FILE

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

NOTE: RECEIVED
Release to Manager, EO Determinations - Cincinnati
DATE: 11/04/2003
SURNAME: [redacted]

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

Date: AUG 14 2003

Contact Person: [redacted]
Identification Number: [redacted]
Contact Number: [redacted]

[redacted]

Employer Identification Number: [redacted]

Dear Applicant:

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 have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You are organized as a public benefit, not-for-profit corporation under [redacted]. According to your [redacted], you are organized "to provide decent and affordable housing for lower income and elderly persons or families, or handicapped persons or families, and those aged and handicapped persons that have been displaced from urban renewal areas or as a result of governmental action, where adequate housing does not exist for such persons." Furthermore, you are organized "to preserve, rehabilitate, and prevent further deterioration of the community, in furtherance of the establishment of a suitable community environment in which economic opportunities for low and moderate income people will expand."

You were formed by [redacted] and [redacted] to address housing, economic, and environmental concerns facing the [redacted] community in [redacted]. You intend to engage in activities to provide decent and affordable housing for low-income and elderly residents of the community, to create job opportunities in the community, and to create a neighborhood free of abandoned lots and buildings and of criminal and illegal drug activity.

Housing Activities

In furtherance of your purpose to provide affordable housing, you have entered into various agreements, including a limited partnership agreement, with for-profit entities for the purpose of developing and operating an Apartment Development as described below. The partnership, [redacted], has constructed a [redacted]. Tenants of the [redacted] must be either low-income individuals or senior citizens in the area. Rental fees are set by local section 8 housing subsidy officials. You state that

[redacted]

[redacted] percent of the apartment units will be occupied by households with income at or below [redacted] percent of area median income. The remaining [redacted] percent of the units will be reserved for households with incomes at [redacted] percent of the area median income.

You have entered into the following agreements with respect to the Apartment Development:

[redacted]

On [redacted], you entered into a "[redacted] (the "Agreement") with [redacted] as general partner, [redacted], as the [redacted] c., the "[redacted]" and [redacted] c., as the [redacted]. [redacted] holds a [redacted]% general partnership interest in [redacted]. ([redacted]). The [redacted] limited partnership interest. [redacted], holds a [redacted]% limited partnership interest. You hold a [redacted] limited partnership interest. In your letter of [redacted], you explain that you entered the Partnership as a limited partner because, at the time of the agreement, you "did not have sufficient managerial skills to step into the general partner role."

The Agreement recitals indicate that the Partnership "has been formed to acquire, own develop, construct ... maintain, and operate a [redacted]-unit apartment development ... to be known as [redacted] (the "Apartment Development"), [redacted]% of such units being set aside for rental to individuals and families of low income as provided in [redacted]." The Partnership holds a fee simple interest in the Apartment Development. The recitals also indicate that the Apartment Complex is intended to qualify for the low-income housing credit provided under section 42 of the Code.

According to Section [redacted] of the Agreement, the purpose of the Partnership is "to acquire the Land, to develop, finance, construct, own, maintain, operate, and sell or otherwise dispose of the Apartment Development, and to allocate to the Partners (i) Profits, Losses, and Credits, (ii) Net Cash Flow, and (iii) Sale or Refinancing Proceeds and Liquidation Proceeds in the maximum obtainable amount."

Section [redacted] of the Agreement provides for the establishment of an Operating Reserve Account under the joint control of the General Partner and the Investment Partnership to be used to fund Operating Deficits and any Tax Credit Recapture Amount.

Section [redacted] of the Agreement represents and warrants that the Apartment Development will be a qualified low-income housing project and each building will be a qualified low-income building under the meaning of section 42 of the Code, and such Apartment Development and buildings will at all times satisfy the Rent Restriction Test, the Minimum Set-Aside Test, and all other requirements to remain qualified for Tax Credit.

