



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201303018**
Release Date: 1/18/2013
Date: October 19, 2012

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL Number: 501.03-08

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.

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.

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,

Holly O. Paz
Director, Exempt Organizations Rulings and
Agreements

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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: June 19, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

State:

Date 1:

Date 2:

X:

Y:

X:

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code (I.R.C.) § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under I.R.C. § 501(c)(3). The basis for our conclusion is set forth below.

FACTS:

You are organized as a nonprofit corporation under the laws of a State on Date 1. You filed Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, on Date 2.

Your Articles of Incorporation (hereinafter, "Articles") state that you are organized and operated exclusively for charitable, educational, and scientific purposes within the meaning of I.R.C. § 501(c)(3). In a letter dated March 19, 2010, you stated that you intend to abandon your charitable activities and to pursue only your educational and scientific activities henceforth. Specifically, your purpose is to create freely available open source software for the music community at large, to provide hosted online tools designed to enhance participation in the further development of the open source software, and to provide education about intellectual property issues, copyright issues, and music industry best practices. You state that you are operated to benefit musicians and music companies.

You state that your educational activities consist of instructing the public about best practices

and current trends in the music industry. Topics include, but are not limited to: media licensing, music management, music marketing tactics, business structures for musicians, technology trends, and case studies of specific examples. All of your educational instruction occurs online through your website and blog. You do not maintain an online forum where the public may ask questions; all questions are fielded through a public e-mail address or via posts on social networking websites. The only in-person educational events you intend to offer are seminars or conferences, but you have not held any such event to date. You state that you spend approximately 15 percent of your financial and personnel resources on your educational activities.

You state that your scientific activities consist of developing open source software for music promotion, sales, and digital distribution. X software—which include an audio player, image galleries, and video players—allows musicians and music companies to create music and media rich websites to sell, share, and promote their music or artists directly to fans. X software is available for download by the public for free from your website. You provide free, informal technical support via e-mail. Y software allows musicians and music companies to manage media, e-mail lists, digital downloads, website security, and basic commerce provided by online payment systems. Y software interfaces with X software to allow musicians and music companies to analyze fan behavior. Although Y software is publicly available, it is intended for a business or information technology audience with more powerful computing ability. Y software may be utilized in one of two ways: as a “self-install” version hosted on the user’s chosen server or a “hosted” version on your server. Although Y software is free, you will charge a flat fee for your hosting services. The fee will cover fixed costs such as hosting and bandwidth. You do not report any restrictions on the amount of fees you can charge for your hosting services. The self-install version of Y software is currently available and you anticipate the hosted version to be available soon. You state that you spend approximately 70 percent of your financial and personnel resources developing software.

You retain the copyright to X and Y software but distribute it under two publicly available and commonly used open source licenses, the Berkley Software Distribution (“BSD”) license for any code that is read by a browser (“interface code”) and the Affero General Public License (“AGPL”) license for all other code. In general, both licenses allow unrestricted redistribution of either the source code or the program, with or without modification, so long as it retains or reproduces the original copyright notice. You explain that these licenses allow third parties to use your software’s source code for any purpose, including commercial purposes. All written or visual material on your website, including your educational material, is distributed under the publicly available and commonly used Creative Commons BY (“CC BY”) license, which allows use of copyrighted information so long as attribution to the original work is provided. Any material covered by the CC BY can be used for any purpose, including commercial purposes. You state that you will not apply for or hold any patents. You will ask contributors to either assign copyright to you or to declare their work to be in the public domain.

You also provide consulting services for a fee through which you create online projects for musicians and music companies. You state that you only accept these projects where it will contribute to the development of X or Y software and where the customer will allow all code to be licensed under an open source license. You state that the fees from this activity have been nominal, a total of \$x for four projects to date. However, you do not report any restrictions on the amount of fees you can charge for your consulting services. You state that these services are not a major part of your long-term plan.

Your primary source of income is from gifts, grants, and contributions. You also receive some income from membership, consulting, and other fees. In the future, you intend to allow artists to pledge a percentage of their net income back to the organization, which will provide you with an additional income source.

