

Internal Revenue Serv.)

Department of Treasury

Washington, DC 20224

Person to Contact: L.E. Kaweck

Telephone Number: (202) 622-6858

Refer Reply to: CP:E:EO:T:5

Date: OCT 24 1996

The Caritas Corporation
c/o Carol Lew
Stradling, Yocca, Carlson & Rauth
660 Newport Center Drive, Suite 1600
Newport Beach, California 92660

Employer Identification Number: 33-0694603
Key District: Los Angeles
Accounting Period Ending: December 31
Foundation Status Classification: 509(a)(3)
Form 990 Required: Yes

Dear Applicant:

Based on the information supplied, and assuming your operations will be as stated in your application for recognition of exemption, we have determined you are exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3).

We have further determined that you are not a private foundation within the meaning of section 509(a) of the Code, because you are an organization described in the section(s) indicated above.

If your sources of support, or your purposes, character, or method of operation change, please let your key district know so that office can consider the effect of the change on your exempt status. In the case of an amendment to your organizational document or bylaws, please send a copy of the amended document or bylaws to your key district. Also, you should inform your key district office of all changes in your name or address.

As of January 1, 1984, you are liable for taxes under the Federal Insurance Contributions Act (social security taxes) on remuneration of \$100 or more you pay to each of your employees during a calendar year. You are not liable for the tax imposed under the Federal Unemployment Tax Act.

Because you are not a private foundation, you are not subject to the excise taxes under Chapter 42 of the Code. However, if you are involved in an excess benefit transaction, that transaction might be subject to the excise taxes of section 4958. Additionally, you are not automatically exempt from other federal excise taxes. If you have any questions about excise,

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employment, or other federal taxes, please contact your key district office.

Donors may deduct contributions to you as provided in section 170 of the Code. Bequests, legacies, devises, transfers, or gifts to you or for your use are deductible for federal estate and gift tax purposes if they meet the applicable provisions of Code sections 2055, 2106, and 2522.

Donors (including private foundations) may rely on this ruling unless the Internal Revenue Service publishes notice to the contrary. However, if you lose your 509(a) status as indicated above, donors (other than private foundations) may not rely on the classification indicated above if they were in part responsible for, or were aware of, the act that resulted in your loss of such status, or they acquired knowledge that the Internal Revenue Service had given notice that you would be removed from that classification. Private foundations may rely on the classification as long as you were not directly or indirectly controlled by them or by disqualified persons with respect to them. However, private foundations may not rely on the classification indicated above if they acquired knowledge that the Internal Revenue Service had given notice that you would be removed from that classification.

Contribution deductions are allowable to donors only to the extent that their contributions are gifts, with no consideration received. Ticket purchases and similar payments in conjunction with fund-raising events may not necessarily qualify as fully deductible contributions, depending on the circumstances. If your organization conducts fund-raising events such as benefit dinners, shows, membership drives, etc., where something of value is received in return for payments, you are required to provide a written disclosure statement informing the donor of the fair market value of the specific items or services being provided. To do this you should, in advance of the event, determine the fair market value of the benefit received and state it in your fund-raising materials such as solicitations, tickets, and receipts in such a way that the donor can determine how much is deductible and how much is not. Your disclosure statement should be made, at the latest, at the time payment is received. Subject to certain exceptions, your disclosure responsibility applies to any fund-raising circumstance where each complete payment, including the contribution portion, exceeds \$75. In addition, donors must have written substantiation from the charity for any charitable contribution of \$250 or more. For further details regarding these substantiation and disclosure requirements, see the enclosed copy of Publication 1771. For additional guidance in this area, see Publication 1391, Deductibility of Payments

~~The~~ Caritas Corporation

Made to Organizations Conducting Fund-Raising Events, which is available at many IRS offices or by calling 1-800-TAX-FORM (1-800-829-3676).

In the heading of this letter we have indicated whether you must file Form 990, Return of Organization Exempt from Income Tax. If "Yes" is indicated, you are required to file Form 990 only if your gross receipts each year are normally more than \$25,000. If your gross receipts each year are not normally more than \$25,000, we ask that you establish that you are not required to file Form 990 by completing Part I of that Form for your first year. Thereafter, you will not be required to file a return until your gross receipts exceed the \$25,000 minimum. For guidance in determining if your gross receipts are "normally" not more than the \$25,000 limit, see the instructions for the Form 990. If a return is required, it must be filed by the 15th day of the fifth month after the end of your annual accounting period. A penalty of \$20 a day is charged when a return is filed late, unless there is reasonable cause for the delay. The maximum penalty charged cannot exceed \$10,000 or 5 percent of your gross receipts for the year, whichever is less. For organizations with gross receipts exceeding \$1,000,000 in any year, the penalty is \$100 per day per return, unless there is reasonable cause for the delay. The maximum penalty for an organization with gross receipts exceeding \$1,000,000 shall not exceed \$50,000. This penalty may also be charged if a return is not complete, so please be sure your return is complete before you file it.

You are required to make your annual return available for public inspection for three years after the return is due. You are also required to make available a copy of your exemption application, any supporting documents, and this exemption letter. Failure to make these documents available for public inspection may subject you to a penalty of \$10 per day for each day there is a failure to comply (up to a maximum of \$5,000 in the case of an annual return). See Internal Revenue Service Notice 88-120, 1988-2 C.B. 454, as modified by P.L. 104-168, 110 Stat. 1452, for additional information.

You are not required to file federal income tax returns unless you are subject to the tax on unrelated business income under section 511 of the Code. If you are subject to this tax, you must file an income tax return on Form 990-T, Exempt Organization Business Income Tax Return. In this letter we are not determining whether any of your present or proposed activities are unrelated trade or business as defined in section 513 of the Code.

The Caritas Corporation

In this letter, we have not determined the effect on your tax-exempt status of financing your activities with the proceeds of tax-exempt bonds since you have not indicated that you intend to use such methods now or in the future.

You need an employer identification number even if you have no employees. Please use that number on all returns you file and in all correspondence with the Internal Revenue Service.

We are informing your key district office of this ruling. Because this letter could help resolve any questions about your exempt status and foundation status, you should keep it in your permanent records.

If you have any immediate questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. For other matters, including questions concerning reporting requirements, please contact your key district office.

Sincerely,



Garland A. Carter
Chief, Exempt Organizations
Technical Branch 5

Enclosure:
Pub. 1771

Form **1023**

(Rev. July 1993)

Department of the Treasury
Internal Revenue Service

Application for Recognition of Exemption

Under Section 501(c)(3) of the Internal Revenue Code

OMB No. 1545-0066

Expires 5-31-96

If exempt status is
approved, this application
will be open for public
inspection.

Read the instructions for each Part carefully.

A User Fee must be attached to this application.

If the required information and appropriate documents are not submitted along with Form 8718 (with payment of the appropriate user fee), the application may be returned to you.

Complete the Procedural Checklist in the Instructions.

Part I Identification of Applicant

1a Full name of organization (as shown in organizing document)

The Caritas Corporation

2 Employer identification number
(if none, see instructions.)

33-0694603

1b c/o Name (if applicable)

Carol L. Lew

3 Name and telephone number of person to be
contacted if additional information is neededCarol L. Lew
(714) 725-4237

1c Address (number, street, and room or suite no.)

Stradling, Yocca, Carlson & Rauth
660 Newport Center Drive, Suite 1600

1d City or town, state, and ZIP code

Newport Beach, California 92660

4 Month the annual accounting period ends
December

5 Date incorporated or formed

01/05/96

6 Activity codes

380 381 399

7 Check here if applying under section:

a ☐ 501(e) b ☐ 501(f) c ☐ 501(k)8 Did the organization previously apply for recognition of exemption under this Code section or under any other
section of the Code? ☐ Yes ☒ No

If "Yes," attach an explanation.

9 Is the organization required to file Form 990 (or Form 990-EZ)? ☐ N/A ☒ Yes ☐ No

If "No," attach an explanation.

10 Has the organization filed Federal income tax returns or exempt organization information returns? ☐ Yes ☒ No

If "Yes," state the form numbers, years filed, and Internal Revenue office where filed.

