I. ADVERSE DETERMINATION CASES

1. Introduction

This topic focuses on adverse determination cases and discusses in particular the degree and nature of development necessary for adverse cases as well as the proper content and organization of adverse determination letters.

A case should be developed to the extent that the specialist can fully support, explain, and justify an adverse decision. For a complete discussion regarding "case development," see the 1984 CPE text (p. 179).

2. Development of an Adverse Determination Case

Case development is the process by which the specialist reviews the exemption application, its attachments, and responses to information letters and telephone contacts; researches for clearly established rules as set forth in the Code and regulations, revenue rulings, Treasury Decisions, or court decisions published in the Internal Revenue Bulletin; and determines whether the organization qualifies for the claimed status based on the facts as presented.

A specialist is not required to follow a prescribed, uniform procedure for developing a case. The extent and depth of development necessary is based on the sound judgment of the specialist, and should be tailored to fit each individual case.

Case development begins by reading carefully the exemption application and attachments. If an organization's application does not adequately describe its purposes and activities or contains some statement inconsistent with its claim of exempt status, the specialist should continue his or her development. We cannot overemphasize the importance of obtaining detailed and explicit descriptions of the purposes, and especially of the actual or prospective activities of the organization.

The 1984 CPE text (p. 179) contains an article on case development which goes into greater detail. Examples of sufficient versus inadequate representations are noted, as well as examples dealing with proper phrasing of developmental questions.

A. Review of Organizational and Operational Tests under IRC 501(c)(3)

The regulations under IRC 501(c)(3) require that to be exempt the organization must satisfy the organizational and operational tests.

Reg. 1.501(c)(3)-1(b)(1)(i) provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes and do not expressly empower the organization to engage, other than as an insubstantial part, in activities which in themselves are not in furtherance of one or more exempt purposes.

There is often confusion regarding the "purposes and powers" provision. What is meant by purposes and powers that are broader than IRC 501(c)(3)? Are purposes and powers separate and distinct concepts? Does a limitation of powers serve to limit purposes?

Under Reg. 1.501(c)(3)-1(b)(1)(ii) an organization's purposes may be stated as broadly as, or more specifically than, the purposes stated in IRC 501(c)(3). If an organization elects to state its purposes broadly, it must limit those purposes by referring in some way to IRC 501(c)(3). However, when an organization states that it is formed for "charitable purposes," such articles ordinarily will be sufficient without further limitation since the term "charitable" has a generally accepted legal meaning. The other purposes enumerated in IRC 501(c)(3) have no generally accepted legal meanings that have been established outside of that context and, therefore, may, if not limited, permit activities other than those for which the exemption was intended.

For instance, an organization organized "exclusively for religious purposes" should limit its purposes with reference to IRC 501(c)(3) even though the term "religious" is not specifically defined in the Code or regulations. The reference manifests an intent to operate in a manner consistent with exempt status under IRC 501(c)(3). An organization organized "exclusively for educational purposes" should also limit its purposes with reference to IRC 501(c)(3). In this instance, such a reference would incorporate the definition of "educational" contained in Reg. 1.501(c)(3)-1(d)(3).

Purposes and powers are separate and distinct concepts. A purpose can be defined as an object toward which one strives or for which one exists. It is a goal or an aim. A power of an organization, on the other hand, is the authorization to act in specific ways or for specific purposes as granted by the creating documents, ratified by the creators, and, in most cases, acknowledged and accepted by the appropriate official of the state in which organized. They are treated as two distinct

concepts in the regulations and are to be considered with reference to their separate functions.

Therefore, while a limitation in the articles specifying that the organization will not engage in activities not permitted under IRC 501(c)(3) may suffice to meet the second requirement in Reg. 1.501(c)(3)-1(b)(1)(i), the limitation on activities does not act as a substitute for the first requirement in Reg. 1.501(c)(3)-1(b)(1)(i) that the articles must limit the purposes to one or more exempt purposes. In other words, a proper limitation of powers does not serve to limit purposes. The same activities which further exempt purposes in one set of circumstances may not further exempt purposes in other circumstances. For example, a teaching activity may be performed for a profit-making, nonexempt educational institution or an exempt institution. Similarly, patient-care activities may be performed for a non-exempt professional association or an exempt organization. Since the acts of teaching and practicing medicine in and of themselves are not charitable, such acts must be done within a framework limited to charitable purposes, in order to accomplish an exempt purpose.

