating . These events include , a , , and . These events are held on the premises.

only files a Form and no unrelated business taxable income is reported. There is no Form filed.

Form for the year ending was selected for examination, and the examiner at that time found the organization failed to keep financial records adequate to conduct an examination. The organization was advised to improve record keeping. The organization was selected for examination again for their year ending , and was now able to provide financial records sufficient to conduct an examination for the year. The examination found % of the Organization's revenue consisted of from the . Additionally, % of expenses consisted of payments on the building owned by the and occupied by the . The for show largest asset is the building that is occupied by the .

The \$ per payments are the largest source of income for , and the \$ per on occupied by the is the largest cash outflow by this public charity. At \$ , the is the largest asset on the books

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of \_\_\_\_\_, and the \$ \_\_\_\_\_ mortgage is the largest liability.

Percentages per general ledger, and reported on Form \_\_\_\_\_ for \_\_\_\_\_ per Examination:

Income from _____ / Total Income:	\$ _____ / \$ _____	( _____ %)	(Note _____)
_____ on Building / Total Expenses:	\$ _____ / \$ _____	( _____ %)	
Net Book Value of Building / Total Assets:	\$ _____ / \$ _____	( _____ %)	(Note _____)
_____ / Total liabilities:	\$ _____ / \$ _____	( _____ %)	

Note : Form \_\_\_\_\_ reports \_\_\_\_\_ of \$ \_\_\_\_\_ while \_\_\_\_\_ reports a \_\_\_\_\_ payment totaling \$ \_\_\_\_\_  
 Note : \_\_\_\_\_ reported at cost \$ \_\_\_\_\_ with \$ \_\_\_\_\_ accumulated depreciation: net \$ \_\_\_\_\_

\_\_\_\_\_ also reports a note payable on their \_\_\_\_\_ Form \_\_\_\_\_. This payable is related to the addition of a \_\_\_\_\_ built on \_\_\_\_\_ for the benefit of \_\_\_\_\_.

Organizations exempt from income tax under Section 501(a) must pass both an organizational test, and an operational test on an ongoing basis. The remainder of this report will focus on the operational test for organizations exempt from income tax described in IRC Sec. 501(c)(3) and 509(a)(2) as it applies to \_\_\_\_\_.

**LAW:**

IRC Sec. 501(c)(3) exempts from income tax, corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, 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 (except as otherwise provided in subsection (h)), 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.

The exempt purposes set forth in Section 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term charitable is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

IRC Sec. 509(a)(2) defines an organization as one which normally receives more than one-third of its support in each taxable year from any combination of gifts, grants, contributions, or membership fees, and gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513),

Form <b>886-A</b>	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
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not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of \$5,000 or 1 percent of the organization's support in such taxable year, from persons other than disqualified persons (as defined in section 4946) with respect to the organization, from governmental units described in section 170(c)(1), or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)), and normally receives not more than one-third of its support in each taxable year from the sum of gross investment income (as defined in subsection (e)) and the excess (if any) of the amount of the unrelated business taxable income (as defined in section 512) over the amount of the tax imposed by section 511.

Treas. Reg. 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 purpose of carrying on an unrelated trade or business as defined in Section 513. 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).

Reg. §1.501(c)(3)-1(c) provides that an organization will be treated as operating exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish those purposes and will not be treated as such if more than an insubstantial part of its activities is not in furtherance of a proper exempt purpose.

In *Orange County Agricultural Society, Inc. v. Commissioner*, the Second Circuit held that a §501(c)(3) organization had a substantial nonexempt purpose where it derived between 29% and 35% of its gross revenue from automobile races. However, the revocation of exemption was also based upon the alternative ground of private inurement, and it is apparent that the court was strongly influenced by the private inurement issue.