11 Check the box for the type of organization. BE SURE TO ATTACH A CONFORMED COPY OF THE CORRESPONDING DOCUMENTS TO
THE APPLICATION BEFORE MAILING (See Specific Instructions, Part I, Line 11.) Get Pub. 557, Tax-Exempt Status for Your Organization,
for examples of organizational documents.)a ☒ Corporation - Attach a copy of the Articles of Incorporation, (including amendments and restatements) showing approval by the
appropriate state official; also include a copy of the bylaws.b ☐ Trusts - Attach a copy of the Trust Indenture or Agreement, including all appropriate signatures and dates.c ☐ Association - Attach a copy of the Articles of Association, Constitution, or other creating document, with a declaration
or other evidence the organization was formed by adoption of the document by more than one person; also include a copy
of the bylaws.If the organization is a corporation or an unincorporated association that has not yet adopted bylaws, check here ☐I declare under the penalties of perjury that I am authorized to sign this application on behalf of the above organization and that I have examined this application, including the
accompanying schedules and attachments, and to the best of my knowledge it is true, correct, and complete.Please
Sign
Here
(Signature)President
(Title or authority of signer)2/22/96
(Date)

Part II Activities and Operational Information

- 1 Provide a detailed narrative description of all the activities of the organization-past, present, and planned. Do not merely refer to or repeat the language in the organizational document. Describe each activity separately in the order of importance. Each description should include, as a minimum, the following: (a) a detailed description of the activity including its purpose; (b) when the activity was or will be initiated; and (c) where and by whom the activity will be conducted.

See Exhibit C

- 2 What are or will be the organization's sources of financial support? List in order of size.

rental income
grant from Belgravia Capital
possibility of grants from governmental units
loans from 4 of 5 Directors totaling \$20,000 (See Exhibit C)

- 3 Describe the organization's fundraising program, both actual and planned, and explain to what extent it has been put into effect. Include details of fundraising activities such as selective mailings, formation of fundraising committees, use of volunteers or professional fundraisers, etc. Attach representative copies of solicitations for financial support.

The organization does not presently have a fundraising program.

Part II Activities and Operational Information (Continued)**4** Give the following information about the organization's governing body:**a** Names, addresses, and titles of officers, directors, trustees, etc.

See Exhibit D

b Annual Compensation
 None of the Directors will receive any salary or compensation. Dr. Michael A. Harn, the Corporation's President, will receive an estimated \$50,000 annual salary in 1997 and \$60,000 in 1998.

c Do any of the above persons serve as members of the governing body by reason of being public officials or being appointed by public officials?☐ Yes☒ No

If "Yes," name those persons and explain the basis of their selection or appointment.

d Are any members of the organization's governing body "disqualified persons" with respect to the organization (other than by reason of being a member of the governing body) or do any of the members have either a business or family relationship with "disqualified persons"? (See Specific Instructions, Part II, Line 4d.)☐ Yes☒ No

If "Yes," explain.

4 Does the organization control or is it controlled by any other organization?
 Is the organization the outgrowth of (or successor to) another organization, or does it have a special relationship with another organization by reason of interlocking directorates or other factors?☒ Yes☐ No☒ Yes☐ No

If either of these questions is answered "Yes," explain.

The corporation controls the affiliated organizations. See Exhibit C.

8 Does or will the organization directly or indirectly engage in any of the following transactions with any political organization or other exempt organization (other than 501(c)(3) organizations): (a) grants; (b) purchases or sales of assets; (c) rental of facilities or equipment; (d) loans or loan guarantees; (e) reimbursement arrangements; (f) performance of services, membership, or fundraising solicitations; or (g) sharing of facilities, equipment, mailing lists or other assets, or paid employees?☐ Yes☒ No

If "Yes," explain fully and identify the other organizations involved.

7 Is the organization financially accountable to any other organization?
 If "Yes," explain and identify the other organization. Include details concerning accountability or attach copies of reports if any have been submitted.☐ Yes☒ No

Part II Activities and Operational Information (Continued)

- 8 What assets does the organization have that are used in the performance of its exempt function? (Do not include property producing investment income.) If any assets are not fully operational, explain their status, what additional steps remain to be completed, and when such final steps will be taken. If "None," indicate "N/A."

N/A

- 9 Will the organization be the beneficiary of tax-exempt bond financing within the next 2 years? ☐ Yes ☒ No
See Exhibit

- 10 a Will any of the organization's facilities or operations be managed by another organization or individual under a contractual agreement? ☐ Yes ☒ No
- b Is the organization a party to any leases? ☐ Yes ☒ No
- If either of these questions is answered "Yes," attach a copy of the contracts and explain the relationship between the applicant and the other parties.

See Exhibit C.

- 11 Is the organization a membership organization? ☐ Yes ☒ No
- If "Yes," complete the following:

- a Describe the organization's membership requirements, and attach a schedule of membership fees and dues.

"N/A"

- b Describe your present and proposed efforts to attract members, and attach a copy of any descriptive literature or promotional material used for this purpose.

"N/A"

- c What benefits do (or will) your members receive in exchange for their payment of dues?

"N/A"

- 12 a If the organization provides benefits, services or products, are the recipients required, or will they be required, to pay for them? ☐ N/A ☒ Yes ☐ No
- If "Yes," explain how the charges are determined, and attach a copy of your current fee schedule.

See Exhibit C.

- b Does or will the organization limit its benefits, services or products to specific individuals or classes of individuals? ☐ N/A ☒ Yes ☐ No
- If "Yes," explain how the recipients or beneficiaries are or will be selected.

See Exhibit C.

- 13 Does or will the organization attempt to influence legislation? ☐ Yes ☒ No
- If "Yes," explain. Also, give an estimate of the percentage of the organization's time and funds which it devotes or plans to devote to this activity.

- 14 Does or will the organization intervene in any way in political campaigns, including the publication or distribution of statements? ☐ Yes ☒ No
- If "Yes," explain fully.

Part III Technical Requirements

- 1 Are you filing Form 1023 within 15 months from the end of the month in which your organization was created or formed? ☒ Yes ☐ No

If you answer "Yes," do not answer questions on lines 2 through 7.

- 2 If one of the exceptions to the 15-month filing requirement shown below applies, check the appropriate box and proceed to question 8.

Exceptions - You are not required to file an exemption application within 15 months if the organization:

- ☐ (a) Is a church, interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church;
- ☐ (b) Is not a private foundation and normally has gross receipts of not more than \$5,000 in each tax year; or
- ☐ (c) Is a subordinate organization covered by a group exemption letter, but only if the parent or supervisory organization timely submitted a notice covering the subordinate.

- 3 If the organization does not meet any of the exceptions on line 2, are you filing Form 1023 within 27 months from the end of the month in which the organization was created or formed? ☐ Yes ☐ No

If "Yes," your organization qualifies under section 4.01 of Rev. Proc. 92-85, 1992-42 I.R.B. 32, for an automatic 12-month extension of the 15-month filing requirement. Do not answer questions 4 through 7.

If "No," answer question 4.

- 4 If you answer "No" to question 3, has the organization been contacted by the IRS regarding its failure to file Form 1023 within 27 months from the end of the month in which the organization was created or formed? ☐ Yes ☐ No

If "No," your organization qualifies for an extension of time to apply under the "reasonable action and good faith" requirements of section 5.01 of Rev. Proc. 92-85. Do not answer questions 5 through 7.

If "Yes," answer question 5.

- 5 If you answer "Yes" to question 4, does the organization wish to request relief from the 15-month filing requirement? ☐ Yes ☐ No

If "Yes," give the reasons for not filing this application prior to being contacted by the IRS. See Specific Instructions, Part III, Line 5, before completing this item. Do not answer questions 6 and 7.

If "No," answer question 6.

- 6 If you answer "No" to question 5, your organization's qualification as a section 501(c)(3) organization can be recognized only from the date this application is filed with your key District Director. Therefore, do you want us to consider your application as a request for recognition of exemption as a section 501(c)(3) organization from the date the application is received and not retroactively to the date the organization was created or formed? ☐ Yes ☐ No

- 7 If you answer "Yes" to the question on line 6 above and wish to request recognition of section 501(c)(4) status for the period beginning with the date the organization was formed and ending with the date the Form 1023 application was received (the effective date of the organization's section 501(c)(3) status), check here ☐ and attach a completed page 1 of Form 1024 to this application.

Part III Technical Requirements (Continued)

8 Is the organization a private foundation?

- ☐ Yes (Answer question on line 9.)
- ☒ No (Answer question on line 10 and proceed as instructed.)

9 If you answer "Yes" to the question on line 8, does the organization claim to be a private operating foundation?

- ☐ Yes (Complete Schedule E)
- ☐ No

After answering the question on this line, go to Part IV.

