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Date 7/14/97

Surname [REDACTED]

[REDACTED]

[REDACTED]

EIN: [REDACTED]

JUN 19 1997

Dear Applicant:

We have considered your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code. You claim to be a section 509(a)(1) & 170(b)(1)(A)(vi) public charity. You filed a completed exemption application with the Service on August 16, 1996.

The information submitted discloses that you were incorporated on August 7, 1996, to "be a public benefit corporation."

Your Articles of Incorporation provide that the purpose for which you are organized is to operate exclusively for charitable and educational purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1986. More specifically, you indicate that you will operate a tax-exempt entity for the benefit of individuals, businesses, foundations and other entities that wish to provide scholarships for students to pursue post-secondary education; to provide professional counseling in the establishment of scholarship programs; and to provide administrative support for the carrying out scholarship programs.

Your By-Laws indicate that you are governed by a four person self-perpetuating Board of Directors, who will elect your officers and Executive board members.

Your current officers and directors are [REDACTED]

[REDACTED] is the sole shareholder of [REDACTED]

In response to Part II of Form 1023, you state that your primary activity will be to provide a tax-exempt entity for the benefit of individuals, businesses, foundations and other entities that wish to provide scholarships for students to pursue

[REDACTED]

post-secondary education. Further, you indicate that you will provide professional counseling in the establishment of scholarship programs that achieve the donors' objectives. Also, you state that you will provide administrative support for the scholarship programs established by the donors.

You indicate that the administrative services will include the annual announcement of the scholarships, the distribution of scholarship applications and brochures, the collection of applications, and the handling of general correspondence. Further, you indicate that independent selection committees will select scholarship recipients, and that you will pay the scholarship awards to the post-secondary institutions attended by the scholarship recipients. Finally, you state that the scholarship activities will begin approximately one year after interest income is earned on funds donated to you.

You furnished no specific information in response to the information requested in Schedule H of Form 1023. You did not describe your scholarship selection procedures but indicate that the scholarship selection criteria will be consistent with IRS guidelines and regulations. You state that recipients would be selected based on selection criteria established by the donors. You state that no award would be based solely on race or employment status of the recipient or relatives of the recipient. You represent that the criteria set will be consistent with IRS guidelines and regulations. Also, you state that you do not know the number of awards or the amount of awards that will be made on an annual basis.

In response to the District's information request of October 31, 1996, you represent that you will comply "in every way with the IRS definitions of scholarships as described in ... Publication 520." Also, you state that "scholarship programs ... for employees or for children of employees will comply with ... Rev. Proc. 76-47."

You submitted an Exhibit "A" with your letter of November 6, 1996, in which you indicate how you propose to operate. This information indicates that you propose to pool the funds donated to you, and to use the interest income from the endowed funds, to provide scholarship awards. In the alternative, you indicate that donors may make an annual donation to cover the annual scholarship award.

You indicate that a minimum contribution of \$100,000 is necessary to endow a scholarship award. You indicate that this amount should provide \$7,000 in interest income and that 10% of this amount would be allocated to administrative expenses. You state that donors who make annual donations of \$25,000 could fund 20 \$1,000 scholarships with the balance allocated to pay for scholarship materials and administrative fees.

You represent that you will operate like the [REDACTED]

[REDACTED]
[REDACTED]. You state that, like [REDACTED], you will receive tax deductible donations for the purpose of providing scholarships and that you will provide administrative services for which you will charge a fee. Also, you state that unlike [REDACTED] you will not have a large staff or large administrative expenses.

In our letter of May 30, 1997, we asked you to "[e]xplain in detail how you will operate to benefit individuals, businesses, foundations, and other entities who wish to provide educational scholarships. Do not refer to how other organizations operate, but explain how you will operate." You did not specifically explain how you will operate. In response you stated that "rather than attempt to answer [our] question directly" you submitted a booklet, identified as Exhibit A, in which you highlighted certain passages, which you indicate are an accurate description of your activities.

Further, we asked you to furnish detailed information about the scholarships including (i) selection criteria used in selecting recipients, (ii) the amount and number of annual scholarship awards, (iii) the composition of the selection committee which selects the recipient, (iv) the method by which applicants learn about the scholarship program, and (v) the selection standards, criteria and award procedures you will use in making scholarship awards. You state it is impossible to specify the selection standards, criteria, and award procedures.

