



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201148008**
Release Date: 12/2/2011

Date: August 17, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.33-00

Dear :

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,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: June 28, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = Date
C = State
D = Date
X = For Profit Business
h = Dollar amount
n = Dollar Amount
s = Dollar Amount
p = Dollar Amount
q = Dollar Amount
r = Dollar Amount

UIL:

501.33-00

Dear :

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.

Issues

Do you qualify for exemption under section 501(c)(3) of the Internal Revenue Code?

No, for the reasons stated below.

Facts

X is a for-profit corporation that provides online exam preparation courses for the College Level Examination Program Tests (CLEP) and the Dantes Subject Standardized Tests (DSST), which enables individuals to earn college credit. Your founder/ president is also the founder/CEO of X. Moreover, your vice president/ treasurer, is also the operations officer of X and your secretary is the information officer of X.

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The course programs that X sells to customers consist of self-study resource packs that are developed in house by X. X owns all the materials.

X's marketing materials show that it is unique in that it brings the best available study materials under one roof. It allows students to perform all studying without using "hard copy" resources. X's marketing literature also states that it has created a system to provide students with the most up to date resources available to assist them in their effort to pass CLEP and DSST credit by examinations.

X provides the following resources to its customers:

- Student center website access
- Academic advisement
- Degree planning
- Online study guides for the exams

Each online study pack, retails at \$m and wholesales at \$n. For an additional fee of \$s, X will provide a client with support in the form of curriculum guidance and advising.

X's sources of revenue are

- Fees for degree planning,
- Fees for initial administrative setup,
- Income from sales of study packs .

You were incorporated on B under the laws of C . Your purpose in your Articles of Incorporation is specifically "to provide scholarships for students wishing to enroll in web-based educational study and coursework programs that prepare the student to earn accredited higher education credits through credit by examination, primarily through X. "

You submitted the Form 1023 on D. Your purpose in the Form 1023 is also "to provide scholarships for students wishing to enroll in web-based educational study and coursework programs that prepare the student to earn accredited higher education credits through credit by examination, primarily through X, an accredited online institution."

Your scholarship program consists of providing access to online test-preparation programs at no cost to persons who wish to earn credits-by-examination but lack the financial resources to purchase the programs. You will normally purchase study packs for your program from X unless the recipient specifically requests another provider. You provided board meeting minutes that showed comparisons of X's services and prices with other entities. You determined that your arrangement with X was the most advantageous available.

You submitted an unsigned agreement with X, which reads:

1. You are a charitable foundation engaged in providing scholarships to students wishing to enroll in education and college credit study programs that prepare the student to earn

accredited higher credit education credits through the credit by examination process.

2. X is a high tech enterprise engaged in the development and application of distance education technology and study materials and possesses a unique advantage in the making and serving of on-line study pack materials using the latest cognitive learning tools.
3. You wish and are willing to contract with X to make educational study materials available for its scholarship recipients and X agrees and is willing to accept such authorization for study pack provision.

The agreement also states "the parties hereto in accordance with any and all applicable laws of the state of C on the principle of volunteerism and equality and through friendly negotiation, covenant and agree on the terms and conditions as follows for the provision of study pack materials targeted toward credit by examination tests."

The agreement concerning Study Pack Provisioning and Availability states:

1. You agree to contract X and to make educational study materials available for its scholarship recipients.
2. The study pack materials provisioning and availability as referred to under this agreement includes the following means:
 - You provide the student information to X and X adds said student to its data base and grants access to the online study pack materials so as to make the study pack materials readily available for use and
 - X provides when available updated study pack materials to all currently enrolled students; and X undertakes to provide 24/7 access of said study pack materials; and
 - Other means agreed upon between the parties, including but not limited to that X prepares the study pack materials for online accessibility.
3. X shall for the study pack materials provisioned provide complete access to the study pack materials. If the study pack materials are deemed unavailable or encounter other technical problems, X shall in a timely manner solve the problem through its best efforts.
4. X shall use its best endeavor to satisfy you, which means making the study pack materials available on line to ensure that You can timely release the study pack materials to the students who have been named as recipients of its scholarship awards.
5. Under no circumstances shall you be required to purchase credit by exam study materials exclusively from X in order to supply study packs to students who have been named as recipients of scholarship awards.

Furthermore, the agreement states that X will own the materials including the online publishing and distribution of the study packs materials.

The "Agreement on Price" states, "The parties hereby agree that at the beginning of each calendar year, they will negotiate to determine the payment rate for online study pack materials for the current year to determine whether it is necessary to adjust the payment rate applicable in the last calendar year."