LAW:

I.R.C. § 501(c)(3) exempts from taxation any corporation 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, or for the prevention of cruelty to children or animals, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in I.R.C. § 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in I.R.C. § 501(c)(3). If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 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 engages primarily in activities which accomplish one or more of such exempt purposes specified in I.R.C. § 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.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(i) provides that an organization may be exempt as an organization described in I.R.C. § 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subsection, the burden of proof is on the organization to show 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)(3)(i) provides that the term educational relates to: (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) The instruction of the public on subjects useful to the individual and beneficial to the community.

Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii)(Example 2) provides that an educational organization includes an organization whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs. Such programs may be on radio or television.

Treas. Reg. § 1.501(c)(3)-1(d)(5)(i) provides that a scientific organization must be organized and operated in the public interest. Therefore, the term scientific, as used in I.R.C. § 501(c)(3),

includes the carrying on of scientific research in the public interest. "Research," when taken alone, is a word with various meanings; it is not synonymous with scientific; and the nature of particular research depends upon the purpose which it serves. For research to be scientific, within the meaning of I.R.C. § 501(c)(3), it must be carried on in furtherance of a scientific purpose. The determination as to whether research is scientific does not depend on whether such research is classified as fundamental or basic as contrasted with applied or practical.

Treas. Reg. § 1.501(c)(3)-1(d)(5)(ii) provides that scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, as, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc.

Treas. Reg. § 1.501(c)(3)-1(d)(5)(iii) provides that scientific research will be regarded as carried on in the public interest: (a) If the results of such research (including any patents, copyrights, processes, or formula resulting from such research) are made available to the public on a nondiscriminatory basis; (b) If such research is performed for the United States, or any of its agencies or instrumentalities, or for a State or political subdivision thereof; or (c) If such research is directed toward benefiting the public. The following are examples of scientific research which will be considered as directed toward benefiting the public, and, therefore, which will be regarded as carried on in the public interest: (1) scientific research carried on for the purpose of aiding in the scientific education of college or university students; (2) scientific research carried on for the purpose of obtaining scientific information, which is published in a treatise, thesis, trade publication, or in any other form that is available to the interested public; (3) scientific research carried on for the purpose of discovering a cure for a disease; or (4) scientific research carried on for the purpose of aiding a community or geographical area by attracting new industry to the community or area or by encouraging the development of, or retention of, an industry in the community or area.

Rev. Rul. 65-1, 1965-1 C.B. 226, describes an organization which promoted and fostered the development and design of machinery in connection with commercial operation, and in connection therewith had the power to sell, assign, and grant licenses with respect to its copyrights, trademarks, trade names, or patent rights, that did not qualify for exemption from Federal income tax under I.R.C. § 501(c)(3). The primary purposes of the organization were to foster the development and design of labor saving agricultural machinery, including the development of new labor saving ideas and methods, and to conduct pertinent research related to this purpose. The organization was engaging in development activities of a type incident to commercial activities and was not exempt under I.R.C. § 501(c)(3).

Rev. Rul. 66-147, 1966-1 C.B. 137, held that an organization formed to survey scientific and medical literature published throughout the world and to prepare and distribute, free of charge, abstracts taken from such literature qualified for exemption under I.R.C. § 501(c)(3). The organization employed technical personnel who surveyed the world's medical and scientific publications as soon as they were published. These individuals then selected and abstracted the articles appearing in the literature. The abstracts were mailed in monthly publications and were distributed free of charge to anyone having particular interest in the subject matter. The Service determined that the organization's activities, consisting of reviewing medical and scientific publications and preparing and disseminating free abstracts of meaningful and accurate reference materials based on articles appearing in such publications, advanced education and science.

Rev. Rul. 66-255, 1966-2 C.B. 210, describes an educational organization that qualified for providing public information. In this ruling, the organization educated the public as to a particular method of painless childbirth. The organization utilized meetings, films, forums, and publications to educate the public. The organization carried out its purpose through (a) public programs of films followed by discussions with doctors and members of the organization; (b) presentations on local radio stations; (c) meetings conducted by a doctor or a registered nurse for expectant parents; and (d) pamphlets, manuals, and books which are distributed to libraries, hospitals, and obstetricians.

