Journal of Affordable Housing & Community Development Law
Summer, 2000

Articles

A REVISIONIST HISTORY OF HOUSING PIONEERS: THE EXPANDING REACH OF PRIVATE BENEFIT DOCTRINE

Barbara Rhomberg[a1]

Introduction

The low-income housing tax credit was created by Congress to encourage private sector construction and renovation of low-income housing.[1] It has become the largest source of federal support for the construction of affordable rental units,[2] with $300 million available for allocation annually.[3] Because Congress intended that nonprofit organizations play a major role in the provision of private low-income housing, 10 percent of the credits available in each state were set aside for qualified 501(c)(3) and 501(c)(4) organizations.[4] These nonprofits are exempt from income tax and cannot directly benefit from tax credits, so it is necessary for them to form partnerships with taxpaying investors to take advantage of the tax credit funding.[5] Such limited partnerships have become a common mechanism for financing low-income housing projects.[6]

The controversial case of *Housing Pioneers*[7] created doubt and confusion about the propriety of a charitable organization[8] participating in a partnership that confers tax benefits on private investors. The U.S. Tax Court denied tax exemption to Housing Pioneers, Inc., a nonprofit corporation formed to participate in California low-income housing partnerships, on the grounds that its activities served the commercial interests of its for-profit partners. The organization thus failed to meet the section 501(c)(3) mandate of operating exclusively for exempt purposes.[9] In affirming the decision, the Ninth Circuit agreed that Housing Pioneers impermissibly benefited private interests and implied that 501(c)(3) status was inconsistent with participation in a tax credit partnership.[10]

The exempt organization bar reacted negatively to both decisions. The outcome of the case was uncontroversial, since the creation of Housing Pioneers appeared to be a scheme designed to obtain property tax benefits for its organizers and board members. But critics charged that the Tax Court and the Ninth Circuit went too far in suggesting that provision of tax benefits to for-profit limited partners, in and of itself, creates impermissible private benefit.[11] Some commentators argued that private inurement rather than public benefit should have been the basis of the decision.[12]

The Internal Revenue Service (IRS) was nonplussed by the case as well. It had originally denied exemption to Housing Pioneers based on the obvious cupidity of its organizers, and argued before the appellate court that "normal private benefit and inurement rules" disposed of the case.[13] Notwithstanding *Housing Pioneers*, the IRS still maintains that a charity may enter a limited partnership that provides tax credits to for-profit partners "if it is able to demonstrate that it operates exclusively for charitable purposes and only incidentally benefits private interests."[14]

Both the IRS and the exempt organization bar consider the case aberrant and dismiss its precedential significance, suggesting that the *Housing Pioneers* holding is limited to the egregious facts of the case.[15] This article argues that practitioners should not be so quick to dismiss *Housing Pioneers*. The Tax Court opinion was neither an aberration nor a departure from established principles of Section 501(c)(3) law. Rather, the decision was entirely consistent with prior private benefit decisions and with the commerciality doctrine.

Although consistent with precedent, the Tax Court holding broke new ground in finding that a blatant purpose to obtain tax savings for investors violates Section 501(c)(3), even if the tax savings are used to reduce consumer costs. While *Housing Pioneers* has had little effect on existing bona fide nonprofit housing developers, the case is important for a nonprofit organization formed to immediately enter a limited partnership as its sole project. Unless the nascent organization can demonstrate that its role and purpose go beyond the acquisition of tax benefits, it may find that *Housing Pioneers* precludes it from obtaining 501(c)(3) status. Further, the Tax Court's emphasis on charitable control of the joint venture as a proxy for charitable purposes has taken root in exempt organization tax law. The conflation of control with purpose is reflected in the IRS approach to hospital joint ventures,[16] and was influential to the outcome of *Redlands Surgical Services*,[17] the most recent Tax Court case to consider a nonprofit's participation in a for-profit endeavor.

The Tax Court decision in *Redlands Surgical Services* has been appealed to the Ninth Circuit,[18] giving that court another chance to clarify the law regarding charity joint ventures. Before the Ninth Circuit decides this closely watched appeal, it is appropriate to reconsider the meaning of its last joint venture decision, *Housing Pioneers*, lest this misunderstood case continue to confuse an increasingly important area of law.

Part I of this article reviews 501(c)(3) private inurement, private benefit, and commerciality doctrine. Part II describes the facts of *Housing Pioneers* and summarizes the Tax Court and Ninth Circuit opinions. Part III analyzes the Tax Court decision and the impact of the case on charitable housing organizations. Part IV examines the Ninth Circuit opinion.

Part I: Private Inurement, Private Benefit, and the Commerciality Doctrine

Three closely related strands of section 501(c)(3) jurisprudence are implicated by *Housing Pioneers*. In preparation for the analysis below of the Tax Court and Ninth Circuit opinions, this part reviews private inurement, private benefit, and commerciality doctrine, and summarizes the state of the law regarding charity joint ventures.

Private Inurement

Private inurement is the use of a tax-exempt organization's income or assets to unduly benefit a person with some close relationship to the organization.[19] It is prohibited by section 501(c)(3) of the Internal Revenue Code, which grants tax-exempt status to entities that are "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes."[20] As a condition of exempt status, the Code requires that "no part of the net earnings [of the organization] inures to the benefit of any private shareholder or individual."[21]

Treasury regulations define the phrase "private shareholder or individual" to mean "persons having a personal and private interest in the activities of the organization."[22] Case law construes this to include anyone in a position to exercise significant control over the charity.[23] The inurement prohibition therefore applies only to the relationship between a charity and its "insiders."[24]

Although there is no precise definition of private inurement,[25] an IRS document states that the "inurement prohibition serves to prevent anyone in a position to do so from siphoning off any of a charity's income or assets for personal use."[26] Most instances of private inurement arise in financial transactions where the charity's payment to the insider is excessive or unreasonable.[27] The IRS takes the position that "inurement may be found even though the amounts are small .... There is no de minimis exception to the private inurement prohibition."[28]

Private Benefit

Private benefit is a broader doctrine that prohibits a charity from conferring "nonincidental benefits" on any private party.[29] The doctrine arises out of the statutory mandate that charities operate exclusively for exempt purposes.[30] Treasury regulations impose an "operational test" to assess compliance with the statute; to pass the test, a charity must engage primarily in activities that accomplish exempt purposes, and no more than an insubstantial part of its activities may further a nonexempt purpose.[31] The Tax Court holds that "the presence of a single substantial nonexempt purpose destroys the exemption regardless of the number or importance of exempt purposes."[32] It is the actual purpose of the organization's activities, and not the nature of the activities that is decisive under the operational test.[33]

Treasury regulations further provide that 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."[34] If a charity is found to serve private interests, it will be deemed to further a nonexempt purpose under the operational test and will therefore be ineligible for 501(c)(3) status.[35] The wording of this regulation might appear to limit its application to a charity's relationship with its insiders, since "private interests" are described in a way similar to the "private shareholders and individuals" of the inurement ban.[36] Although there is dictum supporting this interpretation,[37] it was firmly rejected by the Tax Court in *American Campaign Academy*, which held that an organization's conferral of benefits on outsiders with no control over the organization could cause it to "serve private interests" within the meaning of this section.[38]

Tax regulations and case law forbid a charity from furthering a substantial noncharitable purpose.[39] However, the Tax Court uses an incidental standard to judge whether a charity has improperly served private interests. In *American Campaign Academy*, for example, the court framed its private benefit analysis by asking whether the "petitioner conferred *nonincidental* private benefits upon Republican entities and candidates."[40] After answering this question in the affirmative, the court held that the petitioner operated for a substantial nonexempt purpose.[41] Similarly, the Tax Court awarded 501(c)(3) status to a museum upon finding that benefits conferred on a nonexempt affiliate were merely incidental to the museum's charitable purpose.[42]

The IRS also uses an incidental test: "Any private benefit arising from a particular activity must be 'incidental' ... to the overall public benefit achieved by the activity if the organization is to remain exempt."[43] The standard used in balancing private benefit against public benefit is whether the private benefit is incidental in two respects:

> To be qualitatively incidental, a private benefit must occur as a necessary concomitant of the activity that benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefiting private individuals. Such benefits might also be characterized as indirect or unintentional. To be quantitatively incidental, a benefit must be insubstantial when viewed in relation to the public benefit conferred by the activity.[44]

The IRS test for prohibited private benefit therefore involves two prongs. To be incidental, the private benefit must be a side effect of activities or arrangements that advance an exempt purpose, and it must also be reasonable in proportion to the public benefit.