Section [redacted] of the Agreement pertains to the adjustment of Capital Contribution based upon Maximum Tax Credit. It provides that, if the Maximum Tax Credit for the Credit Period

[redacted]

allocated by the State Agency shall be more or less than the Projected Tax Credit for the same period, the Capital Contribution installments payable by the Investment Partnership shall be adjusted to an amount which is equal to the product of the Unadjusted Capital Contribution multiplied by a fraction, the numerator of which is the Maximum Tax Credit for the Period and the denominator of which is the Projected Tax Credit for the Credit Period. Any amount of reduction of Unadjusted Capital Contribution which exceeds the aggregate amount of unpaid installments of Unadjusted Capital Contribution plus Taxes shall be reimbursed to the Investment Partnership by the General Partner in the form of a breach of warranty penalty.

Section [redacted] of the Agreement provides that, if an event causing a Tax Credit Reduction Amount (TCRA) shall occur during the Capital Contribution Period, the Investment Partnership's Capital Contribution obligation shall be reduced dollar for dollar by the amount of the TCRA, which reduction shall be withheld by the Investment Partnership from unpaid installments of Capital Contribution. If the unpaid Capital Contributions shall be insufficient to recoup the TCRA, any balance shall be recouped by payment to the Investment Partnership as funds become available from any distributions or payments of any kind to the General Partner or its Affiliates from Available Cash, Net Cash Flow, or Sale or Refinancing Proceeds, with interest accruing on the full amount of such payment due at the rate set forth in Code section 6621(a)(2) and 6622. Any such payments by the Partnership shall be deemed to be taken from the General Partner and shall reduce pro tanto the obligation of the Partnership to make such payments to the General Partner.

Section [redacted] of the Agreement provides that, if at any time during the Compliance Period a Tax Credit Recapture Event occurs, the Investment Partnership's Capital Contribution obligation shall be reduced dollar for dollar by the amount of the Tax Credit Recapture Amount, which amount shall be withheld by the Investment Partnership from unpaid installments of the Capital Contribution. If the Investment Partnership fails to recover TCRA or Tax Credit Recapture Amount from unpaid Capital Contribution Installments, then the Partnership shall make payment of any unpaid balance to the Investment Partnership as funds become available from any distributions or payments of any kind to the General Partner or its Affiliates from Available Cash, Net Cash Flow, or Sale or Refinancing Proceeds, with interest accruing on the full amount of such payment due at the rate set forth in Code section 6621(a)(2) and 6622. Any such payments by the Partnership shall be deemed to be taken from the General Partner and shall reduce pro tanto the obligation of the Partnership to make such payments to the General Partner. Any amount due to the Investment Partnership shall be increased so that the Investment Partnership and its partners shall retain such amount on an after tax basis at the highest marginal rate applicable to corporations for the fiscal year(s) in question.

Section [redacted] of the Agreement provides that the obligations of the General Partner and the Guarantors under sections [redacted] shall terminate two years after the commencement of the Credit Period.

Section 6.04 provides that the General Partner or any affiliate may act as the Developer or Management Agent of the Apartment Development, and may receive compensation at the rates so approved , including a Development Fee as specified in the Development Agreement and a Management Fee as specified in section [redacted] For services rendered to the Partnership, the

[redacted]

Partnership shall pay to the General Partner the fees payable pursuant to Section [redacted]

Section [redacted] of the Agreement concerns events of default. It provides that the General Partner may be removed upon the occurrence of an Event of Default, which include the following events among others:

a. Allocation to the Investment Partnership of Actual Tax Credit in an amount which is less than 90% of the amount of the Maximum Tax Credit;
b. Failure to pay Excess Development Costs;
c. Failure to make Operating Deficit Loans;
d. Failure to fund and maintain any reserve accounts set forth in Article III;
e. Failure to pay the Investment Partnership any balance of TCRA or Tax Credit Recapture Amount due it, as required under Sections [redacted]
f. Failure to pay all amounts due the Investment Partnership or NCPPS under the provisions of Articles VI and X;
g. If any commitment of a lender to provide financing, or any agreement entered into by the Partnership to obtain financing is terminated and not reinstated within 30 days.