Rev. Rul. 66-359, 1966-2 C.B. 219, held that an organization that promoted humane treatment of laboratory animals by carrying on a program for the accreditation of animal care facilities that supplied, kept, and cared for animals used by medical and scientific researchers qualified for exemption under I.R.C. § 501(c)(3). The organization was created to conduct a voluntary accreditation program for laboratory animal care facilities. The accreditation program was intended to educate and furnish guidance for the maintenance and operation of laboratory animal care facilities and to upgrade the standards for such facilities. The organization prepared and published specific standards and requirements for accreditation of laboratory animal care facilities. As part of the program, the organization furnished experts to inspect, evaluate, and recommend improvements to applicants for accreditation. All organizations having facilities caring for animals used for research purposes were invited to apply for accreditation. Based on the above, the Service found that the development and publication of standards for the operation of laboratory animal care facilities and the inspection, evaluation, and recommendations for improvement of such facilities were activities that supported and advanced education and science.

Rev. Rul. 67-4, 1967-1 C.B. 121, held that an organization that encouraged basic research of specific types of physical and mental disorders, that improved educational procedures for teaching those afflicted with such disorders, and that disseminated educational information about such disorders qualified for exemption under I.R.C. § 501(c)(3). The organization published a journal containing abstracts of current information about mental disorders from the world's medical and scientific publications. The journal was sold, below cost, to the public. The organization's staff consisted of leading pathologists, other medical specialists, and teachers. The Service determined that an organization engaged in publishing scientific and medical literature may qualify for exemption under I.R.C. § 501(c)(3) if several conditions are met: (1) the content of the publication is educational; (2) the preparation of material follows methods generally accepted as "educational" in character; (3) the distribution of materials is necessary or valuable in achieving the organization's educational and scientific purposes; and (4) the manner in which the distribution is accomplished is distinguishable from ordinary commercial publishing practices. The Service then held that the organization met the four requirements set forth above.

Rev. Rul. 68-373, 1968-2 C.B. 206, described an organization whose principal activity was clinically testing drugs for commercial pharmaceutical companies. These tests were required in order to comply with Food and Drug Administration requirements that drugs be tested for safety and efficacy before they can be marketed. The pharmaceutical companies selected the drugs to be tested and used the results of the tests in their marketing applications to the Food and Drug Administration. In addition, the results of the tests were freely available for publication in various scientific and medical journals. Clinical testing is an activity ordinarily carried on as an

incident to a pharmaceutical company's commercial operations. The fact that the testing must be done by highly qualified professionals does not change its basic nature. Therefore, such testing did not constitute scientific research within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(5)(i). The organization failed to qualify for exemption from Federal income tax under I.R.C. § 501(c)(3).

Rev. Rul. 69-526, 1969-2 C.B. 115, describes an organization formed by a group of physicians specializing in heart disease, to research the causes of heart defects and publish treatments, that qualified for exemption under I.R.C. § 501(c)(3). In this ruling, patients were referred to the organization by physicians and welfare agencies when it appeared that their condition merited special study and evaluation. Each patient underwent a medical examination to determine whether their condition fell within the scope of the organization's research goals. If the patient's case met the criteria, the patient was accepted without regard to their ability to pay. The data collected from the patient studies is used by the organization in the development of new methods and procedures for preventing and treating heart defects. The results of the research, as well as any medical procedures derived, were made public through publication. The organization's research could only be performed by individuals with advanced scientific and/or technical expertise –i.e., cardiologists. Patients in the organization's study underwent medical examination pertaining to their heart defects. The medical examinations naturally entail medical observation and experimentation to formulate and verify objective human bodily responses to treatment. The results of the organization's research were publicly disseminated and add to the knowledge of internal medicine, specifically the causes and treatments for heart disease. Based upon the above, the Service held that the organization's research activities were scientific under I.R.C. § 501(c)(3).

Rev. Rul. 70-129, 1970-1 C.B. 128, held that an organization formed to support research in anthropology by manufacturing quality cast reproductions of anthropological specimens which were sold to scholars and educational institutions in a noncommercial manner qualified for exemption under I.R.C. § 501(c)(3). Specifically, the organization manufactured and distributed anthropological reproductions that illustrated important developments in human evolution. These reproductions were manufactured under the direction of qualified scientific personnel with emphasis placed on quality control to assure accurate reproductions. The reproductions were then sold to scholars and educational institutions in a noncommercial manner to recoup costs and expenses. The Service determined that the examination of anthropological specimens was an important step in anthropological education and research and that the manufacture and sale of accurate reproductions provided an effective means for making these important research and study aids generally available. Therefore, the Service held that the distribution of the reproductions advanced science and education.