In addition, an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. A proper dissolution clause as described in Reg. 1.501(c)(3)-1(b)(4) must be included in the Articles of Organization unless it has been determined that assets can devolve only to charitable use by operation of law under the cy pres doctrine in the state of organization. (See Rev. Proc. 82-2, 1982-1 C.B. 367, and 1981 CPE text, p. 79.)

The organizational test discussed above relates to articles of organization. The operational test relates to the organization's activities. Reg. 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more IRC 501(c)(3) exempt purposes. The fact that the actual operations of the organization have been exclusively in furtherance of one or more exempt purposes is not sufficient to meet the organizational test. Conversely, an organization which does not engage primarily in activities which accomplish one or more exempt purposes specified in IRC 501(c)(3) cannot be exempt by satisfying the organizational test. However, if the defect is curable and operations have been acceptable, we will recognize exemption retroactively.

B. Requesting Amendments to Articles and Changes to Operations

If an organization needs to amend provisions of its enabling instrument or to alter its activities to satisfy either the organizational test or operational test, the specialist should bring this to the attention of the organization and suggest ways to cure the defects during the developmental stage. This allows the organization the opportunity and choice whether to amend its enabling charter or change the nonqualifying operations to avoid a proposed adverse determination. If the organization does not agree with the preliminary conclusions, or is otherwise not willing to make the suggested changes, at that point a proposed adverse determination letter or ruling is issued. It is far easier and more efficient to contact the organization (by telephone or information letter) and discuss ways to cure the defects, if feasible, rather than to immediately issue an adverse letter when problems are noted, waiting to resolve easily-corrected problems later during the appeals process.

However, if it is the opinion of the specialist that no amount of changes can bring the organization within the description of the Code section under which it applied, and no other Code section is applicable, then it is appropriate to issue a proposed adverse determination letter or ruling without seeking amendments or changes, saving the organization undue time and expense.

Occasionally, it may appear that an organization may qualify, but qualification is uncertain without additional information to clarify its operation; yet it is obvious that the articles of organization must be amended to qualify. Should the specialist request the additional information and seek the needed amendments also, regardless of the outcome? The solution is to initially seek only the organization's willingness to amend its articles in the event the Service concludes it qualifies for exemption, while also requesting all additional information needed. This method alerts the organization that it may soon need to submit revised articles to the Board of Directors, Trustees, or state officials. The following is an example of such a question asked in the information letter:

> In order to qualify for exemption under section 501(c)(3) of the Code an organization must satisfy the "organizational test." Section 1.501(c)(3)-1(b) of the Income Tax Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes. Also, the articles must dedicate the organization's assets to exempt purposes.

Your Articles of Incorporation do not satisfy the above requirements. Therefore, before an exemption letter could be issued, your Articles would have to be amended to include the following or similar provisions:

a. Notwithstanding any other provision of these articles, the corporation is formed exclusively for charitable and educational purposes, as specified in section 501(c)(3) of the Code, and shall not carry on any other activities not permitted to be carried on by a corporation exempt from federal income tax under section 501(c)(3).

b. Upon the dissolution of the corporation, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Code, or to the federal, state, or local government for a public purpose.

Accordingly, please provide a statement that you are willing to amend your Articles as set forth above in the event we conclude that you qualify for exemption. Furnish a copy of the proposed amendments.

If the additional information received from the organization indicates that its activities fall outside the scope of the statute, the organization has not expended its time and money on unnecessary amendments when it does not qualify anyway. In this circumstance, the proposed adverse letter would elaborate on both the organizational problems and operational defects. On the other hand, if the organization's response indicates it does qualify, then the actual amendments can be solicited by calling the organization or sending a second information letter, and the organization will be prepared for this circumstance.

Similarly, it is good practice to attempt to correct operational deficiencies, if it appears feasible for the organization to do so; for instance, where an organization intends to sponsor or undertake several activities, only one (or a very few) of which is not permitted under the applicable statute and regulations, or where an organization's program is for the most part permissible, but certain functions within the program tend to be outside the scope of the Code.