The information furnished indicates that you will perform a variety of administrative functions with respect to the design of scholarship programs, the preparation of the scholarship programs and applications, the receipt of the scholarship applications from applicants, and the announcing of scholarship recipients. Further, you state that you will charge fees for your services and that the fees you charge will reflect the current market rate charged by SPA.

The information furnished shows that [REDACTED] charges \$150 per hour consultation fee or \$1,000 for an eight-hour day plus expenses to establish a program, or improve a scholarship program. SPA charges an additional \$1,000 set-up fee to administer a program. SPA states that the client is responsible for all printing costs. Also, SPA charges for announcement and distribution services. In addition, if the client elects a semifinalist option, there is an extra charge for certain semifinalist services of either \$1.00 or \$2.00 per application. A fee of \$3.50 per application is charged for the selection services. Finally, SPA charges the following fees:

- .. \$90 for a 1 year non-renewable scholarship not based on financial need.
- .. \$115 for a 1 year non-renewable scholarship based on financial need.

.. \$100 for a 1 year renewable scholarship not based on financial need.

.. \$125 for a 1 year renewable scholarship based on financial need.

You state that the administration of scholarship programs will be subcontracted with [REDACTED]. You state that you have not entered into a contract with [REDACTED] to administer the scholarship programs, but that you will enter into a management agreement with [REDACTED] when you have received tax exempt status. You state that, under this management agreement, [REDACTED] will provide you with services with respect to the operation and administration of educational scholarships. You state that, under this agreement, you will pay a management fee to [REDACTED] based on the number of hours documented by [REDACTED].

You state that [REDACTED] is a for-profit corporation that specializes in the administration of sponsored scholarship programs. You state that [REDACTED] is the sole shareholder of [REDACTED] and that he is donating funds to cover your administrative expenses, such as postage and long-distance telephone service. It appears that you may reimburse [REDACTED] for these expenses in the future. Further, you state that [REDACTED] is donating office space to you. Thus, you and [REDACTED] have the same business address.

The financial information submitted shows that you will receive donations from individuals, businesses, foundations and other entities that wish to establish educational scholarships. The amount of the individual contributions may be in excess of \$100,000. It does not appear that you will be soliciting funds from the general public. Also, it appears that the individuals, businesses, foundations and other entities will be your clients and that you will receive management fees from them. Also, it appears that you may receive large amounts of investment income.

Section 501(c)(3) of the Internal Revenue Code provides, in part, for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 509(a) provides that organizations described in section 501(c)(3) are private foundations unless they are described in sections 509(a)(1), (2), or (3). Section 509(a)(1) refers to those organizations described in section 170(b)(1)(A), other than in clauses (vii) and (viii).

Section 509(a)(1) includes reference to an organization described in section 170(b)(1)(A)(vi).

Section 170(b)(1)(A)(vi) describes an organization that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section

501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public.

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

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. 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(b)(1)(i) of the regulations provides that, in general, an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes, and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. 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(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. For the definition of the words "private shareholders or individual," see section 1.501(a)-1(c) of the regulations.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of section 1.501(c)(3)-1(d)(1) 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(e)(1) of the regulations provides that "[a]n organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513....An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3)...."

Section 53.4942(b)-1(a)(1) of the Foundation and Similar Excise Tax Regulations states, in pertinent part, that for purposes of section 4942 and the regulations thereunder, the term 'operating foundation' means any private foundation which, in addition to satisfying the assets test, the endowment test or the support test set forth in Sec. 53.4942(b)-2(a), (b) and (c), makes qualifying distributions (within the meaning of Sec. 53.4942(a)-3(a)(2)) directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose equal in value to--

(ii) substantially all of the lesser of the foundation's adjusted net income or minimum investment return.

