

INTERNAL REVENUE SERVICE

DEPARTMENT OF THE TREASURY

c/o McCaslin Industrial Park  
2 Cupania Circle  
Monterey Park, CA 01755

Date OCT 03 1996.

Employer Identification Number:  
[REDACTED]

Case Number:  
[REDACTED]

Person to Contact:  
[REDACTED]

Telephone Number:  
[REDACTED]

Refer Reply To:  
[REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Dear Applicant:

We have considered your application for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code (Code).

FACTS:

The information submitted discloses that you were incorporated under the non profit corporation laws of [REDACTED]. The purpose for which your organization was formed per your Articles of Incorporation is "...The specific purpose of this corporation is to support the educational opportunities for students at [REDACTED]."

The purposes of your organization, per your application, Form 1023, page 2, Part II, Number i are:

- 1) [REDACTED] will provide tuition assistance to the student body of [REDACTED].
- 2) To use extra funding to support students attendance at various events and to provide transportation to the extent it is required.
- 3) To accept donations of equipment and money which will benefit the students.

Your Form 1023 application states that these activities began in September, 1995. Information submitted in a subsequent letter dated May 13, 1996 and signed by [REDACTED] states that the organization has not yet received or disbursed any funds. The proposed budget submitted with your application discloses the following:

	<u>INCOME</u>		
	1995	1996	1997
Contributions, gifts, grants, etc.	\$ [REDACTED]	- \$ [REDACTED]	\$ [REDACTED]
Gross Receipts	[REDACTED]	[REDACTED]	[REDACTED]
Total	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

	<u>EXPENDITURES</u>		
Contributions, gifts, grants, etc.	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
Fund Raising	[REDACTED]	[REDACTED]	[REDACTED]
Other	[REDACTED]	[REDACTED]	[REDACTED]
Total	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

No schedule was submitted to give a breakdown of contributions, gifts, grants, etc. The schedule submitted for "Others" is as follows:

- 1995 - \$ [REDACTED] Incorporation expense
- 1996 - \$ [REDACTED] Outside Fund-raising Counsel
- 1997 - \$ [REDACTED] Outside Fund-raising Counsel

In a letter dated May 21, 1996 [REDACTED] states that the [REDACTED] is not an exempt organization but a private school which is owned by [REDACTED], a member of the Board of Directors of the school. He also listed a number of Revenue Rulings as a criteria for exemption, namely, Revenue Rulings 66-358, 70-533, 71-580 and 75-196.

A flyer submitted as a part of the literature of the organization reads in part as follows:

[REDACTED]

"... [REDACTED] has been created to meet the needs of children and their families who would benefit from attending [REDACTED] but do not have the financial resources to make the commitment. By offering scholarships based on need, the [REDACTED] will be able to admit selected applicants and will also support current students. In doing so, we hope to increase the social, cultural and economic diversity of the student body and to share the positive values of a [REDACTED] education with more families."

ISSUE:

Does the organization qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code? Is the organization organized and operated exclusively for the private benefit of the for profit owned school and for the parents of the children attending the school?

LAW:

Section 501(c)(3) of the Internal Revenue Code describes certain organizations exempt from income tax under section 501(a) and reads in part as follows:

..."Corporations, and any community chest, fund, or foundation 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 (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on legislation, (except as otherwise provided in subsection (b)), and which does not participate in, or intervene in (including the publishing or distribution of statement), any political campaign on behalf of any candidate for public office."

Section 1.501(a)-1(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earning inures in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) of the Income Tax Regulations defines "Private shareholders or individuals" as an individual having personal and private interest in the activity of the corporation.

Section 53.4945-4(a)(5)(b)(2) of the Income Tax Regulations provides that selection of grantees for scholarships must be on an objective and nondiscriminatory basis. "This requires that the group from which grantees are selected be chosen on the basis of criteria reasonably related to the purpose of the grant. Furthermore, the group must be sufficiently broad so that the giving of grants to members of such groups would be considered to fulfill a purpose described in section 170(c)(2)(B). Thus, ordinarily the group must be sufficiently large to constitute a charitable class."

