Internal Revenue Service
TEGE Appeals Division
300 N. Los Angeles
Los Angeles, CA 90012

CERTIFIED

Department of the Treasury

Date: NOV - 4 2009

Number: **201004045**
Release Date: 1/29/2010

Taxpayer Identification Number:

Person to Contact:

Employee ID Number:
Tel:
Fax:
Refer Reply to:

In Re:
Exempt status
Tax Years:

UIL Index:
501.03-00
501.33-00

Last Day to File a Petition with the
United States Tax Court: FEB - 2 2010

Dear :

This is a final adverse determination as to your application for exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reason(s):

You are not organized or operated for an exclusive exempt purpose as required by Internal Revenue Code section 501(c)(3). You did not meet the organizational or operational tests as required by section 1.501(c)(3)-1(b) and 1.501(c)(3)-1(c)(1) of the Treasury Regulations. You have not established that your income will not inure to the benefit of individuals and shareholders, which is prohibited by Internal Revenue Code section 501(c)(3). You are operated for a substantial private purpose, which is prohibited by Internal Revenue Code section 501(c)(3).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown above.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed before the 91st (ninety-first) day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for Taxpayer Advocate assistance.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate, can however, see that a tax matter, that may not have been resolved through normal channels, gets prompt and proper handling.

We will notify the appropriate State officials of this final adverse determination of your exempt status, as required by Code section 6104(c).

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

Sincerely,

Karen A. Skinder

Karen A. Skinder
Appeals Team Manager

cc:

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

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

Date: NOV - 4 2009

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:
M = Applicant
N = State Government Insurance Program
X = State Government Department
Y = Related Exempt Organization

Z = County
A = Founder of and Substantial Contributor to the Applicant
DATE 1 = date
DATE 2 = date
x = dollars

UIL Index:
501.03-00
501.03-05
501.33-00

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

ISSUES:
Does M qualify for exemption under section 501(c)(3) of the Internal Revenue Code?

FACTS:
M incorporated on DATE 1 and its application was received by the Service on DATE 2. The Third Article of M's governing instrument states that the nature of M's business, and the objects and purposes to be transacted, promoted, and carried on are as follows:

M

> To solicit, collect and otherwise raise money and receive gifts of property for charitable, philanthropic, eleemosynary, educational and benevolent purposes; to expend, contribute, manage, disburse and otherwise handle and dispose of the same for such purposes, either directly or by contributions to other agencies, organizations or institutions organized for the same or similar purposes; to assist in harmonizing and making more efficient the work of charitable, philanthropic and educational benevolent organizations, by cooperating with and assisting such organizations, and by receiving by gift, will, or otherwise money or other property and by managing, handling and distributing it as may be deemed best for the promotion of charity, education and philanthropy, and to do any and all other things necessary or proper in connection with or incidental to any of the foregoing.

M's narrative from the application Form 1023 describes the purpose of providing housing accommodations for people with developmental disabilities in Z. M plans to be a private operating foundation. A is a substantial contributor to the organization. A's son suffers from developmental disabilities. A has purchased a residential property and has proposed to make a gift to M to be used to provide housing accommodations for persons with developmental disabilities. A's son is the first resident of the residential property. Also residing at the residence is a qualified mental health counselor, who is providing counseling services to A's son under the supervision of X. If and when the residency of A's son terminates, the residence will be made available for other persons with developmental disabilities. A's son is 32 years old and expected to have a normal life expectancy. A qualified counselor will continue to reside at the residence to provide counseling services to such person or persons. Persons with developmental disabilities often require a separate residence when they are unable to reside in group facilities for persons with developmental disabilities. The activities of M will be managed by its directors and officers. A is not a director or officer of the organization. It is A's intention to acquire one or more additional residences and give them to M to provide additional housing accommodations for people with developmental disabilities.

M will be supported by annual cash contributions from A and also from the qualified counselor's monthly rent of **$x**, of which part of the rental expense of the counselor will be borne by X.

The counselor is employed by Y. Y is a tax exempt organization as described under section 501(c)(3) of the Code. The counselor is charged a small amount of rent by M to offset costs. The counselor is not on call 24 hours a day, but is available as needed by the disabled individual.

Y has a working agreement with A, whereby N is billed. The organization receives no funding from X or any other governmental agencies.

M stated that none of the officers or directors of the organization are related to A. M indicated that two of its officers/directors are employed by Y. However, it was determined that Y has a working arrangement with A. The third officer/director is an assistant to A and the fourth officer/ director is the attorney representing A. (Note: the attorney expired in 2005.)

M has indicated that it has short term plans for a second residence for another developmental disabled person and a third residence as a day center for developmentally disabled persons. Long term plans are in place for the acquisition of a fourth and fifth residence for additional developmentally disabled persons. However, the additional residences would not take place until the receipt of its determination letter.