Example 1. An organization applies for exemption under IRC 501(c)(13). It is a nonprofit corporation formed for the purpose of procuring and holding land to be used exclusively for a cemetery or place of burial. Lot owners hold the lots only for bona fide burial purposes and not for purposes of resale. Its activities include acquiring

cemetery property under a fixed-price, closed-end sale; operating, maintaining and improving the cemetery; and investing any surplus to provide income to fund the above functions. The organization also indicates that in the future it may establish and operate a mortuary on the cemetery grounds. The specialist researches a revenue ruling which concluded a mortuary does not qualify as a cemetery or as necessarily incidental to cemetery operations. Following discussions between the specialist and organization, the organization drops the plans to establish the mortuary, while maintaining all other activities.

Example 2. An organization applies for exempt status under IRC 501(c)(3). It was formed for charitable and educational purposes within the meaning of IRC 501(c)(3), specifically to relieve the distress of the elderly. It plans to operate residential care facilities for senior citizens. The application indicates that the residents will be provided adequate health care through a definitive health program. In addition, the information provided by the organization indicates that the facility is committed to an established policy of maintaining in residence any person unable to pay the regular charge; that the home is operated so as to provide services to the elderly at the lowest feasible cost; and that the housing appears to be within the financial reach of a significant segment of the community's elderly persons. However, the specialist determines from the housing description and blueprints that no elevators are planned. In addition, the building plan lacks ramps for wheelchair use and grab bars by the regular height bathtubs and toilets. Under the circumstances, these safety features are necessary to satisfy the special physical needs of the elderly residents. The organization submits a new housing design and blueprints featuring the appropriate safety designs following a discussion with the specialist. Accordingly, the organization was willing and able to correct its operational deficiency.

Substantive and non-substantive changes can be sought. See Rev. Proc. 84-47, 1984-1 C.B. 545, for instructions regarding the effective date for substantive, versus nonsubstantive, amendments to the articles or operational changes. The extent to which changes appear feasible for an organization so that activities can be brought within the scope of the Code and regulations is a matter of judgment for the specialist.

C. Informing Applicant of Possible Adverse Determination

Soliciting changes in operations will unavoidably alert the organization that adverse action is contemplated. The discussion of suggested alterations would include an explanation as to why the organization should consider such changes: that an adverse determination more than likely would follow unless the unsuitable activities are corrected. In these circumstances, generally such discussions are essential for a complete, thorough, and justified adverse conclusion.

The specialist should not ordinarily take the initiative to contact the organization to inform it that adverse action is contemplated unless the contact relates to organizational or operational defects that could feasibly be corrected. Often, however, the organization will request a status update. As in all phases of the developmental process, the appropriateness of informing the organization of a likely adverse conclusion in response to its request for status update is a decision that rests with the specialist and is within his or her own prerogative. Courtesy should be extended to all taxpayers. Remember, though, that taxpayers are not entitled, as a matter of right, to developmental conferences unless the Service invites them to one to clarify the proposed or current activities and/or purposes of the organization. Instead, taxpayers are entitled to protest, in writing, and request a conference, after issuance of the proposed adverse determination.

D. Seeking Consent to Adverse Determination

Although there are circumstances where it is appropriate to seek substantive and non-substantive amendments or operational changes, and circumstances where it may be appropriate to discuss the possibility of an adverse determination, it is rarely appropriate for the specialist to seek the organization's consent regarding the adverse decision prior to issuance of the proposed adverse letter. Such action by the specialist ignores his or her responsibility to maintain an impartial attitude and to thoroughly develop the application, and pre-empts the administrative rights afforded the organization.

Form 6018, Consent to Proposed Adverse Action, may be used before (under limited circumstances) or after the issuance of a proposed adverse letter. However, it is not used on determination cases subject to the declaratory judgment provisions of IRC 7428 where the organization submits a protest and then decides to concede the issue. See IRM 7(10)62. 6. Form 6018 will not be solicited unless an organization has been fully advised of its appeal rights.

3. Content of Adverse Letters

The basic objectives in writing adverse letters are to be correct, concise, and clear. In other words, be exact in the wording and avoid ambiguous words. Where appropriate, define unclear or abstract words to avoid disputes over what the Service meant. Get to the point by eliminating unnecessary words and round-about phrases. Write for the reader; it may be more appropriate to use sophisticated legal terminology when writing to a tax attorney than, say, a cub scout leader.