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 (a) limit the purposes of such organization to one or more exempt purposes; and (b) do not expressly empower the organization to engage otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations 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. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or the family, shareholders of the organization, or persons controlled directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulation provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

See Church of Boston v. Commissioner, (1878) 71 T.C. 102; Colorado State Chiropractic Society, (1989) 93 T.C. 487; Best Lock Corporation, (1959) 31 T.C. 1217; St. Louis Science Fiction Limited v. Commissioner, T.C. Memo 1985-162 and Minnesota Kingsmen Chess Association Inc. v. Commissioner, T.C. Memo 1983-495. All of these court cases held that the presence of a single non-exempt purpose and substantial non 501(c)(3) activities results in loss of exemption despite the presence of other exempt purposes.

Human Engineering Institute, T.C. Memo 1978-145, afd (1980, CA6) 629 F2d 1160. 80-2 USTC section 9600, 46 AFTR 2d 80-5479; Kenner Williams v. Comm., (1963 CA7) 318 F2d 632 63-2 USTC Section 9519, 11 AFTR 2d 1596; and Gondia Corp. T.C. Memo 1982-422 all affirm that an organization is not organized and operated exclusively for one or more exempt purposes if its net earning inures in whole or in part to the benefit of private shareholders or individuals.

In Puritan Church of America v. Comm., (1953, Dist Col) 209 F2d 306, 53-2 USTC section 9601, 45 AFTR 119 cert den (1954) 347 US 975 98L Ed 1115, the court found that an organization is disqualified if it serves a private rather than a public interest. It must therefore establish that it is not organized or operated for the benefit of private interest such as designated individuals, the creator of the organization or his family, shareholders, or persons controlled (directly or indirectly) by such private interest, and the accomplishment of the exempt purpose must not be accompanied by personal, private or selfish consideration.

In American Campaign Academy, (1989) 92 T.C. 1053 the court also found that nonincidental benefits conferred on disinterested persons may also serve private and non public interests and unrelated third parties (i.e., those not within the scope of private shareholders or

individuals but not merely members of the general public) aren't excluded from the class of private persons whose receipt of benefit would cause an organization to be operated for non exempt purposes.

Revenue Ruling 69-175, 1969-1 C.B. 149, denied exemption to a non profit organization formed by parents of pupils attending a private school that provided school bus transportation for its member children because it serves a private rather than a public interest and does not qualify for exemption under section 501(c)(3) of the Code.

In Revenue Ruling 72-102, 1972-1 C.B. 149, an organization formed to provide housing to low-income families was held not to be exempt under 501(c)(3) of the Code because it gave preference to low-income families employed on a farm owned by the individual who created and controlled the organization. The Revenue Ruling reasoned that, even though the organization was providing housing for low-income families, the fact that all families occupying the housing were farm employees of the creator of the organization demonstrated that the organization was operated for a private benefit.

In Revenue Ruling 72-206, 1976-1 C.B. 154, an organization formed to generate community interest in the retention of a classical music program by a local for-profit radio station by seeking program sponsors, encouraging continuation of contracts by existing sponsors, urging the public to patronize the sponsor, soliciting subscription to the station's program guide, and distributing material promoting the classical music program, all which tried to increase the station's revenue, does not qualify for exemption under section 501(c)(3) of the Code.

In Revenue Ruling 70-533, 1970-2 C.B. 112, an educational day care center operated in conjunction with an industrial company that enrolls children on a basis of family financial need and the child's needs for the care and development program of the center is exempt under section 501(c)(3) of the Code.

In Revenue Ruling 71-580, 1971-2 C.B. 235 a non profit organization formed to compile genealogical research data on its family members in order to perform religious ordinances in accordance with the precepts of the religious denomination to which family members belong is exempt under section 501(c)(3) of the Code.

In Revenue Ruling 66-358, 1968-2 C.B. 218, a corporation contributed funds and realty adjacent to its plant reception area to an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954. The exempt organization used the funds and realty to establish a park for the use of the general public. Held, acceptance of this gift by the exempt organization will not affect its exempt status even though the donor retained the right to continue using the picture of a certain scenic view in the park as its brand symbol.

