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

2013

PLR/TAM 201350049 - 201350001

PLR 201350042 -- IRC Sec(s). 501, 12/13/13

Private Letter Rulings

Private Letter Ruling 201350042, 12/13/13, IRC Sec(s). 501

UIL No. 501.03-00

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. failed to file protest to proposed adverse determination within requisite 30 days.

Reference(s): Code Sec. 501;

Full Text:

Number: **201350042**

Release Date: 12/13/2013

Date: September 17, 2013

Contact Person: [Redacted Text]

Identification Number: [Redacted Text]

Contact Number: [Redacted Text]


Employer Identification Number: [Redacted Text]



Form Required To Be Filed: [Redacted Text]




Tax Years: [Redacted Text]


UIL: 501.03-00

Dear [Redacted Text]:

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in  Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code  section 501(c)(3), donors may not deduct contributions to you under Code  section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code  section 6110, after deleting certain identifying information. Please read the enclosed  Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in  Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code  section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Karen Schiller

Acting Director, Exempt Organizations

Rulings & Agreements

Enclosure

 Notice 437

Redacted Proposed Adverse Determination Letter

Redacted Final Adverse Determination Letter

Date: April 12, 2013

Contact Person: [Redacted Text]

Identification Number: [Redacted Text]

Contact Number: [Redacted Text]

FAX Number: [Redacted Text]

Employer Identification Number: [Redacted Text]

UIL: 501.03-00

Legend:

Internet donation service =


Networking event =


Corporation =

Website =


Tech =

Dear [Redacted Text]:


We have considered your application for recognition of exemption from Federal income tax under  Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you

do not qualify for exemption under Code  section 501(c)(3). The basis for our conclusion is set forth below.

Facts:

You applied for tax-exempt status under  section 501(c)(3), but failed to indicate the type of public charity status you are requesting. Your amended Articles of Incorporation state that your primary purpose is to:

[I]ncrease charitable giving from individuals and decrease the cost of fundraising for nonprofits by providing the public with a safe, easy, efficient way to give to the charity of their choice and by creating an online community for nonprofits, profits and people; enabling non-profits to engage supporters through low-cost online fundraising; and helping profit market their business and products while supporting a charitable or non-profit. [sic]

You also state that you are organized for charitable and educational purposes to make distributions to  section 501(c)(3) organizations. Furthermore, you will organize weekly networking events for non-profits and businesses at which community volunteers will speak about various business topics. You describe these as educational.

You entered into an agreement with Corporation, a for-profit entity that your founders and officers created to manage a social network Internet site, including the advertising and e-commerce on it. (**See attachment**) You plan to create and maintain a web page for each charity registered with you on a website that Corporation manages and maintains. Thus, you provide information about the non-profits participating in your Internet donation service to the Corporation's clients. The Corporation will transfer through you a percentage of its Internet sales as donations to various tax-exempt organizations. Therefore, you will accept, process, and forward donations received from the Corporation's e-commerce website to your participating non-profits. A majority of your time and resources are devoted to these activities. According to a fundraising agreement you entered into, you only serve as the administrator of the funds donated through the website.

The transaction works in the following manner. Corporation will donate 10 percent of transaction fees generated by activity on its e-commerce website. Either the buyer or the seller of the product purchased on the website may select an exempt organization registered with you to receive a portion of the transaction fee. If neither party selects a registered tax-exempt organization, you will select one at random from those registered with you. You will retain the donation for 45 days in case there is a problem with a transaction which may require a refund of the donation You state that you do not plan to charge any fees to your clients, but you plan to keep a portion of each donation you received from the Corporation. At different times, you described your share as 5 percent, 10 percent, or "no more than 20

percent." So, for a \$200.00 purchase on Corporation's website, you will receive \$20.00 (10 percent) from the transaction. You may keep \$1.00 (5 percent for example) as a fee and send \$19.00 to the registered tax-exempt organization. Users of the social network site may also donate to one of the registered charities without transacting business. You will transfer these donations as well, but will deduct 3.5 percent as a fee.

Only non-profits registered with you may receive donations that originate from the Corporation's e-commerce website. You plan to manage all web pages and information about non-profits participating on Corporation's e-commerce website. Corporation will provide the hardware and software to facilitate the operation of the Internet donation service, and Tech will provide IT support. All non-profits wanting to participate on Corporation's e-commerce website must register with you.

You plan to organize free weekly Networking events for non-profits, for-profits, and individuals to develop business-networking relationships and promote business connections. The meetings will present training material and other information on Internet marketing as well as sales and technology to ensure that nonprofits keep ahead in technologies. Speakers from the community will provide advice. You will provide the facilities and live forum for business people to exchange business ideas, referrals, contact, services, and business.

Ninety-five percent of your funding will come from your share of the Corporation's 10 percent transaction fee as indicated above. You expect that the remaining 5 percent of your revenue will come from direct donations.


