Internal Revenue Service

No Protest Received

[redacted]

Department of the Treasury

Washington, DC 20224

Contact Person: [redacted]

Telephone Number: [redacted]

In Reference to: [redacted]

Date: [redacted]

Employer Identification Number: [redacted]
Key District: [redacted]

Dear Taxpayer:

This is in response to your Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.

You were incorporated [redacted] to provide affordable housing for very low, low and moderate income families and individuals. You will carry out your purpose through the participation in two limited liability companies, [redacted] ("LLC-1") and [redacted] ("LLC-2").

Both LLC-1 and LLC-2 (either may be referred to as "Fund") are investment vehicles providing for the syndication of tax credits to investors. The Funds sell subscription units to businesses that can use the tax credits.

LLC-1 admitted three classes of members. The Class A members are investors seeking the benefits of the tax credits. The Class B member is [redacted] a [redacted] business corporation. The Class B member manages LLC-1. Under the provisions of the LLC-1 agreement, the manager has the full, complete and exclusive authority to control the business of the Fund.

You are the Class C member. You have provided LLC-1 with your expertise on low-income housing matters. You operated to approve or disapprove the Fund's investment in local housing partnerships under consideration. You have been paid fees for the performance of such services. You state that you received reasonable fee as compensation for the services you performed.

[redacted]

As a syndicator of tax credits LLC-1 had to organize as a partnership or a limited liability company electing to be treated as a partnership so the credits could pass through to the Class A members. It was the responsibility of the manager of the fund to sell subscriptions to acquire investment capital for the Fund. Once the Fund was capitalized, the manager and the Class C member determined which housing projects with tax credit allocations would be syndicated through the Fund. The Fund would then invest in a housing partnership as a limited partner. Thus, the credits would flow through the housing partnership and Fund to the Class A members. All local housing partnership have been selected. However, nothing in the file discloses criteria for the selection of housing partnerships.

LLC-1 has completed its investments and is inactive other than providing oversight of the investments. You have no further function with this fund.

You have also proposed to become involved in a second fund, LLC-2. This fund will be similar to LLC-1 except that you will be the Class B member managing the Fund and there would be no Class C member. You will take over many of the functions performed by [redacted] in LLC-1. However, you will contract out services that you cannot otherwise provide. In LLC-2 you will select which housing partnerships the Fund will invest in. Similar to LLC-1 nothing in the file discloses criteria for the selection of housing partnerships.

Both Funds are organized for the benefit of its Class A investors. You state that the Class B member is under a fiduciary obligation to protect the Class A members' investment. If there is ever a conflict, your first duty is to protect the interest of the Class A members.

Sections 501(a) and 501(c)(3) of the Code provide, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that to be exempt under section 501(c)(3) of the Code an organization must be organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(1) of the regulations provides, in part, that an organization may be exempt under section 501(c)(3) of the Code if it is organized for charitable purposes. However, it is not organized or operated exclusively for a charitable purpose unless it serves a public rather than a private interest. Thus, an organization must establish that it

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is not organized or operated for the benefit of designated individuals.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" in its generally accepted legal sense and it is not limited by the separate enumeration of exempt purposes in section 501(c)(3) of the Code. The term includes, inter alia, relief of the poor and distressed.

Rev. Proc. 96-32, 1996-20 I.R.B. 14, provides that an organization will be considered to relieve the poor and distressed if it establishes that 75 percent of the units are occupied by residents that qualify as low-income and that either (a) 20 percent of the units are occupied by very low-income residents or (b) 40 percent of the units are occupied by residents that do not exceed 120 percent of the area's very low-income limit. In addition, the units must be affordable to the residents. This will ordinarily be satisfied by adopting a government-imposed rent restriction.

Plumstead Theatre Society, Inc. v. Commissioner, 74 T.C. 1324 (1980), 675 F.2d 244 (9th Cir. 1982) holds that an organization's participation as a general partner in a limited partnership would not adversely affect its tax-exempt status under sections 501(a) and 501(c)(3) of the Code where pursuant to an arm's length transaction, the charitable general partners sold two-thirds of its half interest in the play to three limited partners. Important to the holding is that the general partner was not obligated to return capital to the investors out of its own funds and that the limited partners have no control over the way the organization manages its affairs and that none of the limited partners are directors or officers of the general partner. The opinion concludes that an interest in a single play is not intrusive or indicative of serving private interests.

Housing Pioneers, Inc. v. Commissioner, T.C.M. 1993-120, aff'd 58 F.3d 401 (9th Cir. 1995) holds that an organization's participation as a general partner in a limited partnership precludes exemption where the non-exempt entity privately benefits from the arrangement. The organization would split property tax savings with the for-profit partnership in exchange for acting as a co-general partner. However, the opinion notes that the organization exercised virtually no substantive control over the partnership.

Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U. S. 279 (1945), holds that an organization that educates the public and local businesses about honest business practices has a purpose to advance the members' business as well

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as a purpose to educate the public. Thus, when an organization carries out a non-exempt purpose, substantial in nature, it will destroy the exemption regardless of the number and importance of the truly exempt purposes.

