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Private Letter Rulings & Technical Advice Memoranda (1950 to Present)

2013

PLR/TAM 201343031 - 201343001

PLR 201343028 -- IRC Sec(s). 501, 11/01/2013

Private Letter Rulings

Private Letter Ruling 201343028, 11/01/2013, IRC Sec(s). 501

UIL No. 501.03-19

Exempt orgs.-exempt status-final adverse determinations.

Headnote:

IRS issued final adverse determination revoking Code Sec. 501(c)(3); org.'s exempt status, effective stated date, where org. wasn't operated exclusively for exempt purposes because substantial part of its assets inured to private benefit of its founder, and substantial amount of its charitable assets were used for private purposes.

Reference(s): Code Sec. 501;

Full Text:

Release Number: **201343028**

Release Date: 10/25/13

Date: July 20, 2013

Taxpayer Identification Number: [Redacted Text]

Person to Contact: [Redacted Text]

Tax Period(s) Ended: [Redacted Text]

UIL: 501.03-19

A



B

C


D

Certified Mail

Dear [Redacted Text]


This is a final adverse determination regarding your exempt status under  section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under  section 501(c)(3) of the Code effective January 1, 2008.


The revocation of your exempt status was made for the following reason(s):

A substantial amount of your organization's assets inured to the private benefit of your founder. Because a substantial amount of your charitable assets were used for private purposes, the organization is not operated exclusively for exempt purposes described in  section 501(c)(3) of the Code.

Contributions to your organization are not deductible under  section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of revocation, you are considered to be taxable private foundation until you terminate your private foundation status under  section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

You have waived your right to contest this determination under declaratory judgment provisions of  section 7428 of the Internal Revenue Code.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892

Date: April 12, 2012

Taxpayer Identification Number: [Redacted Text]

Form: [Redacted Text]

Tax Year(s) Ended: [Redacted Text]

Person to Contact/ID Number: [Redacted Text]

Contact Numbers:

Telephone: [Redacted Text]


Fax: [Redacted Text]

ORG

ADDRESS

Certified Mail - Return Receipt Requested

Dear [Redacted Text]



We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under  section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies.  Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with  section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at: [Redacted Text]

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing

Director, EO Examinations

Enclosures:

Publication 892


Publication 3498


Report of Examination

ISSUE:

Whether ORG, operates exclusively for exempt purposes.

FACTS:

ORG, (ORG) was incorporated in the state of State as a Non-profit (Non-Stock) - Domestic Corporation on July 22, 19XX. ORG was recognized as tax-exempt by the Service as an organization described in Code  section 501(c)(3) in a determination letter dated February 14, 20XX. ORG was also determined to be a publicly supported organization during its advanced ruling period.

The following activities are listed on the Form 1023, Application for Recognition of Exemption under  Internal Revenue Code Section 501(c)(3), Part II, #1, Activities and Operational Information:

The organization is formed to host high school sporting events around the country. Formed at the request of participating school principals, athletic directors, and coaches, participation in these events and open to high schools of any size, type, strength, or geographic location. Currently contests in football, boys and girl's soccer, boys and girl's basketball, girl's field hockey, and girl's volleyball are occurring. All events are known and sanctioned by the local and state high school organizing bodies of each team that participates and the National Federation of High School Associations. The contests take place in several cities across the country. Additional sports and cities will be added as resources allow as to make these athletic and scholarship opportunities available to more students."

The purpose of the events is the purpose of the organization. It is to provide high school athletic programs of all sizes and competition levels with an opportunity to further develop and demonstrate the educational aspects of sports through the competition of interstate interscholastic athletic competitions; exposure to world-class competition facilities; experience in team travel and travel participations; the responsibility of

representing their organization through sportsmanship and citizenship; and the opportunity to provide exposure to themselves, their team, their school, and their community; and to accomplish these objectives while providing continuing education scholarships to participating student-athletics.

All of the organizations' time is spent either: 1) marketing to and preparing participating teams to travel; 2) organizing and producing the event and 3) securing funding to cover the event cost and the scholarships given to each participating team. This work is preformed primarily by the Executive Director with great leadership and volunteer assistance from the Board of Directors. Actual Events employ the use of Event Volunteers.

ORG hosts high school sporting event competitions at the professional sports facilities located in CO-1 in City, State, for high schools located in 46 of 50 states of the United States of America. The 5-day events are for both male and female sports activities; the sports hosted are: Baseball, Basketball, Lacrosse, Softball, Football, Field Hockey, Track and Field, Volleyball, Wrestling, and Cheerleading. During the 5 day stay, the teams participate in around 1 to 3 games, depending on the sport. The teams stay at CO-1 and are able to take in all the entertainment it offers, while not participating in the ORG sporting events. If the sporting event were not hosted by a charitable organization, none of the 46 State Athletic Association would allow their high school sports teams to participate in the experience.