Since the IRS test requires an activity to be incidental in both a qualitative and quantitative sense, failing either prong of the test would be grounds for the loss of charitable status. If an activity conferred private benefit directly and intentionally, it would violate the private benefit doctrine even if the benefit to the private party were relatively insignificant. A general counsel memorandum confirms that the IRS takes this position: "[I]f an activity provides a direct benefit to private interests, it does not matter that the benefit may be quantitatively insubstantial; the direct private benefit is deemed repugnant to the ideal of an exclusively public charitable purpose and the organization cannot be exempt under section 501(c)(3)."[45]

On the other hand, if an activity generates a private benefit that is disproportionate to its public benefit, it may violate the private benefit doctrine even though the charity had a legitimate, exempt purpose for conducting the activity.[46]

Although the bans on private inurement and nonincidental private benefit resemble each other, they are doctrinally distinct. "[W]hile the prohibitions against private inurement and private benefits share common and often overlapping elements ... the two are distinct requirements which must independently be satisfied."[47] The crucial substantive difference is that inurement only applies to benefits conferred on insiders, while private benefit doctrine is violated when any private party benefits unduly from a charity's operations.[48] There is, however, an additional and subtle difference in lexicon. Private inurement is a label applied only after a benefit has been deemed improper.[49] This designation is fatal to the exemption, since any private inurement violates section 501(c)(3).[50] Private benefit, on the other hand, is subject to a balancing test. Only nonincidental private benefit violates the operational test; incidental private benefit is consistent with 501(c)(3) status.[51] Numerous cases and revenue rulings have found nonprofit organizations to be exempt charities even though their activities incidentally benefit private businesses and individuals.[52]

Private Benefit and Participation in For-Profit Partnerships

A landmark 1982 case, *Plumstead Theatre Society*, established that a charity may serve as the general partner in a for-profit limited partnership.[53] After *Plumstead*, the IRS developed a two-step analysis to determine whether a given partnership was consistent with 501(c)(3) status.[54] First, the IRS must find that the partnership serves a charitable purpose. Once the charitability of the partnership's purpose has been established, the IRS will scrutinize the agreement to see whether it "allows the organization to act exclusively in furtherance of an exempt purpose."[55] The latter inquiry seeks to ensure that the exempt organization does not place its charitable assets at risk, and that only incidental benefits are bestowed on the for-profit partners.[56] The ordinary private benefit standard—that any benefits to private interests be incidental to a charitable purpose—is therefore an integral part of the inquiry.[57]

The IRS developed a list of favorable and unfavorable factors to inform its case-by-case determination. Favorable factors include, inter alia, a lack of control over the partnership by the for-profit limited partners; the absence of any obligation to return the limited partners' capital from the exempt organization's funds; a cap on the rate of return on the limited partners' investment; all transactions with the limited partners negotiated at arm's length; and a primary motivation other than profit.[58] Unfavorable factors include a disproportionate allocation of profits and losses in favor of the limited partners, control of the exempt organization by the limited partners, and a profit motive on the part of the exempt organization.[59] These and other factors are weighed by the IRS to determine whether the organization will operate for charitable purposes and whether undue private benefit will result from the deal.

Commerciality Doctrine

The commerciality doctrine holds that when an exempt organization conducts an activity in a commercial manner, that activity does not further an exempt purpose. An activity will be considered "commercial" if it has a direct counterpart in the private sector or is conducted in the same manner as a for-profit business.[60]

The commerciality doctrine arose out of judicial interpretations of the requirement that a charity operate exclusively for exempt purposes.[61] A seminal case concerned the status of a Better Business Bureau chapter, which sought tax exemption as an educational organization. The U.S. Supreme Court found that promotion of a profitable business community was a nonexempt purpose and that consequently the Bureau did not operate exclusively for exempt purposes. The Court tied the Bureau's ineligibility for tax exemption to the organization's "commercial hue," stating that its "activities are largely animated by this commercial purpose."[62]

A charity may engage in commerce and generate profits without running afoul of the commerciality doctrine.[63] But the tail cannot wag the dog; the commercial activities must be incidental to an exempt purpose.[64] When commerce becomes an end rather than a means, the organization will not be exempt. For example, an organization that sold religious literature was denied tax exemption when the court found that it was primarily commercial in character, with religious objectives merely incidental.[65] Similarly, a nonprofit that sold its founder's books was denied 501(c)(3) status upon a finding that it operated primarily for a commercial purpose, with education secondary.[66]

The doctrine is typically applied against organizations that resemble private sector counterparts. The resemblance to a business and the adoption of business practices are seen by the courts as evidence that commercial purposes have become primary.[67] However, it also reflects a judicial concern that an operation indistinguishable from a business should not get favored tax treatment. In a decision affirmed by the Seventh Circuit, the Tax Court held that "[c]ompetition with commercial firms is strong evidence of a substantial nonexempt purpose."[68]

Since resemblance to a private sector business is a key factor in the commerciality doctrine, a nonprofit can stave off revocation of its 501(c)(3) status by demonstrating that its operations differ from a comparable for-profit business.[69] For example, the IRS argued that Plumstead Theatre Society was ineligible for tax-exempt status because it operated for the commercial purpose of selling tickets to plays. In rejecting this attack, the Tax Court stressed the differences between commercial and noncommercial theaters.[70] The former present crowd-pleasing favorites, while the latter produce both classic and original works; commercial theaters extend their runs as long as a show is profitable, while nonprofit theaters usually present a number of shows each season regardless of popularity; and so on.[71] These differences justified the exempt status of nonprofit theaters because they demonstrated that artistic and educational purposes, not money making, were dominant.

Part II: Facts and Opinions in *Housing Pioneers*

Although *Housing Pioneers* attracted widespread attention because of its possible implications for low-income housing projects funded with federal tax credits, no low-income housing tax credits were actually involved in the case. But both the

Tax Court and the Ninth Circuit referred to federal tax credits in their opinions, generating concern that *Housing Pioneers* would imperil the use of tax credits by 501(c)(3) developers. This part reviews the facts of the case and summarizes the trial and appellate court decisions.