In Revenue Ruling 75-196, 1975-1, C.B. 155, an organization operating a law library whose rules limit access and use to members or their designees, of a local bar association, composed of substantially all of the members of the legal profession in the municipality and providing the library's primary support, qualifies for exemption under section 501(c)(3) of the Code as educational in nature.

ANALYSIS AND CONCLUSION:

All of the preceding Code Sections, Income Tax Regulations, Revenue Rulings and Court Cases describe the criteria under which an organization may be exempt as an organization described in section 501(c)(3) of the Internal Revenue Code and when an organization is deemed not to be exempt under section 501(c)(3) of the Internal Revenue Code.

In order to qualify for exemption under section 501(c)(3) an organization must be both organized and operated exclusively for one or more of the purposes specified in that section. Also, there can be no inurement of private benefit to any individual, organization, etc.

The primary purpose of this corporation is to support the educational opportunities for students at [REDACTED], a privately owned for profit school. The only activity is collecting donations to fund scholarships and other activities of the students of the school. This would constitute private benefit to the for profit school and to the parents of the children attending the school as well as pre-selection.

The three Revenue Rulings mentioned by [REDACTED] are completely unrelated to what this organization does:

1) Revenue Ruling 66-358 - in this case the ruling is on whether an organization will lose its exempt status by accepting a gift of a for profit organization of land which the for profit organization had developed into a park. The park was opened to the general public. There is no access from the park to the corporation's plant reception area and nothing has been done to identify the park with the corporation's business, except to retain in the park the scenic attraction. The corporation's cash contribution to the organization were to be used to operate and maintain the park. There is no private benefit to the for profit corporation.

2) In Revenue Ruling 70-533 - The center enrolls pre-school age children of employees of the company, children of parents employees in nearby factories, and children of parents recommended through contacts with antipoverty and welfare agencies. Employment with the company does not give any employee the right to have his child enrolled in the center. Children are selected on the basis of the

financial need of the family and the need of a child for the care and development program. The center is open to the general public and there is no private benefit.

3) In Revenue Ruling 71-580 - organization performed genealogical research that the church needs in order to perform certain religious ordinances. Without the services carried on by the organization, the religious rites could not be conducted. Any private benefit to a given family or individual that may result is regarded as merely incidental to the general public benefit that is served.

4) In Revenue Ruling 75-196 - The rules of the library provide that the facilities are available for use only by members of the local bar association, and any parties such members may choose to designate. Membership in the local bar association is open to all members of the legal profession in good standing with an office or residence in the municipality. What is of importance is that the class benefited is broad enough to warrant a conclusion that the educational facility or activity is serving a broad public interest rather than a private interest, and is therefore exclusively educational in nature.

It is the position of the Internal Revenue Service, based on the information submitted, that you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code, inasmuch, as you are not organized and operated exclusively for any of the specified purposes within that section but are both organized and operated exclusively for the private benefit of the [redacted], a for profit corporation owned by [redacted], a private shareholder, and for the parents of the children attending that school, as well as pre-selection of students for scholarships.

If you are in agreement with this determination, we request that you sign and return the enclosed agreement, Form 6018. Please note the instructions for signing on the reverse side of the form.

If you are not in agreement with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for a hearing should include a written appeal giving the facts, law, and any other information to support your position, as explained in the enclosed Publication 892. You will then be contacted to arrange a date for a hearing. The hearing may be held at the office of Regional Director of Appeals or, if you request, at a mutually convenient District Office. A self-addressed envelope is enclosed.

If we do not hear from you within 30 days from the date of this letter, and 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 and will then become our final determination.

Section 7423(b)(2) of the Internal Revenue Code provides in part that "declaratory judgement of decree under this section shall not be is due in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determined that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Sincerely yours,

*Steven A. Jensen*  
District Director

Enclosure:  
Publication 892  
Form 6018  
Envelope