

Internal Revenue Service

District Director

Department of the Treasury

P.O. Box 2508
Cincinnati, OH 45201

Person to Contact:

Telephone Number

Refer Reply to:

Employer Identification Number:

Date: SEP 19 1995

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a trust or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the staff of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

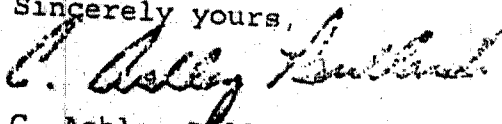
[REDACTED]

If you do not protest this proposed determination 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 Internal Revenue 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 involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely yours,



C. Ashley Bullard
District Director

Enclosures: 3

Facts

Information submitted with your application indicates that you were incorporated on [REDACTED]. Your Articles of Incorporation state that you are organized, in part:

1. To provide a variety of educational opportunities for [REDACTED] of all ages to observe, understand and enjoy the harmonious coexistence of economically sound sustainable agriculture, resource conservation, history and preservation, and diversity of wildlife and ecology within the unique resource of the [REDACTED].
2. To plan, prepare and enable the long-term agricultural viability, conservation and preservation of the [REDACTED] through cooperative interaction between members of the [REDACTED] and other cooperators as the [REDACTED] deems appropriate.

The [REDACTED] is owned by [REDACTED], [REDACTED], and [REDACTED] who are the founders and officers of the organization. You later added five more officers who are not compensated and not related to the [REDACTED]. The [REDACTED] has [REDACTED] acres. The residence, yard and personal gardens, and [REDACTED] sit on [REDACTED] of those [REDACTED]. You stated that the [REDACTED] is being used for educational and charitable purposes except for these two acres.

You indicated in your application that you will develop and implement educational programs for kindergarten through grade 12 students and professional farmers, including the following:

- (a) biocontrol of pests
- (b) sustainable agricultural systems (organic and alternative crops, innovative stock practices, low capital/low energy systems)
- (c) water quality (bioengineering, water testing, indicator species research, etc.)
- (d) innovative agricultural marketing (on-site food handling and processing)
- (e) historic preservation (rock fence restoration, adaptable re-use of historic buildings)

- [REDACTED]
- [REDACTED]
- (f) wild life habitat (compatibility with agriculture; especially for existing habitats such as wetlands, stream, savanna woodlands)
 - (g) natural resources conservation (such as the preservation of the savanna remnant in existence on the property)

When asked for specific examples of programs, you gave two: the students of two area high schools have done a soil judging project on the [REDACTED], and another school is planning to do a water monitoring project on the [REDACTED]. When asked for a copy of any brochures, announcements, educational materials, or any publicity materials pertaining to your organization and activities, you indicated that you do not have any yet.

Since [REDACTED], your activities have been conducted by [REDACTED], a for profit organization. You indicated that [REDACTED] serves as the [REDACTED] manager and organizes and implements educational programs and activities of the [REDACTED]. An agreement was executed among three parties: [REDACTED], ("[REDACTED]"), the [REDACTED], and [REDACTED].

According to the agreement, [REDACTED] "will raise organic vegetables and market those vegetables in [REDACTED] sole discretion" and will care for cattle on the [REDACTED]. Stone will make necessary minor repairs to barns and sheds and perform upkeep on farm machinery on the [REDACTED] farm. The agreement also provides: "[REDACTED] and [REDACTED] will work together to renovate part of the stock barn as a work center for the operations." [REDACTED] will supply or pay for vegetables and hay seed, fuel, fencing and repair materials, tools, small machinery and veterinarian care until "such time as the [REDACTED] operation generates enough income to support these expenses."

You are to pay [REDACTED] \$[REDACTED] per month and will be reimbursed by the [REDACTED] as a donation from them until you and [REDACTED] generate enough income to support these expenses. The agreement also provides that "All income from cattle operations and vegetable farming shall be divided equally between you and [REDACTED]."

Financial information submitted indicates that for the years ending June 30, 1996 and 1997, you expect to be supported by the sale of livestock and vegetables and contributions. Expenses will be from those used to raise livestock and vegetables. Prior to this, an amount of \$[REDACTED] was spent on farming equipment.

Law

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from Federal income tax of those organizations that are organized and operated exclusively for charitable, educational, or religious 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(d)(3)(i) of the Income Tax Regulations states that the term "educational", as used in section 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.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states 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 or operational test, it is not exempt.

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 operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of private interests.

Section 1.501(a)(1)-1(c) of the Regulations states that the words "private shareholder or individual" mean an individual having a personal and private interest in the activities of the organization.

[REDACTED]

Application of Law

Your claim to exemption under section 501(c)(3) of the Code is that you are formed and operated for (a) educational and (b) charitable purposes.

(a) Educational

The public information and demonstration programs you propose may qualify as educational within the meaning of section 501(c)(3) and section 1.501(c)(3)-1(d)(3)(i).

In Revenue Ruling 72-560, 1972-2 C.B. 248, an organization which educates the public and prevents environmental deterioration through workshops, exhibits, and operation of a solid waste recycling center) is ruled to be educational and was granted exemption.

The Service also concluded in Revenue Ruling 68-17, 1968-1 C.B. 247 that an organization that conducts a model demonstration housing program merits exemption as one that is educational.

(b) Charitable

It is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public serve a charitable purpose.

In Revenue Ruling 76-204, 1976-1 C.B. 152, the Service ruled that a nonprofit organization formed for the purpose of preserving the natural environment by acquiring, by gift or purchase, ecologically significant undeveloped land, and either maintaining the land itself with limited public access or transferring the land to a government conservation agency by outright gift or being reimbursed by the agency for its cost, qualifies for exemption.