Facts of Housing Pioneers

Housing Pioneers, Inc., was founded in 1989 with the ostensible purpose of providing affordable housing to low-income, handicapped, and previously incarcerated people.[72] Its operations were designed to take advantage of a California property tax reduction available to nonprofit organizations—or to partnerships in which the managing general partner was a qualifying nonprofit organization—that owned low-income housing.[73]

The new organization's first endeavor was a management agreement with Grant Square Properties, an existing for-profit limited partnership owned by Jerry and Howard Harris.[74] Jerry Harris was the incorporator and board president of Housing Pioneers; his father Howard Harris was also a Housing Pioneers board member, as well as its secretary and chief financial officer.[75] Under this agreement, Grant Square loaned Housing Pioneers $5,000 to buy a 1 percent stake in Grant Square, and Housing Pioneers became a Grant Square general partner.[76]

The arrangement was designed to qualify Grant Square for the California property tax reduction available to nonprofit housing partnerships, and the contract provided that Housing Pioneers would split the resulting tax savings with its cogeneral partner, a for-profit entity owned by the Harris family.[77]

Housing Pioneers entered into a similar management agreement with Hidden Cove Associates, another for-profit limited partnership.[78] No member of the Harris family had an interest in Hidden Cove.[79] The agreement provided that Housing Pioneers would be entitled to a share of the California tax savings that Hidden Cove obtained through Housing Pioneers' participation in the partnership; it also required Hidden Cove to use the balance of the tax savings exclusively to reduce rents or otherwise maintain the affordability of the residential units that it owned.[80]

Housing Pioneers planned to seek out other limited partnerships that owned low-income rental housing and offer to become a general partner in order to qualify these partnerships for the California property tax reduction. As in the Grant Square and Hidden Cove agreements, Housing Pioneers would be compensated based upon the amount of the property tax reduction.[81] With its share of the tax windfall, Housing Pioneers stated that it would provide services to the low-income tenants living in the rental housing owned by its partnerships, although it had not adopted any plans to initiate services at the time of the Tax Court litigation.[82] Although Housing Pioneers would have the status of general partner in these ventures, its actual authority would be "narrowly circumscribed" by the partnership agreement.[83] The Tax Court found that "[i]n general, the management agreement denies petitioner [[Housing Pioneers] authority to screen or select the tenants or conduct general maintenance. Moreover, petitioner has no on-site management authority."[84] Housing Pioneers' main responsibility as a general partner would be to ensure that the partnerships continued to qualify for the property tax reduction and other tax credits.[85]

Tax Court Decision

The Tax Court held that Housing Pioneers did not qualify for 501(c)(3) status. It failed the operational test by having a substantial nonexempt purpose of creating tax benefits for its limited, for-profit partners.[86] The conferral of tax advantages benefited the limited partners even though at least one of the partnership agreements required the tax savings to be used to maintain the affordability of the rental units:

> [S]ignificant Federal income tax benefits will flow to the nonexempt partners, including depreciation deductions and sections 38 and 42 general business credits. In addition, the California property tax reductions, even though they are to be used exclusively for the purpose of reducing the rents or otherwise maintaining the affordability of the residential units, inure indirectly at least to the benefit of the nonexempt partners in that the partnerships are thereby relieved of the necessity of maintaining rents at a level sufficient to cover operating expenses which would otherwise have to be paid out of partnership capital.[87]

Using its 501(c)(3) status to achieve the California property tax reduction was "[t]he keystone of petitioner's entire plan," the court found.[88] "Given the combined thrust of section 42 [low-income housing tax credits] and California section 214(g) [low-income housing property tax reduction], which if available will significantly benefit the nonexempt partners, it is difficult to see how petitioner can avoid the taint of nonexclusive operation for charitable purposes."[89] The court concluded that Housing Pioneers' activities "serve[d] the commercial purposes" of its for-profit limited partners.[90]

After holding that Housing Pioneers failed the operational test because it served private interests, the Tax Court noted that private inurement would be "an additional reason for the denial of exempt status."[91] Jerry and Howard Harris were directors of Housing Pioneers, so they were "insiders" in a position to control the nonprofit organization; they were also limited partners in Grant Square and would benefit from the tax reductions gained through Housing Pioneers' participation in the partnership. While finding that Housing Pioneers violated the private inurement prohibition,[92] the Tax Court considered it unnecessary to reach the inurement issue in its decision.[93] The private benefit conferred on Housing Pioneers' limited partners served private interests even if the partners were not insiders subject to the inurement ban, and the organization therefore violated the broader private benefit doctrine.[94]

Ninth Circuit Opinion

On appeal to the Ninth Circuit, Housing Pioneers interpreted the Tax Court decision as a blanket prohibition on the participation of 501(c)(3) organizations in ventures that give tax benefits to for-profit partners. Housing Pioneers argued that section 501(c)(3) of the Internal Revenue Code was therefore in conflict with section 42(h)(5), which requires 10 percent of low-income housing tax credits to be set aside for 501(c)(3) and 501(c)(4) organizations.[95] Since tax-exempt organizations cannot directly benefit from tax credits, their use of the credits depends on participation in partnerships with nonexempt investors, and an "inescapable corollary of such projects is that participation by the qualified nonprofit will bestow a tax credit on its for-profit partners."[96] Housing Pioneers contended that to eliminate the conflict between tax code sections, the appellate court "must recognize that as a matter of law section 42(h) limits the requirements of section 501(c)(3)."[97]

The Ninth Circuit called this argument "attractive enough to deserve elaboration and powerful enough to require refutation."[98] The court stated that "[i]t might well be a successful argument" if made by a nonprofit organization that qualified for tax credits under section 42(h).[99] However, Housing Pioneers was not eligible for section 42 tax credits because it did not "materially participate" in the development and operation of the housing projects as required by the tax credit law.[100] Therefore, its modification argument failed: "As Pioneers has not shown itself to be a section 42(h) nonprofit, we have no reason to decide the relationship between section 42(h) and section 501(c)(3) and no need to decide if the former modifies the latter," the Ninth Circuit opined.[101] "The usual rules for applying 501(c)(3) apply."[102] The appellate court then affirmed the Tax Court's finding that Housing Pioneers had a substantial nonexempt purpose that conferred private benefit.[103]

Following criticism of its decision, the Ninth Circuit took the unusual step of amending the opinion.[104] The amended decision distinguished *Housing Pioneers* from *Plumstead Theatre Society*, the Ninth Circuit decision allowing a charity to form a joint venture with for-profit partners, because the *Plumstead* investors were "not shareholders nor officers nor directors of the theatre group," while Housing Pioneers went into a for-profit partnership with two of its own directors.[105] Since "[t]he Tax Court was not clearly erroneous in its findings as to the nonexempt purpose of Pioneers," the lower court's denial of 501(c)(3) status was affirmed.[106]

Part III: Analysis of the Tax Court Decision

The Tax Court opinion in *Housing Pioneers* has been read to suggest that 501(c)(3) status is incompatible with participation in joint ventures that yield tax benefits to for-profit partners.[107] The Ninth Circuit decision reinforced this impression. By giving serious consideration to Housing Pioneers' argument that section 42(h) modifies section 501(c)(3), the appellate court appeared to accept the contention that these two provisions of the tax code were in conflict—a contention based on the understanding that section 501(c)(3) prevents charities from participating in tax credit partnerships. However, this is almost certainly a misreading of the Tax Court decision. As critics have pointed out, such a holding would be inconsistent with *Plumstead Theatre Society* and with a decade of previous IRS rulings allowing charities to participate in for-profit partnerships.[108]

Rather, the key holding of *Housing Pioneers* was that bestowing tax credits on for-profit investors creates private benefit, which must be incidental to the charitable purpose of the partnership if the charity is to remain exempt. A naked purpose to obtain tax benefits for investors violates the private benefit doctrine even if the benefits will be used to keep rental units affordable. Language in the opinion also implicated the commerciality doctrine, suggesting that participation in a low-income housing partnership that operates like a typical business venture may be incompatible with 501(c)(3) status.

