



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: JAN 19 2004

Contact Person:

UIL 501.00-00

Identification Number:

Contact Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated in the \_\_\_\_\_ on \_\_\_\_\_ to:

1.

2.

3.

4.

On January 9, 2003 your articles of incorporation were amended by replacing the second, third and fourth purpose with the following:

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Your amended application describes you as a demonstration that self-determination for disabled citizens is a viable alternative to institutional living. You will do so by providing care for a disabled adult in a private home. Your client is the \_\_\_\_\_ and \_\_\_\_\_ of \_\_\_\_\_

and . They are of your . It will also receive a \$ annual salary as . It appears that the have contributed a customized and furniture/equipment to you. Your articles of incorporation provide that upon dissolution, your net assets shall be distributed to the family if no legal guardian exists.

The State will reimburse your direct and administrative costs. You expect approximately \$ per year, to cover the care for your client. You do not expect to conduct fundraising in addition to this reimbursement.

You also plan to collect data to evaluate the communication skills of your clients, and to become a clearing-house for information regarding independent living for severely disabled people. You will advocate the creation of nonprofit "self-directed support corporations." Such a corporation manages the support system for a single individual with a disability, with friends and family serving on the board. However, you state that you plan to expand [clients]

Section 501(c)(3) of the Internal Revenue Code (the Code) recognizes as exempt from federal income tax organizations that are organized and operated exclusively for charitable purposes, no part of the net earnings of which inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(4) of the Income Tax Regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal Government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

Section 1.501(c)(3)-1(e) of the Income Tax Regulations (the regulations) provides that an organization may meet the requirements of section 501(c)(3) of the Code 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.

Section 1.501(c)(3)-1(c)(1) of the regulations states 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). 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 states 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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Thus, an organization must 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.

Kemper Military School v. Crutchley, 274 F. 125 (WD Mo 1921) held that a school run by officers who also were stockholders and obtained private benefit in that capacity could not be found to be organized and operated exclusively for exempt purposes without inurement to the benefit of any private stockholder or individual.

Charleston Chair Co. v. United States, 203 F.Supp. 126 (E.D.S.C. 1962) held that a foundation was not operated exclusively for charitable purposes where a substantial part of its distributions was made for a scholarship for the child of a trustee of the foundation, who also was a stockholder and officer of the foundation's donor.

The Callaway Family Association, Inc. v. Commissioner, 71 T.C. 340 (1978) held that an organization supported by 600 members to research the genealogy of the Callaway family was not organized and operated exclusively for educational purposes, although it did further some general educational purposes, because the primary benefit flowed to members of the Callaway family rather than to the general public.

Wendy L. Parker Rehabilitation Foundation, Inc. v. Commissioner, T.C. Memo 1986-348, held that an organization formed to aid coma victims was not operated exclusively for exempt purposes, and that part of the benefits inured to the benefit of private shareholders or individuals, where the organization was founded and controlled by Parker family members and 30% of the income was expected to be expended for the benefit of Wendy L. Parker, a family member. Accord, Rueckwald Foundation, Inc. v. Commissioner, T.C. Memo. 1974-298 (payments made for nursing home and medical expenses of mother and college expenses of son of officer and director).

Airlie Foundation v. IRS, 283 F. Supp. 2d 58 (D.D.C. 2003), held that the organization operated a conference facility in a commercial manner by accepting many for-profit clients at rates competitive with commercial enterprises, advertising to attract such clients, and charging some of its nonprofit clients fees that were in some cases discounts, but not below cost.

We find that you are not organized or operated exclusively for exempt purposes, and that a part of your net earnings inures to the benefit of private shareholders or individuals.

You are not "organized" exclusively for exempt purposes, because your net assets, upon dissolution, will apparently revert to the benefit of your \_\_\_\_\_, the \_\_\_\_\_

Also, you are not "operated" exclusively for exempt purposes. An organization is not operated exclusively for exempt purposes if it provides either benefits to insiders, known as inurement, or substantial, non-incidental benefits to any private individual. Section 1.501(c)(3)-1(c) of the regulations. A private person is a specific person or organization as opposed to the general public or the intended charitable class. Section 1.501(c)(3)-1(c) of the regulations.

In order to justify the subsidy by the taxpayers of the United States that exemption from income taxation provides, an organization must prove that it is benefiting the general public and not substantially benefiting private interests. You have stated that you intend to provide nearly all of your services to one designated individual. This directly violates the requirements of section 1.501(c)(3)-1(d)(1)(ii) cited above. It is well settled that the prohibition against inurement to the "benefit of any private stockholder or individual" was meant to distinguish benefits conferred on an individual from those provided to the general public. See *Kemper Military School, supra*. Furthermore, the person who will receive most of your services is closely related to two of your officers. While you state that you intend to collect information on the communication skills of disabled persons, to serve as a clearinghouse for persons interested in self-determination, and to advocate for self-directed support corporations such as yours, you have no plans to raise any money to conduct those general services. All of your budget derives from the State for the care of the designated individual, although you claim an intention to expand your services to other people with disabilities at some point.

You are providing even more of your resources to benefit one person than the organizations in *Wendy Parker Foundation and Charleston Chair Co., supra*. In those cases, only about 30 percent of the budget was to benefit the relative of the board members. The court in *Wendy Parker* found

petitioner's selection of Wendy Parker as a substantial beneficiary of its disbursements is the determinative factor in this case. Inurement of a benefit to "private individuals," whether monetary or not, as a result of contributions made to a purportedly exempt organization is proscribed.

In this case, most if not all of your initial budget will be expended for the benefit of the  
 These founders effectively control your board (through their veto power over any decisions).

You argue that you are distinguishable from the Wendy Parker Rehabilitation Foundation because you are not a family assistance agency, but an organization licensed by the State to provide residential care services. We find no material distinction under the circumstances.

Moreover, you have not distinguished your operation as a "fully licensed" provider of  
 from a commercial provider of

such services. You acknowledge that commercial \_\_\_\_\_ may provide a similar set of services, but argue that "they serve a different purpose" than your purpose of assisting clients to lead a \_\_\_\_\_. You evidently have met the general requirements of the \_\_\_\_\_, will be regulated by, and accountable to it. You will hire employees through a normal commercial process. As articulated by the court in the recent case of *Airlie Foundation, supra*, when an organization is conducting a commercial enterprise it must show that it is doing so in a non-commercial manner. This may mean that it offers below-cost services, does not compete with for-profit entities, and receives charitable donations. Your description of your operation does not indicate a distinction from commercial providers of similar services. You will be funded through the state payment for services, will meet the same regulatory requirements as commercial providers, will hire employees from the normal employment pool.

You are substantially benefiting a relative of your founders and board members and are conducting an enterprise in a commercial manner. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

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

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

If you do not protest this 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 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 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 a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

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- 6 -

When sending additional letters to us with respect to this case, you will expedite their receipt by faxing to \_\_\_\_\_ or by using the following address:

Internal Revenue Service  
TE/GE (SE:T:EO:RA:T:2)

1111 Constitution Ave, N.W.  
Washington, D.C. 20224

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

Sincerely,

Michael Seto  
Acting Manager  
Exempt Organizations  
Technical Group 2