Section [redacted] also provides that, upon the removal of the General Partner, (i) without any further action by any Partner, the Special Limited Partner or its designee shall automatically become a General Partner and acquire such portion of the Interest of the removed General Partner as counsel to the Investment Partnership shall determine in its reasonable discretion is the minimum appropriate Interest in order to assure the continued status of the Partnership as a partnership; (ii) the remaining portion of the Interest of the removed General Partner shall automatically be converted to an equal Interest as a special limited partner; and (iii) the new General Partner shall automatically be irrevocably delegated all of the powers and duties of the removed General Partner under the Agreement.

Section [redacted] of the Agreement provides that a General Partner may withdraw from the Partnership or sell, transfer, or assign its General Partner's Partnership Interest only upon the prior Consent of the Investment Partnership.

Section [redacted] of the Agreement provides that the Partnership's initial Managing General Partner, [redacted] or its successor (the "Withdrawing General Partner"), shall withdraw from the Partnership under the terms and conditions of the Transfer Agreement entered into between you and [redacted], such withdrawal not to occur prior to the happening of the following events: (a) conclusion of the [redacted]; (b) the expiration of two years from the date the Project is Place in Service; and (c) Permanent Loan closing. According to Article 1, the term "Seasoning Period" means the period beginning on the later of the date the Apartment complex is 100% rented by Qualified Tenants and the Permanent Loan has closed and ending on the date on which, as determined by the Accountant, the Apartment Development has for 12 consecutive months produced income (other than rental subsidies) actually received by the Partnership on a cash basis from normal operations, plus rental subsidies on an accrual basis, at least equal to (i) all cash requirements of the Apartment Development on an accrual basis and, on an annualized basis, all projected expenditures, including those of a seasonable nature, which might reasonably be expected to be incurred on an unequal basis during a full annual period of operation plus (ii) [redacted]% of the debt service

[redacted]

payable during such calendar month, or a portion of any payment covering more than one month attributable to said calendar month. The determination of the Accountant that the [redacted] has ended shall be subject to confirmation by [redacted] an [redacted] which has contracted with the Investment Partnership to perform certain investor services and to monitor the operation of the Partnership on its behalf.

Section [redacted] also provides that an Affiliate of the Withdrawing General Partner shall have the contractual right to continue management of the Project after the withdrawal of the Withdrawing General Partner. You shall only terminate this management agent for cause or with the consent of the Investment Partnership and any successor management agent shall only be engaged with the consent of the Investment Partnership.

Section [redacted] of the Agreement provides that under no circumstances will any offer, sale, transfer, assignment, hypothecation, or pledge of a Limited Partner's Partnership Interest be permitted unless the General Partner and the Investment Partnership, in their sole discretion, shall have Consented and given Notice thereof. It also provides that the Investment Partnership may assign or pledge its rights and obligations as a Limited Partner, in whole or in part, to another similarly structured investment limited partnership of which [redacted] is the general partner, to a creditor of the Investment Partnership, or to [redacted], without the Consent of the General Partnership.

Section [redacted] of the Agreement provides that Available Cash of the Partnership, after payment of operating expenses, debt service, and satisfaction of reserve funding requirements, shall be used to pay (after payment of the Reporting Fee, unpaid Tax Credit Recapture Amount, and unrepaid debts of the Partners or Affiliates) an amount equal to [redacted]% of any remaining balance to the General Partner as an Incentive Management Fee.