Private Benefit

The Tax Court held that Housing Pioneers "has a nonexempt purpose which is substantial, and that private interests will be served by its activities."[109] Tax attorney Celia Roady believes that these findings constitute two independent grounds for denial of tax-exempt status.[110] First, Housing Pioneers had a substantial nonexempt purpose of obtaining California property tax benefits for its limited partners; second, the organization served private interests by conferring those tax benefits on its limited partners.[111]

However, there is no meaningful distinction between the two. IRS regulations bar exemption for organizations that "serve private interests" because they are deemed to further a nonexempt purpose under the operational test.[112] Moreover, the conferral of tax benefits on for-profit investors was the only nonexempt purpose discussed in the decision.[113] The findings are therefore two sides of the same coin. Both relate to the court's conclusion that by bestowing tax advantages on its limited partners, Housing Pioneers served private interests in violation of the requirement that a charity operate exclusively for exempt purposes. Hence, the court's decision is based squarely on private benefit doctrine.[114]

Under this doctrine, a charity does not fail the operational test whenever its activities benefit private interests. Only the conferral of *nonincidental* private benefit disqualifies an organization from 501(c)(3) status.[115] To find that Housing Pioneers served private interests in violation of the private benefit doctrine, the Tax Court must have determined that the benefits that Housing Pioneers conferred on its limited partners were not incidental to any charitable purpose.[116] An ample factual basis for this determination appears in the opinion but the court did not explicitly consider whether the private benefit was incidental or not incidental. This omission of a key analytic step appears to be the source of the confusion surrounding the case.

Under the "qualitatively and quantitatively incidental" standard used by the IRS,[117] Housing Pioneers benefited its partners more than incidentally. The private benefits were not qualitatively incidental because the court found that Housing Pioneers conferred financial benefits on its partners purposefully: "The keystone of petitioner's entire plan is of course to lend its exempt status to achieving the objective of property tax reduction."[118] Housing Pioneers would also fail the quantitatively incidental prong because the private benefit was disproportionate to any public benefit that might have resulted from its activities. The organization did not intend to involve itself in any projects that built or rehabilitated low-income housing; it sought only to become a general partner of projects that already owned rental housing. Furthermore, Housing Pioneers' management role was narrowly limited to ensuring that the partnerships qualified for tax benefits.[119] Some public benefit might have resulted from the services that Housing Pioneers said it would provide with its share of the tax windfall[120] but the private benefit was substantial compared to any possible public benefit. Failing either prong is enough to make the private benefit nonincidental; Housing Pioneers failed both. Because Housing Pioneers conferred nonincidental benefits on its limited partners, the Tax Court properly held that it served private interests and was therefore not qualified for 501(c)(3) status.

Although the Tax Court failed to make explicit findings regarding the nonincidental nature of the private benefit, the opinion did outline the purposeful nature of Housing Pioneers' conferral of tax benefits and the lack of tangible public benefit arising from its activities.[121] Once these facts were established, the court may have considered it obvious that the benefits were not incidental. However, private benefit is an obscure and rarely invoked doctrine, and the omission of this crucial finding caused confusion regarding the holding of the case.

Until *American Campaign Academy*[122] was decided in 1989, private benefit was not an important doctrine. A leading treatise on exempt-organization tax law published in 1987 did not even mention private benefit.[123] All the cases decided up to that point in time that considered whether private benefit was incidental or nonincidental involved beneficiaries with a close relationship to the charity, such as founders or major donors or members. It was therefore possible for treatise authors and practitioners alike to ignore the subtle doctrinal differences and lump the private benefit cases together with private inurement cases.[124] But while private benefit and private inurement are similar in their substantive prohibitions, they differ significantly in their formal doctrine. There is no such thing as incidental private inurement. Once an organization has engaged in a transaction judged to be private inurement, the organization cannot be exempt.[125] If observers confuse private benefit with private inurement, the finding of private benefit in a transaction would appear to be a death knell for the charitable status of the organization.

Indeed, critics of *Housing Pioneers* appeared to believe that it cast doubt on the ability of any charity to participate in a limited partnership that conferred tax benefits on investors.[126] Although *Housing Pioneers* involved a state property tax reduction, the court also discussed the federal low-income housing tax credit in its analysis,[127] suggesting that its holding also applies to nonprofits obtaining federal tax credits for investors. Since the nature of the benefit to investors is parallel, *Housing Pioneers* implied that giving low-income housing tax credits to investors also creates private benefit. Some commentators appeared to believe that such a finding would make limited partnerships incompatible with charitable status. Celia Roady, for example, wrote that "the court's analysis seems to discount the express purpose of the low-income housing credit (i.e., to provide tax incentives for the development and ownership of low-income housing) and the congressionally-sanctioned role of exempt organizations as partners in low-income housing tax credit partnerships."[128] Roady seems to assume that the type of private benefit found to be improper in *Housing Pioneers* would be improper in all cases—that private benefit, like private inurement, is a fatal designation once applied. However, this assumption ignores the doctrinal difference between private benefit and private inurement. Private benefit is only impermissible if it is nonincidental, so charities may continue to participate in tax credit partnerships as long as they can demonstrate that investors receive only incidental benefits.

Most nonprofit organizations that participate in low-income housing joint ventures will be able to make that showing. The benefits will be qualitatively incidental because the primary goal of most nonprofit housing developers is to construct or rehabilitate affordable housing. Participation in joint ventures is a necessary means to raise capital, not a scheme to obtain lower taxes as it was for Housing Pioneers. The benefits to investors will also be quantitatively incidental because most joint ventures by nonprofit housing organizations deliver substantial charitable benefits to low-income people in need of affordable housing. Unlike Housing Pioneers, nonprofits involved in low-income housing partnerships generally either build housing or manage it or both. Because the private benefit to investors is incidental in most tax credit partnerships, charitable nonprofits may participate in them without violating private benefit doctrine.

Since *Housing Pioneers* will not affect the ability of most charities to participate in tax credit partnerships, commentators may be correct that its holding will have limited application.[129] But practitioners should not be too quick to dismiss the case. *Housing Pioneers* may still have bite for a nascent nonprofit organization that is formed to participate in a low-income tax credit limited partnership.

It is not uncommon for new entities to seek recognition of exempt status in order to obtain access to low-income housing tax credits set aside for qualified nonprofit organizations.[130] Since the tax credits are only available to build or rehabilitate rent-restricted apartments for low-income tenants,[131] the new nonprofits generally have a bona fide charitable purpose of expanding the supply of decent affordable housing. Nevertheless, they may fail to qualify for 501(c)(3) status if their role is limited to obtaining the credits or other tax benefits for the partnership. Under *Housing Pioneers*, a naked purpose to obtain tax benefits for investors will violate the private benefit doctrine. The court emphasized that this will be true even if the partnership agreement requires the tax savings to be applied to the reduction of rents or maintenance of affordability of the housing units.[132] To be eligible for charitable status, the new nonprofit will need to show that its activities to further a charitable purpose go beyond the acquisition of tax benefits.