Rev. Rul. 70-584, 1970-2 C.B. 114, held that an organization that recruited college students for government internship programs that related to their course of study qualified for exemption under I.R.C. § 501(c)(3). The internship program advanced the students' education because it trained the individual for the purpose of improving or developing his capabilities in his chosen field of study.

Rev. Rul. 71-506, 1971-2 C.B. 233, describes an engineering society formed to engage in scientific research in the areas of heating, ventilating, and air conditioning ("HVAC") for the public that qualified as a scientific research organization under I.R.C. § 501(c)(3). The Service found that the organization was comprised of HVAC engineers, architects, educators and others

who have a professional interest in HVAC-with full membership in the organization limited to persons with 8 years of experience in the science related to HVAC. The organization's research was conducted by a full-time paid staff in the organization's own laboratory. Typical subjects of investigation for the organization included the effects of solar radiation through various materials, the phenomena of heat flow and transfer, development of data on air friction, the problems of panel heating, and the physiological effects of air conditioning upon the human body. The organization's research was devoted exclusively to the development of data on basic physical phenomena, which data can be used by anyone. The organization published a regular journal and maintained a library where its data, and specifically scores of model codes of minimal standards for HVAC, are stored for public review. The Service concluded that this organization engaged in scientific research. Specifically, the organization used observation and experimentation to formulate and verify facts or natural laws pertaining to HVAC –such as the effects of solar radiation through various materials. Its activities were performed by professionals with extensive scientific and/or technical expertise in HVAC –such as members with a minimum of 8 years experience in HVAC science. The organization conducted experimentation in its own laboratory. The organization's activities added to the knowledge of HVAC science, specifically with the organization publishing scores of model codes of minimum standards for HVAC. All the organization's data was maintained in a library and was publicly available. Based upon the above, the Service held that the organization's research activities were scientific under I.R.C. § 501(c)(3).

Rev. Rul. 75-284, 1975-2 C.B. 202, held that an organization that provided high school graduates and college students with uncompensated work experience in selected trades or professions qualified for exemption under I.R.C. § 501(c)(3). The program provided students with exposure to five of twenty-five trades or professions. Such exposure advanced the students' education by familiarizing the students with various career fields and developing the students' capabilities.

Rev. Rul. 77-365, 1977-2 C.B. 192, describes an educational organization that conducted clinics, workshops, lessons, and seminars at municipal parks and recreational areas to instruct and educate individuals in a particular sport.

Rev. Rul. 78-310, 1978-2 C.B. 173, held that an organization that provided law students with practical experience in exempt public interest law firms and legal aid societies qualified for exemption under I.R.C. § 501(c)(3). The organization advanced the law students' education by developing or improving the students' capabilities.

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 private benefit, if substantial in nature, will destroy an organization's tax-exempt status regardless of the organization's other charitable purposes or activities.

In IIT Research Institute v. United States, 9 Cl. Ct. 13, (1985), the issue before the U.S. Court of Claims was whether certain activities of which a recognized I.R.C. § 501(c)(3) tax-exempt scientific research organization was engaging in would constitute scientific research and thus not be subject to unrelated business income taxation under I.R.C. § 512. The Court held that "in the context of this litigation, 'science' will be defined as the process by which knowledge is systematized or classified through the use of observation, experimentation, or reasoning." The Court further held that as scientific research does not include activities of a type ordinary carried

on as incident to commercial or industrial operations, the organization was found not to be involved "in the commercialization of the products or processes developed as a result of its research," as it "would only develop a project to the point where the research principles were established." The Court held that the projects at issue were scientific.

In Midwest Research Institute v. United States, 554 F. Supp. 1379, (W.D. Mo 1983), the issue before the U.S. District Court was whether certain activities of which a recognized I.R.C. § 501(c)(3) tax-exempt scientific research organization was engaging in would constitute scientific research and thus not be subject to unrelated business income taxation under I.R.C. § 512. The Court held that "while projects may vary in terms of degree of sophistication, if professional skill is involved in the design and supervision of a project intended to solve a problem through a search for a demonstrable truth, the project would appear to be scientific research." The Court further held that as scientific research did not include activities of a type ordinary carried on as incident to commercial or industrial operations, the organization was found not to engage in the ordinary or routine testing of products and processes, but rather engaged in "testing done to validate a scientific hypothesis." The Court concluded that the projects at issue were scientific.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court determined that the American Campaign Academy, a training program for political campaign professionals, operated for the private benefit of the Republican party because its curriculum was tailored to Republican interests, its graduates worked for Republican candidates and incumbents, and it was financed by Republican sources. The Tax Court defined private benefit as "nonincidental benefits conferred on disinterested persons that serve private interests." Private benefits included "advantage; profit; fruit; privilege; gain; [or] interest."