M contended that the private benefits to A and A's son will be merely incidental. M claimed that A's son will be one of many beneficiaries as A will contribute additional homes to M. M indicated that at this time its does not know how many people will apply for housing, and no publication or application form has been developed. M noted that there is a central registry at the local County's office of persons with developmental disabilities, which would be available to publicize the housing program.

The residential property purchased by A has not been transferred pending receipt of the tax-exempt status.

M stated that it will have no financial activities until the receipt of a favorable determination letter under IRC 501(c)(3).

LAW:
Section 501(c)(3) of the Internal Revenue Code describes certain organizations exempt from income tax under section 501(a) and reads in part as follows:

..."(3) Corporations, and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on legislation, (except as otherwise provided in subsection (h), and which does not participate in, or intervene in (including the publishing or distribution of statement), any political campaign on behalf of (or in opposition to) any candidate for public office."

Section 1.501(a)-1(c) of the Regulations defines the term "private shareholder or individual" as any person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations 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 of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

M

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements, an organization must establish that it is not organized or operated for the benefit of private interest, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the Regulations Charitable defined. The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such terms include: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization, which is organized and operated for the relief of indigent persons, may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes. The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under section 501(c)(3) so long as it is not an "action" organization of any one of the types described in paragraph (c)(3) of this section.

Schoger Foundation v Commissioner, 76 T.C. 380 (1981) held that because an activity served a substantial nonexempt purpose, an organization did not qualify for exemption under 501(c)(3) even though the activity also furthered an exempt purpose.

The Church of the Living Tree v. Commissioner, T.C. Memo 1996-291(1996), determined that activities concerning the papermaking (industry) constituted a substantial non-exempt purpose which did not entitle the organization to exemption under 501(c)(3) and constituted a benefit to private individuals.

Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), held that the presence of a single nonexempt purpose, because it was substantial in nature, precluded tax exemption under section 501(c)(3) of the Code.

Rueckwald Foundation, Inc. v. Commissioner, TC Memo 1974-298, stated that an organization was not operating for exempt purposes but rather for the private benefits of related family members.

Wendy L. Parker Rehabilitation Foundation, Inc. v. Commissioner, TC Memo 1986-348, denied exemption under 501(c)(3) to an organization that was mainly operating for the benefit of one individual person who was a family member of the founder rather than for general public interests.

Revenue Ruling 67-367, 1967-2 CB 188, stated that a nonprofit organization whose sole activity was the operation of a scholarship plan for making payments to pre-selected, specifically named individuals did not qualify for exemption 501(c)(3).

ORGANIZATION POSITION:

M stated that its purpose is to provide housing for developmentally disabled persons. M asserted that while the first residence A will contributed to M is specifically for the benefit of A's son, M's substantial contributor and founder, that residence will be available for use by other developmentally disabled persons after A's son no longer needs it. M claimed that A will contribute additional (three to five) residences to M two to three years after receipt of a favorable determination letter.

M claimed that it will permit qualifying persons to live in neighborhoods where they otherwise would not be able to live and that they will be able to find employment near their housing and become partially self-sustaining.

M claimed that the housing will be within the exclusive control of M to be used for its charitable purposes. M said that the fact that A's son, who is a developmentally disabled person, will be its first beneficiary should not prevent it from qualifying for exempt status under 501(c)(3).

M cited Revenue Ruling 62-113, 1962-2 CB 10 and George E. Peace v. Commissioner, 43 TC 1. M stated that 62-113 ruled on the deductibility of contributions to a church fund that was used to support missionary activities carried out by the son of the taxpayer in that case. M said that although the taxpayer in that case made contributions to the church fund after the son became a missionary, the taxpayer had done so over a period of years before his son's departure for the mission. In that case, the church had control over the donated funds and discretion as to their use, so as to insure that they would be used to carry out its functions and purposes.

M stated that George E. Peace v. Commissioner, held that the amount paid by the petitioners were contributions to and for the use of the Sudan Interior Mission, an exempt organization, and were not personal gifts to four designated missionaries. M said that the court ruled against the IRS on the basis that the organization's policy was that it has exclusive control of both the administration and distribution of the funds contributed by the donors

Also, M stated that in Revenue Ruling 62-113 and George E. Peace case, that the private benefit in those cases was incidental and did not prevent those organizations from having tax-exempt status simply because the organization had control over its assets and operations.

M

M stated that the two unfavorable court cases cited by the IRS were not applicable to its case. M claimed that in Rueckwald Foundation v. Commissioner, the organization in that case was used for the private benefit of the sponsor and did not have a genuine charitable purpose. As to Wendy L. Parker , M asserted that the organization in that case was used principally for the benefit of a relative of the donor who lived in the donor's personal residence and did not set forth a well-defined program for supporting other persons with similar disabilities. M also noted that, in the Parker case, there was no independent board. M claims to have an independent board that is not controlled by A, the founder and substantial contributor.

M stated that Revenue Ruling 67-367 does not apply to it because M's services will be available to all persons with developmental disabilities who would benefit from the individual housing and the day center.