This aspect of *Housing Pioneers* is consistent with the emerging IRS concern regarding control in 501(c)(3) joint ventures. When a nonprofit seeking tax exemption plans to participate in a joint venture as its only project, "the organization must necessarily demonstrate that it causes the partnership to carry out an exempt function, otherwise, there is precious little to support the organization's exemption."[133] To make that showing, the IRS suggests that the nonprofit organization must demonstrate control of the partnership: "If the organization does not have management control, control to enforce charitable operations, majority interest, or is not providing charitable services to the residents as its role in the operation of the partnership, then its qualification for exemption must be questioned."[134]

A recent private letter ruling exemplifies this requirement of control. The letter concerned a nonprofit corporation that served as a general partner in a limited partnership to construct and operate low-income housing.[135] The IRS advised that the nonprofit would not be exempt because it had “only minimal control over the partnership.”[136] It therefore could not claim to have a role in the partnership beyond obtaining tax credits: “Under these circumstances you were not in a position to claim that you caused the partnership to carry out your charitable housing program. Accordingly, you were unable to claim the housing provided through the operation of the partnership as your charitable function,” the IRS wrote.[137] The letter ruling did not cite *Housing Pioneers* but commentators noted that the IRS decision was supported by its holding.[138] For a nonprofit organized to participate in joint ventures, *Housing Pioneers* may prove to be a significant precedent that cannot be ignored.

Commerciality Doctrine

The Tax Court found that Housing Pioneers’ activities “serve[d] the commercial purposes” of its for-profit partners.[139] While the case was decided on private benefit grounds, this language indicates the relevance of the commerciality cases. Both the private benefit and commerciality doctrines are judicial interpretations of the section 501(c)(3) requirement that a tax-exempt charity operate exclusively for exempt purposes,[140] and there is no sharp distinction between the two doctrines in case law.[141] The Tax Court may have considered the commercial character of Housing Pioneers’ activities to be additional support for its finding that the organization failed to operate exclusively for exempt purposes.

Commercialty doctrine is typically applied against organizations engaged in a commercial activity that has a direct counterpart in the private sector or is conducted in the same manner as a for-profit business.[142] Construction and management of low-income housing is a commercial activity that has counterparts in the business sector. The facts of *Housing Pioneers* make this clear, since both the Grant Square and Hidden Cove partnerships owned and managed low-income housing projects before they affiliated with Housing Pioneers.[143] Also, federal low-income housing tax credits are available to for-profit investors; only 10 percent of the credits are reserved by federal law for nonprofit organizations.[144] There is nothing inherently charitable about constructing or managing subsidized housing.[145]

Therefore, the commerciality doctrine may bar 501(c)(3) status for nonprofit housing developers unless they can show that charitable purposes are primary and that commerce is incidental.[146] To establish the primacy of charitable purposes, nonprofits must demonstrate that their projects are operated in a manner that is different from a commercial housing development.[147]

The IRS issued a revenue procedure in 1996 to expedite the exemption process for 501(c)(3) housing organization.[148] This guideline establishes an objective “safe harbor” that sets numerical standards for income of tenants and affordability of units. If a housing organization’s projects fall within the safe harbor limits, its charitable purpose will not be questioned by the IRS.[149] These charities need not be concerned with the commerciality doctrine because the safe harbor standards themselves differentiate them from for-profit counterparts.

Housing organizations that fall outside the safe harbor limits may still be charitable based on facts and circumstances of their case[150] but they must demonstrate that they operate for charitable purposes. Housing Pioneers could not have made such a showing because the court found that it was operated for a commercial purpose.[151] Also, since the organization had no real role in managing the rental housing that its partnerships owned,[152] the projects presumably continued to be operated as they had been before Housing Pioneers became involved—that is, they were operated as purely commercial businesses.

As in the private benefit issue, many charitable housing organizations will be able to distinguish their case from *Housing Pioneers* by demonstrating that relief of poverty is their true purpose and that managing rental housing is a means to that end rather than a commercial end in itself. Such organizations will also be able to demonstrate that their projects differ from those run entirely by for-profit businesses. For example, nonprofit housing developers typically spend more to manage their housing projects than is spent by purely commercial projects financed with low-income housing tax credits. Apartment managers take on a quasi-social worker role and work more closely with tenants having difficulty making the rent, with the result that tenant turnover in projects managed by nonprofits is lower than in their commercial counterparts.[153] Also, nonprofits often keep the housing rent restricted and affordable to low-income tenants for a longer period of time.[154] Nonprofit housing organizations may provide other services to tenants[155] or serve a higher proportion of very low-income tenants than a commercial low-income housing project would. The commercial hue attributed to Housing Pioneers does not threaten the 501(c)(3) status of nonprofit housing developers with more favorable facts on their side.

But here too, *Housing Pioneers* may have some effect. Practitioners complain that "nonprofit housing providers have frequently struggled with the IRS's application" of the charitable purpose requirement.[156] Before *Housing Pioneers*, there does not appear to have been any case law directly supporting the IRS interpretation of charitable purpose in the housing area.[157] The Tax Court decision strengthens the IRS position by affirming that a nonprofit organization's participation in a low-income housing development may be deemed to be commercial rather than charitable.

Part IV: Analysis of the Ninth Circuit Opinion

The Ninth Circuit appeared to accept Housing Pioneers' characterization of the Tax Court holding, and implied that section 501(c)(3) status was inconsistent with participation in a for-profit partnership that conferred tax benefits on limited partners. This implication added to the confusion that the Tax Court opinion had caused.

However, the appellate court did not actually decide the substantive issues of 501(c)(3) law raised by the case. Rather, the court responded narrowly to the argument raised by appellant Housing Pioneers, which based its appeal on the supposed conflict between section 501(c)(3) and section 42(h).[158] The Ninth Circuit was able to dispose of the case without deciding the relationship between the two tax code sections, and without determining the meaning and significance of the lower holding, because Housing Pioneers was not eligible for section 42(h) tax credits.[159] The decision is analogous to dismissing a complaint for lack of standing; in a sense, the court found that Housing Pioneers had no standing to make a modification argument so therefore the court was not required to rule on it. As one commentator put it, "the court bailed out on a technicality."[160]

This would have been an unobjectionable exercise in judicial restraint if the court had clearly indicated that it addressed the possibility of a conflict between the tax code sections arguendo. Instead, the opinion characterized Housing Pioneers' argument favorably, calling it "attractive," "powerful," and suggesting that "[i]t might well be ... successful."[161] This positive characterization was unfounded and unwise—unfounded because section 501(c)(3) does not forbid participation in tax credit partnerships and thus does not conflict with section 42(h),[162] and unwise because the court appeared to comment substantively on an issue that it declined to analyze or decide.

The Ninth Circuit exacerbated the confusion by amending its opinion to discuss *Plumstead Theatre Society*.[163] While the court correctly found that *Plumstead* was not controlling, the case was distinguished on unconvincing grounds. The Ninth Circuit found *Plumstead* distinguishable because Housing Pioneers went into partnership with entities owned by its officers and board members. However, this holding put the appellate court at variance with the Tax Court, since the Tax Court avoided the private inurement argument and held that Housing Pioneers' arrangements were improper even where the limited partners were not connected to the organization.[164] Further, it is inconsistent with established IRS practice, which considers presence of board members among the limited partners to be merely one of many factors to consider in assessing charity joint ventures.[165] Appellate courts are not bound by either lower court decisions or IRS positions, of course, but they normally are not overturned summarily without analysis.[166]

An alternative ground to distinguish *Plumstead* would be that Housing Pioneers lacked control over its limited partnerships. Plumstead Theatre Society exercised "full management control" over its limited partnership's activities,[167] while Housing Pioneers lacked any significant management control over the housing projects that its partnerships owned.[168] But to convincingly distinguish *Plumstead*, the Ninth Circuit would have needed to analyze the substantive law of charity joint ventures, which the court declined to do when it decided that Housing Pioneers' argument could be dismissed on a technicality.