The original agreement indicated that the "Agreement on Price" would be that you would compensate X its wholesale price, \$n, for each for the study packs.

You subsequently amended the original agreement with the only changes made in the "Agreement on Price" section, The arrangement in this amendment is that if you purchased two study packs at \$n, X would provide a third at no charge, and the scholarship recipient would be entitled to receive X's counseling services at no charge.

You submitted another agreement (signed) with the only changes again made in the "Agreement on Price" section. You will purchase each study pack for \$p, which is X's "minimum cost per study pack to deliver the product to the customer/student." X will provide curriculum guidance and advising services, for which its regular customers must pay a separate charge, at no cost to you or to your scholarship beneficiaries. This is your current arrangement.

You estimate that you will purchase h units from X by your third fiscal year; in addition, sales to you will be less than 10 percent of X's estimated total sales.

Your Scholarship Policies Statement submitted with the Form 1023 states:

- To be eligible for a scholarship, the recipient must be underserved, with financial need, attending a private school, a charter school, or an individual that is deemed deserving by the board, a Bureau of Indians or Department of Defense School, enrolled in a web based education study and coursework program that prepares the students to seek higher education credits through credit by examination.
- To be eligible for a Scholarship Award, the student must be undertaking to obtain higher education credits other than through advanced placement studies, dual credits or international baccalaureate studies.
- All scholarship funds awarded shall be paid directly to the school to which the recipient is attending.

You further clarified that "school" used in this context refers to private, charter and public schools that choose to implement the "X" program. The thought behind paying the school was to forge a partnership. The school would be the primary deliverer of the course content with X's website providing a secondary resource. The plan for the school was is to integrate or overlay course material with that currently being taught and augment it with a goal of preparing students to pass the official CLEP or DSST exam. X currently has no formal programs in these types of schools. You will also provide grants to any individual deemed worthy.

Your board of directors will annually determine the amount of funds available for grants. The availability of scholarships will be publicized through internet postings on key clearinghouse

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websites and by notifying individual educational institutions of the scholarships. Neither X's current website nor any other of X's public communications refer to you. Your current officers, who are also officers of X, have also represented that X will not make any other use of your programs to promote the sales of its products.

You will hire a Program Development and Operations Director, who will, on a full time basis and at an estimated salary of \$r per annum, be responsible for building participation in your scholarship programs including student, parental, guardian and school participation. The paid director will also build support from donors, and coordinate the communications and logistics elements required to schedule and conduct your program. The estimated compensation is higher than the median compensation of non-profit CEOs. Compensation is commensurate with the higher level of education that this employee will require to perform his duties.

Your initial bylaws indicated that X was your only member and that X could designate one or more additional members. During the application process, you amended your bylaws to remove X as your sole member as well as to provide for the election of new directors unrelated to X.

Gifts, grants and contributions will finance your operations.

Your principal expenditures will be for the purchase of test-preparation programs primarily from X.

Law

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

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that if the organization fails either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the Income Tax Regulations provides that 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)(2) of Internal Revenue Regulations states that an organization whose net earnings inure to the benefit of private shareholders or individuals or which is operated for the benefit of private interests is not operated exclusively for exempt purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for an exempt purpose unless it serves a public rather

than a private interest. The organization must demonstrate 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.

In Rev. Rul. 69-279, 1969-1 C.B. 152, an irrevocable inter vivos trust, which provides that a fixed percentage of the income must be paid annually to the settlor with the balance of the income to charity does not meet the organizational test.

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

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974), the court held that an organization seeking a ruling as to recognition of its exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd without opinion, 647 F.2d 170 (9th Cir. 1981), the Tax Court concluded that an organization created to disseminate educational programs, the rights to which were owned by for-profit corporations, furthered the commercial, private purposes of the for-profit entities and did not qualify for exemption under IRC 501(c)(3). The organization used the franchiser's methods, employees, and materials, and paid royalties for the right to use the franchiser's programs.

In Church by Mail, Inc. v. Commissioner, 765 F. 2d 1387 (9th Cir. 1985), affg. TCM 1984-349, Tax Court concluded that the extent of the integration between the operations of a non-profit entity and related for-profit entities controlled by the non-profit directors precluded exemption. Furthermore, the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated: "*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, 56 T.C.M. 1140, 1989-36, the court ruled as non-exempt under section 501(c)(3) of the Code an organization formed to sponsor medical seminars and symposia that was founded and run by an individual who was a shareholder and officer in a for-profit travel agency that provided travel arrangement services to the nonprofit. Finding that the nonprofit was formed to obtain customers for the for-profit's business, the court concluded that the nonprofit had, as a substantial purpose, increasing the for-profit's income. When a for-profit organization benefits substantially from the manner in which the activities of a related nonprofit organization are carried on, the court reasoned, the nonprofit organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if the nonprofit furthers other exempt purposes.