RATIONALE:

An organization seeking tax-exempt status under I.R.C. § 501(c)(3) must be organized and operated exclusively for charitable or other exempt purposes with no part of its net earnings inuring to the benefit of any private shareholder or individual. See also Treas. Reg. § 1.501(c)(3)-1(a)(1). The presence of a single non-exempt purpose, if substantial in nature, will destroy exemption under I.R.C. § 501(c)(3) regardless of the number or importance of any other exempt purposes. Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945). The materials you submitted state that you are seeking tax-exempt status under I.R.C. § 501(c)(3): (1) as an educational organization for educating the public about intellectual property issues, copyright issues, and music industry best practices; and (2) as a scientific organization for creating open source software. Based upon a review of your activities, you are not described in I.R.C. § 501(c)(3) as explained below.

1. Educational Purpose

You are not described in I.R.C. § 501(c)(3) as an educational organization for providing information on your website relating to best practices and current trends in the music industry. The term "educational", as used in I.R.C. § 501(c)(3) relates to (a) the instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i). The regulations provide several examples of organizations that qualify as educational organizations, including "organizations whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs." See Treas. Reg. §

1.501(c)(3)-1(d)(3)(ii), example (2). One such educational organization was described in Rev. Rul. 66-255, 1966-2 C.B. 210, which describes an organization formed to educate the public as to a particular method of painless childbirth. The organization carried out its purpose through (a) public programs of films followed by discussions with doctors and members of the organization; (b) presentations on local radio stations; (c) meetings conducted by a doctor or a registered nurse for expectant parents; and (d) pamphlets, manuals, and books which are distributed to libraries, hospitals, and obstetricians. Another example of a qualifying educational organization was described in Rev. Rul. 77-365, 1977-2 C.B. 192, in which the organization qualified for its activities of conducting clinics, workshops, lessons, and seminars at municipal parks and recreational areas to instruct and educate individuals in a particular sport. Here, you are not conducting any of the activities described above. You do not conduct any public discussion groups, forums, panels, lectures or similar programs; all of your educational instruction occurs online on your website and blog. These activities are best described as providing product information and are analogous to a product manual, which does not rise to the level of educational as required under I.R.C. § 501(c)(3).

Furthermore, you are not described in I.R.C. § 501(c)(3) as a charitable organization for providing information on your website relating to best practices and current trends in the music industry. The revenue rulings provide several examples of organizations that advance education. For example, the organization described in Rev. Rul. 70-584, 1970-2 C.B. 114, recruited college students to participate in a government internship program, the organization described in Rev. Rul. 75-284, 1975-2 C.B. 203, provided high school graduates and college students with uncompensated work experience in selected trades and professions, and the organization described in Rev. Rul. 78-310, 1978-2 C.B. 173, provided law students with practical experience in exempt public interest law firms and legal aid societies. Here, you are not conducting any of the activities described above.

2. Scientific Purpose

You also claim to qualify for tax-exemption as a scientific research organization for your activities related to the development open source software. For an organization to qualify as an I.R.C. § 501(c)(3) scientific research organization, the organization must (1) engage in scientific research; (2) the scientific research must not include activities that are incident to commercial or industrial operations; and, (3) the scientific research must be undertaken in the public's interest. Treas. Reg. § 1.501(c)(3)-1(d)(5).

Under the first element, the organization seeking exempt status as a scientific research organization must be engaging in scientific research. Treas. Reg. § 1.501(c)(3)-1(d)(5). For research to be "scientific," within the meaning of I.R.C. § 501(c)(3), it must be carried on in furtherance of a 'scientific' purpose. Treas. Reg. § 1.501(c)(3)-1(d)(5)(i). Although the Regulations provide that research that is scientific can be practical or applied as well as fundamental or theoretical, the term "scientific" is not clearly identified in either the Code or the Treasury Regulations. However, several revenue rulings and cases have interpreted "science" and "scientific" in terms of scientific research for I.R.C. § 501(c)(3) purposes.