Conclusion

Critics of *Housing Pioneers* decry its potential impact at the same time that they dismiss its precedential significance.[169] Neither of these contradictory views accurately assesses the holding of the Tax Court opinion or its relationship to 501(c)(3) jurisprudence.

The Tax Court's decision in *Housing Pioneers* represents a modest expansion of private benefit doctrine in the area of charity joint ventures. The post-*Plumstead* standards for a charity's participation in a limited partnership have always incorporated the ban on nonincidental private benefit;[170] no new ground was broken by applying a private benefit analysis to the Housing Pioneers partnership agreements. Rather, the significant holding of the case is that obtaining tax benefits for a low-income housing partnership will not constitute a charitable purpose, even if the benefits are dedicated to maintaining the affordability of the rental units. To be eligible for 501(c)(3) status, a housing organization must take an active management role and have sufficient control over the partnership to ensure that charitable rather than commercial goals are paramount.

Because the Ninth Circuit declined to decide the central question of the case, its opinion has little significance as precedent. The remarks implying that section 501(c)(3) bars participation in tax credit partnerships are dicta unsupported by legal analysis, so the IRS and practitioners are probably safe in dismissing the opinion as an aberration.[171]

But practitioners should not allow the furor over the appellate opinion to overshadow the the real significance of the Tax Court decision, which is good law. Because it extends the reach of private benefit doctrine in the important area of tax credit partnerships, the case has significant implications for nascent nonprofit housing organizations, and practitioners ignore it at their peril.

Footnotes

a1 *Barbara Rhomberg received her J.D. degree from Stanford Law School in June 2000*.

1 *See* Tracy A. Kaye, *Sheltering Social Policy in the Tax Code: The Low-Income Housing Credit*, 38 VILL. L. REV. 871, 877 (1993). The tax credit law is codified at 26 U.S.C.A. § 42 (1988 & 1998 Supp.).

2 *See id.* at 878.

3 Lynn Kawecki & Marvin Friedlander, *Recent Developments in Housing Regarding Qualification Standards and Partnerships Issues*, *in* 1995 (for FY1996) EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM TEXTBOOK (Internal Revenue Service Exempt Organizations Division ed., 1995).

4 *See* Kaye, *supra* note 1, at 886. A 501(c)(3) organization is a nonprofit entity recognized as tax exempt under 26 U.S.C.A. § 501(c)(3), also referred to in this article as a 501(c)(3). A 501(c)(4) is an organization exempt from income tax under 26 U.S.C.A. § 501(c)(4).

5 *See* Kaye, *supra* note 1, at 886.

6 Kawecki & Friedlander, *supra* note 3, at 30.

7 Housing Pioneers, Inc. v. Comm'r 65 T.C.M. (CCH) 2191 (1993), *aff'd*, 49 F.3d 1395 (9th Cir. 1995), *amended and superseded by* 58 F.3d 401 (9th Cir. 1995).

8 The terms "charity" and "charitable organization" are often used to refer to organizations eligible to receive tax-deductible charitable contributions. BRUCE R. HOPKINS, NONPROFIT LAW DICTIONARY 51 (1994). Most organizations eligible to receive tax-deductible gifts are recognized as tax exempt under 26 U.S.C.A. § 501(c)(3), so "charity" is often used as a synonym for an organization exempt under section 501(c)(3).

9 65 T.C.M. 2191 (1993).

10 *Housing Pioneers*, 58 F.3d at 403-04.

11 *See* Marlis L. Carson, *Practitioners Criticize Ninth Circuit Opinion in* Housing Pioneers, *11* EXEMPT ORG. TAX REV. 919

(1995); Bruce R. Hopkins, *Appeals Court Tries to Fix Its Erroneous Partnership Opinion—and Fails*, 12 EXEMPT ORG. TAX REV. 728 (1995); Celia Roady, *Housing Pioneers: Right Result, Wrong Reasons*?, 7 EXEMPT ORG. TAX REV. 929 (1993); Shawn Luther & Jason Yots, *Housing Pioneers and Affordable Housing Joint Ventures: Forging a New Frontier or Straying from the Well-Traveled Path*?, 5 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 216 (1996).

[12] *See* Luther & Yots, *supra* note 11, at 275; Roady, *supra* note 11, at 930.

[13] Kawecki & Friedlander, *supra* note 3, at 71.

[14] *Id.*

[15] *See id.* at 73 (advising that "the application of *Pioneers* to an organization's exempt status may be limited to the particular facts of the case"); Carson, *supra* note 12, at 919 (quoting Bruce Hopkins as suggesting that the case is an "aberration"); Roady, *supra* note 11, at 931 ("We believe that *Housing Pioneers* presents a unique set of facts which should not be regarded as establishing any precedent beyond its unique factual situation.").

[16] *See* Rev. Rul. 98-15, 1998-1 C.B. 718.

[17] Redlands Surgical Services v. Comm'r, 113 T.C. 47, 76-78, 92-93 (1999).

[18] *See Current Litigation Status Report*, 27 EXEMPT ORG. TAX REV. 331, 332 (2000).

[19] *See* BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS § 19 (7th ed. 1998).

[20] 26 U.S.C.A. § 501(c)(3) (1988). This section also grants exempt status to organizations that foster amateur sports competition or prevent cruelty to children or animals. *See id.*

[21] *Id.* The inurement prohibition is reiterated in Reg. § 1.501(c)(3)-1(c)(2), which provides that an organization will not be considered to be operated exclusively for exempt purposes if it allows "its net earnings to inure in whole or in part to the benefit of private shareholders or individuals."

[22] Reg. § 1.501(a)-1(c). All citations to Treasury regulations can be found at 26 C.F.R. § 1.501.

[23] *See* Variety Club Tent No. 6 Charities Inc. v. Comm'r, 74 T.C.M. 1485, 1492 (1997).

[24] *See* HOPKINS, *supra* note 19, § 19.3.

[25] *See Variety Club*, 74 T.C.M. at 1494.

[26] Gen. Couns. Mem. 39,862 (Dec. 2, 1991) (citation omitted).

[27] *See* HOPKINS, *supra* note 19, § 19.8.

[28] Gen. Couns. Mem. 39,862 (Dec. 2, 1991) (citation omitted).

[29] *See* American Campaign Academy v. Comm'r, 92 T.C. 1053, 1068 (1989) (holding that a school for political campaign professionals conferred nonincidental private benefit on the Republican party and candidates).

[30] 26 U.S.C.A. § 501(c)(3) (1988).

[31] Reg. § 1.501(c)(3)-1(c). The private inurement prohibition from section 501(c)(3) of the Internal Revenue Code is reiterated in the operational test regulations, so that a charity that violates the statutory inurement ban will also fail the regulatory operational test. *See id.*

[32] *American Campaign Academy*, 92 T.C. at 1066.

[33] *See id.* at 1064.

[34] Reg. § 1.501(c)(3)-1(d)(1)(ii).

[35] *See id.*

[36] *Id.* § 1.501(c)(3)-1(c)(2), (d)(1)(ii).

[37] *See* Goldsboro Art League, Inc. v. Comm'r, 75 T.C. 337, 345-46 (1980).