10 If you answer "No" to the question on line 8, indicate the public charity classification the organization is requesting by checking the box below that most appropriately applies:

THE ORGANIZATION IS NOT A PRIVATE FOUNDATION BECAUSE IT QUALIFIES:

- | | | |
|---|--|---|
| (a) <input type="checkbox"/> | As a church or a convention or association of churches
(CHURCHES MUST COMPLETE SCHEDULE A.) | Sections 509(a)(1)
and 170(b)(1)(A)(i) |
| (b) <input type="checkbox"/> | As a school (MUST COMPLETE SCHEDULE B.) | Sections 509(a)(1)
and 170(b)(1)(A)(ii) |
| (c) <input type="checkbox"/> | As a hospital or a cooperative hospital service organization, or a
medical research organization operated in conjunction with a hospital
(MUST COMPLETE SCHEDULE C.) | Sections 509(a)(1)
and 170(b)(1)(A)(iii) |
| (d) <input type="checkbox"/> | As a governmental unit described in section 170(c)(1). | Sections 509(a)(1)
and 170(b)(1)(A)(v) |
| (e) <input checked="" type="checkbox"/> | As being operated solely for the benefit of, or in connection with, one
or more of the organizations described in a through d, g, h, or i
(MUST COMPLETE SCHEDULE D.) | See Exhibit C.
Section 509(a)(3) |
| (f) <input type="checkbox"/> | As being organized and operated exclusively for testing for public
safety. | Section 509(a)(4) |
| (g) <input type="checkbox"/> | As being operated for the benefit of a college or university that is
owned or operated by a governmental unit. | Sections 509(a)(1)
and 170(b)(1)(A)(iv) |
| (h) <input type="checkbox"/> | As receiving a substantial part of its support in the form of
contributions from publicly supported organizations, from a
governmental unit, or from the general public. | Sections 509(a)(1)
and 170(b)(1)(A)(vi) |
| (i) <input type="checkbox"/> | As normally receiving not more than one-third of its support from
gross investment income and more than one-third of its support from
contributions, membership fees, and gross receipts from activities
related to its exempt functions (subject to certain exceptions). | Sections 509(a)(2) |
| (j) <input type="checkbox"/> | The organization is a publicly supported organization but is not sure whether it
meets the public support test of block h or block i. The organization would
like the IRS to decide the proper classification. | Sections 509(a)(1)
and 170(b)(1)(A)(vi)
or
Section 509(a)(2) |

If you checked one of the boxes a through f in question 10, go to question 15.

If you checked box g in question 10, go to questions 12 and 13.

If you checked box h, i, or j, go to question 11.

Part III Technical Requirements (Continued)

- 11 If you checked box h, i, or j on line 10, has the organization completed a tax year of at least 8 months?
- ☐ Yes-Indicate whether you are requesting:
- ☐ A definitive ruling (Answer questions on lines 12 through 15.)
- ☐ An advance ruling (Answer questions on lines 12 and 15 and attach two Forms 872-C completed and signed.)
- ☐ No-You must request an advance ruling by completing and signing two Forms 872-C and attaching them to the application.
- 12 If the organization received any unusual grants during any of the tax years shown in Part IV-A, attach a list for each year showing the name of the contributor; the date and the amount of the grant; and a brief description of the nature of the grant.

- 13 If you are requesting a definitive ruling under section 170(b)(1)(A)(iv) or (vi), check here ☐ and:

- a Enter 2% of line 8, column (e) of Part IV-A _____
- b Attach a list showing the name and amount contributed by each person (other than a governmental unit or "publicly supported" organization) whose total gifts, grants, contributions, etc., were more than the amount entered on line 13a above.

- 14 If you are requesting a definitive ruling under section 509(a)(2), check here ☐ and:

- a For each of the years included on lines 1, 2, and 9 of Part IV-A, attach a list showing the name of and amount received from each "disqualified person." (For a definition of a "disqualified person," see Specific Instructions, Part II, Line 4d.)
- b For each of the years included on line 9 of Part IV-A, attach a list showing the name of and amount received from each payer (other than a "disqualified person") whose payments to the organization were more than \$5,000. For this purpose, "payer" includes, but is not limited to, any organization described in sections 170(b)(1)(A)(i) through (vi) and any governmental agency or bureau.

- 15 Indicate if your organization is one of the following. If so, complete the required schedule. (Submit only those schedules that apply to your organization. Do not submit blank schedules.)

	Yes	No	If "Yes," complete Schedule
Is the organization a church?		X	A
Is the organization, or any part of it, a school?		X	B
Is the organization, or any part of it, a hospital or medical research organization?		X	C
Is the organization a section 509(a)(3) supporting organization?	X		D
Is the organization a private operating foundation?		X	E
Is the organization, or any part of it, a home for the aged or handicapped?		X	F
Is the organization, or any part of it, a child care organization?		X	G
Does the organization provide or administer any scholarship benefits, student aid, etc.?		X	H
Has the organization taken over, or will it take over, the facilities of a "for profit" institution?		X	I

Part IV Financial Data

Complete the financial statements for the current year and for each of the 3 years immediately before it. If in existence less than 4 years, complete the statements for each year in existence. If in existence less than 1 year, also provide proposed budgets for the 2 years following the current year.

A. Statement of Revenue and Expenses

		Current tax year	3 prior tax years or proposed budget for 2 years			
		(a) From	(b) 19 <u>96</u>	(c) 19 <u>97</u>	(d) 19 <u> </u>	(e) TOTAL
R e v e n u e	1 Gifts, grants, and contributions received (not including unusual grants)	to				
		N/A - Less	-0-	-0-		-0-
	2 Membership fees received	than 60 days	-0-	-0-		-0-
	3 Gross investment income (see instructions for definition)	from first	-0-	-0-		-0-
	4 Net income from organization's unrelated business activities not included on line 3	day of	-0-	-0-		-0-
		annual accounting period	-0-	-0-		-0-
	5 Tax revenues levied for and either paid to or spent on behalf of the organization		-0-	-0-		-0-
	6 Value of services or facilities furnished by a governmental unit to the organization without charge (not including the value of services or facilities generally furnished the public without charge)		-0-	-0-		-0-
	7 Other income (not including gain or loss from sale of capital assets) (attach schedule)	SCHEDULE 1	69250.00	100100.00		169350.00
	8 Total (add lines 1 through 7)		69250.00	100100.00		169350.00
	9 Gross receipts from admissions, sales of merchandise or services, or furnishing of facilities in any activity that is not an unrelated business within the meaning of section 513		-0-	-0-		-0-
	10 Total (add lines 8 and 9)		69250.00	100100.00		169350.00
11 Gain or loss from sale of capital assets (attach schedule)		-0-	-0-		-0-	
12 Unusual grants <u>Grant From Belgavia Capital</u>		30000.00			30000.00	
13 Total revenue (add lines 10 through 12)		99250.00	100100.00		199350.00	
E x p e n s e s	14 Fundraising expenses		-0-	-0-		
	15 Contributions, gifts, grants, and similar amounts paid (attach schedule)		-0-	-0-		
	16 Disbursements to or for benefit of members (attach schedule)		N/A	N/A		
	17 Compensation of officers, directors, and trustees (attach schedule)	SCHEDULE 2	50000.00	60000.00		
	18 Other salaries and wages		-0-	-0-		
	19 Interest		-0-	-0-		
	20 Occupancy (rent, utilities, etc.)		-0-	-0-		
	21 Depreciation and depletion		-0-	-0-		
	22 Other (attach schedule)	SCHEDULE 3	35800.00	36200.00		
	23 Total expenses (add lines 14 through 22)		85800.00	96200.00		
	24 Excess of revenue over expenses (line 13 minus line 23)		13450.00	3900.00		

SCHEDULE NO. 1

**The Caritas Corporation
Form 1023
Part IV Financial Data
Revenue, Line 7**

	<u>1996</u>	<u>1997</u>	<u>Total</u>
Other Income:			
Although not income, the corporation will receive loan proceeds from its Directors (\$5,000 loan from each of four Directors at 4% interest, interest and principal payable in single balloon payment 12/31/98)	\$ 20,000	-0-	\$ 20,000
Transfer Payments from Caritas Affiliated Corporations:			
Affiliated Corporation No. 1	\$ 49,250	\$ 100,100	\$ 149,250
Affiliated Corporation No. 2	Undetermined	Undetermined	
Affiliated Corporation No. 3	Undetermined	Undetermined	
Totals	<u>\$ 69,250</u>	<u>\$ 100,100</u>	<u>\$ 169,250</u>

SCHEDULE NO. 2

**The Caritas Corporation
Form 1023
Part IV Financial Data
Expenses, Line 17**

	<u>1996</u>	<u>1997</u>	<u>Total</u>
Compensation of Officers & Directors:			
Salary of President, Dr. Michael A. Harris	\$ 50,000	\$ 60,000	\$ 110,000

SCHEDULE NO. 3

**The Caritas Corporation
Form 1023
Part IV Financial Data
Expenses, Line 22**

	<u>1996</u>	<u>1997</u>	<u>Total</u>
Other:			
Director/Officer, Liability, and Workers' Compensation Insurance	\$ 3,200	\$ 3,400	\$ 6,600
Car expenses (lease payment, insurance, gas, repairs)	\$ 6,000	\$ 6,000	\$ 12,000
Health Insurance for Presidents	\$ 6,600	\$ 6,800	\$ 13,400
Accounting, Financial Consulting, & Legal Expenses (including all professional fees & expenses related to property acquisitions by Affiliated Corporations)	<u>\$20,000</u>	<u>\$20,000</u>	<u>\$ 40,000</u>
Totals	<u>\$ 35,800</u>	<u>\$ 36,200</u>	<u>\$ 72,000</u>