For example, in Rev. Rul. 71-506, 1971-2 C.B. 233, the Service held that an engineering society qualified as a scientific research organization under I.R.C. § 501(c)(3). The organization was operated to engage in scientific research in the areas of heating, ventilation, and air conditioning ("HVAC") for the public benefit. The organization was comprised of HVAC engineers,

architects, and others who had a professional interest in HVAC. Its main activity was research conducted by highly skilled personnel in the organization's own laboratory, which personnel used observation and experimentation to formulate and verify facts or natural laws pertaining to HVAC—such as the effects of solar radiation through various materials, the phenomena of heat flow and transfer, development of data on air friction, the problems of panel heating, and the physiological effects of air conditioning upon the human body. The organization published its results, along with papers related to its findings in its journal. These results became model codes of minimum standards for HVAC. The organization's research was devoted exclusively to the development of data on basic physical phenomena, which data could be used by anyone, and not on the development or improvement of particular products or services. The testing and improvement of commercial products was forbidden by the organization's charter. The organization's activities added to the knowledge of HVAC science.

In another example, the Service held that an organization formed by a group of physicians specializing in heart disease to research the causes of heart defects and publish treatments, qualified under I.R.C. § 501(c)(3). Rev. Rul. 69-526, 1969-2 C.B. 115. Patients were referred to the organization by physicians and welfare agencies when it appeared that their condition merited special study and evaluation. The data collected from the patient studies was used by the organization in the development of new methods and procedures for preventing and treating heart defects. The results of the research, as well as any medical procedures derived, were made public through publication. The medical examinations entailed medical observation and experimentation to formulate and verify objective human bodily responses to treatment. The results of the organization's research was publicly disseminated and added to the knowledge of internal medicine, specifically the causes and treatments for heart disease.

Furthermore, two court cases have interpreted "science" and "scientific" in terms of scientific research for I.R.C. § 501(c)(3) purposes. Specifically, the Court of Claims in IIT Research Institute v. United States, 9 Cl. Ct. 13, 20 (1985), held that "in the context of this litigation, 'science' will be defined as the process by which knowledge is systematized or classified through the use of observation, experimentation, or reasoning." The court further held that as scientific research does not include activities of a type ordinary carried on as incident to commercial or industrial operations, the organization must not be involved in the commercialization of the products or processes developed as a result of its research, but rather must only "develop a project to the point where the research principles are established." *Id.* at 21. Whereas, the District Court in Midwest Research Institute v. United States, 554 F. Supp. 1379, 1386 (W.D. Mo 1983), *aff'd* 744 F.2d 635, found that "while projects may vary in terms of degree of sophistication, if professional skill is involved in the design and supervision of a project intended to solve a problem through a search for a demonstrable truth, the project would appear to be scientific research." The Court further held that as scientific research does not include activities of a type ordinary carried on as incident to commercial or industrial operations, the organization was found not to engage in the ordinary or routine testing of products and processes, but rather engaged in "testing done to validate a scientific hypothesis." *Id.*

Based upon the above law, you do not meet the first and second elements for recognition as a scientific research organization under I.R.C. § 501(c)(3) because you do not engage in scientific research and your development activities are of a type incident to commercial or industrial operations. Unlike the organizations described above, you are not utilizing objective scientific methods to formulate or verify facts or natural laws, or to search for a demonstrable truth. You do not propose a hypothesis pertaining to the verification of facts or natural laws. You do not

utilize scientific methods to test this hypothesis and objectively record the results of your experimentation. Finally, you do not objectively evaluate your research results and publish the findings for the public to utilize. Instead, you describe your scientific research activities as developing open source software. These activities can best be described as routine product development, which are a type incident to commercial operations. Under Treas. Reg. § 1.501(c)(3)-1(d)(5)(ii), scientific research does not include activities carried on as an incident to commercial or industrial operations, such as the design or improvement of goods or services. For example, in Rev. Rul. 65-1, 1965-1C.B. 226, the Service held that an organization operated to research, design and develop labor saving agricultural machinery was not a scientific organization under I.R.C. § 501(c)(3) but rather was engaging in product development incident to commercial purposes. Similarly, in Rev. Rul. 68-373, 1968-2 C.B. 206, the Service held that an organization that engaged in clinical testing of pharmaceuticals by highly qualified personnel was not a scientific research organization under I.R.C. § 501(c)(3) but rather was engaging in ordinary testing necessary to comply with standards to bring the pharmaceuticals to market. Here, you are engaging in routine software development similar to what a commercial software company engages in to develop new products to be competitive in the market. As such, your activities are incident to commercial operations and are not exempt under I.R.C. § 501(c)(3).