[38] *American Campaign Academy*, 92 T.C. at 1069.

[39] *See id.* at 1065; Reg. § 1.501(c)(3)-1(c)(1).

[40] *American Campaign Academy*, 92 T.C. at 1069 (emphasis added).

[41] *Id.* at 1078-79.

[42] Bob Jones Univ. Museum & Gallery, Inc. v. Comm'r, 71 T.C.M. (CCH) 3120, 3125 (1996); *see also* Kentucky Bar Found., Inc. v. Comm'r 78 T.C. 921 (1982) (holding that benefits to the legal profession were incidental to the charitable purposes of a bar association foundation).

[43] Gen. Couns. Mem. 39,862 (Dec. 2, 1991).

[44] *Id.*

[45] Gen. Couns. Mem. 39,876 (Aug. 10, 1992).

[46] For example, the IRS denied exemption to a nonprofit organization with the recognized exempt purpose of promoting classical music programming on the grounds that its activities excessively benefited a private radio station. Rev. Rul. 76-206, 1976-1 C.B. 154. The organization sought to keep a private station's classical programming on the air by promoting the programs to radio listeners, soliciting subscriptions to the station's program guide, and encouraging businesses to sponsor the classical programs. Although the organization was not affiliated with the radio station and there was no suggestion in the ruling that its campaign was motivated by anything other than its stated exempt purpose, the pecuniary benefit to the station defeated the tax exemption. *Id.*

[47] *American Campaign Academy*, 92 T.C. at 1068 (citations omitted).

[48] *See supra* notes 23-24, 34-40 and accompanying text.

[49] A charity's transactions with an insider are subject to a reasonableness requirement. For example, unreasonable compensation to an employee and unreasonable loan arrangements with a board member are private inurement, but reasonable compensation and fair market loan transactions are not. *See* HOPKINS, *supra* note 19, § 19.4. Similarly, payment of excessive rent to an insider is private inurement, while reasonable rental arrangements with an insider are not private inurement. *See id.* "Private inurement" is therefore a conclusory designation, applied when financial transactions with an insider have been deemed to be unreasonable.

[50] *See* McGahen v. Comm'r, 76 T.C. 468, 482 (1981), *aff'd*, 720 F.2d 664 (3d Cir. 1983).

[51] *See supra* notes 35-49 and note 51 and accompanying text.

[52] *See, e.g.*, *Bob Jones Univ.*, 71 T.C.M. at 3125 (holding that a museum incidentally benefiting a nonexempt affiliate was exempt); *Kentucky Bar Found.*, 78 T.C. at 921 (holding that a bar association foundation was exempt although it incidentally benefited local lawyers); *see also* Rev. Rul. 77-367, 1977-2 C.B. 193; Rev. Rul. 76-4, 1976-1 C.B. 145; Rev. Rul. 74-146, 1974-1 C.B. 129.

[53] Plumstead Theatre Society, Inc. v. Comm'r, 675 F.2d 244 (9th Cir. 1982).

[54] *See* Gen. Couns. Mem. 39,005 (June 28, 1993). For a detailed discussion of the IRS facts and circumstances test for 501(c)(3) organizations that are general partners in for-profit partnerships, see MICHAEL I. SANDERS, PARTNERSHIPS & JOINT VENTURES INVOLVING TAX-EXEMPT ORGANIZATIONS § 4.2 (1994 and 1998 Cumulative Supplement). Application of the test to low-income housing partnerships is discussed in Kawecki & Friedlander, *supra* note 3.

[55] Kawecki & Friedlander, *supra* note 3, at 55.

[56] *See* SANDERS, *supra* note 54, § 4.2(d)(ii).

[57] *See id.*

[58] *See id.* § 4.2(d)(ii)(A).

[59] *See id.* § 4.2(d)(ii)(B).

[60] *See* HOPKINS, *supra* note 19, § 25.1(a).

[61] *See id.* § 25.1(d).

[62] Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, 283-84 (1945).

[63] *See* Aid to Artisans, Inc. v. Comm'r, 71 T.C. 202 (1978) (finding that an organization that purchased and resold handicrafts from artisans in disadvantaged countries was eligible for 501(c)(3) status); Scripture Press Found. v. United States, 285 F.2d 800, 805 (Ct. Cl. 1961) (rejecting the argument that profits alone preclude tax exemption).

[64] *See* Greater United Navajo Dev. Enters., Inc. v. Comm'r, 74 T.C. 69, 79 (1980).

[65] *See Scripture Press Found*., 285 F.2d at 805-06.

[66] *See* Christian Manner Int'l v. Comm'r, 71 T.C. 661, 670-71 (1979).

[67] *See* Living Faith, Inc. v. Comm'r, 950 F.2d 365, 372-74 (7th Cir. 1991).

[68] Living Faith, Inc. v. Comm'r, 60 T.C.M. (CCH) 710, 713 (1990), *aff'd*, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization's vegetarian restaurant and food stores were operated substantially for commercial purposes).

[69] *See* Interneighborhood Housing Corp. v. Comm'r, 45 T.C.M. (CCH) 115 (1982) (finding that a nonprofit building management company failed the operational test because it "failed to prove that its management activities differed significantly from a commercial real estate management company").

[70] *Plumstead*, 74 T.C. at 1332-33.

[71] *See id.*

[72] *See Housing Pioneers*, 65 T.C.M. at 2191.

[73] *See id.* at 2192.

[74] *See id.* at 2193, 2195. Later Jerry Harris's brothers and grandfather became limited partners in Grant Square. *See id.* at 2193.

[75] *See id.* at 2194; *Housing Pioneers*, 58 F.3d at 401.

[76] *See Housing Pioneers*, 58 F.3d at 401-02.

[77] *See Housing Pioneers*, 65 T.C.M. at 2194.

[78] *See id.* at 2194-95.

[79] *See id.* at 2194.

[80] *See id.* at 2194.

[81] *See id.* at 2192-93.

[82] *See id.* at 2194-95.

[83] *See id.* at 1293.

[84] *Id.*

[85] *See id.*

[86] *See id.* at 2196.

[87] *Id.* at 2195.

[88] *Id.*

[89] *Id.* at 2196.

[90] *Id.*

[91] *Id.*

[92] *See id.* at 2194.

[93] *See id.* at 2196.

[94] *See id.*

[95] *See Housing Pioneers*, 58 F.3d at 403.

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] *See id.* at 403-04.

[101] *Id.* at 404.

[102] *Id.*

[103] *Id.*

[104] The original decision, reported at 49 F.3d 1395, was amended and superseded by 58 F.3d 401.

[105] *See id.* (citing *Plumstead*, 675 F.2d at 244).

[106] *Housing Pioneers*, 58 F.3d at 404.

[107] *See, e.g.*, SANDERS, *supra* note 54, § 4.2(d)(ii); J. William Callison, *Tax Topics: IRS Follows* Housing Pioneers *Down a Bumpy Road*, 6 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 108, 108 (1997).

[108] *See* Roady, *supra* note 11, at 929.

[109] *Housing Pioneers*, 65 T.C.M. at 2196.

[110] Roady, *supra* note 11, at 930.

[111] *See id.*

[112] *See id.*; Reg. § 1.501(c)(3)-1(d)(1)(ii).

[113] *See Housing Pioneers*, 65 T.C.M. at 2195-96.