Part IV Financial Data (Continued)**B. Balance Sheet (at the end of the period shown)**

Current tax year

Date 1995

Assets

1	Cash	1	0
2	Accounts receivable, net	2	0
3	Inventories	3	0
4	Bonds and notes receivable (attach schedule)	4	0
5	Corporate stocks (attach schedule)	5	0
6	Mortgage loans (attach schedule)	6	0
7	Other investments (attach schedule)	7	0
8	Depreciable and depletable assets (attach schedule)	8	0
9	Land	9	0
10	Other assets (attach schedule)	10	0
11	Total assets (add lines 1 through 10)	11	0

Liabilities

12	Accounts payable	12	0
13	Contributions, gifts, grants, etc., payable	13	0
14	Mortgages and notes payable (attach schedule)	14	0
15	Other liabilities (attach schedule)	15	0
16	Total liabilities (add lines 12 through 15)	16	0

Fund Balances or Net Assets

17	Total fund balances or net assets	17	0
18	Total liabilities and fund balances or net assets (add line 16 and line 17)	18	0

If there has been any substantial change in any aspect of the organization's financial activities since the end of the period shown above, check the box and attach a detailed explanation ☐

Schedule D. Section 509(a)(3) Supporting Organization

1a Organizations supported by the applicant organization: Name and address of supported organization	b Has the supported organization received a ruling or determination letter that it is not a private foundation by reason of section 509(a)(1) or (2)?
Caritas Affiliated Corporation No. 1	
c/o Carol Lew	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
660 Newport Center Drive, Suite 1600	<input type="checkbox"/> Yes <input type="checkbox"/> No
Newport Beach, CA 92660	<input type="checkbox"/> Yes <input type="checkbox"/> No
Additional affiliated organizations will be formed in the coming year.	<input type="checkbox"/> Yes <input type="checkbox"/> No
	<input type="checkbox"/> Yes <input type="checkbox"/> No
	<input type="checkbox"/> Yes <input type="checkbox"/> No
	<input type="checkbox"/> Yes <input type="checkbox"/> No

c If "No," for any of the organizations listed in 1a, explain.

The 509(a)(2) supported organization described above has submitted a Form 1023 application concurrently herewith.

2 Does the supported organization have tax-exempt status under section 501(c)(4), 501(c)(5), or 501(c)(6)? ☐ Yes ☒ No
 If "Yes," attach: (a) a copy of its ruling or determination letter, and (b) an analysis of its revenue for the current year and the preceding 3 years. (Provide the financial data using the formats in Part IV-A (lines 1-13) and Part III (lines 12, 13, and 14).)

3 Does your organization's governing document indicate that the majority of its governing board is elected or appointed by the supported organizations? ☒ Yes ☐ No
 If "Yes," skip to line 9.
 If "No," you must answer the questions on lines 4 through 9.

4 Does your organization's governing document indicate the common supervision or control that it and the supported organizations share? ☒ Yes ☐ No
 If "Yes," give the article and paragraph numbers. If "No," explain.
 See Exhibit B - Bylaws, Article III, Section 3.

5 To what extent do the supported organizations have a significant voice in your organization's investment policies, in the making and timing of grants, and in otherwise directing the use of your organization's income or assets?
 The Board of Directors of this supporting organization consist of the same persons that control and manage the supported organization described above. Therefore, the supported organization has complete control over this organization's investment policies, grant procedures, and direction of its assets.

6 Does the mentioning of the supported organizations in your organization's governing instrument make it a trust that the supported organizations can enforce under state law and compel to make an accounting? ☐ Yes ☒ No
 If "Yes," explain.

7a What percentage of your organization's income does it pay to each supported organization?
 This organization has no income. Its expenses are paid by the supported organization.

b What is the total annual income of each supported organization?
 Caritas Affiliated Corporation No. 1 has a projected income for 1996 (6 months) of \$132,919. Its projected annual income for 1997 (12 months) is \$262,638.

c How much does your organization contribute annually to each supported organization?

"N/A"

Schedule D. Section 509(a)(3) Supporting Organization (Continued)

- 8** To what extent does your organization conduct activities that would otherwise be carried on by the supported organizations? Explain why these activities would otherwise be carried on by the supported organizations.

The management expertise offered by this organization enables the supported organizations to coordinate their operations and to accomplish their purpose of providing affordable housing to very low, low and moderate income persons. This organization provides all financial analysis, legal and accounting services for the supported organizations. These functions would otherwise have to be provided by the supported organizations.

- 9** Is the applicant organization controlled directly or indirectly by one or more "disqualified persons" (other than one who is a disqualified person solely because he or she is a manager) or by an organization that is not described in section 509(a)(1) or (2)? ☐ Yes ☒ No
- If "Yes," explain.

Instructions

For an explanation of the types of organizations defined in section 509(a)(3) as being excluded from the definition of a private foundation, see Pub. 557, Chapter 3.

Line 1

List each organization that is supported by your organization and indicate in item 1b if the supported organization has received a letter recognizing exempt status as a section 501(c)(3) public charity as defined in section 509(a)(1) or 509(a)(2). If you answer "No" in 1b to any of the listed organizations, please explain in 1c.

Line 3

Your organization's governing document may be articles of incorporation, articles of association, constitution, trust indenture, or trust agreement.

Line 9

For a definition of a "disqualified person," see Specific Instructions, Part II, line 4d, on page 3 of the application's instructions.

Exhibit C

Purpose

The principal purpose of the Caritas Corporation (the "Assistance Corporation") is to lessen the burdens of government by working with local governmental entities to provide and maintain affordable housing projects, including possibly mobile home parks.

Proposed Activity

The Assistance Corporation intends on achieving its purpose by forming and coordinating the activities of a number of subordinate corporations which will be under the control of the Assistance Corporation and which will conduct the activity of owning and maintaining affordable housing projects, including possibly mobile home parks (each subordinate corporation is referred to hereinafter as an "Affiliated Corporation"). The Assistance Corporation will serve as the controlling corporation over all Affiliated Corporations, however, the Affiliated Corporations will be the operational entities that manage the proposed affordable housing projects. There is currently one Affiliated Corporation, Caritas Affiliated Corporation No. 1. A separate IRS 1023 application for Caritas Affiliated Corporation No. 1 has been filed concurrently herewith.

Each Affiliated Corporation will own and operate, under the supervision of the Assistance Corporation, one affordable housing project, including possibly a mobile home park, located in a city which has an existing unfulfilled statutory obligation to provide affordable housing. By restricting the occupancy of between 60% and 100% of the dwelling units in the affordable housing project or mobile home park to low or very low income households as those terms are defined under Section 8 of the United States Housing Act of 1937¹, each Affiliated Corporation will satisfy a significant portion of its city's affordable housing obligation and thereby lessen a governmental burden. To ensure that the Affiliated Corporations continue to meet their respective cities' statutorily imposed housing obligations, each Affiliated Corporation will enter into a long-term implementation agreement with the local governmental entity responsible for developing and maintaining affordable housing. (Bylaws, Art. V., § 2) The implementation agreement will set forth specific criteria on tenant income eligibility and rental rates, provide for the recordation of conditions, covenants and restrictions against the subject properties (or mobile home spaces in the case of mobile home parks) to guarantee the long-term affordability of the dwelling units, and include such other provisions as are necessary to qualify the dwelling units as affordable housing units under applicable federal, state, and local housing laws and regulations. In addition, it is anticipated that each of the cities will appoint a governmental liaison housing specialist to oversee the operations of the Affiliated Corporation and insure continued compliance with applicable housing law. Under the Bylaws of each Affiliated Corporation, the Affiliated

¹"Lower income household" means persons and families whose income, adjusted for family size, does not exceed 80 percent of area median income as established by the United States Department of Housing and Urban Development ("HUD"). "Very low income household" means persons and families whose income, adjusted for family size, does not exceed 50 percent of area median income.

Corporation must be responsive to the requirements of the governmental liaison housing specialist. (Bylaws, Art. V, § 1).

Illustration - Lessening Governmental Burdens Under California Law

California law imposes a number of statutory obligations on local governments to expand and/or preserve their stock of affordable housing. These statutory obligations include the requirement that a city develop a "General Plan" setting forth its development policies, objectives and standards. (California Government Code Section 65300 et seq.) The General Plan must include a "Housing Element" describing the city's plan for meeting its fair share of the regional housing need as determined by the California Department of Housing and Community Development. The Housing Element must assess the housing needs of all economic segments of the community and include an implementation program formulated to meet those needs.