Section 53.4942(b)-1(b)(2)(i) of the regulations provides that if a foundation makes or awards grants, scholarships, or other payments to individual beneficiaries (including program related investments within the meaning of section 4944(c) made to individuals or corporate enterprises) to support active programs conducted to carry out the foundation's charitable, educational, or other similar exempt purpose, such grants, scholarships, or other payments will be treated as qualifying distributions made directly for the active conduct of exempt activities for purposes of paragraph (a) of this section only if the foundation, apart from the making or awarding of the grants, scholarships, or other payments, otherwise maintains some significant involvement (as defined in subdivision (ii) of this subparagraph) in the active programs in support of which such grants, scholarships, or other payments were made or awarded. Whether the making or awarding of grants, scholarships, or other payments constitutes qualifying distributions made directly for the active conduct of the foundation's exempt activities is to be determined on the basis of the facts and circumstances of each particular case. The test applied is a qualitative, rather than a strictly quantitative, one. Therefore, if the foundation maintains a significant involvement (as defined in subdivision (ii) of this subparagraph) it will not fail to meet the general rule of subparagraph (1) of this paragraph solely because more of its funds are devoted to the making or awarding of grants, scholarships, or other payments than to the active programs which such grants, scholarships, or

other payments support. However, if a foundation does no more than select, screen, and investigate applicants for grants or scholarships, pursuant to which the recipients perform their work or studies alone or exclusively under the direction of some other organization, such grants or scholarships will not be treated as qualifying distributions made directly for the active conduct of the foundation's exempt activities. (Emphasis added) The administrative expenses of such screening and investigation (as opposed to the grants or scholarships themselves) may be treated as qualifying distributions made directly for the active conduct of the foundation's exempt activities.

Rev. Rul. 72-369, 1972-2 C.B. 245, holds that an organization, which was formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code.

Section 5.02 of Rev. Proc. 90-27, 1990-1 C.B. 514, provides that "[e]xempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. . . . The organization must fully describe the activities . . . including the standards, criteria, procedures, and other means adopted or planned to carry out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures. Where the organization cannot demonstrate . . . its proposed activities will be exempt, a record of actual operation may be required. . . ."

In American Institute for Economic Research v United States, 302 F.2d 934 (Ct. Cl.1962), the court said that, although the existence of a profit was not conclusive of a business purpose, the overall circumstances and the fact that the organization was competing with commercial concerns established the private business purpose.

In National Foundation, Inc., v U.S., 60 AFTR 2d 87 5926, (hereafter NFI) the Court concluded that NFI qualified for exemption under section 501(c)(3) of the Code. NFI accepted earmarked cash donations pursuant to a project proposal made by the prospective donor. When NFI's governing board approved the proposal, the donation was accepted and NFI had full control, ownership, and discretion over the use of the funds. The donor attached no restrictions to the donation.

The threshold issues are whether you are organized and will be operated exclusively for charitable and educational purposes and whether you will be serving public rather than private interests.

Your creating document provides that you operate for the benefit of individuals, businesses, foundations and other entities that wish to provide scholarships for students to pursue

post-secondary education. Also, your creating document provides that you will provide professional counseling to these entities concerning the establishment of scholarship programs, and will provide administrative support in the carrying out of the scholarship programs.

You have not described in detail how you will establish scholarship programs for individuals, businesses, foundations and other entities. You did not furnish copies of standard contracts or agreements with these individuals, businesses, foundations and other entities. You did not provide the standards, criteria, and selection procedures in awarding scholarships. You did not identify the individuals who serve on the scholarship selection committee. Because you have not described the scholarship selection activities in detail, and because you have not explained how you will carry out the scholarship selection activities, you have not furnished sufficient information to establish that you will meet the requirements for exemption under section 501(c)(3) of the Code as provided by section 5.02 of Rev. Proc. 90-27, supra. Therefore, we conclude that you have not established that you will be organized and operated exclusively for one or more exempt purposes within the meaning of section 1.501(c)(3)-1(c)(1) of the regulations.

Because the information furnished does not establish that you will be operated for charitable and educational purposes within the meaning of section 501(c)(3) of the Code, but shows that your primary activity and function will be providing managerial, consulting, and administrative services for which you will charge a fee; and because the fees you charge will reflect current market rates, we conclude that you will be competing with commercial business concerns like the organizations described in American Institute for Economic Research, supra, and Rev. Rul. 72-369, supra. Therefore we conclude that you will be operated in a commercial manner.

The information furnished shows that you will subcontract with [REDACTED] to provide the scholarship programs' counseling and administrative services. Also, the information furnished shows that you share office space with [REDACTED]. Further, you state that [REDACTED]. Under the circumstances, there is nothing to distinguish your operations from those of [REDACTED]. Moreover, and more important, even though you will not compensate your officers and directors and you will have no paid employees, you will enter into a contract with [REDACTED] under which you will compensate [REDACTED] for the services it will provide you. Because [REDACTED] is [REDACTED]'s sole shareholder, we conclude that your income is inuring to the benefit of [REDACTED] your President.