You also have a close relationship with Tech, a for-profit technology company. Your CEO and President is also the CEO and President of Tech. Your Vice President and Treasurer is also the Vice President of Tech. These two individuals are husband and wife, respectively, and receive their compensation from Tech, and are two of your three directors. Furthermore, you share office space with Tech and Corporation



You have an agreement with Tech that provides for IT support services as well as administration and maintenance of your social networking internet site. The agreement specifies that you will reimburse Tech for out-of-pocket expenses, such as bank transfer fees, long-distance calls, photocopies, computer printouts, fax charges, messenger services, and local or out-of-town travel incurred in connection with this agreement. You indicated that Tech could serve non-profits that participate in your services but you stated that you and Tech would not "cross market" one another nor share customer information.


You initially stated that you plan to assist small for-profits with internet marketing of their businesses and products. You subsequently indicated that you would limit your fund raising activities to only nonprofits. However, you still plan to include small businesses in your social networking activities and e-commerce. You will only offer Internet donation services to non-profits recognized as tax-exempt by the Internal Revenue Service, and the non-profits must agree to use all donations received from you in accordance with their tax-exempt status.



You currently do not have any employees; and officers, directors, trustees are uncompensated, with one exception. You project that the CEO will receive \$20,000.00 in annual compensation. You, Corporation, and Tech share the same officers and directors, as well as office space. Your principal officers, as previously stated, are husband and wife.


Law:



 Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations which are organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.


 Section 1.501(a)-1(c) of the Income Tax Regulations states that "[t]he words 'private shareholder or individual' in  section 501 refer to persons having a personal and private interest in the activities of the organization."

 Section 1.501(c)(3)-1(b)(1)(iii) states that an organization is organized exclusively for one or more exempt purposes only if its articles limit its purposes to one or more exempt purposes and do not expressly empower it to carry on activities which are not in furtherance of exempt purposes.

 Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it is engaged primarily in activities which accomplish one or more of such exempt purposes specified in  section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.


 Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement 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.


 Section 1.501(c)(3)-1(d)(3) defines the term 'educational' for the purposes of  section 501(c)(3) as including the instruction of the public on subjects useful to the individual and beneficial to the community.


 Rev. Rul. 76-206, 1976-1 C.B. 154, considered an organization formed to promote broadcasting of classical music in a particular community. The organization carried on a variety of activities designed to stimulate public interest in the classical music programs of a for-profit radio station, including soliciting sponsors, soliciting subscriptions to the station's program guide, and distributing pamphlets and bumper


stickers encouraging people to listen to the station. The organization's board of directors represented the community at large and did not include any representatives of the for-profit radio station. The revenue ruling concludes that the organization's activities enable the radio station to increase its total revenues and therefore benefit the for-profit radio station in more than an incidental way. Therefore, the organization is serving a private rather than a public interest and does not qualify for exemption.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 [34 AFTR 5] (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

American Institute for Economic Research v. United States, 302 F.2d 934 [9 AFTR 2d 1426] (Ct. Cl. 1962), cert. denied, 372 U.S. 976 (1963), described an organization that had a stated aim of teaching and disseminating economic knowledge, published two semi-monthly periodicals available for subscription, and provided investment advice services for a fee. The court held that this organization did not qualify for exemption under  section 501(c)(3) of the Code, because its commercial purpose was primary and not incidental to its educational purpose.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve 501(c)(3) purposes because it also served private interests more than incidentally. The court found that persons affiliated with a particular political party created and funded the organization and that most of the organization's graduates worked in campaigns for that party's candidates. Consequently, the court concluded that the organization conducted its educational activities to benefit the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of  section 1.501(c)(3)1(d)(1)(ii) of the regulations.

In Christian Manner Int'l. Inc. v. Comm'r, 71 T.C. 661, the petitioner organized for religious and educational purposes, published and sold books that its founder wrote. The Tax Court found that the organization's actual purpose was to benefit the founder, by publishing his books and promoting his theories. Even if the publication of his books in part furthered religious or educational purposes, petitioner would still not qualify for exemption under  § 501(c)(3) because a substantial part of its activity benefited him personally.

In Easter House v. United States, 12 Cl.Ct. 476 (1987), aff'd w/o opinion, 846 F.2d 78 (Fed. Cir. 1988), the court found that an adoption agency was not entitled to exemption from federal income tax under  section 501(c)(3) of the code because it operated in a manner not "distinguishable from a commercial adoption agency." The taxpayer did not solicit contributions, its operation made substantial profits, and


there was a substantial accumulation of capital surplus in comparison to direct expenditures by the taxpayer.

In P.L.L. Scholarship v. Commissioner, 82 T.C. (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The court reasoned that, because the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The court was not persuaded:


A realistic look at the operations of these two entities, however, shows that the activities of the taxpayer and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accountings of receipts and disbursements do not change that fact.



The court went on to conclude that, because the record did not show that the organization was operated for exempt purposes, but rather indicates that it benefited private interests, exemption was properly denied.