Most importantly, put words together so as to enable the organization to grasp their meanings, so that the organization clearly understands why it fails to qualify as tax-exempt. To write clearly, take the time to think clearly. Work out a logical plan of presentation. Pattern language provided in IRM 7600 may be useful in many situations, but should not be employed at the expense of completeness or clarity; attempts to "force" complex issues to fit canned paragraphs can often result in gobbledegook. They can save minutes and waste hours.

A. IRM 7660 Guidelines

A good beginning for a logical plan of presentation is provided in the Manual throughout IRM 7660. The Manual presents general guidelines to follow in preparing the various adverse ruling or determination letters.

(1) Foundation Status Issues

In applications for recognition of exemption, when an organization meets the requirements of IRC 501(c)(3), but fails to meet the requirements of IRC 170(b)91)(A)(i), (ii), (iii), (iv), or 509(a)(3), the key District issues letter 1079 (DO) with Form 5795, Basis for Adverse Determination, attached. Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues, should also be sent with the Letter 1079 (DO). Form 5795 sets forth the basis for the holding and is individually prepared. It contains the facts, applicable law and regulations, and a discussion of the application of the law to the facts. If necessary, the IRC 508(e) pattern paragraph, P-432, should be added. See IRM 7666.52(1)(c).

Organizations that have received advance rulings or determinations that they will be "treated" as organizations described in IRC 170(b)(1)(A)(vi) or IRC 509(a)(2) must, within 90 days after the end of their advance ruling period, establish whether or not they are in fact publicly supported. Key Districts are responsible for follow-up action on both National Office "advance" rulings and key

district office "advance" determinations. Where the information has been sufficiently developed and the organization has not established that it is entitled to a favorable foundation status determination, adverse determination letters are issued by the key districts. IRM 7666.73(6) details the elements which should be included in the letter.

(2) Private Operating Foundation Status

IRM 7666.9 provides that if an organization that claims in its IRC 508(b) notice that it is a private operating foundation has not been issued a determination letter on its exempt status, and does not meet the requirements of IRC 4942(j)(3), the key district should issue Letter 1080 (D), along with Form 5795, Basis for Adverse Determination, and Publication 892.

If an organization has previously been issued a determination or ruling letter classifying it as a private foundation, and it does not meet the requirements of IRC 4942(j)(3), a dictated letter containing the information required in Form 5795 above should be issued by the key district.

(3) Nonexempt Charitable Trust Foundation Status

The procedures set out in IRM 7666(10)3 and IRM 7666.10(4) cover adverse determinations to nonexempt charitable trusts. A letter is prepared stating that the information submitted indicates an adverse determination is warranted, and advising the representatives of the trust of their right to protest the determination by requesting Appeals Office consideration. If an adverse determination is still indicated following the organization's protest and conference with the Appeals office, the Appeals office issues the adverse letter to the Trust.

(4) Denial of a Group Exemption

If the denial is based on a failure to meet the requirements for group exemption rather than for failure to meet the requirements for exemption under IRC 501(c), and if the central organization is not already exempt, the central organization's application should be handled as if it were a request for individual exemption. The usual protest and conference rights should be afforded. Where the request for a group exemption is denied on the basis that the central organization does not qualify for exemption on the merits, the usual denial letter, based on the guidelines set out in IRM 7669.1, will be prepared. However, the IRC 7428

declaratory judgment paragraph should be inserted as written in IRM 7667.52(3). See IRM 7667.52 for greater detail on writing group exemption denials.

(5) 501(c) Adverse Rulings and Determination Letters

The everyday "garden-variety" proposed adverse ruling and determination letters are individually composed by specialists. The guidelines as to the content of 501(c) adverse letters are specified at IRM 7669.1(1). Components of a 501(c) adverse letter include:

a) the material facts upon which the determination is made;

b) applicable statute, regulations, and other governing precedents;

c) the Service's conclusion and a clear explanation of the underlying reasoning;

d) a refusal to recognize status under any related paragraph of IRC 501(c);

e) the organization's right to protest the proposed action;

f) conference rights;

g) a statement that the determination will become final if the organization does not submit a written protest within the allotted time;

h) in cases under IRC 501(c)(3), a statement that appropriate State officials will be advised of the action in accordance with IRC 6104(c) if the determination is the final disposition; and

i) in cases under IRC 501(c)(3), the IRC 7428 paragraph dealing with failure of the organization to exhaust available administrative remedies-paragraph 1881(P) as stated at IRM 7669.1(1)(i).