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978), a corporation which plans as its sole activity to offer consulting services for a fee to nonprofit, limited resource organizations engaged in various rural-related activities does not operate exclusively for charitable, educational or scientific purposes as required by sec. 501(c)(3). The organization's service consists of obtaining appropriate individuals to perform research projects for the clients. Some of the organization's clients will be exempt organizations, but others may not be exempt. The fees charged by the organization will be set at or close to cost but will in no event be less than the organization's full cost of providing its services. The organization will realize a projected net profit in its first year of operation. The administrative record fails to show that the organization will not be in competition with commercial enterprises.

In *Schoeger Foundation v. Commissioner*, 76 T.C. 380 (1981), a not-for-profit corporation owns and operates a mountain lodge that it characterizes as a religious retreat facility. The lodge makes available to its guests numerous activities, religious, recreational, and social, none of which are regularly scheduled or required. The religious activities revolve around individual prayer and contemplation, with optional daily devotions and occasional Sunday services available to the guests. The recreational and social activities are those of the usual vacation resort. The record does not show the extent to which the

Form <b>886-A</b>	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
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guests participated in any of the activities, religious or otherwise. The court held that Schoger did not meet its burden to establish that it was operated exclusively for religious or other exempt purposes within the meaning of sec. 501(c)(3), I.R.C. 1954.

In *Est of Hawaii v. Comm'r of Internal Revenue*, 71 T.C. 1067 (1979), aff'd, 647 F.2d 170 (9th Cir. 1981), the Court held that the organization did not qualify for exemption under Section 501(c)(3). The organization engaged in activities relating to 'Est' programs involving training, seminars, lectures, etc., in areas of intra-personal awareness and communication. Such activities were conducted under licensing arrangements with for-profit corporations. *Although the organization's* activities were educational in nature, they served the commercial purposes of the for-profit corporations. Therefore, it was not operated exclusively for exempt purposes.

In *Easter House v. United States*, 12 Cl. Ct. 476 (1987), aff'd, 846 F.2d 78 (Fed. Cir. 1988), after the Internal Revenue Service denied the adoption agency's application for tax exempt status, *Easter House* filed action for declaratory judgment to effect that it qualified as tax exempt charitable or educational organization. The court held that (1) the agency's business purpose, rather than advancement of educational and charitable activities purpose was its primary goal; (2) burden was on agency to demonstrate that its net earnings never inured to benefit of private individual; (3) portions of agency's net earnings inured to benefit of its president; and (4) IRS determination that agency was not entitled to tax exempt status on basis that it was not "distinguishable from commercial adoption agency" was supported by record.

In *Airlie Foundation v. United States*, 283 F. Supp. 2d 58 (D.D.C. 2003), the primary activity was the operation of a conference center in a manner consistent with that of a commercial business. On average, plaintiff hosts about 600 groups per year. An average of 20 percent of events are for government clients, 50 percent from nonprofit and/or educational clients, and 30-40 percent for "other" users. The IRS conceded that foundation was organized for an exempt purpose, only the operational test is at issue. The Tax Court ruled the IRS was correct in denying plaintiff's application for recognition as a Section 501(c)(3) entity stating although the organization carries out a number of charitable and educational activities, these are incidental to its primary commercial activity of operating the conference center, a substantial nonexempt purpose.

In *Greater United Navajo Dev. Enters. v. Commissioner*, 74 T.C. 69 (T.C. 1980), under the operational test, the developer's most substantial activity and primary source of revenue was the leasing of oil well drilling equipment for profit and therefore, was not operated exclusively for exempt purposes within the meaning of Section 501(c)(3). Nor could the destination of the business income to a charitable purpose transform a nonexempt business into an exempt activity.

#### Debt Financed Rental Income:

IRC Sec. 514, as it exists today, expands "unrelated business income" to include "unrelated debt-financed income" from investment property in proportion to the debt acquired in purchasing it. Property purchased with borrowed money (an "acquisition indebtedness") and held to produce investment income is called "debt financed property." Basically, due to the provisions of IRC 512(b)(4), IRC 514 taxes income that would be otherwise excluded from taxation under IRC 512(b)(1), (b)(2), (b)(3), and (b)(5) (for example, dividends, interest, royalties, rents, and certain gains or losses from the sale of property), but only if two conditions are met. (1) the income arises from property acquired or improved with



Form <b>886-A</b>	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
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borrowed funds, and (2) the production of income is unrelated to the purpose constituting the basis of the organization's tax exemption.