In addition to having a statutory obligation to meet its fair share of affordable housing pursuant to the "General Plan Housing Element," a California city which has activated a redevelopment agency must utilize at least 20% of its redevelopment tax increment to increase, improve and preserve its supply of affordable housing. (California Health and Safety Code Section 33000 et seq.) These redevelopment agencies are also subject to a statutory requirement that at least 30% of all new and substantially rehabilitated dwelling units developed by the redevelopment agency be affordable to low or moderate income households and that at least 50% of these affordable dwelling units be affordable to very low income households.²

In summary, California law imposes mandatory obligations on cities and redevelopment agencies to produce dwelling units which are affordable to very low, low and moderate income households. Redevelopment agencies and cities which fail to keep up with their statutory obligation to provide housing affordable to very low, low and moderate income households accrue what is commonly referred to as an "inclusionary housing deficit." The Affiliated Corporations will reduce the inclusionary housing deficits of the cities in which they operate by placing long-term affordability covenants on the dwelling units which comprise their housing projects in accordance with California law and thereby lessen the burdens of local government. Where mobile home parks are concerned, the Assistance Corporations will place long-term affordability covenants on the mobile home park spaces; mobile home coaches will be owned by the residents.

Funding Sources

The Assistance Corporation, and through it each Affiliated Corporation, will be initially funded by a \$30,000.00 grant from Belgravia Capital, Inc. and possibly by grants from governmental units. In addition, each of the four Directors will loan to the Assistance Corporation the sum of \$5,000.00 (total loans from Directors will be \$20,000.00). The four

²Under California law, the terms "low income households" and "very low income households" have the same meanings as under Section 8 of the United States Housing Act of 1937. The term "moderate income households" means persons and families whose income does not exceed 120 percent of area median income.

\$5,000.00 loans will accrue interest at the rate of 4% per annum and each will be due and payable, in full, on December 31, 1998. There will be no penalty for prepayment of the loans.

It is anticipated that financing to acquire a mobile home park or other housing project will be provided by a loan of tax-exempt bond proceeds made to the applicable Affiliated Corporation by the governmental unit issuing the tax-exempt bonds. It is anticipated that the bonds of the applicable governmental unit will be structured as qualified 501(c)(3) bonds which will comply with all applicable requirements of Section 103 and Section 141 through 150 of the Internal Revenue Code of 1986, as amended.³ Each Affiliated Corporation will maintain and operate each mobile home park, or other housing project, with monies received as rental income. Some rental income will be transferred to the Assistance Corporation to further the charitable purpose of the Assistance Corporation and to reimburse the Assistance Corporation for salaries and expenses such as legal and accounting fees.

Commencement of Activity

The Assistance Corporation and the Affiliated Corporations were formed in January and February of 1996 and expect to begin operations, including construction of and/or acquisitions of housing projects, including possibly mobile home parks, within a reasonable time. Upon the commencement of the provision of housing, each Affiliated Corporation will be funded by the receipt of rental income. None of the funds received by any of the corporations will be distributed to or inure to the benefit of, directly or indirectly, any individual or group of persons, other than the intended beneficiaries, as stated above.

Management

The Assistance Corporation currently has a Board of Directors, consisting of six persons, including individuals with experience in the housing market. The Board of Directors will manage and control the direction of the Assistance Corporation and the Affiliated Corporations. Each member of the Board of Directors of the Assistance Corporation will also be a member of the Board of Directors of each Affiliated Corporation. Each Affiliated Corporation may also elect two tenants of the mobile home park or other housing project owned and operated by that Affiliated Corporation to its Board of Directors. Neither the Assistance Corporation nor any Affiliated Corporation will have members; therefore, all authority and power to manage the applicable corporations will be vested in their respective Boards of Directors.

Area of Operation

Initially, the Assistance Corporation intends to form Affiliated Corporations which will provide affordable housing throughout California. Eventually, however, the Assistance Corporation intends to expand its operations to other states.

³See Exhibit C, Attachment No. 1 (Information Letter Responses) of Caritas Affiliated Corporation No. 1 Form 1023 Application for more specific information regarding the Affiliated Corporations' proposed uses of tax exempt bond financing.

Exhibit D
Officers and Directors

Chairman

General William Lyon
The William Lyon Company
4490 Von Karman
Newport Beach, CA 92660

Vice Chairman and Secretary

Arthur Birtcher
Birtcher Enterprises
27611 La Paz Road
P.O. Box 30009
Laguna Niguel, CA 92607

President and Chief Financial Officer

Dr. Michael A. Harris
The Caritas Corporation
27611 La Paz Road
P.O. Box 30009
Laguna Niguel, CA 92607

Executive Board Member

Roger Kirwan
Ganis Corporation
660 Newport Center Drive
Suite 200
Newport Beach, CA 92660

Executive Board Member

Justice John K. Trotter
JAMS/End Dispute
500 North State College Boulevard
Suite 600
Orange, CA 92668

Executive Board Member

Danielle Garr
Danielle Garr Designs
1811 Sirrine Drive
Santa Ana, CA 92705

¶ J-3248

Qualified 501(c)(3) bonds.

A private activity bond may be a tax-exempt qualified bond (see ¶ J-3150) if it qualifies as a "qualified 501(c)(3) bond." 28 Qualified 501(c)(3) bonds are bonds that are part of an issue if: 28.1

. . . all property which is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or by a governmental unit; 28.2 and

. . . the bond would not be a private activity bond under the tests discussed at ¶ J-3100 et seq., with the following modifications of those tests 28.3 --

ù 501(c)(3) organizations are treated as governmental units with respect to its exempt activities); 28.4 and

ù improper use of more than 5% (rather than 10%) of the net proceeds (rather than of the proceeds) of the bonds are privately secured or paid would cause an issue to meet the private business tests (¶ J-3101). 29

28 Code Sec. 141(e)(1)(G).

28.1 Code Sec. 145(a).

28.2 Code Sec. 145(a)(1).

28.3 Code Sec. 145(a)(2).

28.4 Code Sec. 145(a)(2)(A).

29 Code Sec. 145(a)(2)(B).

Composite issues of tax-exempt bonds -- that is, issues part of whose proceeds are used for governmental activities and part for the activities of 501(c)(3) organizations operating within the issuer's jurisdiction -- may be used, provided that each component, viewed as a separate issue, satisfies all requirements for tax-exemption as (a) a governmental bond, or (b) a qualified 501(c)(3) bond. In addition, where a state or local governmental university or hospital (including a public benefit corporation) has received an IRS determination letter regarding its tax-exempt status under Code Sec. 501(c)(3), to the extent that such an entity is a governmental unit or an agency or instrumentality of a governmental unit (determined under the law in effect prior to passage of PL 99-514), bonds for the entity will be treated as governmental bonds rather than as qualified 501(c)(3) bonds. 30

30 Conf Rept No. 99-841, Vol. II (PL 99-514) p. II-726.

For effect of private activity bond regulations on qualified 501(c)(3) bonds, see ¶ J-3248.1 et seq.

For effective date of the above rules, see ¶ J-3248.9.

(1) **Storage and training facilities.** Storage or training facilities directly related to a facility described in paragraph (1), (2), (3), or (11) of subsection (a) shall be treated as described in the paragraph in which such facility is described.

(2) **Exception for certain private facilities.** Property shall not be treated as described in paragraph (1), (2), (3), or (11) of subsection (a) if such property is described in any of the following subparagraphs and is to be used for any private business use (as defined in section 141(b)(6)).

(A) Any lodging facility.

(B) Any retail facility (including food and beverage facilities) in excess of a size necessary to serve passengers and employees at the exempt facility.

(C) Any retail facility (other than parking) for passengers or the general public located outside the exempt facility terminal.

(D) Any office building for individuals who are not employees of a governmental unit or of the operating authority for the exempt facility.

(E) Any industrial park or manufacturing facility.

(d) Qualified residential rental project.

For purposes of this section—

(1) **In general.** The term “qualified residential rental project” means any project for residential rental property if, at all times during the qualified project period, such project meets the requirements of subparagraph (A) or (B), whichever is elected by the issuer at the time of the issuance of the issue with respect to such project:

(A) 20-50 test. The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income.

(B) 40-60 test. The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income.

For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

(2) Definitions and special rules. For purposes of this subsection—

(A) **Qualified project period.** The term “qualified project period” means the period beginning on the 1st day on which 10 percent of the residential units in the project are occupied and ending on the latest of—

(i) the date which is 15 years after the date on which 50 percent of the residential units in the project are occupied,

(ii) the 1st day on which no tax-exempt private activity bond issued with respect to the project is outstanding, or

(iii) the date on which any assistance provided with respect to the project under section 8 of the United States Housing Act of 1937 terminates.