Section [redacted] of the Agreement grants you a right of first refusal under section 42(i)(7) of the Code to purchase the Apartment Development after the end of the 15-year Compliance Period at a purchase price equal to the sum of the outstanding debt secured by the Apartment Development and an amount sufficient to actually distribute to the Partners all federal, state, local, and other taxes that will be incurred as a result of the sale by the Partnership, provided that (i) all loans made by the Investment Partnership to the Partnership are paid in full at Closing; (ii) all TCRA and Tax Credit Recapture Amount is paid to the Investment Partnership; and (iii) any indemnification rights the Investment Partnership may have under the Partnership Agreement are fully satisfied. At any time prior to the Closing, the Partnership shall have the right, exercisable in its sole discretion, to make a gift/charitable contribution of the Apartment Development to you. The right of first refusal granted to you shall be void upon your failure to qualify as a tax-exempt organization under the Code.

Section [redacted] of the Agreement provides that the Partnership shall be dissolved upon, among other things, the election of the Investment Partnership pursuant to the Revised Uniform Limited Partnership Act.

Section [redacted] of the Agreement provides that the Partnership shall engage such Management Agent as the General Partner may select to manage the operation of the

[redacted]

Apartment Development. The Management Agent shall be paid a base management fee in an amount approved by the Investment Partnership, which fee shall not exceed [redacted]% of Gross Rents collected by the Management Agent. The Partnership and the Management Agent shall enter into a Property Management Contract, which shall be subject to the approval of the Investment Partnership. [redacted], has been selected by the General Partner to act as the Management Agent and has been approved by the Investment Partnership. The General Partner, upon receiving notice from the Investment Partnership, shall remove the Management Agent for, among other things, failure to produce for any calendar year an Actual Tax Credit in an amount at least equal to [redacted]% of the Maximum Tax Credit.

Transfer Agreement

You have entered into an agreement with [redacted] dated [redacted] under which each party agrees to use its good faith efforts to assist the other in the successful completion of the Apartment Development. Furthermore, you agree to use reasonable efforts to assist [redacted] and the Partnership in obtaining all necessary approvals, acknowledgments, or variances from adjoining property owners, community organizations, and governmental entities.

Under the Agreement, [redacted] shall quitclaim, convey, and contribute to you all its right, title, and interest in the Partnership, including its general partnership interest in the Partnership upon the occurrence of certain events, including the following:

a. Written acknowledgment by the Partnership and the Lenders that all personal guarantees and obligations of [redacted] and any of its members relating to the Partnership and the Development have been fully released, satisfied, and discharged;

b. Written acknowledgment by the Partnership, the Lenders, and the Investors that all reserves, escrows, and holding accounts that the Partnership is obligated to maintain have been fully funded and that [redacted] has received the maximum distributions from all such accounts to which it could become entitled, including a return to [redacted] of the entire amount placed on deposit in the operating reserve accounts;

c. Written confirmation by the Partnership, the Lenders, and the Investors that all deferred development and management fees and expenses payable by the Partnership to its developer and its property manager have been paid in full;

Section [redacted] of the Agreement provides that [redacted] shall develop the exterior of the existing building located at [redacted] (the "Building"). You and [redacted] shall use your best efforts to secure funds to renovate the interior of the Building, and to seek funds to reimburse the Partnership for the funds spent to acquire the Building, provided that the reimbursement amount shall not exceed $[redacted]. [redacted] and the Partnership shall lease the existing Building to you for a term of 99 years. The annual rental shall be one dollar per year for your use of the Building as the [redacted]

Section 9 of the Agreement provides that, as successor general partner, you will cause the Partnership to utilize [redacted] as the exclusive manager of the Development through and including the date the Note has been paid in full.

As of your letter dated [redacted], [redacted] had not yet transferred its general

[redacted]

. partnership interest in the Partnership to you

Development Agreement

[redacted] (the "Partnership"), entered into a Development Agreement with, [redacted] (the "Developer"), dated [redacted], under which the Partnership retains the Developer to serve as developer with respect to the development of a 40-unit affordable housing project utilizing low-income housing tax credits to be know as [redacted] (the "Project"). In consideration of the performance by the Developer of the services described in the Development Agreement, the Developer shall receive from the Partnership a fee of [redacted] (the "Development Fee").