IRC 514(a)(1) "Percentage of Income Taken Into Account: There shall be included with respect to each debt-financed property as an item of gross income derived from an unrelated trade or business an amount which is the same percentage (but not in excess of 100 percent) of the total gross income derived during the taxable year from or on account of such property as (A) the average acquisition indebtedness (as defined in subsection (c)(7)) for the taxable year with respect to \_\_\_\_\_ is of (B) the average amount (determined under regulations prescribed by the Secretary) of the adjusted basis of such property during the period it is held by the organization during such taxable year."

**Taxpayer's Position:**

The taxpayer has submitted additional information regarding the organization's activities. This information has been reviewed and it does not change the Services position that \_\_\_\_\_ activities provide a private benefit to shareholders of \_\_\_\_\_ and is, therefore, not an organization described in IRC Sec. 501(c)(3).

This is the second \_\_\_\_\_-day notice that is being issued to the taxpayer due to the case being transferred from the original examiner to a new examiner. The taxpayer should respond accordingly as the \_\_\_\_\_-day timeline will be followed. If a response is not received by \_\_\_\_\_, a final adverse determination letter will be issued.

**Government's Position:**

With similar cultural themes, events, names, and location, the lines of distinction between these organizations are difficult to discern. It is unlikely that a person who purchases a ticket for admission to the \_\_\_\_\_, and \_\_\_\_\_ from the vendor, understands the transactions involve \_\_\_\_\_ separate entities, or that the admission fee paid to the charity might ultimately be used to pay the \_\_\_\_\_ of a for-profit \_\_\_\_\_. Similarly, it is unlikely that a customer of the \_\_\_\_\_ will be aware that the net proceeds from the price of their dinner will flow to the shareholders of that \_\_\_\_\_ while the meal was served on property owned by a public charity. Furthermore, a shareholder in the \_\_\_\_\_ could make tax deductible contributions to the landlord, and see that funding used for improvements to the building his \_\_\_\_\_ operates in.

A Section 501(c)(3) organization will jeopardize its exemption if it ceases to be operated exclusively for exempt purposes. An organization will be operated exclusively for exempt purposes only if it engages primarily in activities that accomplish the exempt purposes specified in Section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities does not further an exempt purpose. A Section 501(c)(3) organization must ensure that its earnings do not inure to the benefit of any private shareholder or individual. Additionally, a Section 501(c)(3) organization must not operate for the primary purpose of conducting a trade or business that is not related to its exempt purpose, such as a public charity whose primary purpose is supporting a \_\_\_\_\_.

The organization's past history of failure to maintain adequate financial records identified in the year ending \_\_\_\_\_, and current reporting that shows the primary activity to be a support role for a \_\_\_\_\_, are not consistent with tax exemption. \_\_\_\_\_, functions primarily as a property holding \_\_\_\_\_.

Form <b>886-A</b>	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
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and maintenance organization for the benefit of the \_\_\_\_\_, a for-profit corporation, with benefits ultimately flowing to individual shareholders of that corporation. This \_\_\_\_\_ holding and maintenance function is not consistent with tax exemption under IRC Sec. 501(c)(3). The \_\_\_\_\_ on the \_\_\_\_\_ brings rise to debt financed rental income as unrelated business income as defined and described in IRC Sec. 514. The magnitude of this rental income in proportion to total income shows this organization's income is primarily unrelated business income, and not related exempt function income. \_\_\_\_\_ fails the operational test that all organizations exempt from income tax under IRC Sec. 501(c)(3) are required to pass.

**Conclusion:**

Whereas \_\_\_\_\_ activity results primarily to the private benefit of shareholders of \_\_\_\_\_, it is not an organization described in IRC Sec. 501(c)(3). In consideration of the facts, details, law, and analysis described above, \_\_\_\_\_ status as an organization exempt from income tax should be revoked effective \_\_\_\_\_.