(B) **Income of individuals; area median gross income.** The income of individuals and area median gross income shall be determined by the Secretary in a manner consistent with determinations of lower income families and area median gross income under section 8 of the United States Housing Act of 1937 (or, if such program is terminated, under such program as in effect immediately before such termination). Determinations under the preceding sentence shall include adjustments for family size. Section 7872(g) shall not apply in determining the income of individuals under this subparagraph.

(3) Current income determinations. For purposes of this subsection—

(A) **In general.** The determination of whether the income of a resident of a unit in a project exceeds the applicable income limit shall be made at least annually on the basis of the current income of the resident.

TAX EXEMPT BONDS

EXPLANATION IRC §145

§146

§1460

will be replaced by tax-exempt bond financing, and the replacement occurs in a reasonable period.

- If, at the time of the facility's first use, no state or local program for tax-exempt financing existed and such financing was subsequently obtained. IRC §145(d)(3).

In general, rules similar to those of IRC §47(c)(1)(C) which defines substantial rehabilitation for the credit are to apply to determine substantial rehabilitation, but the special 60-months phased-in exception (IRC §47(c)(1)(C)(ii)) doesn't apply here. Also, the 24-month testing period for rehabilitation must start within the 12 months preceding or following the date the property is acquired with the bond proceeds by the IRC §501(c)(3) organization, but the Treasury may extend the 24-month testing period in the event that rehabilitation is delayed by unforeseen circumstances not within the control of the owner (for example, a fire resulting from an act of God). IRC §145(d)(4).

The above rules also apply to that component of a continuing care facility which constitutes residential rental property.

The '88 TAMRA Conference Report, ¶1451.005, also excluded residential rental property for family units located outside the issuer's jurisdiction from being treated as "investment property" under arbitrage rules of IRC §148(b), if the issuer is required to implement a court-ordered or approved housing desegregation plan.

[¶1454.04] Effective dates. The restrictions on residential rental property bonds and the exclusion from treatment as investment property under arbitrage rules generally apply to obligations issued after 10-21-88. The '88 TAMRA House Report, ¶1451.005, provided an exception for construction, reconstruction, or rehabilitation of property commenced before (or pursuant to a binding agreement entered before) 7-14-88.

ANNOTATIONS

[¶1455.01] Qualified tax-exempt bonds.

(5) **Tax-exempt financing.** Exempt corp. providing homes for aged received favorable ruling from IRS on its proposed replacement of interim construction financing provided by bank: with respect to IRC §145(d)(3)(A)(iii),

sale within 90 days of receipt of ruling and delivery of proposed bonds in exchange for purchasing price within 120 days of ruling letter will represent replacement of taxable financing within reasonable period.

LtrRul 9516027.

CODE

[¶1460] IRC §146. Volume cap.

(a) **General rule.**

A private activity bond issued as part of an issue meets the requirements of this section if the aggregate face amount of the private activity bonds issued pursuant to such issue, when added to the aggregate face amount of tax-exempt private activity bonds previously issued by the issuing authority during the calendar year, does not exceed such authority's volume cap for such calendar year.

(b) **Volume cap for state agencies.**

For purposes of this section—

(1) **In general.** The volume cap for any agency of the State authorized to issue tax-exempt private activity bonds for any calendar year shall be 50 percent of the State ceiling for such calendar year.

of outstanding tax-exempt qualified 501(c)(3) non-hospital bonds that benefit the organization during a 3-year test period) makes the total face amount exceed \$150 million. The three year test period begins on the later of the date the facilities were placed in service or the issue date of the bonds. The \$150 million limit only takes qualified 501(c)(3) bonds (as opposed to other qualified private activity bonds) for use in determining the limit. IRC §145(b)(4). If an issue is partly used for hospitals, only the portion actually used for hospitals is exempt from the \$150 million limit. IRC §501(c)(3) organizations can alternatively elect to treat non-hospital qualified 501(c)(3) bonds as exempt facility bonds or qualified redevelopment bonds provided the State private activity bond limitations have not been exceeded. For example, an IRC §501(c)(3) organization can participate in a multifamily residential rental project financed with bonds subject to the State volume limitations by making such an election. The election must be made in the bond indenture or a related document (as defined in Reg. §1.103-(b)(8)) on or before the issue date. Bonds issued on or before 8-16-86 for IRC §501(c)(3) organizations count towards the \$150 million limit only if more than 25% of the proceeds were to be used directly or indirectly by the organizations and the security interest test in effect prior to 8-16-86 was satisfied.

An issuer of tax-exempt bonds can elect to treat a portion of an issue as a qualified 501(c)(3) bond if that portion would have qualified as a 501(c)(3) had it been issued separately. This election must be made in the bond indenture or a related document (as defined in Reg. §1.103-13(b)(8)) on or before the date of issue.

[¶1454.03] Restrictions on bonds used to provide residential rental property for family units. Bonds cannot be qualified 501(c)(3) bonds if any portion of the net proceeds of the bond issue is directly or indirectly used to provide residential rental property for family units. IRC §145(d)(1). This rule does not apply if the bonds are used to provide qualified residential rental projects. This means that qualified 501(c)(3) bonds can be used for residential rental property for family units if the property in question satisfies any of the following:

- (1) The property consists of residential rental property for family units whose first use is pursuant to the purpose of the tax-exempt financing of such bond issue.
- (2) The property consists of qualified residential rental projects, as defined by IRC §142(d). This requires satisfaction of the low-income tenancy occupant requirements of IRC §142.
- (3) The property is to be substantially rehabilitated, within the meaning of IRC §47(c), and the rehabilitation begins within a two-year period that ends one year after the property's acquisition. IRC §145(d)(2).

It should be noted that the low-income tenancy occupant requirement explained in (2) above only needs to be satisfied if qualified 501(c)(3) bonds are issued to finance residential rental property for family units that consist of existing property and neither exception (1) nor (3) listed above applies. Bonds used to finance construction of *new* residential rental property for family units (original use starts with the beneficiary of the bonds) are not subject to the low-income tenant occupancy requirements, even if the bonds do not satisfy exceptions (1) or (3) above.

The bonds become taxable retroactively to their issuance if the above requirements aren't satisfied. Existing property will be treated as new, and therefore, not subject to the low income tenant occupancy requirements, in two other circumstances:

- If the housing is first financed by sources other than tax-exempt bonds, and at the time of initial financing there is a reasonable expectation that the financing

¶ J-3101

Private activity bonds.

There's no exemption from federal income tax for the interest on state or local bonds that are private activity bonds, unless they are qualified bonds. ³ The purpose of the private activity bond tests is to limit the volume of tax-exempt bonds that finance the activities of nongovernmental persons (¶ J-3119.2), without regard to whether a financing actually transfers benefits of tax-exempt financing to a nongovernmental person. The private activity bond tests serve to identify arrangements that have the potential to transfer the benefits of tax-exempt financing, as well as arrangements that actually transfer these benefits. The private activity bond regulations may not be applied in a manner that is inconsistent with these purposes. ⁴

³ Code Sec. 103(b)(1).

⁴ Reg § 1.141-2(a).

For purposes of the federal income, estate, gift, employment, withholding, and excise taxes, a private activity bond is any bond that's part of an issue that:

(1) satisfies the 'private business use test' described at ¶ J-3104 et seq., and the 'private security or payment test' described at ¶ J-3110 et seq.; ⁵ or

(2) satisfies the private loan financing test described at ¶ J-3115 et seq. ⁶

⁵ Code Sec. 141(a)(1).

⁶ Code Sec. 141(a)(2).

The private business use test and the private security or payment test described above are, together, referred to as the 'private business tests.' ⁷

⁷ Reg § 1.141-1(b).

For effect of 'reasonable expectations' and 'deliberate actions,' see ¶ J-3102 et seq.

There are special 'private business use' and 'private security or payment' tests for certain bond issues whose 'private use' is unrelated or disproportionate to their government use, see ¶ J-3117 et seq.

There are also special rules for bonds used to finance (¶ J-3119) 'output facilities' (see ¶ J-3116 et seq.) and certain power pooling and exchange arrangements, and spot power sales (see ¶ J-3116.6).

In addition, the private business use, private security or payment, and private loan financing tests don't apply to the portion of the proceeds of an issue (¶ J-3119.3) that, if issued separately, would be treated as a qualified 501(c)(3) bond (see ¶ J-3248). This rule applies, however, only if the issuer elects to treat that portion of the issue's proceeds as a qualified 501(c)(3) bond. ⁸ The election must be made in writing on or before the issue date and retained as part of the bond documents, and, once made, may not be revoked without the permission of IRS. ⁹

⁸ Code Sec. 141(b)(9).