Consultation Agreement

[redacted] (the "Partnership") entered into a Consultation Agreement with [redacted] ("[redacted]"), dated [redacted], under which the Partnership retains [redacted] to serve as consultant to the Partnership and the Developer with respect to the development of the Apartment Development. In consideration for the services performed by [redacted] under the Consultation Agreement, the Partnership shall pay [redacted].

Management Agreement

[redacted] (the "Owner"), entered into an Agreement with [redacted] (the "Agent"), dated [redacted], under which Owner employs the Agent exclusively to rent and manage the property known as [redacted] for a term of one year, beginning on the [redacted] and ending on the [redacted] and thereafter for annual periods from time to time. In consideration for the services performed by the Agent, the Owner agrees to pay the Agent each month:
1) For Management: the greater of $[redacted] per month or [redacted] percent of the monthly gross receipts from the operation of the Property during the Period the Agreement remains in full force and effect;
2) Accounting Fees: in addition to the Management Fee, the Agent shall be paid a fixed monthly per unit reimbursement from funds in the operating expense account equal to $[redacted] per unit per month.

Other Activities

You state that you work directly with low-income and elderly residents of [redacted] to effect the removal of abandoned and below code properties so as to rid the neighborhood of criminal and illegal drug activities. The activity consists of your board members canvassing the neighborhood and talking with citizens regarding vacant buildings and lots. Your members identifying areas where drug-related activities are conducted and identify abandoned houses and overgrown lots and other activities (e.g., absentee landlords, excessive non-operating vehicles on property and abandoned vehicles) that diminish the quality of life in the community. You promote community improvements through volunteers who disseminate

[redacted]

information provided by other organizations and government entities.

You state that your board members work to ensure that minority and other individuals in the area have an opportunity to be involved in the management and maintenance of [redacted]. In your letter of [redacted] you state that you promote job opportunities through volunteers who disseminate information provided by other organizations, and through distribution of copies of correspondence regarding employment to community churches and other community groups.

You state that you are in the process of renovating a vacant building to provide a [redacted] and meeting space for the community. The building is owned by [redacted], and leased to you for $1.00 a year. The meeting space will be used to provide training for home ownership and wealth building seminars sponsored by [redacted]. In your letter of [redacted], you state that the [redacted] center is not yet operational.

You are assisting a church in developing a program to work with inmates and help them to reenter their communities. In your letter of [redacted] you state that the program is called the [redacted]. As part of the development of the Program, you are assisting with the renovation of an office building located on the property of [redacted], and also assisting with the effort to find funding to staff the office."

Law:

Section 501(a) of the Internal Revenue Code exempts from federal income taxation organizations described in section 501(c).

Section 501(c)(3) of the Code describes corporations, trusts, and associations organized and operated exclusively for charitable and other exempt 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(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized and operated exclusively for exempt purposes under section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, an organization must 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 by such private interests.

Rev. Proc. 96-32, 1996-1 C.B. 717, sets forth procedures for determining whether an organization that provides low income housing will be considered charitable as described in section 501(c)(3) of the Code because it relieves the poor and distressed. Section 7 provides that if an organization furthers a charitable purpose, such as relieving the poor and distressed, it nevertheless may fail to qualify for exemption because the private interests of individuals with a financial stake in the project are furthered.

