



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200606043**

Release Date: 2/10/06

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UIL: 501.00-00

Date: November 15, 2005

Employer Identification Number:

Form:

Tax Years:

Contact Person:

Identification Number:

Telephone Number:

Dear _____ :

This letter constitutes a final adverse ruling with respect to your claim of exemption from federal income taxation under section 501(c)(3) of the Internal Revenue Code.

We make our ruling for the following reasons :

You are not organized exclusively for exempt purposes because your articles of incorporation, as amended, do not limit your purposes to those within section 501(c)(3) of the Code.

You have failed to establish that you are operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. You did not describe your proposed activities in sufficient detail to show that you will engage primarily in activities which accomplish an exempt purpose described in section 501(c)(3). You have failed to establish that your activities will serve a public rather than a private interest. Finally, you have failed to establish that your net earnings will not inure to the benefit of private shareholders or individuals.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30

days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date that we mailed this letter to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, 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, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: March 25, 2005

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

LEGEND

X =

Dear _____ :

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we cannot conclude that you are organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3). We find that you do not qualify for exemption under section 501(c)(3) for the following reasons:

FACTS

Your original articles of incorporation, filed with the state on October 24, 2001 did not contain exempt purposes, an inurement provision, or dissolution clause. Amendments that appear to have been filed with and certified by the state on January 16, 2003 added a statement that "To provide decent housing that is affordable to low-and moderate-income persons must be among the purposes of the organization," but did not otherwise add to your organizing document.

There was no narrative description of your current or proposed activities in your application for exempt status. You did enclose two announcements of seminars. One was described as mortgage pre-underwriting for residential and commercial loans, sponsored by X, offering "50% off purchase price for teachers and police officers." We requested a fuller narrative in our letter of March 3, 2004. You responded that you were:

...created in order to educate, assist, and qualify low and moderate-income persons in becoming first time homebuyers. Education in teaching them

how to take back their communities; how to improve their communities; how and what to do to clean up their credit and stay out of debt; how to purchase their first home. Assistant through seminars and workshops. And to help qualify them for their purchase. Events were put in place for these purposes listed below...(sic)

The listed events include social ones, fundraisers, meetings with fire and police departments concerning problems in the neighborhood, events for children, charitable events, and a few home-buying seminars. In another answer, you state that you project that you will build and sell to low-income families ten houses in 2004 and nine houses in each of the following two years. You provided no additional description of the way in which you would accomplish this.

You stated that you plan to donate nearly \$ of computer equipment to public schools in 2004, without further explanation. You stated that you would put \$ "into a pot" to give away to help low income people "qualify for housing" on a "first come first serve" basis. You provided no written standards or procedures for disbursing the grants.

In response to a question about the Balance Sheet you submitted for , you said that:

Once the Organization started to make money and houses starts to be built, we perceived theses numbers to be somewhat close to actual assets and liabilities. As of today there is only \$ in the cash account, no assets or liabilities exist. Line 13, Contributions, gifts, etc is not an actuate number. This is a budgetary amount for future gifts and grant donations by the Organization. (sic)

You listed among budget items for that year a \$ car and a \$ truck.

One of the several copies of Part IV Financial Data in the file has a date mark at the top that reads " " and the dates at the top of the columns have been erased and written over by hand, although the rest of the form was filled out in type.

The file contains a letter asserting that the author gave you acres in one location and acres in another, more commercial area. In response to a question about how you assessed the value of the land that was donated to you, your entire response was that the donor "states that the average acre price in the ...area is selling at \$ per acre and her assumptions are merely derived from those facts." In other words, you accepted the bare assertion of the donor of what the average selling price in the neighborhood was, without any research to substantiate it or any independent appraisal of the specific parcels of land.

In response to a question about salaries you said that no salaries are paid at this time, but you intend to pay your officers the following very specific amounts:

CEO: \$

VP: \$
 CFO: \$
 Ex Dir.: \$ (with an address in a distant state)
 Dir. Admin.: \$
 Marketing Dir.: \$

You stated that “The salaries were determined by the market value study in [the]...area,” and that “The Board and committee’s members will vote on the salaries along with the information that was received from the survey for that particular area.” All of the board members appear to be also salaried officers or employees.

In response to a question about the home-buying seminars, you said that you plan to “work with several Real Estate and Mortgage Companies in the area...educating the people on choosing the right Realtor, pre-qualification, the advantages of owning a home, documentations required, etc....We plan to have professional volunteers helping us to conduct these workshops. Volunteering for these workshops is a way for them to network to the community.” You did not describe any safeguards to prevent the professionals from marketing their services. In fact, you imply that they are willing to volunteer exactly for the opportunity to “network to the community.”