CO-2 (CO-2), a for-profit corporation, conducts business from the same location as ORG and shares two of three common board members: husband and wife, BM-1 and BM-2. CO-2 performs the marketing for ORG. An interested team submits a ORG application, along with a minimum deposit, to CO-2. CO-2 then invoices the team for the remaining amount due and deposits the check into its checking account.

At this point, ORG invoices CO-2 for a tournament entry fee of \$\$ to \$\$, tournament related costs, and the amounts that were being charged by CO-1 for meals, hotels, park passes, special events, and the facility where the tournament takes place, plus an additional 3 percent to pay ORG employee salaries.

A participating team typically holds fundraising events to cover expenses and submits partial payments to CO-2 until the invoice is paid in full. CO-2 records the expenses of the airfare and land transportation on its books and records; no part of these expenses are recorded on ORG's books and records. CO-2 pays ORG for tournament costs on an allocated basis per payment received and uses the remaining moneys not sent to ORG for travel expenses recorded on CO-2 books and records; CO-2 keeps any residual dollars submitted by each team.

The following descriptions of both organizations' activities were submitted by ORG:

Marketing

CO-2 Enterprises markets to High Schools via Email and Faxes. Primary Department of the Treasury-Internal Revenue Service Explanation of Items marketing is from hosting State Dinners which are organized by our Steering Committee Coaches. We found over the years that majority of our new Schools were being referred by other teams that had participated. By hosting these dinners we are creating a relationship with these coaches that is ensuring a more memorable experience."

Team Booking

A Coach will either request information over the phone, website or at one of our dinners. CO-2 will then make a travel proposal for the school which includes meals, hotels, park, passes, special events, and the tournament they will be participating in. There are many other inclusions but those are the primary ones. The packages are bundled and is [sic] not an Ala Carte option for them. Once a team decides they are going to attend they complete a Team Application which is a ORG [Redacted Text] Document and submit it typically with a team deposit. At that time a team is invoiced from CO-2 and a [sic] invoice is made from ORG [Redacted Text] to CO-2 for booking the team into the tournament.

Receivables

Majority of teams are fundraising to participate in this event so they are set up on payment plans. Teams will typically make 4 to 5 payments throughout the process. Payments will be sent into CO-2 on behalf of the schools for a tentative number of participants. As invoices adjust in CO-2 they will be adjusted in ORG [Redacted Text] as well.

Payments

As payments are required to suppliers CO-2 will pay its bills to ORG [Redacted Text] All event items are paid through ORG [Redacted Text]. Facility rental, officials, hotels, park passes, etc. CO-2 pays for travel related items such as buses and airlines.

Expenses

Primarily all expenses are recorded in CO-2 Enterprises except for a few salaries in ORG [Redacted Text] ORG [Redacted Text] charges a tournament entry fee of \$\$ - \$\$, plus % to cover the salaries.

Travel Experience

From the time the team gets on the plane back home until the time they are on their way back we handle all the details for them. When a team arrives at the airport we will meet them at baggage claim and load them on buses to the hotel. When a team arrives at a hotel we have a check in area that is special just for our participants. Coaches won't even need to go to the front desk and check in their team. We are creating a "College Like" road trip feel for the team and the coach where all the coach needs to worry about is Coaching. During their stay they will typically play 1 to 3 games a day and also attend some type of attraction. Attractions range from CO-1, CO-3, CO-4, CO-5, and so on.

Scholarship Awards

At the end of the school year ORG [Redacted Text] sends out notifications to all our participating coaches for that school year. Each coach is responsible to nominate one graduating senior to be awarded a \$\$ to \$\$ Book Scholarship.

Ultimately it is up to the coach who is awarded this but we do have a list of criteria that we would like them to follow. The entire experience is much more than [sic] who the best athlete is. It is more about who is a team leader, involvement in the community, overcoming adversity, improving grades and so on and so on. Once the school has their Book Scholarship winner that same student athlete is then eligible to enter our Essay Competition. The topic is different each year and is chosen by our Steering Committee Coaches. These same coaches are also the ones that will read all the essays and determine the winner. Each of our sports will receive a Essay Scholarship winner. Volleyball, Field Hockey, Football, Boys and Girls Basketball, Wrestling, Baseball, Softball and Boys and Girls Lacrosse. Scholarship amounts are determined on the size of the tournaments participation. Scholarships typically range from \$\$ to \$\$ per sport. The payments are made out to the College that the winner will be attending and can be used for any college related expenses."


CO-2, a for-profit entity, receives benefits from making the travel arrangements for all travel related to a ORG event . ORG stated that approximately [Redacted Text] percent of CO-2's business is derived from ORG events.


Since CO-2 deposits all receipts associated with an athletic competition hosted by ORG on its books and records and pays ORG the cost plus [Redacted Text] percent for tournament related costs (mostly payments to CO-1), the income inures to CO-2, the for-profit entity operated by the officers of ORG.