B. Organization and Writing Style

Although the Manual provides the above basic guidelines from which to work, and certain types of adverse determinations are District Form Letters, generally, the specialist still has the task of composing an adverse letter. In other words, it is up to the specialist to apply the guidelines and put them into clear, concise, technically accurate, legally sound writing. To accomplish this, the specialist should utilize an effective legal writing style and format.

Many of the types of adverse determination letters detailed above require the specialist to compose most of the paragraphs themselves. Therefore, this section will discuss the components of a properly written and complete proposed adverse letter from beginning to end.

The opening paragraph of the letter should immediately make reference to the purpose of the letter. The adverse letters discussed here will either concern an organization's application for recognition of exemption or request for non-foundation classification.

A statement of the facts follows the opening paragraph. However, when a District Form Letter is used, it will normally state that an explanation of the determination is attached. The specialist then is able to expand on the facts, law, rationale, and holding on the attached Form 5795.

Only the pertinent and relevant facts should be stated. These include the date the organization was created; the purposes of the organization as set forth in the organizational document; and a summary of the material activities and operations. Although the Service stresses a concise statement of the facts, it is important to include all facts which have a bearing on the decision. The importance stems from the need for a complete record for purposes of the appeal rights afforded the organization. The goal of conciseness should not be accomplished at the expense of completeness.

Applicable law should be cited following the fact statement. Applicable law includes the pertinent Internal Revenue Code sections, regulations, revenue rulings, and court decisions. Code sections and regulations are usually quoted in order that there may be no misunderstanding as to the language. Revenue rulings, court decisions, and the like, by necessity, must be summarized. If necessary to do so in support of the Service's position, distinguish revenue rulings, regulations, and court decisions that appear to bear closely on the issue, but which in reality are not controlling.

The format of adverse letters next applies the law to the facts. Here is where the most common weakness in denial letters can be found: the failure to adequately support the conclusion in the rationale. There is often a tendency to state the rules and then the conclusion, as if the connection were self-evident.

The rationale is the crux of the denial letter. It is where the organization is told why we have concluded that they do not qualify. It is in the rationale that the specialist shows why the Code sections, regulations, revenue rulings or court decisions cited previously have applicability to the case at hand.

To check whether you have applied the law to the facts, always ask yourself whether you have explained why. Take as an example the conclusion that the organization fails to qualify for exemption under section 501(c)(3) of the Code. Why doesn't it qualify? A common reason would be that you have determined that the organization's activities are not educational, although the organization claimed they were. Why aren't the activities educational? What does the organization either lack or fail to engage in for its activities to be educational? Conversely, with what does the organization involve itself that prevents the activities from being educational? List the specific activities and/or purposes which cause the organization to fail to qualify under the law. Specifics help explain the "why's." Extraneous arguments should be avoided; they can weaken a case.

After tying the facts and the law together in the rationale, you have arrived at the conclusion. The conclusion is the outcome or result of the process; the decision reached after deliberation. It is a definite statement that the organization fails to qualify for the exemption or to qualify for non-private foundation status.

The remainder paragraphs of a denial letter are basically the same wording for all denial letters, therefore, they are similar to "pattern paragraphs" in that whole paragraphs can be inserted to satisfy manual requirements. A specialist can individually compose the paragraphs so long as they contain the manual requirements, however, it is advisable to include the remainder paragraphs as usually written to insure uniformity. These "pattern paragraphs" include the remaining elements outlined in IRM 7669.1 and mentioned earlier.

C. Examples

The following are two examples of proposed denials showing proper organization, coherence of thoughts, and effective legal writing style.

1. Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

You were incorporated on _____ under the laws of _____. Your stated purposes in pertinent part are:

1. To serve as an organization for mutual communication and support for all not-for-profit resident-owned and controlled housing within the boundaries of _____.