In response to a question about the criteria that you will use to choose a construction company you said: “Once we choose a construction company we plan to use them for all of our needs. In choosing the right contractors we will except bids from 5 different companies and choose the most affordable. Or we will go with a certified construction company recommended by HUD(sic).” You did not respond at all to questions about how you will contract with and oversee a property management company.

LAW

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

Section 1.501(c)(3)-1(c)(2) of the Treasury regulations states that an organization is not operated exclusively for the statutory purposes if its net earnings inure to the benefit of individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations requires an applicant organization to show that it serves a public rather than a private interest and specifically 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.

Section 1.501(c)(3)-1(c)(2) of the regulations 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. Section 1.501(a)-1(c) defines the words “private

shareholder or individual” in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 53.4958-6 of the regulations creates a rebuttable presumption that compensation is reasonable if arrived at by a particular procedure. A decision will be entitled to the presumption if it is approved in advance by an authorized body composed entirely of individuals who do not have a conflict of interest, and which relied upon appropriate data when making the decision, and adequately documented the basis for the decision.

Rev. Proc. 90-27, 1990-1 C.B. 514 provides in part that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere statement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned, and the nature of the contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or determination letter will be issued. In those cases where an organization is unable to describe fully its purposes and activities, a refusal to issue a determination letter will be considered an initial adverse determination from which administrative appeal or protest rights will be afforded.

In Mabee Petroleum Corporation v. U.S., 203 F. 2d 872 (Fifth Circuit, 1953), the court held that a \$100,000 salary paid to the founder of the charitable organization was unreasonable compensation and therefore inurement. In deciding that the salary was unreasonable, the court noted that he devoted only a small part of his time to the organization, that he had previously served as president of the predecessor organization without salary, that the gift of his stock was encumbered by the obligation to pay the annual salary for 15 years, that comparable services from an outside source through an arms-length transaction would probably have been available at a lower cost, and that the long term of the contract without consideration of changes in the business or in economic conditions indicated that it was unrelated to services performed. The underlying premise, that while reasonable salaries do not constitute inurement, excessive or unreasonable salaries do constitute inurement of corporate net earnings, was thought to be “too well settled to require citation of authority.”

In Birmingham Business College v. Commissioner, 276 F.2d 476 (1960), the court affirmed revocation of exempt status of the school, based in part on the inurement of its earnings through salaries, loans and draws against future earnings to the three shareholders who were also employees.

In The Founding Church of Scientology v. United States, 412 F. 2d 1197 (1969), the court found that the net earnings of the organization inured to its founder through a combination of salary, fees, commissions, royalties, loans, expenses, and variously titled payments to family members. Because the founder and his wife were two of the three members of the board of trustees, in the absence of alternative explanation, the court drew the logical inference that the payments were disguised and unjustified distributions of earnings. The court cited to Maybee

Petroleum and Birmingham Business College for the proposition that excessive salaries are one type of inurement.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court concluded that the Foundation was operated for a substantial non-exempt purpose. It based this conclusion on the manner in which the organization managed a conference center. "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, *inter alia*, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations." Thus, the court looked at the business methods of the organization as a method of inferring whether its purpose was to serve the public or whether there was a substantial non-exempt purpose of operating a business for profit. See section 1.501(c)(3)-1(e), Income Tax Regulations.

DISCUSSION

We find that you have failed to meet a number of the criteria for exempt status. In spite of repeated questions and opportunities from the Service, you have not described your purposes and activities with any specificity. The information that you have presented is contradictory, confusing, and raises significant questions about your exempt purpose and whether your operations will result in inurement and private benefit. You fail the organizational test because you are not organized exclusively for exempt purposes. Nor are you operated exclusively operated for exempt purposes. Your operations and proposed operations indicate the possibility of significant inurement of your assets to your officers and possibly to a donor, especially through the payment of excessive compensation. Furthermore, you do not have in place any protections to prevent such inurement. The description of your current and proposed activities also indicate the possibility of private benefit to service providers such as the mortgage banker and real estate broker who will teach your seminars as a way of promoting their services. Finally, you have not established any criteria for the grants that you intend to give to organizations and individuals, creating additional risks of private benefit to the recipients.