Finally, you do not meet the third element for a scientific research organization, which requires that scientific research to be directed toward benefiting the public. Treas. Reg. § 1.501(c)(3)-1(d)(5)(iii). Your research does not benefit the public. First, you do not publish the results of your research. See Treas. Reg. § 1.501(c)(3)-1(d)(5)(iii)(a). Rather, you make X and Y software's source code and documentation, not the results of your research, available to the public. The release of X and Y software's source code is akin to the release of a commercial product, not the publication of scientific research. Second, your research is not performed for the United States. See Treas. Reg. § 1.501(c)(3)-1(d)(5)(iii)(b). Third, your research is not carried on for the purpose of aiding in the scientific education of college or university students; obtaining scientific information, which is published in a treatise, thesis, trade publication, or in any other form that is available to the interest public; discovering a cure for a disease; or aiding a community or geological by attracting new industry to the community or area or by encouraging the development of, or retention of, an industry in the community or area. See Treas. Reg. § 1.501(c)(3)-1(d)(5)(iii)(c). Production of X and Y software benefits musicians and music companies, not the public generally. Therefore, you do not qualify under I.R.C. § 501(c)(3) as a scientific research organization.

You also are not described in I.R.C. § 501(c)(3) as a charitable organization advancing science for your activities related to the continued research and development of open source software. Activities that advance science include reviewing medical and scientific publications and the disseminating the abstracts of those articles for free, conducting a voluntary accreditation program for laboratory animal care facilities, publishing a journal with current technical literature relating to physical and mental disorders, and selling quality cast reproductions of anthropological specimens to scholars and educational institutions. Rev. Rul. 66-147, 1966-1 C.B. 137; Rev. Rul. 66-359, 1966-2 C.B. 219; Rev. Rul. 67-4, 1967-1 C.B. 121; Rev. Rul. 70-129, 1970-1 C.B. 128. Here, you are not conducting any of the activities described above. Therefore, your activities will not be regarded as advancing science within the meaning of I.R.C. § 501(c)(3).

3. Private Benefit

An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than private interest. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Private benefit has been defined as “nonincidental benefits conferred on disinterested persons that service private interests.” American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). “Prohibited private benefit may include an ‘advantage; profit; fruit; privilege; gain; [or] interest.’” Id. It is the organization’s burden 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).

You benefit the private interests of musicians and music companies by providing open source software tools assisting with the promotion, sale, and distribution of the musicians’ music. X and Y software are broadly available to the public under two commonly and widely used open source licenses. Both licenses allow redistribution of the source code or the software, with or without modification, so long as the subsequent product retains or reproduces the original copyright notice. Both licenses allow for the commercial use of the original source code or software. Thus, anyone may download X or Y software and redistribute it, with or without modification, for a fee. However, both programs target a specific audience—musicians and music companies. That audience derives a commercial advantage from your open source programs because, in its absence, the musician or company would either need to develop their own software or would have to purchase commercial software. Thus, by providing open source software, you reduce or eliminate production costs and provide musicians and music companies with a distinct commercial advantage. Furthermore, musicians and music companies profit from being able to redistribute your open source programs, with or without modification, for a fee. Thus, you are operated for private rather than public interests in violation of I.R.C. § 501(c)(3).

CONCLUSION:

Based on the above, we have determined that you fail to meet the requirements necessary to be recognized as a tax-exempt organization under I.R.C. § 501(c)(3). 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.

This declaration must be signed by an elected officer, a member of the board of directors, or a trustee rather than an attorney or accountant.

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:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T3)

1111 Constitution Ave, N.W.
Washington, DC 20224

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, Exempt Organizations Rulings and
Agreements