The purposes for which you were formed are educational and charitable within the meaning of section 501(c)(3) of the Code. However, the conduct of activities to achieve charitable and educational purposes must not inure to private shareholders and individuals. The [REDACTED] where activities are being conducted belongs to the [REDACTED]. You indicated in your application that you were formed to preserve your [REDACTED] as a [REDACTED]. As long as the [REDACTED] is owned by private individuals, preserving the [REDACTED] as a [REDACTED] would serve to benefit those individuals and their heirs and this is in violation of the exclusivity of public purpose required in IRC 501(c)(3).

[REDACTED]

In Dumaine Farms v. Commissioner, United States Tax Court, 73 T.C. 650 (1980), a perpetual, irrevocable trust organized to operate an experimental model demonstration farm is held to be exempt under section 501(c)(3) of the Code... The instant organization conducts research projects designed to demonstrate (1) marginally arable land should be held as conservation land to improve the watershed, provide ground cover and food for wild life, and for timber production; and (2) modern, ecologically sound farming techniques can restore to productive use land exhausted by repetitive cash-crop farming.

The trust's purpose is to hold the property, consisting of 75 acres of land in Rockingham County, North Carolina, and to maintain, improve, operate and manage the same as an experimental and demonstration farm for the benefit of the general public and particularly the farmers and other people of Rockingham County, North Carolina. The purpose of the farm shall be to improve the quality of farming by the selection and types of crops grown, the management and restructuring of the land, the planting and harvesting of trees, the selective preservation of native growth in such manner as to demonstrate that farming can be profitable while maintaining sound, ecological principles and native wildlife.

In Noice v. Schnell, 137 A. 582 (N.J. 1927), the court held that a bequest, in trust, to preserve and protect from commercial development the Palisades along the Hudson River was a valid charitable trust.

Similarly, in President and Fellows of Middlebury College v. Central Power Corporation of Vermont, 143 A. 384 (Vt. 1928), the court found that a devise of land to preserve a specimen of original Vermont forest was a charitable bequest.

A common thread among the above court cases and revenue ruling is that all properties being preserved belong to the government or the public and private individuals do not have retained interest in those properties.

Retained interest in the organization's assets is a form of indirect benefit not permitted by the statute. In Texas Trade School v. Commissioner, 30 T.C. 642, affirmed 272 F.2d 168 (5th Circ. 1959), the officers of a school leased property owned by the officers to the school and caused it to erect improvements which benefited them individually. The Court held that the school was not entitled to exemption under section 101(6) of the Code of 1939.

In Revenue Ruling 66-259, 1966-2 C.B. 214, a trust which provides for the reversion of principal on termination to the creator does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code. The trust agreement provides that all of the net income of the trust must be expended each year for charitable purposes. However, the provision for reversion of trust principal to the creator

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████████████████████

precludes a trust from being organized and operated exclusively for charitable purposes. Where an individual has a reversionary interest, any gains derived from investing and reinvesting the principal would flow to him.

In addition to inurement to insiders, the facts and circumstances also indicate that there is private benefit to an outsider. Your activities are conducted by a for profit organization. According to the ██████████, all income from cattle operations and vegetable farming will be shared equally between ██████████ and you. An exempt organization may hire whomever necessary to achieve its exempt purposes provided it is done at arm's length. The sharing of income of the exempt organization by an outside party constitutes private benefit.

In Gemological Institute of America v. Commissioner, 17 T.C. 1604, the corporation paid an individual a flat salary plus 1/2 of its net earnings as compensation. The Court did not dispute the reasonableness of his salary but stated:

"Regardless of what these amounts are called, salary or compensation based on earnings, it is obvious that half of the net earnings of petitioner inured to the benefit of an individual."

The Court further concluded that "such a distribution of net earnings is unequivocally prohibited by the statute".

Conclusion

Preserving the ██████████ as a ██████████ involves maintaining structures such as fence and barns, planting of perennials such as fruit and nut trees and amending the soil, and thus providing long-term added value to the property. Conserving and preserving natural habitats such as the savanna remnant on the property will also provide the same. As long as the ██████████ own the property, they retain interest in the property. All improvements to the property would benefit the ██████████ and their heirs. Further, the agreement between you and the for profit organization is not established at arm's length because the for profit organization is allowed to share net earnings with you.

Accordingly, you are in violation of the proscriptions in sections 1.501(c)(3)-1(c)(2) and 1.501(c)(3)-1(d)(1)(ii) of the Regulations. Therefore, you do not qualify for exemption under section 501(c)(3) of the Code.

Department of the Treasury Internal Revenue Service
Consent to Proposed Adverse Action
(All references are to the Internal Revenue Code)

Prepare in Duplicate

Case Number

Date of Latest Determination Letter

Employer Identification Number

Date of Proposed Adverse Action Letter

SEP 19 1996

Name and Address of Organization

INTERNAL REVENUE SERVICE
WASHINGTON, D.C.

OCT 17 1996

RECEIVED
E/ED DIVISION

I consent to the proposed adverse action relative to the above organization as shown by the box(es) checked below. I understand that if Section 7428, Declaratory Judgments Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

Denial of exemption

Revocation of exemption, effective

Modification of exempt status from section 501(c)() to 501(c)(), effective

Classification as a private foundation (section 509(a)), effective

Classification as a non-operating foundation (section 4942(j)(3)), effective

Classification as an organization described in section 509(a)(), effective

Classification as an organization described in section 170(b)(1)(A)(), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgment under section 7428.

(Signature instructions are on the back of this form.)

Name of Organization

Signature and Title

Date

Signature and Title

Date