Rev. Rul. 77-3, 1977-1 C.B. 140, holds that an organization that leases housing to the City at cost does not carry out a charitable purpose in housing disaster victims. The City provides the service. The organization merely leases the property to the city.

Rev. Rul. 71-529, 1971-2 C.B. 234, holds that an organization that provides services in the management of endowment funds at substantially below cost for member colleges and universities qualifies for exemption under 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, holds that the provision of management and consulting services to unrelated organizations does not qualify for exemption under section 501(c)(3) of the Code.

Since your operations will differ with respect to your function in LLC-1 and LLC-2, each will be discussed separately. Concerning LLC-1, you have not demonstrated that you carry out a charitable purpose through your participation in the Fund.

An organization may carry out an exempt function through a partnership or in this case a limited liability company ("LLC") and qualify for exemption under 501(c)(3) of the Code provided that (1) the organization carries out a charitable purpose through the partnership or LLC and (2) participation in the partnership or LLC does not prevent it from acting exclusively for charitable purposes.

To satisfy the first prong of the test the organization must demonstrate control over the partnership or LLC. That is, the organization must be able to demonstrate that as a direct result of its participation in the project a charitable purpose is carried out. This is an essential element in a claim for tax exemption where the activity in question is carried out by a partnership.

In Housing Pioneers, Inc. v. Commissioner, T.C. Memo 1993-120, the organization seeking exemption offered to become a co-general partner in existing housing partnerships to secure property tax benefits for the partnership. The court noted that the organization did not exercise management control over the partnership. In short, the court held that a more than

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insubstantial purpose of the organization was to benefit the partnership. Furthermore, it was unable to determine that charitable housing was a direct result of the organization's participation.

Conversely, in Plumstead Theatre Society, Inc. v. Commissioner the Court noted that the lack of control by for-profit partners, the investors, was a favorable factor because they had no control over the way the organization operated or managed its affairs. The investors had no voice in the operation of the production and they had no interest in other productions of the organization. The organization controlled the charitable operations. This is unlike your situation where you are a non-controlling member and do not control the operations of the LLC. In fact, the Class B member carries out the operation. In this respect, you are more like the organization described in the Housing Pioneers case.

In your case, the agreement vests control in the for-profit Class B member. The agreement designates the Class B member as the managing member. It also permits it to approve your activities. The surrounding circumstances further demonstrate that control over LLC-1 is exercised by the for-profit Class B member.

In LCC-2 you demonstrate the requisite control because you are the Class B member. However, we still can not conclude that you carry out an exempt purpose through the operation of the Fund, because it does not carry out a charitable purpose. It is organized and operated for the benefit of its Class A members. The Fund provides an investment vehicle for the Class A member in an ordinary commercial manner. In fact, there is little to distinguish the operation of the either Fund from the many commercial syndicators operated by banks and investment firms. There is nothing particularly charitable in providing an investment for investors seeking tax credits.

As the Class B member you are providing management services that are commercial in nature. In fact, you have replaced the commercial investor that managed LLC-1. In either Fund it is apparent that you are providing services to the Fund to assist it in the provision of its commercial services. Even, if we concluded that either Fund carried out an exempt function, this would not make your participation an exempt function because you are merely providing commercial services that allow the fund to carry out its purpose.

In Rev. Rul. 77-3, 1977-1 C.B. 140, an organization leases property to the city which provides emergency housing disaster

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relief. The ruling notes that charity is carried out by the city. The organization merely leases the property to the city. Similarly, the organization that provides management services to unrelated exempt organizations at cost is not exempt. See Rev. Rul. 72-369.

There is nothing preventing an organization from charging for the performance of its charitable purposes. However, when the function of the organization is the performance of ordinary commercial services to a charitable class or to a tax-exempt charity, it must provide these services at substantially below cost. See Rev. Rul. 71-529, supra. The exemption relies on the donative element of the reduced cost. In the present case, you are not providing services directly to accomplish a charitable purpose. Rather, you are providing services to a for-profit investment fund that invests in for-profit partnerships that may provide charitable housing. Your connection to any charity, that may be provided, is too tenuous to conclude that you are exempt.

Because you participate in Funds formed to benefit investors and because you provide services for a fee to the Funds, we conclude that you are not organized and operated for a charitable purpose. Even if the Funds did carry out a charitable function, we still would conclude that you are not organized and operated for a charitable purpose because a substantial purpose of yours concerns your participation a Fund over which you lack management control. Therefore, you are not described in section 501(c)(3) of the Code and are not exempt under section 501(a). Contributions to you are not deductible under section 170 of the Code. You are required to file federal income tax returns on Form 1120.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days from today and must be signed by one of your principal officers. When sending a protest or other correspondence with respect to this case, you will expedite its receipt by placing the following symbols on the envelope: CP:E:EO:T:5-LK, Room 6539. These symbols do not refer to your case, but rather to its location.

You also have the right to a conference in this office after your protest statement is submitted. If you desire a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

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If you do not protest this proposed 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 proceedings unless the United States Tax Court, the United States Claims Court, 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 copies will be forwarded to the District Director for your key district. Thereafter, any questions about your federal income tax status should be addressed to your District Director. The appropriate State Officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely,

/s/

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Chief, Exempt Organizations

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cc: [redacted]

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