The total amount of scholarships given by ORG. are small compared to the revenues reported. ORG reported on its Form 990 for 20XX scholarships in the amount \$\$ and gross receipts of \$\$\$. For the 20XX, ORG reported scholarships in the amount of \$\$ and gross receipts of \$\$.

ORG stated that in order for a high school team to be allowed to participate in an amateur sporting event, that event must be hosted by a non-profit organization pursuant to the guidelines of the State Athletic Associations.. In the past, CO-2 asked Rotary Clubs to "host the amateur sporting activities;" though "hosted" by the Rotary Club, all financial transactions were reported on CO-2's books and records. An officer of CO-2 researched other organizations that conduct music competition events in a similar manner and decided to establish an exempt organization to host the sporting events, making the whole process much easier for CO-2 to manage. The organizations on which ORG stated that it modeled its operations were [Redacted Text] and [Redacted Text]

LAW:


Organizations that are exempt from federal income tax under  Internal Revenue Code section 501(c)(3) are described as follows:



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

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

Prohibited private interests include those of unrelated third parties as well as insiders. Christian


Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to be a part of a "franchise system which is operated for private benefit; therefore, the Tax Court determined that it should not be recognized as exempt under  section 501(c)(3) of the Code. est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the "est" body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations."

The Tax Court in Wayne Baseball, Inc., v. Commissioner, T.C. Memo 199-304, held that an adult amateur baseball league could not be described in  section 501(c)(3) because a substantial part of the league's activities furthered the social and recreational interests of its members. The Tax Court determined that the sponsoring of an adult amateur baseball team furthered the team members' social and recreational interests to a more than insubstantial extent; accordingly, the Tax Court determined that the organization did not operate exclusively as a  section 501(c)(3) organization. Id.

GOVERNMENT POSITION:

It appears that ORG is organized and operated primarily to benefit CO-2, a for-profit organization, rather than to achieve a tax exempt purpose such that it is similar to the organization described in est of Hawaii, 71 T.C. 1067. In addition, ORG operates to promote the social and recreational interests of the team members who participate in its events with such activities as visits to CO-1 as part of the event packages, making it similar to the organization in Wayne Baseball, T.C. Memo. 19XX-304.

CO-2 receives a benefit from being the only for-profit organization used to book travel arrangements for ORG events. ORG has not established that "it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."  Treas. Reg. §

1.501(c)(3)-1(d)(1)(ii). Rather, ORG was created to meet each State Athletic Association's requirement that an event must be hosted by a charitable organization in order for a high school team in that state to participate in a sporting event and to provide a stream of business opportunity for CO-2. Like the organization in est of Hawaii, 71 T.C. 1067, the organization appears to have been established for the benefit of CO-2, a for-profit entity, in order to provide the main stream of revenue for it and appears to have no life independent of CO-2.

TAXPAYER'S POSITION:

We believe that the facts reflect that the organization is fulfilling its exempt purpose as originally requested on Form 1023, Application for Recognition of Exemption. Internal Revenue Services in a determination letter to the taxpayer in response to form 1023 approved their application for recognition of exemption.

In reviewing your letter dated April 12, 20XX in which you propose revocation of the taxpayer's exemption, it appears that the primary issue which leads you to your determination that the taxpayer's exempt status should be revoked is that ORG (ORG) utilizes the services of an entity known as CO-2 We stipulate that the facts reflect the owners and officers of CO-2 are also officers and directors of ORG. We further stipulate that a substantial portion of CO-2's revenues arise from services preformed for ORG. However, we believe that the facts reflect that there is no private enurement to CO-2 from these activities. In fact, CO-2 has in recent years reflected operating loses and, other than reasonable salaries paid to employees and the officers of CO-2 for their services, no amounts have enured to their benefit.

In addition, we provided you with evidence to show that this type of relationship between a for-profit entity and a not-for-profit entity in this industry (that being provision of travel services and the hosting of youth sports events) is very typical.

Further, you make a reference in your report to various cases supporting the government's position that ORG is essentially no more that a glorified travel agent, we have reviewed these cases and do not believe they are on point.

We believe that the IRS has not appropriately considered all of the evidence provided; importantly, but not limited to, the mischaracterization of ORG as an organization formed to promote the social and recreational interest of team members. Rather, we believe it is apparent from all of the evidence available to the field agent that ORG is fulfilling its exempt purpose as reflected on Form 1023 and as approved by the IRS determination letter.

We respectfully request that this information be reviewed by an appeals officer along with testimony that we provided.

ORG has entered into contracts to provide events for various youth groups through December 20XX. As an alternative to appealing the revocation, if the IRS would agree to allow ORG to cease operation and liquidate as of December 31, 20XX, we would agree to that.

CONCLUSION:

ORG is not operated exclusively for one or more exempt purposes, and it provides private benefit to shareholders or individuals associated with CO-2, a for-profit entity.. Accordingly, the exempt status of ORG is revoked as of January 1, 20XX.