A Code section 501(f) organization provides investment activities to certain exempt organizations. However, if such an organization is formed by a private brokerage or investment company, it would not qualify as a section 501(f) organization because it would be serving private interests to more than an

[REDACTED]

insubstantial degree. You are like this organization because you were formed by [REDACTED] the owner of [REDACTED], a for-profit organization that specializes in the administration of sponsored scholarship programs. Because you and [REDACTED] operate out of the same offices and engage in the same activities, and because you have contractual dealings with [REDACTED] we conclude that your proposed operations and the current operations of [REDACTED], are indistinguishable. Accordingly, we conclude that you serving private interests to more than an insubstantial degree. Therefore, we conclude that your operations serve the private interests of [REDACTED] within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

Because it appears that your clients will have continuing restrictions on the scholarship funds they distribute to you, we conclude that your proposed operations will be distinguishable from those of the organization described in National Foundation, Inc., supra.

The information furnished reflects that you will be receiving income from donations, investment income, and fees for services. Also, the information furnished reflects that investment income from the amounts donated would fund the scholarship awards. You indicate that it would take a minimum donation of \$100,000 to establish an endowed scholarship of \$7,000.

Because your projected financial information does not accurately reflect the amounts received in investment income and fees for services and because you state it is impossible for you to estimate (i) the amount of your annual donations, (ii) the number of donors you will have, (iii) the amount of your donors' average donation, (iv) the amount of annual investment income, and (v) the amount of income received from the fees charged for your services, we are not able to determine whether you would be a Code section 509(a)(1) & 170(b)(1)(A)(vi) public charity.

Moreover, and more importantly, it appears that you will not be soliciting funds from the general public, but will be soliciting funds from select individuals, businesses, foundations and other entities who want to establish scholarship programs. If your donations do not come from the general public, but come from a select number of individuals, businesses, foundations, or other entities, only \$5,000 of such donations from each source would be public support. Also, the investment income and the income from the fees for services would not be public support. Therefore, even if you can establish that you qualify for exempt status under section 501(c)(3) of the Code, you would be a private foundation and would be subject to the excise tax provisions of Chapter 42.

Because you do no more than select, screen, and investigate applicants for grants or scholarships, pursuant to which the recipients perform their work or studies alone or exclusively under the direction of some other organization, the grants or

scholarships will not be treated as qualifying distributions. Therefore, even if you were a private foundation under section 501(c)(3) of the Code, you would not be an operating foundation within the meaning of section 4942(j)(3) of the Code.

In summary, (1) you have not established that you will engage in charitable, educational, or scientific activities within the meaning of section 501(c)(3) of the Code; (2) your income will inure to private interests within the meaning of section 1.501(c)(3)-1(c)(2) of the regulations; (3) you have not shown that you will be operated exclusively for one or more exempt purposes within the meaning of section 1.501(c)(3)-1(a)(1) of the regulations; (4) you will be serving private rather than public interests as prohibited by section 1.501(c)(3)-1(d)(1)(ii) of the regulations; and (5) even if you qualified for exemption under section 501(c)(3) of the Code you would be a section 509(a) private foundation and you would not be an operating foundation within the meaning of section 4942(j)(3) of the Code.

Based on the information furnished, we conclude that you are not organized or operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code.

Therefore, based on the above, we conclude that you do not qualify for recognition of exemption from federal income tax under section 501(c)(3) of the Code. Contributions to you are not deductible under section 170. You are required to file federal income tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your principal officers. You also have the right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that 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 has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days this ruling will become final and copies will be forwarded to your key District Director in Baltimore, Maryland. Thereafter, any questions about your federal income tax status should be addressed to that

[Redacted]

office. The appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

When sending additional correspondence to the Internal Revenue Service with respect to this case, you will expedite their receipt by using the following address:

[Redacted]

111 Constitution Avenue, N.W.
Washington, D.C. 20224

Thank you for your cooperation.

Sincerely yours,

[Redacted]

[Redacted]

Chief, Exempt Organizations
Technical Branch 3

cc:

[Redacted]

Attn: EO Group

[Redacted]

6/18/97

[Redacted]

6/18/97