[redacted]

In Rev. Rul. 98-15, 1998-1 C.B. 718, the Service surveyed the judicial authorities pertaining to the participation of a section 501(c)(3) organization in a partnership with for-profit organizations. The ruling states that the activities of a partnership (including an LLC treated as a partnership for federal tax purposes) are considered to be the activities of a nonprofit partner when evaluating whether the nonprofit organization is operated exclusively for exempt purposes under section 501(c)(3) of the Code. A section 501(c)(3) organization may form and participate in a partnership and meet the operational test if participation in the partnership furthers a charitable purpose and the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners. Similarly, a section 501(c)(3) organization may enter into a management contract with a private party, giving that party authority to conduct activities on behalf of the organization and direct the use of the organization's assets, provided that the organization retains ultimate authority over the assets and activities being managed and the terms and conditions of the contract are reasonable, including reasonable compensation and a reasonable term. However, if a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be organized and operated exclusively for exempt purposes. The nonprofit in Situation 1 of the ruling continued to be operated exclusively for charitable purposes where the partnership's governing documents gave priority to charitable purposes over maximizing profits for the owners, the partnership's board structure gave the nonprofit's appointees voting control, and the nonprofit appointed community members familiar with the hospital to the partnership board. The nonprofit in Situation 2 of the ruling was held not to be operated exclusively for exempt purposes where there was no binding obligation in the partnership's governing documents to serve charitable purposes, the nonprofit shared control of the partnership with its for-profit partner and thus could not necessarily give priority to charitable concerns over profits, the primary source of information for the non-profit's board members was the chief executives (who had a prior relationship with the for-profit partner), and the management company was a subsidiary of the for-profit with broad discretion over the partnership's activities and assets.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Court held that an organization was not organized and operated exclusively for charitable purposes. The Court reasoned that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of exempt purposes.

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), a non-profit hospital with an independent board of directors executed a contract with a medical partnership composed of seven physicians. The contract gave the physicians control over the care of the hospital's patients and the stream of income generated by the patients while also guaranteeing the physicians thousands of dollars in payment for various supervisory activities. The Court held that the benefits derived from the contract constituted sufficient private benefit to preclude exemption.

In Plumstead Theatre Society, Inc. v. Comm'r, 74 T.C. 1324 (1980), *aff'd*, 675 F.2d 244 (9th Cir. 1982), the Tax Court held that a charitable organization's participation as a general

partner in a limited partnership did not jeopardize its exempt status. The organization co-produced a play as one of its charitable activities. Prior to the opening of the play, the organization encountered financial difficulties in raising its share of costs. In order to meet its funding obligations, the organization formed a limited partnership in which it served as general partner, and two individuals and a for-profit corporation were the limited partners. One of the significant factors supporting the Tax Court's holding was its finding that the limited partners had no control over the organization's operations or over the management of the partnership. Another significant factor was that the organization was not obligated for the return of any capital contribution made by the limited partners from its own funds.

In Housing Pioneers, Inc. v. Comm'r, T.C.M. 1993-120, *aff'd*, 49 F.3d 1395 (9th Cir. 1995); *amended by* 56 F.3d 401 (9th Cir. 1995), a substantial non-exempt purpose was found where a nonprofit organization entered into limited partnerships with for-profit entities to operate low-income housing projects. While the nonprofit served as a co-general partner, its actual authority was narrowly circumscribed. The organization had no on-site management authority, no authority to screen or select tenants, and could describe only a vague charitable function of surveying tenant needs and ensuring that requirements for federal tax credits under sections 38 and 42 of the Code were met. The organization had been formed to promote low-income housing, but the court found that the "keystone" of its plan was "achieving the objective of property tax reduction," and that it "has made no attempt to adopt any actual plan by which [it] expects to use its hoped-for share of property tax reductions to implement its stated objectives." The Tax Court concluded that the organization did not qualify under section 501(c)(3) because it had a substantial non-exempt purpose and served private interests, and therefore did not reach the Service's inurement argument based on the indirect participation by insiders in the partnerships. On appeal, the Ninth Circuit did not reach the inurement argument either, but held that the organization had a substantial non-exempt purpose because it failed to "'materially participate' ... in the development and operation of the project.... It has shown no regular, no continuous, no substantial activity in developing or operating the projects," and instead allowed the for-profit partners to control the activities. The court distinguished Plumstead, 74 T.C. at 1324, as not involving a situation where the partners included insiders of the nonprofit organization.