You have failed to describe your purposes and activities in your application or in response to two follow-up letters of inquiry. The Service cannot recognize the exempt status of an organization in advance of operations unless it provides sufficient detail and description to determine that the organization will clearly meet the requirements of the law. *See* Rev. Proc. 90-27, *supra*. No narrative description of your activities was included with your application, only two brief flyers advertising what appear to be commercially sponsored home-buying seminars. In your first letter to the Service, undated, you summarized your purpose as "to educate, assist, and qualify low and moderate-income persons in becoming first time home buyers. ..how to take back their communities, how to improve their communities...what to do to clean up their credit...." But, other than a bare list of events (mostly community celebrations, fundraisers, and support for children), you provided no additional description of details, procedures, expenditures, etc. Other answers were equally inadequate. You stated that you could not estimate the number of construction projects you will undertake. You did not provide guidelines, standards or procedures that you will use to allocate "grants to help low income qualify for housing." You provided answers to questions that conflict, and some of which appear to have

been copied from an application submitted ten years ago.

You also failed to respond to many questions such as:

- Provide copies of materials given to participants in the workshops, and training materials used by instructors;
- Will the organization refer individuals to services provided by other companies;
- Are members of your organization or their relatives eligible to receive assistance;
- Explain specifically how you will ensure that salary decisions are made in an unbiased manner; and
- Explain how you will ensure that the sale of homes furthers exempt purposes.
- Your response to a question about the method of valuing land that was donated to you only relayed that the donor stated that “the average acre price in the ... area is selling at \$ _____ per acre and her assumptions are merely derived from those facts.”

An applicant for exempt status has the burden of proof to establish that it is not organized or operated for the benefit of private interests. Section 1.501(c)(3)-1(d)(1)(ii) of the regulations. When an applicant does not provide requested information, the Service may conclude that the information would have been detrimental to the organization. See American Campaign Academy, supra. You have failed to establish that you are organized and operated for exempt purposes.

Your estimates of salaries for your officers vary, but all are very substantial: \$ _____ in the application and \$ _____ in correspondence (including \$ _____ for an executive director who has an address in the distant state). It is been settled that an unreasonable salary is one method of conveying inurement to an officer. See Mabee Petroleum, supra. One way to show that salaries are reasonable is to demonstrate that they are comparable to similar organizations in the area. You asserted that such a survey was done, but have not provided any data to show that individuals with similar responsibilities in comparable organizations in your area earn similar salaries. You state that the board of directors approves salaries. All of the board members are also paid officers or employees, making them interested persons with significant conflicts of interest. See Section 53.4958-6 of the regulations, supra.

Another indication of possible inurement to the officers is the large excess of revenue over expenses. Your budgeted expenses, as inflated as the salaries appear to be, are barely one-quarter of your revenue. Thus, you have budgeted for approximately 73% profit or excess of revenue over expenses. You have given no information about your plans for a sum that you estimate will be more than \$ _____ in 2006. All of the members of your board appear to be salaried officers or employees. Thus, the body that makes financial decisions for the organization, about salaries and the disposition of assets, is comprised entirely of people with conflicts of interest. The large excess of revenue over expenses increases the possibility of inurement. This violates the requirements of sections 1.501(c)(3)-1(c)(2) and section 1.501(a)-1(c) of the regulations.

The very large profit that you project is also evidence that you plan to operate as a commercial business rather than an exempt organization operated for public benefit. See Airlie

Foundation, *supra*. You have not provided any explanation for the large profit. While exempt organizations may accumulate capital for specific reasons, or for limited amounts of time, you have not met the burden of proving that in your case, the profits will further any exempt purposes.

You mention that each homebuyers seminar will be conducted by a realtor and a mortgage banker who will also provide the teaching materials. They will educate people on how to choose the right Realtor, the advantages of owning a home, and documentation required. You said that "volunteering for these workshops is a way for them to network to the community." It appears that the workshops are opportunities for the for-profit professionals to market their services to potential clients. This constitutes private benefit in violation of the requirements of section 501(c)(3). See section 1.501(c)(3)-1(d)(1)(ii) of the regulations above.

There is also a possibility of private benefit to the donor of land through inflated valuation of the gift. The documentation that you provided to substantiate the donation of land was merely a note from the donor without any independent appraisal or a deed. This is insufficient to establish fair market value for deductibility purposes.

In your application and in response to two letters you have failed to provide the detail and support required by law to demonstrate that you are organized and operated exclusively for exempt purposes. The information that you have submitted indicates that you are, or intend to be operated for significant non-exempt commercial purposes and that your operations will result in substantial private benefit to your founders, officers, employees and other persons. Accordingly, we conclude that you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be

forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If it is convenient, you may fax your reply using the fax number below. Please contact the person identified in the heading of this letter by telephone to confirm that your fax was received.

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:)

1111 Constitution Ave., NW, PE-
Washington, D.C. 20224
Fax:

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437