⁹ Reg § 1.141-1(c).

Where as a result of actions after the issue date of bonds, the bonds fail to meet certain

requirements of Code Sec. 141 through Code Sec. 150 relating to use of proceeds, the issuer of the bonds may enter into a closing agreement with IRS to prevent, for a specified period, the interest on the bonds from being includible in the gross income of bondholders solely as a result of the later actions, see ¶ T-9553. ¹⁰

¹⁰ Rev Proc 97-15, 1997-5 IRB 21.

For treatment of related parties, see ¶ J-3101.1.

For effective date of the private activity bond regulations, see ¶ J-3120 et seq.

For obligations issued before Mar. 10, '87, the election (described at footnotes 8-9, above) must have been made before Mar 10, '87 and need not have been made in the bond indenture or a related document, but must have been made in writing and kept as part of the issuer's books and records. ¹¹

¹¹ Reg § 301.9100-7T(g).

exempt facility. This property is eligible for tax-exempt financing only if a specified number of housing units in the project are occupied by individuals having low or moderate incomes (determined on a continuing basis)¹⁷ and only if the property remains as rental property for a prescribed qualified project period. In addition, the bill requires operators of these projects to certify annually that the project is in compliance with the set-aside requirement applicable to the project, and requires the Treasury Department to make annual reports to the Committee on Ways and Means and the Committee on Finance on nationwide compliance with Code requirements.

Property comprising the exempt facility

A qualified residential rental project includes a building containing residential rental units and other property that is directly related and essential to the function of providing residential rental units. As under present law, a project may include multiple buildings having similarly constructed housing units, provided the buildings are located on the same tract of land, are owned by the same person for Federal income tax purposes, and are financed pursuant to a common plan of financing.

Facilities directly related and essential to the housing function of the project and thereby comprising qualified residential rental property include such tenant amenities as swimming pools, other recreational facilities¹⁸ and parking areas. Additionally, trash disposal facilities and common heating and cooling plants are included, as are housing units occupied by resident managers or maintenance personnel. (See generally, Treas. Reg. sec. 1.103-8(b)(4)(iii).)

Multifamily residential rental property is eligible for tax-exempt financing only if the housing units are used on other than a transient basis. In addition, each residential rental unit must include separate and complete facilities for living, sleeping, eating, cooking, and sanitation. Hotels, dormitories, hospitals, nursing homes, and trailer parks are not qualified residential rental property. (See, e.g., Treas. Reg. sec. 1.103-8(b)(4)(i).)

As under present law, residential rental property may qualify as an exempt facility even though a portion of the building in which the residential rental units are located is used for a commercial use. Unlike present law where up to 10 percent of the proceeds may be so used, no portion of exempt-facility bond proceeds may be used to finance property not actually used for the residential rental property. The committee intends that the costs of such a mixed-use facility may be allocated according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the

residential rental units and nonqualifying property. (See, e.g., Prop. Treas. Reg. 1.103-8(b).)

Required set-aside for low- and moderate-income tenants

The bill amends the present set-aside requirements to permit issuers of exempt-facility bonds for multifamily residential rental property to elect to receive financing for projects if either of two set-aside requirements is satisfied. This election must be made no later than the earlier of the date on which the qualified project period begins or, if later, the date on which the bonds are issued. Once made, this election is irrevocable.

Residential rental projects may qualify for tax-exempt financing if—

(1) [40] percent or more of the units are occupied by tenants having incomes of [60] percent or less of the area median income, or

(2) 20 percent or more of the units are occupied by tenants having incomes of [50] percent or less of the area median income.

Unlike under present law, there are no special rules for multifamily residential rental projects located in targeted areas.

As under present law, the set-aside requirement must be satisfied continuously during a qualified project period. Unlike present law, however, the determination of whether a tenant qualifies as having low- or moderate-income is made on a continuing basis, rather than only on the date the tenant initially occupies the unit. The increase in a tenant's income may, therefore, result in a unit ceasing to qualify as occupied by a low- or moderate-income person. * * *

The bill also clarifies that present law requires that adjustments for family size be made in determining the area median incomes used to qualify tenants as having low or moderate income. In general, these adjustments are the same as the adjustments presently made under section 8 of the United States Housing Act of 1937. Thus, if a project qualifies by setting aside 25 percent of the units for tenants having incomes of 80 percent or less of area median income, a family of four generally will be treated as having a low- or moderate-income if the family has an income of 80 percent or less of the area median income; a family of three having an income of 72 percent or less generally will qualify; a family of two having an income of 64 percent or less generally will qualify; and, a single individual having an income of 40 percent or less generally will qualify. The committee intends that similar 10-percent reductions be made to reflect family size if the option of setting aside 20 percent of the units for tenants having incomes of 70 percent or less of area median income is elected. The committee is aware that, in

¹⁷ This requirement is referred to as the set-aside requirement.

¹⁸ Tax-exempt financing is prohibited generally for recreational facilities that comprise a health club.

Therefore, these bonds may continue to be issued to finance depreciable property and land, including such land *** financed under the first-time interest exception. ***

Section 501(c)(3) organization bonds

The bill permits continued tax-exemption for interest on bonds issued for the benefit of section 501(c)(3) organizations.²⁴ Interest on section 501(c)(3) organization bonds is tax-exempt, however, only if all of the net proceeds of the bonds (i.e., all proceeds other than proceeds used to pay costs of issuance and amounts invested in a reasonably required reserve or replacement fund) are used in activities directly related and essential to the conduct of the charitable activities of the organization. Additionally, facilities financed with section 501(c)(3) organization bonds must be owned by a section 501(c)(3) organization, or else by (or on behalf of) a qualified governmental unit. These general provisions apply both to bonds issued to provide hospital facilities and to other section 501(c)(3) organization bonds.

If any portion of the net proceeds of an issue of section 501(c)(3) organization bonds is used by a nongovernmental person other than a section 501(c)(3) organization, interest on the issue is taxable. For example, section 501(c)(3) organization bonds may not be used to finance office space for use by nongovernmental persons in carrying on trades or businesses. Additionally, the committee intends that no portion of the proceeds of a section 501(c)(3) hospital bond may be used to finance an office building for use by physicians in carrying on the private practice of medicine (regardless of whether the ownership or operation of the office building is a related trade or business to that of section 501(c)(3) organization). Similarly, no portion of the net proceeds of these bonds may be used to finance any other facilities that are leased to or operated by other nongovernmental persons if the use pursuant to the lease or other arrangement would result in the bonds being nonessential function bonds were the section 501(c)(3) organization a governmental unit.²⁵

As under present law, the use of bond proceeds by section 501(c)(3) organizations in unrelated trades or businesses (as determined by applying sec. 513(a)) is a nonexempt use. Thus, use of bond proceeds or of bond financed property in such an unrelated trade or business results in interest on the issue being taxable. (A small-issue bond could, however, be used for such a purpose.)

The committee understands that certain facilities eligible for financing with section 501(c)(3) organization bonds may comprise part of a larger

facility otherwise ineligible for such financing or that portions of a section 501(c)(3) organization facility may be used for activities of persons other than section 501(c)(3) organizations. The committee intends that the Treasury Department may adopt rules for allocating the costs of such mixed use facilities (including common elements) according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the various users of the facility. Only the portions of such mixed use facilities owned and used by a section 501(c)(3) organization may be financed with bonds for such organizations.

\$150 million limitation for non-hospital section 501(c)(3) organization bonds

General rules

The bill limits the aggregate amount of outstanding tax-exempt bonds (other than qualified hospital bonds) from which any section 501(c)(3) organization may benefit. Bonds subject to this provision include both section 501(c)(3) organization bonds and all other nonessential function bonds (e.g., small-issue bonds) from which a section 501(c)(3) organization benefits. Bonds, the proceeds of which are used to finance hospital facilities, are not subject to the limitation and are not counted in determining how many bonds are allocated to a section 501(c)(3) organization that operates a hospital and also carries out other activities (e.g., a medical school, a nursing home facility, an ambulatory care facility, or a research laboratory. Such organizations may have up to \$150 million of bonds outstanding for such nonhospital facilities, in addition to any bonds for actual hospital facilities, if the other facilities are directly related and essential to the purpose qualifying the organization for exemption from tax.) For purposes of the \$150 million limitation, qualified student loan bonds used to finance loans to students at a section 501(c)(3) educational institution are not allocated to the institution.

An issue of section 501(c)(3) organization bonds is denied tax-exemption if the aggregate authorized face amount of the issue, when increased by the face amount of all other types of tax-exempt bonds (not including section 501(c)(3) hospital bonds) outstanding and allocated to the section 501(c)(3) organization, exceeds \$150 million. In determining whether the \$150 million limitation has been exceeded, however, bonds that are to be redeemed with the proceeds of the new issue are not considered.

In general, the face amount of such bonds will be allocated in its entirety to one or more section

²⁴ These bonds are subject to the new unified State volume limitation applicable to bonds for nongovernmental persons; however, as discussed in 4., below, a portion of each State's volume limit is reserved specifically for such bonds.

²⁵ See, Rev. Proc. 77-352, *supra*, for an example of circumstances under which use of section 501(c)(3) organiza-

tion facilities by other nongovernmental persons may result in the facilities being treated as used in the other person's trade or business.

501(c)(3) organization that both owns and uses the bond-financed property. The committee is aware that section 501(c)(3) organizations also may lease or otherwise be a principal user of a portion of property financed with other types of tax-exempt bonds. For example, a section 501(c)(3) organization may lease office space in a building financed with an issue of small-issue bonds. In such cases, property leased or otherwise principally used by a section 501(c)(3) organization is to be allocated to that organization for purposes of the \$150 million limitation.

The \$150 million limitation generally is to be administered in a manner similar to the present \$40 million limitation for small-issue bonds. For example, bonds generally are to be allocated only among those persons (including section 501(c)(3) organizations) who are test-period beneficiaries. Test-period beneficiaries are defined as owners or principal users of the facilities being financed by the issue at any time during the three-year period beginning on the later of (1) the date such facilities are placed in service, or (2) the date of the issue. No portion of an issue generally is allocated to persons other than owners and principal users during this three-year test period. It is intended that this rule may not be used to avoid the intended effect of the \$150 million limitation.

Under the \$40 million limitation, all owners of bond-financed facilities during the three-year test period are allocated that portion of the issue that is equivalent to the portion of the facilities that they own. All principal users of the facilities during the three-year test period are allocated a portion of the face amount of the issue equivalent to that portion of the facility used by them.

In determining whether a portion of an issue is allocated to a section 501(c)(3) organization, the related person rules generally applicable to small-issue bonds apply. For example, a university and all related persons (as defined in sec. 267), included related entities engaged in unrelated trades or businesses, are treated as one person in determining whether they are principal users of bond-financed property. The committee intends that any section 501(c)(3) organization will be treated as related to any other person if the two have (a) significant common purposes and substantial common membership or (b) directly or indirectly, substantial common direction. For example, a local chapter of a national organization is related to its national organization. The committee further intends that any section 501(c)(3) organization is to be treated as related to any other person if it either owns 50 percent or more of the capital interests or the profit interests in the other. Finally, any section 501(c)(3) organization is related to any other such organization

with respect to a particular transaction if such transaction is part of an attempt to avoid the application of the Act.

Once a portion of an issue is allocated to a section 501(c)(3) organization, that allocation remains in effect as long as the bonds are outstanding. This is true even if the person or organization no longer owns or uses the property financed with the bonds. Similarly, the fact that persons are no longer related persons after an allocation is made does not alter the allocation to that person as long as the bonds are outstanding.

Bonds issued before January 1, 1986, also are allocated to section 501(c)(3) organizations if the bonds are outstanding on that date. The committee intends that the determination of test-period beneficiaries of bonds issued more than three years before January 1, 1986, that are outstanding on that date, be made by reference to the owners and principal users of the bond-financed facilities on January 1, 1986. If an organization is allocated \$100 million in all types of tax-exempt bonds as of January 1, 1986, the maximum amount of additional section 501(c)(3) organization bonds from which the organization may benefit is limited to \$50 million, until some or all of the outstanding bonds are redeemed. If an organization is allocated \$150 million or more of bonds on January 1, 1986, no additional bonds may be issued until that allocation falls before \$150 million following redemption of some or all of the bonds.

If an issue of section 501(c)(3) organization bonds causes the \$150 million limitation to be exceeded, only the issue that causes the limitation to be exceeded is taxable. If the \$150 million limitation is violated with respect to an issue by a change of owners or principal users of bond-financed facilities at any time during the three-year test period, the interest on that issue is taxable from the date the bonds were issued. In no case does this restriction affect the tax-exemption of interest on bonds issued prior to January 1, 1986.²⁶

Exception for qualified hospital bonds

The \$150 million limitation does not apply to bonds used to finance qualified hospital facilities. A hospital is a facility that—

(1) is accredited by the Joint Commission on Accreditation of Hospitals (JCAH), or is accredited or approved by a program of the qualified governmental unit in which such institution is located if the Secretary of Health and Human Services has found that the accreditation of comparable approval standards of such qualified governmental unit are essentially equivalent to those of the JCAH;

²⁶ The tax-exempt status of bonds issued pursuant to transitional exceptions to this rule similarly is not affected; however, these bonds (like bonds issued before 1986) are

counted in determining how many bonds are allocated to a section 501(c)(3) organization.

(2) is primarily used to provide, by or under the supervision of physicians, to inpatients diagnostic services and therapeutic services for medical diagnosis, treatment, and care of injured, disabled, or sick persons;

(3) has a requirement that every patient be under the care and supervision of a physician; and

(4) provides 24-hour nursing services rendered or supervised by a registered professional nurse and has a licensed practical nurse or registered nurse on duty at all times.

The term hospital does not include rest or nursing homes, daycare centers, medical school facilities, research laboratories, or ambulatory care facilities (e.g., surgicenters).

e. Student loan bonds

The bill continues the tax-exemption for interest on qualified student loan bonds, generally defined as under present law. These bonds include bonds issued by qualified governmental units or by qualified scholarship funding corporations in connection with certain programs of the United States Department of Education.

The bill also expands the definition of qualified student loan bond to include obligations to make or finance loans under certain State supplemental loan programs. Programs qualifying for this financing include any program of general application approved by the State to which part B of title IV of the Higher Education Act of 1965 (relating to guaranteed student loans) does not apply, if loans under the program are limited to the difference between (1) the total cost of attendance and (2) other forms of student assistance. For purposes of determining other forms of student assistance, loans made pursuant to section 428B(a)(1) of the Higher Education Act of 1965 (relating to parent loans), and loans made pursuant to subpart C.I of Title VII of the Public Health Service Act (relating to certain student assistance), are not taken into account.

As under present law, issuers of tax-exempt student loan bonds (other than bonds not issued in connection with a Department of Education guarantee) may not restrict availability of bond-financed loans based upon (1) legal residence of individuals attending schools located within the State, or (2) the location of schools attended by legal residents of the issuing State. Rather, loans financed with these bonds must be available on a nondiscriminatory basis to all individuals attending schools located within the State and to all legal residents of the State, regardless of the location of the schools they attend. As is required with respect to all nonessential function bonds, all student loan bond proceeds (other than proceeds used to pay costs of issuance and amounts invested in a reasonably required reserve or replacement fund) must be used to make or finance loans to individuals for educational expenses.

f. Qualified redevelopment bonds

In general

The bill provides tax-exemption for the interest on a new category of bonds issued by qualified governmental units, qualified redevelopment bonds. Qualified redevelopment bonds are bonds which are part of an issue (1) all the net proceeds of which are to be used for redevelopment purposes in a locally designated blighted area, and (2) with respect to which property tax revenues (or their equivalent) attributable to any increase in real property values by reason of bond-financed redevelopment is reserved exclusively for debt service on the issue, to the extent necessary to cover such debt service. The fact that a local government lends its full faith and credit to these bonds, in addition to earmarking incremental tax revenues, does not affect their status as qualified redevelopment bonds.

Real property taxes imposed in the designated blighted area must be imposed at the same rate and in the same manner as taxes on other real property located in the same jurisdiction. Additionally, no owner or user of property in the designated area may be subject to a charge or fee (other than real property taxes) which is not imposed on similarly situated owners or users in the designated area or elsewhere in the jurisdiction.

Qualified redevelopment bonds may be issued only pursuant to a State law which authorizes the issuance of such bonds for use in blighted areas. Additionally, the bonds must be issued pursuant to a redevelopment plan adopted by the governing body of the general purpose local governmental unit (e.g., the city, or if not located in a city, the county) having jurisdiction over the designated blighted area, before the issuance of the bonds.

Qualified redevelopment bonds may not be repaid, and the repayment of the bonds may not be secured, by any nongovernmental person, other than by means of incremental real property tax revenues (as described above). Thus, bonds which are IDBs under present law may not be qualified redevelopment bonds.

These new restrictions do not affect the tax status of bonds used for governmental activities such as construction and repair of streets and sidewalks or other similar essential government functions. For a description of the rules governing such bonds, see the discussion of bonds for essential governmental functions, above.

Qualified redevelopment activities

Qualified redevelopment bonds may be used only for specified redevelopment purposes. The purposes for which these bonds may be issued are (1) to acquire (pursuant to the power of eminent domain or the threat of exercise thereof) real property in a designated blighted area, which real property is subsequently to be transferred to non-