Redlands Surgical Services v. Comm'r, 113 T.C. 47 (1999), *aff'd*, 243 F.3d 904 (9th Cir. 2001), held that a nonprofit organization was not organized exclusively for exempt purposes under section 501(c)(3) of the Code where its sole activity was participating as co-general partner with a for-profit corporation in a partnership that was the general partner of an operating partnership that owned and operated an ambulatory surgery center. The court reasoned that an organization's purposes may be inferred from its operations. To the extent it cedes control over its sole activity to for-profit parties having an independent economic interest in the same activity and having no obligation to put charitable purposes ahead of profit-making objectives, the organization cannot be assured that the partnerships will in fact be operated in furtherance of charitable purposes. The court determined from the facts involved that the nonprofit organization had ceded effective control over the operations of the partnerships and the surgery center to the for-profit partners and management company, impermissibly benefiting private interests. Nothing in the partnership agreement or any binding commitments relating to the operation of the surgery center established any obligation that charitable purposes be put ahead

[redacted]

of economic objectives in the center s operations. The nonprofit lacked formal control over the partnerships in several significant respects. For example, the management contract between the operating partnership and the management company (an affiliate of the for-profit partner) gave the latter broad power to make contracts, negotiate with third-party payors, and set patient charges. The contract provided for fees of six percent of gross revenues, thus providing an incentive to maximize profits. The term of the contract ran for at least fifteen years, terminable for cause only by a majority vote of the managing directors. Also, nothing in the record indicated that the nonprofit exercised informal control over the surgery center.

Analysis:

Under the facts presented, we conclude that you are not operated exclusively for charitable purposes, but substantially for the purpose of benefiting private interests. Our conclusion is based on the grounds that the Partnership into which you have entered: (1) does not place charitable objectives ahead of profit objectives; (2) is under the control of the for-profit general partner, and is subject to control by the investment limited partners; and (3) has a substantial purpose to obtain tax credits, fees, and other benefits for the for-profit general and limited partners.

You have entered into a Partnership, [redacted], with various for-profit entities. The purpose and business of the Partnership is "to develop, finance, construct, own, maintain, operate, and sell or otherwise dispose of the Apartment Development, and to allocate to the Partners profits, loses, and credits, net cash flow, and sale or refinancing proceeds and liquidation proceeds in the *maximum obtainable amount*."

Under this partnership arrangement, there is no obligation of the for-profit parties to place any charitable purpose ahead of their investment and other commercial objectives, which was a key factor in *Redlands Surgical Services v. Comm'r* and Rev. Rul. 98-15. The Agreement is silent with respect to any charitable purpose. Instead, the Agreement is designed to maximize and protect the economic interests of the for-profit general and limited partners. Moreover, the court in *Redland Surgical Services* held that incentive compensation arrangements for management services provide incentives to maximize profits at the expense of charitable objectives.

Housing Pioneers, *Redlands Surgical Services*, and Rev. Rul. 98-15 indicate that, where a charity's primary activity is conducted through a partnership, the charity must control the partnership to ensure that operations are conducted in furtherance of charitable purposes. *See also Plumstead*. Here, we find that you fail to materially participate in the development and operation of the Apartment Development because you have shown no regular, continuous, or substantial activity in developing and operating the Apartment Development, but instead have allowed the for-profit partners to control the activities of the Partnership.

A basic premise of partnership law is that the general partner takes an active part in the management and operation of the business of the partnership whereas the limited partners do not. Here, [redacted] is the general partner of the Partnership. Thus, you have no control over the management of the Partnership or the management of the Apartment Development.

[redacted]

Furthermore, [redacted] controls the Partnership for its own substantial benefit. It has chosen itself as the developer of the Apartment Development, and has chosen a related entity, [redacted] to be the Management Agent. As general partner and developer, [redacted] earns significant incentive distributions and development fees. [redacted], ear[redacted] significant management fees in its role as Management Agent.