Application of Law

You are not as described in section 501(c)(3) of the Code because you are not exclusively organized and operated for charitable or educational purposes.

You are not as described in Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you fail both the organizational and operational tests.

You do not meet the requirements in Section 1.501(c)(3)-1(b)(1)(i) of the Income Tax Regulations. Your Articles of Incorporation state you are organized "exclusively for charitable purposes" as well as "to provide scholarships for students wishing to enroll in web-based educational study and coursework programs that prepare the student to earn accredited higher education credits through credit by examination primarily through X." Because you are organized to administer your educational programs by using X, a related for profit corporation, you are not organized exclusively for purposes described in the regulations.

As described in section 1.501(c)(3)-1(c)(2) of the Regulations, you are not operated exclusively for exempt purposes because your net earnings inure to the benefit of private shareholders or individuals. This is evidenced by the fact that you were formed and are controlled by the same board members and officers as X with whom you have a comprehensive contract. You have adopted a conflict of interest policy and have provided an analysis comparing X's programs with its competitors and concluded that X is the best choice as the provider; however, this does not change the fact that your entire board has a personal interest in X and are in a position to profit from your relationship with X.

You are not as defined in Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations, because you are operating for the private interests of X. This is evidenced by the fact that the scholarship recipients will receive X's programs unless the recipients request another product. In addition, the fact that you will "pay" the school and forge a partnership with the school in order to administer the scholarships enables X to promote its programs to that school, which gives X more business opportunities.

You are like the organization in Rev. Rul. 69-279, 1969-1 C.B. 152 because you are organized and operated for charitable and non-charitable purposes. In your case, you are organized and operated for the benefit of X and your net earnings are inuring to X.

Similar to the organization in Harding Hospital, Inc. v. United States, 505 F2d 1068 (1974), you have the burden of proving that you satisfy the requirements for tax exemption. You have failed to prove to us that you are not operating for the benefit of X.

You are like the organization in Better Business Bureau v. Commissioner. Although your organization has educational and charitable purposes and you may benefit those in need, the presence of the non-exempt purpose of providing a benefit to a related for-profit organization precludes exemption.

You are similar to the organization in est of Hawaii v. Commissioner because you have a comprehensive contract with a for-profit entity and are totally dependant on one for profit for

your operations. X has considerable influence over your operations. You are unable to remove yourself from X because your scholarship program could not function without X. This is further demonstrated by the following terms of your contract with X:

- You provide the student information to X and X adds said student to its data base and grants access to the online study pack materials so as to make the study pack materials readily available for use and
- X provides when available updated study pack materials to all currently enrolled students; and X undertakes to provide 24/7 access of said study pack materials; and
- Other means agreed upon between the parties, including but not limited to that X prepares the study pack materials for online accessibility.

These provisions indicate that X is totally responsible for administering your scholarship program.

You are like the organization in Church by Mail. Because you are purchasing X's educational programs for recipients of your scholarships, you are essentially providing a market for X's products. You are also increasing X's visibility and ultimately its market share by targeting schools that are currently not using X's programs.

You are like the organization in International Postgraduate Medical Foundation. Even though you are purchasing the study packs from X at below wholesale cost, X is still receiving a substantial benefit from you. You indicated that after three years, you will only account for 10% of X' sales. However, the number of study packs you expect to purchase is large and will produce a substantial amount of revenue for X. Thus, X benefits substantially even from below-market sales to you, since its revenues from you will help it significantly in covering its fixed costs. Therefore, you were formed for the substantial non-exempt purpose of providing a related commercial entity with business revenue.

Applicant's Position

You did not provide a written statement describing your position.

Conclusion

You do not qualify for exemption under section 501(c)(3) of the Internal Revenue Code, because you do not meet the organizational and operational tests of Reg. 1.501(c)(3)-1(c)(1) and Reg. 1.501(c)(3)-1(d)(1)(ii). You are not organized and operated exclusively for an exempt purpose; you are operated for the purpose of benefiting X, a private related business and you serve a private rather than a public interest.

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. If your statement does not provide a basis to reconsider our determination, we will forward your case to

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our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in 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 appeal 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 the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may 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.

A copy of this letter has been sent to your authorized representative.

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

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure
Publication 892