2. The not-for-profit management, support, development, ownership, financing, and other promotion of multifamily housing for low to moderate and middle income persons.

3. To provide member-controlled property management services on a direct basis, and to provide screening, referral, monitoring and evaluation of contracted management and legal services for members, and as appropriate in the larger community.

4. To engage in training of members' board of directors in general leadership, member education and development, public policy and a program education, and other matters relevant to resident-owned and controlled housing.

5. To furnish direct and indirect financial support and technical services including, but not limited to, a revolving loan fund, joint fundraising, location of short term and permanent financing and subsidies, combined packaging of public and private financing, provision of tax advisory services, auditing and other financial advice, and assistance with grants for members and the larger community as appropriate.

You plan to direct your services for the benefit of principally low-to-moderate income groups who have purchased, or intend to purchase, the apartments in which they reside. Those groups who become members of your organization must consist of no more than 49% of resident households with incomes above the current local mean income for households. You were formed as a goal of the city at the request of tenant groups receiving city assistance to purchase their homes and avoid condominium-related displacement. You intend to provide property services to member groups on a cost reimbursement basis. Such services will include loan oversight, management monitoring and review, bulk purchasing, property management and maintenance, bookkeeping and accounting, and vacant unit marketing.

Your sources of financial support will consist of membership dues, public grants, contributions, and cost reimbursement contracts for services. The financial information submitted with your application reflects that a large portion of your income will be from property service fees.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(b) of the regulations provides that an organization is organized exclusively for the required purposes only when its charter or other creating document authorizes it to carry on only activities that are in furtherance of those purposes. An organization is not organized exclusively for exempt purposes if its articles expressly empower it to carry on, other than as an insubstantial part of its activities, activities which are not in furtherance of exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is not broader than the purposes specified in section 501(c)(3). Also, an organization is not organized exclusively for the required purposes unless its assets are dedicated to an exempt purpose.

Section 1.501(c)(3)-1(c) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it primarily engages in activities which accomplish exempt purposes.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" to include relief of the poor and distressed or of the underprivileged.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code 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 purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

Revenue Ruling 70-535, 1970-2 C.B. 117, provides that a nonprofit organization formed to manage low and moderate income housing projects for a fee does not qualify for exemption under section 501(c)(4) of the Code. The organization operated in a manner similar to those providing such management services for profit. The fact that these services were being performed for tax-exempt corporations did not change the business nature of the activity.

Revenue Ruling 72-369, 1972-2 C.B. 245, provides that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code. The ruling emphasizes that an organization is not exempt merely because its operations are not conducted for the purpose of

producing a profit. Further, providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit. The fact that the services are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Revenue Ruling 75-283, 1975-2 C.B. 201, provides that an organization comprised of public housing tenant groups in a state and formed to promote the rights and welfare of public housing tenants by providing them with information and technical assistance regarding regulations and laws concerning public housing and acting as the state's recognized agent for public housing tenant organizations qualifies for exemption as operated exclusively for charitable purposes. The tenants residing in housing projects in the state are families whose income is too low for them to otherwise obtain decent, safe, and sanitary housing. The services of the organization are made available to any public housing organization without charge.

Your primary activities are similar to the activities of the organization described in Revenue Ruling 72-369 in that you are essentially a consulting service and technical advisor to your member organizations. You are engaged in the business of providing such services even though you are organized on a nonprofit basis. As stated in Revenue Ruling 72-369, the provision of managerial and consulting services for a fee at no more than cost is not an exempt activity under section 501(c)(3) of the Code. This principle would not change merely because an organization has members who are exempt and/or nonprofit or because it requires its members to consist of no more than 49% of resident households with income above the current local mean income. Note that, as stated in Rev. Rul. 70-535, the management of low and moderate income housing projects for a fee is considered similar to a business conducted for profit. Because you actually engaged in such property management activities, you are conducting an activity indistinguishable from an ordinary commercial enterprise. (See Regulations section 1.501(c)(3)-1(a)). Although the services you provide may be beneficial to the community and are undertaken on a nonprofit basis, they cannot be regarded as conferring a charitable benefit on the community unless they directly accomplish one of the established categories of charitable purposes.