Although, under the Transfer Agreement, [redacted] might eventually transfer its general partnership interest to you, such transfer has not yet occurred, and the timing of any transfer is largely in the hands of [redacted] and the Investment Partnership. Any transfer would not occur before "[redacted] has received the maximum distributions ... to which it could become entitled" under the Partnership Agreement or the Loan Documents. Even if [redacted] transfers its general partnership interest to you, you would still be obligated, under the Transfer Agreement, to "utilize [redacted] as the exclusive manager of the Development through and including the date the Note [payable to [redacted] in an amount equal to the maximum distribution which could then be payable to [redacted] from the Operating Reserve at the time of the transfer of the general partnership interest] has been paid in full."

Once the general partnership interest was transferred to you, the Agreement allows the investment limited partner to effectively assume managerial control over the Partnership through its power to removal you as general partner upon a number of grounds listed in section [redacted] of the Partnership Agreement, including tax credit shortages, loan defaults, operating deficits, failure to fund and maintain reserve accounts, or breaches of the Agreement. Once you were removed as general partner, an entity related to the investment limited partner would automatically step in as the general partner. The Agreement also prevents you from engaging in various activities listed in section [redacted] the Agreement without the consent of the investment limited partner. Thus, any control you might have over the daily operations of the Partnership upon transfer of the general partnership interest to you would be limited. Therefore, we find that you lack the requisite control over the Partnership required under *Redlands*, *Housing Pioneers*, and Rev. Rul. 98-15. The for-profit partners to whom you have yielded control have economic goals different from, and often in conflict with, the charitable goal of providing low-income housing.

The Partnership is structured largely with the design of generating tax credits and other financial benefits for the Investment Partnership. The Agreement, in effect, guarantees a minimum investment return to the investor limited partner through a guarantee of tax credits. Any Tax Credit Reduction or Recapture reduces the Investment Partnership's Capital Contribution obligation dollar for dollar. If unpaid Capital Contributions are insufficient to recoup the Tax Credit Reduction Amount, distributions or payments owed by the Partnership to the General Partner must be paid to the Investment Partnership instead. The General Partner has responsibility under the Agreements to ensure that the projected tax credits are realized, and can be removed as general partner for causing any material reduction in the tax benefits. If the actual tax credits are less than the projected tax credits, and the reduction of unadjusted capital contribution exceeds unpaid installments of the capital contribution, then the General Partner must reimburse the Investment Partnership in the form of a breach or warranty penalty. These terms advance the financial interest of the Investment Partnership and would also, should you ever acquire a general partnership interest, place your charitable assets at risk. In summary, a

[redacted]

substantial purpose of the activities of the Partnership, as in *Housing Pioneers*, is the production and protection of tax credits and other benefits for the Investment Partnership. Therefore, we find that your participation in the Partnership has a substantial non-exempt purpose of impermissibly benefiting the private interests of your for-profit partners.

With respect to the other activities of monitoring abandoned houses, vacant lots, and criminal and drug traffic in the [redacted] community, it is uncertain to us whether these should be considered your own activities or simply the activities of private individuals. The activities do not appear to be carried on in your name. You do not produce any reports, petitions, memoranda, or other communications of your own. Rather, individuals claiming association with you disseminate to the community information prepared by other organizations. It is also uncertain what role you play in the development of the [redacted] beyond assisting [redacted] to obtain government grants for the renovation of a building owned by [redacted] of which [redacted] is the general partner. In comparison with your participation in the Partnership, we find these informal activities insufficient to conclude that you are operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code.

Accordingly, 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 judgement 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).

[redacted]

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
TE/GE (T:EO RA:T 2)
[redacted]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

In the alternative, you may fax your correspondence to [redacted]

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

Sincerely,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

[redacted]

[redacted]