In Church By Mail, Inc. v. Commissioner, T.C. Memo 1984-349 [¶84,349 PH Memo TC], affd 765 F. 2d 1387 [56 AFTR 2d 85-5483] (9th Cir. 1985), the Tax Court found that a church was operated with a substantial purpose of providing a market for an advertising and mailing company owned by the same people who controlled the church. The church argued that the contracts between the two were reasonable, but the Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."



In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36 [¶89,036 PH Memo TC] (1989), the court concluded that the petitioner was not described in  section 501(c)(3). The petitioner was organized to provide continuing medical education to physicians. To this end, it took physicians on three-week tours throughout the world. The petitioner shared offices with a for-profit travel agency that the petitioners' principle officer controlled. It made all its travel arrangements through the agency. The court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It also found that the tour activities served a substantial recreational purpose.

Rationale:


Based on the information you submitted, for the reasons explained below, we have concluded that you are not operated exclusively for one or more tax-exempt purposes within the meaning of  §501(c)(3).





We have also concluded that you benefit private interests more than an insubstantial amount rather than furthering a public purpose under  §§ 1.501(c)(3)-1(c)(1) and  1.501(c)(3)-1(d)(1)(ii).

Organizational Test


To qualify for exemption from federal income tax, you must be organized exclusively for tax-exempt purposes within the meaning of  § 501(c)(3) and  1.501(c)(3)-1(b)(1)(iii). You were formed to "increase charitable giving from individuals and decrease the cost of fundraising for nonprofits by providing the public with a safe, easy, efficient way to give ... and by creating an online community for nonprofits, profits and people; and helping for-profit market their business...." None of these purposes constitute a tax-exempt purpose as defined by the code and regulations. Therefore, your Articles of Incorporation do not limit your purposes to those recognized as taxexempt, and you are not properly organized.

More than Insubstantial Non-Exempt Purpose

Although an organization may carry on activities that further one or more exempt purposes, it will not be treated as operated exclusively for a tax-exempt purpose if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.  Section 1.501(c)(3)-1(c)(1); Better Business Bureau of Washington, D.C., Inc.



Your administrative, fundraising, and networking, activities do not exclusively further a tax-exempt purpose within the meaning of  sections 501(c)(3),  1.501(c)(3)-1(c)(1), and  1.501(c)(3)-1(d)(3). Your activities are primarily administrative and commercial. You plan to manage Internet pages and process contributions made by advertising and e-commerce customers of your related commercial entity on its Internet social networking site. Collecting and transmitting donations made by customers on a commercial website is not a tax-exempt purpose under  § 501(c)(3), but is merely a commercial function. Better Business Bureau, Easter House.


A minor activity you expect to engage in is to organize educational presentations about business using the internet accompanied by social networking opportunities for for-profits and non-profits. You plan to encourage and host social networking activities immediately following your seminars between potential donors and exempt organizations seeking contributions and funding. You will market these networking activities to individuals and commercial businesses.

While there may be some educational content, these activities primarily foster future commercial business transactions for the for-profit entities. The fact that you do not plan to charge for the meetings does not make this activity charitable. The educational purpose of the meetings is secondary to their commercial purpose. See American Institute for Economic Research, supra at 939 (the court held that the organization did not qualify for exemption under  section 501(c)(3) because its commercial purpose

was primary and not incidental to its educational purpose). In any case, you expect these meetings to be a minor activity.

Impermissible Private Benefit

An organization is not organized or operated exclusively for one or more tax-exempt purposes unless it serves a public rather than a private interest. To meet this requirement, 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.  Section 1.501(c)(3)-1(d)(1)(ii). You operate for the benefit of private interests rather than for the community as a whole.  Rev. Rul. 76-206.

The service that you offer to customers of the commercial website that your founders and officers own and established presumably enhances its utility and appeal. By attracting charities to use this commercial website, you increase its traffic, like the entities in P.L.L. Scholarship Fund. Adding the "registered" nonprofits to the networking events would increase their attendance, and thus attractiveness to the presenters and commercial attendees. Even if some of your activities further a charitable purposes, you would still not qualify for exemption under  section 501(c)(3) because a substantial part of your activity benefits the related for-profits rather than the public at large. See Christian Manner Int'l, supra.

Common control of an exempt organization and a commercial business presents a risk of private benefit, which is more serious if the entities engage in transactions with each other. The law of exempt organizations has long recognized the possibility that an exempt organization could be used to enhance a commercial business. Many court opinions have denied exempt status because a related business benefited from an affiliated exempt organization. For example: P.L.L. Scholarship Fund, 82 T.C. 196; Church by Mail, 765 F.2d 1387 [56 AFTR 2d 85-5483]; and Int'l Postgraduate Medical Foundation, T.C. Memo 1989-36 [¶89,036 PH Memo TC].


Therefore, we conclude that the activities you conduct with the related for-profits do not exclusively promote an exempt purpose, and thus you are not entitled to exemption from federal income tax.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code  section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

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

Please send your protest statement, Form 2848 and any supporting documents to this address:

[Redacted Text]

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

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

Sincerely,

Holly O. Paz

Director, Rulings and Agreements