You can be distinguished from the organization described in Revenue Ruling 75-283. That organization exclusively benefitted a distinct charitable class. Further, it provided services without charge.

In addition, your Articles of Incorporation expressly empower you to engage in commercial activities which are not in furtherance of an exempt purpose. To reiterate, such Articles provide, in part, that you will provide property management services, technical services, etc. Also, your Articles do not contain a dissolution provision dedicating your assets to an exempt purpose. Therefore, you do not meet the organizational test requirements of section 1.501(c)(3)-1(b) of the regulations.

In light of the above, we hold that you are not entitled to exemption under section 501(c)(3) of the Code because you are not organized or operated exclusively for charitable purposes.

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, signed by one of your principal 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 Practice requirements.

If we do not hear from you within 30 days, this ruling will become final, and copies of it will be forwarded to your District Director. Thereafter, any questions about your federal income tax status or the filing of tax returns should be addressed to that office. Also, the appropriate State officials will be notified of this action.

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 Internal Revenue Code provides, in part, that, "A declaratory judgment or decree under this section shall not be issued in any proceedings unless the Tax Court, 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."

Sincerely yours,

2) Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(6) of the Internal Revenue Code.

You are an unincorporated association of _____ and other employers created under authority granted by _____ for the sole purpose of enabling participating employers to provide pensions for their employees and their beneficiaries. Any _____ operating in _____ and any other employer providing services to or for _____ may upon application and with the approval of the Trustees become a participating employer. You act as sponsors of the master pension plan which members adopt. The member employers elect the officers, who are also appointed to act as Trustees of the Trust Fund for the master plan.

You provide administrative support services for the employee pension plans adopted, including providing adopting employers with all federal reporting and disclosure forms; collecting all contributions to the plan; investing such funds; and paying all benefits due to plan participants. An operating fund is maintained to separately provide for the administrative costs. The operating fund is never co-mingled with the master trust fund. The operating fund is derived from membership fees charged to member employers, based on the number of employee/participants of the employer in the plan.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues not organized for profit, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. The activities of the organization must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only enough income to be self-sustaining, it is not a business league.

Rev. Rul. 66-151, 1966-1 C.B. 152, holds that a business league, with the principal purpose of representing member firms in matters pertaining to their relations with labor and labor unions, conducts an activity that is not substantially related to the purposes for which the exemption under section 501(c)(6) was granted when it manages a health and welfare plan for its members for a fixed fee.

Rev. Rul. 66-354, 1966-2 C.B. 207, describes an organization formed pursuant to a collective bargaining agreement between an association of manufacturers and a labor union. The organization received federal and state employment taxes, prepaid and filed the necessary returns and paid over the amounts received to the appropriate tax authorities. The ruling held that the organization did not qualify for tax exemption under section 501(c)(6) because it did not serve any of the exempt purposes described therein.

Rev. Rul. 74-81, 1974-1 C.B. 135, provides that a nonprofit organization formed to promote the business, welfare, and interests of persons engaged in the contracting trade and related industries and whose principal activity is to provide its members with group workmen's compensation insurance is not entitled to exemption under section 501(c)(6) of the Code.

The administration and management of pension and welfare benefit plans provided by you is similar to the services for members described in Rev. Rul. 66-151 (management of a welfare plan); in Rev. Rul. 66-354 (personnel and accounting functions); and in Rev. Rul. 74-81 (management and payment of workmen's compensation insurance). The revenue rulings cited above concluded that such services constitute the performance of particular services for individual members. By providing administrative services and paying pension benefits, you relieve your members of the necessity of securing the services commercially (or performing the service on an individual basis) in order to properly conduct the member's business, resulting in a convenience and economy to your members. Therefore, you are rendering particular services for individual members rather than working toward improvement of business conditions in your industry generally.

Accordingly, based on the facts and circumstances, we conclude that you are not a business league as described in section 501(c)(6) of the Code and that you do not qualify for

recognition of exemption from federal income tax. You are, therefore, required to file federal tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views with a full explanation of your reasoning. This statement, signed by one of your trustees, 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 trustees, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

If we do not hear from you within 30 days, this ruling will become final and copies of it will be forwarded to the District Director. Thereafter, any questions about your federal income tax status or the filing of tax returns should be addressed to that office.

Sincerely yours,