Also, M indicated that court cases Schoger Foundation v. Commissioner, 76 TC 380 (1981), Church of the Living Tree v. Commissioner, TC Memo 1996-291 (1996), and Better Business Bureau of Washington, DC, Inc. v. United States, 326 US 279 (1945) do not apply to its case.

M indicated that any benefits to A and A's son are and will be incidental as long as it also makes similar goods, services, or facilities are available to the general public.

M asserted that it would expand its board, if requested by the Service.

SERVICE'S POSITION:

M cited Revenue Ruling 62-113, 1962-2 CB 10 and George E. Peace v. Commissioner, 43 TC 1. In both, the tax exempt organizations were determined to have control over the donated funds and both supported unspecified numbers of missionaries. M may have control over the donated funds, but the initial impetus of M was, and will be to support one particular, named individual - who happens to be the founder's son. The founder and substantial contributor is sufficiently connected to M and to Y and the founder sufficiently controls M through financial means so as to guarantee that M will care for his son for the rest of his son's life, which could be more than 50 years.

M indicated that an incidental private benefit does not necessarily disqualify a tax exempt organization, such as in Revenue Ruling 73-313, 1973-2 CB 174, whereby residents of an isolated rural community provided a medical building and facility to a doctor at a reasonable rate. Of course, it that organization, the doctor could have been any doctor, not necessarily a pre selected, named relative of a substantial contributor to the organization. The organization obviously had to pay the doctor to attract him or her to provide medical services in an isolated rural community. However, the revenue ruling does not appear to apply to M. Z is a major metropolitan area with a population of over a million people rather than an isolated rural community. M could easily provide housing to developmentally disabled persons without the stipulation that the first of such persons must be the son of its substantial contributor. The fact that M decided to first provide benefits to A's son indicates that this consideration was the very impetus for M's creation as opposed to being incidental to a pre-existing effort by M to benefit the public at large.

M indicated that its goods, services, or facilities will be made available to the general public after taking care of the needs of A's son, and that, therefore, all of the private benefits to A and A's son are incidental to M's broad charitable general purpose of benefiting the public at large. Thus far, the only named individual who will definitely benefit from the housing is the son of the substantial contributor / founder. Also, at this time the first residence still belongs to the substantial contributor / founder rather than to M. A has not transferred the property to M. M does not have any written guidelines in selecting other developmentally disabled persons. M has not developed any form of publication or publicized the exempt purposes of the organization. M has not provided a listing of contacts involving other local governmental agencies or community based services organizations that may refer qualified individuals to the organization. M's Board of Directors are affiliated, associated, or have vested interests with the substantial contributor / founder. A is the only contributor to M. M indicated that it plans to acquire more homes to be used as residences for developmentally disabled who are not relatives of A. However, there is no assurance that this will occur. The fact that M requested classification as a private operating foundation indicates that it intends that the substantial contributor / founder will maintain control over M in order to guarantee that his sons will be M's primary beneficiary. Even if M does add other housing for other persons the unique relationship of M and A to A's son will persist. This counters M's argument that M's stipulated plan to first and foremost house A's son is incidental to its plans to subsequently confer a broad charitable benefit on unrelated members of the public who are developmentally disabled. On the contrary, it seems that a desire to provide permanent housing for A's son is the main reason for M's existence. Also, it is clear that M can do nothing in the short term or in the long term, for the benefit of A's son or for the benefit of others, without the contributions of property from A. That means that M will be controlled financially by A.

M has on several occasion been given the opportunity to expand the board has not done so. Board expansion would be a positive factor in relation to qualification for exempt status, but it would probably not alter the fact that A, as the substantial contributor / founder would continue to exercise effective control over M through financial means. Furthermore, M apparently has already made the decision that it will, first and foremost, house A's son for life. Additional, unrelated persons added to M's board would apparently not be able to revoke that crucial decision.

CONCLUSION:

Based on the information presented by the organization, M does not qualify for exemption under Internal Revenue Code section 501(c)(3) as a charitable or educational organization or under any section within the Internal Revenue Code. In providing housing for life to the son of the substantial contributor / founder, M's earnings inure to the benefit of A, a private individual who effectively controls M through financial means. Even a small amount of inurement is fatal to a request for exempt status under IRC 501(c)(3).

Even if A were not M's substantial contributor and even if A did not sufficiently control M to produce prohibited inurement, M would still fail to qualify for exemption under IRC 501(c)(3) because the private benefit of M's primary function of housing for life a pre-selected individual would be substantial, not incidental, in comparison to M's secondary function of planning to

M

subsequently provide similar benefits to qualifying members of the public who have not been pre-selected.

YOUR RIGHTS:
You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, under the penalties of perjury, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues.*

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative,* if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney.* All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree 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 all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

If you wish to protest this proposed denial, please send your protest statement, Form 2848, and any supporting documents to the applicable address:

M

Mail to:
Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201
ATTN:

Deliver to:
Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202
ATTN

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements