

Dear Council Member:

Oh My Goodness! I do not envy you this task of trying to fit a square peg into a round hole for this upcoming Ordinance Reading of a lease for a portion of 801 Magnolia! Because it actually cannot be done. At a **minimum** you will need to table this "Reading" in order to amend the proposed lease to provide contingencies protecting both the City and The Piedmont Center For The Arts entity. The actual appropriate procedure at this point would involve seeking serious legal and tax advice, which I am confident will lead to the conclusion that this proposed lease is a very ill-advised action for the City to take.

THE EXISTING ROUND HOLE

1. Piedmont City Code Section 17.22.020 cites as a "permitted use" for Zone B **a nonprofit entity**. In the case that The Piedmont Center For The Arts, Inc ("PCA") lost its nonprofit status, the City's leasing city property to it in Zone B would no longer be permitted. Additionally, since IRS required all of PCA's assets to be irrevocably dedicated to charity, a loss of its exempt status would mean such assets would have to be distributed to other charities.

2. The "charitable purpose" of PCA in 2011 was to "lessen the burdens of government" by taking on the renovation of a public building which had been a wasting city asset for 8 years. City Administrator Grote made the finding, at the time, that the PCA's proposed activities were the government's burden (See Video of Council Meeting, March 7, 2011). The stated intention of PCA, at that time, was, after raising private money & fixing it up, to lease the premises for the purpose of providing Exhibit and Performance space for the arts for free. There was no objective statement, at the time, that the City considers the exhibiting and presentation of performance arts to be the government's burden. Thus the free "arts" space was not charitable because it lessened a government burden; rather because it was furnished to Piedmonters with donative intent.

3. Section 1.501(c)(3) of the Income Tax Regulations provides that in order to be exempt as an organization described in such section, the organization must be one that is both organized and operated **exclusively** for one or more of the purposes specified in that section, i.e. charitable, educational, literary. PCA does not carry on active educational services or publishing or book selling services; it only acts as an intermediary between the City (as owner of the building) and arts rental users. Therefore there must be a finding of an "exclusively charitable purpose" in its organization and operation **in order for PCA to retain exempt status**.

4. The current "services" provided by PCA consist of booking the venue for performances and art exhibits. The Staff Report dated Nov. 16, 2020, states its finding that PCA's "primary exempt purpose is to 'provide an affordable rental venue for artists to showcase their talents.'" The Staff Report further expresses its opinion that "with Piedmont Community Hall and the Piedmont Veteran's Memorial Building as a frame of reference, PCA's usage fee schedule indicates it is an affordable rental venue. **Unfortunately, this is not the right question or standard for a claim of nonprofit status**. And it is not an acceptable "primary exempt purpose" just to provide a rental venue that is cheaper than the \$840 charged by the Community Center or the \$700 charged by the Veteran's Hall. This purpose completely **lacks the donative intent required for exempt status**.

4. According to the PCA's filed tax returns for 2018 & 2019, the **rental fees** charged "for the arts" in 2018 were **29% above PCA's actual costs**; in 2019 such rental fees were 11.6% above their actual costs. It is hard for an exempt organization to sell services, even below market but above cost, and have those services considered part of an exempt activity.

5. IRS Rev. Ruling 72-369 (attached as Exhibit. A) found that the organization in question in that

Ruling was regularly carrying on services for a fee that ordinarily would be carried on for profit. "The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. **Furnishing the services at cost lacks the donative element** necessary to establish this activity as charitable. Accordingly it is held that the organization's activities are not charitable and therefore the organization does not qualify for exemption under section 501(c)(3)."

6. PCA does not actively solicit donations, or rely on donations to "subsidize" its rental fees to artistic groups. PCA operates a commercial website and has substantial advertising expenditures (According to PCA's tax returns, these were 19% of total costs in 2018,; 27% in 2019.). Its clients are private. These are all "commercial" characteristics of what is, in essence, a very profitable real estate operation.

7. The actual services provided by PCA are "commercial in nature". It rents out a building to performers, a business group (BNI) and a commercial sub-tenant at a profit. It is hard not to conclude that PCA operates as a for-profit entity. It maintains substantial unrestricted cash accounts and investments.

8. The Staff Report finds that "PCA's 2016-2019 tax forms indicate compliance with the requirements of retaining tax-exempt status." This appears to be accurate for the tax period cited. However, when the data from the year 2020 is added to the 5 year cumulative tabulation used to justify such status, PCA will no longer comply. Under Section 509(a)(2) of the IRS Code, an exempt organization may not receive more than 1/3 of its total support from gross investment income. At the due date of its 990 Tax Return on May 15, 2021, PCA's 2020 return will no longer be able to support that requirement of retaining tax-exempt status. I have verified this with a CPA specializing in exempt organization taxation.

9. The reported gross revenue of the Community Center in Fiscal Year 2018-2019 was \$449,482 (As reported by the City Clerk.). During Calendar Year 2019, the PCA was un-used for over 65% of its available time (measured by the 9.5 daily hours available at other Rec. facilities). The lost "opportunity cost" here by the City is upwards of \$260,000 and those would not be from activities taken away from other facilities. The demand for Recreation Department programs has only been increasing; every year many applications for space have to be turned down (See Exhibit B for rental revenue estimates of the 801 facility.).

THE PROPOSED SQUARE PEG

1. The proposed Lease Agreement, as a contract between the City of Piedmont and the PCA, does not provide any benefit to the City. Ordinarily, something of value has to change hands. The proposed Agreement states that some unspecified benefit, some "consideration" **has already been received** by the City in exchange for them handing over control of their City building for 10 years. "In consideration of other good and valuable consideration, receipt and sufficiency of which is **hereby** acknowledged. ." Mere words are insufficient if the benefit of the bargain is not specified. This Agreement says, basically, the City gets nothing but PCA gets control of its building for 10 years and can charge what it likes to whomever it is willing to rent to. The City may want to do this give-away, but the Proposed Lease Agreement may be questionable as a valid contract without something of value flowing to the City from this deal.

2.. **The City may not make a gift of public funds.** Providing a City-owned building rent-free is the same as giving away revenue that belongs to City residents. In 2011 PCA committed to renovating 801 Magnolia with donated private funds. In the Proposed Lease Agreement, PCA does not commit to providing any work to offset government expense, much less an amount commensurate with what

could be earned by the Recreation Department renting out the facility.

3. Staff Report says PCA **will** maintain and improve the City building and **will** provide low-cost arts programming to the community ; however the **actual lease terms** say that PCA is “authorized” to make major and minor alterations, not required, and has **the “ability”** to rent the venue to performing arts groups plus **the right** to charge user fees for non-arts rentals to BNI, (the business networking group), garden clubs, even the Piedmont Ed. Foundation (See P 15.1).

4. The prior lease gave PCA a 10 year lease in exchange for the City’s **“requirement”** that PCA make improvements to the property specified in the lease. Tenant was **required** to do all the specified construction & work, and to maintain all portions of the premises with City maintaining only the landscaping and sidewalk. Tenant was **required** to promptly remove litter, graffiti and all trash from the area immediately surrounding the premises as well as the storage areas. This Proposed Agreement has City maintaining all exterior, all structural integrity (including seismic) plus landscaping and sidewalk maintenance. PCA no longer has to even pick up the trash left by renters or others using the side patio or front lawn.

BOTTOM LINE

This Proposed Lease Agreement, as written, lacks any standards or requirements for the operation of a private group given control of a public building. There are no requirements for PCA to fairly rent the facility to all Piedmonters at, or below, rates reflecting its minimal costs. It cites unspecified past consideration as what the City is getting in addition to its \$1.00, which = nothing. It contains no contingent provisions, in favor of the Landlord, providing for consequences if the Tenant loses its nonprofit status. It contains zero provisions for what might happen to the nonprofit’s considerable assets in the event of loss of its nonprofit status.

A rushed and ill-considered Proposal coasting on prior good will. I urge you to examine the consequences of trying to make this all fit together. . .and to what end? The popular exhibits & performance offerings of The Piedmont Center can be retained by giving it free hours of usage in a Recreation Department-run building. For 20 years such an arrangement was made by the PUSD with The Piedmont Light Opera Theatre, resulting in wonderful summers of theatrical musicals enjoyed by all.

-Nancy Lehrkind

An organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code; Revenue Ruling 71-529 distinguished.

Advice has been requested whether an organization that otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 is operated for charitable purposes when engaging in the activities described below.

The organization was formed to provide managerial and consulting services for nonprofit organizations exempt from Federal income tax under section 501(c)(3) of the Code to improve the administration of their charitable programs.

The organization enters into agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The services consist of writing job descriptions and training manuals, recruiting personnel, constructing organizational charts, and advising organizations on specific methods of operation. These activities are designed for the individual needs of each client organization.

Receipts of the organization are from services rendered. Disbursements are for operating expenses.

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

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

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test' the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and the applicable regulations.

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

charitable.

Accordingly, it is held that the organization's activities are not charitable and therefore the organization does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

This case is distinguishable from the situation where an organization controlled by a group of exempt organizations and providing investment management services for a charge substantially less than cost solely to that group qualifies for exemption from Federal income tax under section 501(c)(3) of the Code. See Rev. Rul. 71-529, C.B. 1971-2, 234.

Exhibit A
Page Two

Nancy Lehrkind

November 13th, 2020 at 2:57 pm

Thank you for your participation. Your comment will be reviewed and considered for publication.

Replying to the question of whether the Recreation Department could realize revenues exceeding \$200,000/year by renting out 801 Magnolia's West Wing while STILL giving The Piedmont Center some 450 hours of FREE usage to do the same venue rentals they do now, here is a rough calculation for that figure:

The Recreation Dept. would take over renting to the BNI group (\$15,000/year), the Post (\$15,000/yr), The East Bay Children's Choir (\$7,000/year est.), Community Group Fundraisers (\$2000/yr. est) and to teachers for recitals (\$6,000/yr. est.). that comes to 44,000. In June, July & August, when PCA presents few arts groups to the public (4 in June, 2019 for 20 hrs; 6 in July for 27 hrs; 4 in Aug. for 26 hrs.), the Rec. could run summer camps. 5 weeks of kids' yoga/hip-hop (\$37,275) & 2 of Princess Ballet (\$9000), plus 8 weddings a month on the weekends (\$146,400 based on S/S resident fees at Community Center), amounts to \$236,000. Add in two weeks vacation camps (ski week & Xmas) when the "going rate", based on the current Rec. "Camp Smart" of \$1100 for a max of 56 students (assuming 30, that would be \$66,000) for a grand total of \$302,000 while leaving plenty of time for PCA's art exhibits and musical offerings. 801 Magnolia far exceeds the cold, sterile atmosphere of the Veteran's Hall for a wedding. And, N.B.: today's mobile caterers no longer cook in kitchens! Bottom Line: The City's opportunity cost for again giving up control of 801 Magnolia is truly closer to \$300,000.

Exhibit B