[114] It is unclear from the opinion whether private inurement was an additional basis for the decision. The court states initially that Housing Pioneers did violate the inurement ban, *id.* at 2194, but the opinion concludes that it was unnecessary to reach the inurement question. *See id.* at 2196.

[115] *See American Campaign Academy*, 92 T.C. at 1069. *See also supra* text accompanying notes 39-42.

[116] Judge Nims, the author of the *Housing Pioneers* opinion, was undoubtedly aware of this case law. His opinion cites *American Campaign Academy*, 92 T.C. at 1069, a case explicitly recognizing that only nonincidental benefits would cause an organization to serve private interests. 65 T.C.M. at 2196. Judge Nims also wrote *American Campaign Academy* less than four years before his *Housing Pioneers* decision.

[117] *See* text accompanying notes 42-43 *supra*.

[118] *Housing Pioneers*, 65 T.C.M. at 2195.

[119] *See id.* at 2193.

[120] *See id.*

[121] *See id.* at 2193-95.

[122] *American Campaign Academy*, 92 T.C. at 1053.

[123] *See generally* HOPKINS, *supra* note 19.

[124] *See id.* § 12. A telling example of this can be seen in Hopkins's treatment of *Callaway Family Ass'n v. Comm'r*, 71 T.C. 340 (1978). Hopkins, as the attorney of record in the case, must be aware that the Tax Court opinion never mentions private inurement but denies tax exemption on the basis of private benefit. Yet his treatise continues to list it as a private inurement case. HOPKINS, *supra* note 199, § 19.4.

[125] *See supra* notes 28 and 49. The intermixing of private benefit and private inurement cases led to some confusion about whether or not there is such a thing as "incidental private inurement." Bruce Hopkins reports that the Tax Court and the IRS both firmly reject any de minimis exception to the ban on private inurement, but cites a string of IRS rulings that he claims demonstrate an exception for incidental private inurement. HOPKINS, *supra* note 19, § 19.9. However, none of these rulings actually involved private inurement; all were cases where private benefit was found to be incidental to a charitable purpose. *See* Rev. Rul. 80-106, 1980-1 C.B. 113; Rev. Rul. 77-367, 1977-2 C.B. 193; Rev. Rul. 76-4, 1976-1 C.B. 145; Rev. Rul. 74-146, 1974-1 C.B. 129; Rev. Rul. 74-575, 1974-2 C.B. 1611; Rev. Rul. 70-533, 1970-2 C.B. 112; Rev. Rul. 66-358, 1966-2 C.B. 218.

[126] *See, e.g.*, Roady, *supra* note 11, at 930; Luther & Yots, *supra* note 11, at 275.

[127] *Housing Pioneers*, 65 T.C.M. at 2195-96.

[128] Roady, *supra* note 11, at 930-31.

[129] *See supra* note 15 and accompanying text.

[130] *See* Kawecki & Friedlander, *supra* note 3, at 67-69.

[131] *See* 26 U.S.C.A. § 42(d), (e), (g) (West 1988 & Supp. 1998).

[132] *See Housing Pioneers*, 65 T.C.M. at 2195.

[133] Kawecki & Friedlander, *supra* note 3, at 58.

[134] *Id.* at 59.

[135] Priv. Ltr. Rul. 9736-039 (June 9, 1997).

[136] *Id.*

[137] *Id.*

[138] *See* Callison, *supra* note 106, at 108; Carolyn D. Wright, *Ruling May Foreshadow IRS Position on Whole Hospital Joint Ventures*, 76 TAX NOTES 1534 (1997).

[139] *Housing Pioneers*, 65 T.C.M. at 2196.

[140] *See supra* notes 30 and 61 and accompanying text.

[141] The seminal case in both doctrines is Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), which held that an organization failed to operate exclusively for exempt purposes because it served members' business interests and had a "commercial" motive. *Id.* at 283-84.

[142] *See* HOPKINS, *supra* note 19, § 25.1(a).

[143] The partnerships must have owned low-income housing projects, or they would not have qualified for California's property tax reduction. *See Housing Pioneers*, 65 T.C.M. at 2192.

[144] *See* Kaye, *supra* note 1, at 886.

[145] *See* Jennifer Gilbert & Jonathan Klein, *Tax Exemption for Organizations: Finally, Safe Harbor Is Truly Safe*, 4 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 289, 290 (1995).

[146] *See* text accompanying notes 63-64 *supra*.

[147] *See* text accompanying notes 67-68 *supra*.

[148] Rev. Proc. 96-32, 1996-1 C.B. 717. For a detailed description of the safe harbor provisions, see generally Jennifer Gilbert, *IRS Releases Final Revenue Procedure on Tax Exemption for Housing Organizations*, 6 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 81 (1996); *see also* Gilbert & Klein, *supra* note 145.

[149] *See* Gilbert, *supra* note 148.

[150] *See* Gilbert & Klein, *supra* note 145, at 290.

[151] *Housing Pioneers*, 65 T.C.M. at 2196.

[152] *Id.* at 2193.

[153] *See* Carlos Romero, Remarks at Stanford Law School Community Economic Development Seminar (Nov. 1, 1998). Carlos Romero is the Executive Director of Mercy Charities Housing California. His observations are consistent with a General Accounting Office finding that nonprofit low-income housing developers budget larger operating reserves than their for-profit counterparts. *See* GENERAL ACCOUNTING OFFICE GAO/RCED 99-60, TAX CREDITS: REASONS FOR COST DIFFERENCES IN HOUSING BUILT BY FOR-PROFIT AND NONPROFIT DEVELOPERS; *see also* Angela Mulkerin Christy, *Nonprofits Bring Concrete Benefits to Affordable Housing Transactions*, 8 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 29, 30 (1998) (noting that on-site social services are an "increasingly important aspect of successful management and sustainability of affordable housing developments.").

[154] *See* Kaye, *supra* note 1, at 887; Angela Mulkerin Christy, *Nonprofits Bring Concrete Benefits to Affordable Housing Transactions*, 8 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 29, 29 (1998).

[155] *See* Christy, *supra* note 153, at 29.

[156] Gilbert & Klein, *supra* note 145, at 290.

[157] *See* Rev. Proc. 96-32, 1996-1 C.B. 717 (citing only revenue rulings, not case law, as the background of the low-income housing safe harbor); HOPKINS, *supra* note 19, § 6.1 (citing only revenue rulings in a discussion on low-income housing as an activity that furthers a charitable purpose).

[158] *Housing Pioneers*, 58 F.3d at 403.

[159] *Id.* at 404.

[160] *See* Hopkins, *supra* note 12, at 728.

[161] *Housing Pioneers*, 58 F.3d at 403.

[162] *See supra* notes 126-132, 146-155 and accompanying text.

[163] *Housing Pioneers*, 58 F.3d at 404 (discussing *Plumstead*, 675 F.2d at 244).

[164] *Housing Pioneers*, 65 T.C.M. at 2196.

[165] *See* SANDERS, *supra* note 54, § 4.2(d)(ii)(A), (B). The IRS has approved many joint ventures where directors and officers of the charity were investors in the limited partnership. *See* Hopkins, *supra* note 12, at 728.

[166] *Cf. American Campaign Academy*, 92 T.C. at 1970 (noting that it is "self-evident that in general a taxpayer may rely" on previous IRS decisions with parallel facts).

[167] *Plumstead*, 675 F.2d at 245.

[168] *Housing Pioneers*, 65 T.C.M. at 2193.

[169] *See supra* notes 12 and 15.

[170] *See supra* text accompanying notes 54-57.

[171] *See supra* note 15.