

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

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PROTEST REVLD

800
7-30-99

Date: JUN 16 1999

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

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

Employer Identification Number: [REDACTED]

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 are a corporation formed under the [REDACTED] nonprofit public benefit law. The date of your formation was [REDACTED]. This corporation is organized and operated exclusively for educational and scientific purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code. You state that you will be offering your services in different countries to include [REDACTED], [REDACTED] countries of [REDACTED], other countries of [REDACTED], [REDACTED] countries of the [REDACTED]. One of the stated purposes of this organization is electronic document delivery which will, as stated in your submission to the Service from [REDACTED] "...helps the scientists of the [REDACTED] to find and obtain essential information about the achievements of American science and technology".

Your directors are as follows: [REDACTED], President, [REDACTED], [REDACTED], and [REDACTED]. The founder and President is the only paid (\$ [REDACTED] per year) employee at this time. The position of Secretary is unfilled but the salary is set at \$ [REDACTED] per year. There is no conflict of interest clause in the Articles of Incorporation, nor any procedure to set salaries of officers.

You state in your submission to the Service, Form 1023, Attachment 1 (Response to Part II, Activities and Operational Information, line 1); "[REDACTED] is a newly established non-profit corporation which will engage in the following activities:

Scientific: (a) Development and introduction of modern software and other technological means for organizing the cooperative processes among libraries. Evaluation and analysis of the state of current subscription rates among various library collections, and development of a method for determining optimal means for the movement of patron requests. Development of a prototype system for the collection and registration and administration of request handling. We plan to spend 30% of all time for this activity."

Educational: (a) Organization and realization of instruction in the new methodologies and technologies for library specialists in the above-named countries and in the United States. Organization of seminars, conferences and teleconferences for the instruction of these specialists. We plan to spend 40% of all time for this activity."

[REDACTED]

"Humanitarian: (a) Development of low-cost, efficient means of interlibrary cooperation, especially where traditional methods have been prohibitively expensive for libraries and library patrons. Exploring and increasing the viable activities of library workers in situations where government support of libraries has forced them to curtail even their normal, low level of international cooperation. Fostering international communication and understanding through cultural and scientific exchange. We plan to spend 20% of all time for this activity."

"Methodological: (a) Development of technologies and methods for cooperation between libraries of various levels in different countries. The following priorities are planned for the introduction of these new cooperative methods with different countries: [REDACTED]

[REDACTED] Other countries of [REDACTED]
[REDACTED] Organization of the means to introduce these technologies and methods into the various countries. Organization of the process for delivering to American patrons information from the libraries of the above named countries, and from American libraries to international patrons. We plan to spend 10% of all time for this activity."

In your [REDACTED] response ([REDACTED]), to the Service you state: "[REDACTED] has considered following programs as a basis for its activity: a. Information program b. Digital libraries program. c. Educational and productivity enhancement program. You also state ([REDACTED], [REDACTED] 1); [REDACTED] is in process of assisting the [REDACTED] specialist to prepare the Internet teaching materials for [REDACTED] students."

In your [REDACTED] response [REDACTED], you state that you are engaging in the sale of services. They are as follows: Document Delivery - Database Search - Information Counseling - OCR services - Conferences/Seminars - Semi-Monthly Alert Services - Translation Services - Programming - Internet Development. In the same response ([REDACTED]), you state; "The fees for the above services are individually determined. Mainly, the rate for above services will be based at cost. Some services will be above cost, which will allow company growth..."

In your submission to the Service, Form 1023, Attachment 2 (Response to Part II, Activities and Operational Information, line 2) you state: "[REDACTED] is a new organization and has not yet commenced operations and plans to have the following sources of financial support from: (a) Providing fee based information search and delivery service to academic and research communities... . Fee policy will be determined and will be lower than similar services provided by for-profit organizations. (b) Providing fee based services related to the development and implementation of the digital libraries at academic and research communities... . (c) Providing fee based educational programs designed for the foreign information professionals and library specialists mainly from [REDACTED]... . (d) Participating in the government sponsored program, which include various grants. (e) Private contributions."

You go on to state that: "In order to provide quality activities [REDACTED] require financial support of \$ [REDACTED] You indicate that \$ [REDACTED] will come from government grants and private contributions ([REDACTED]%), and \$ [REDACTED] ([REDACTED]%) of your income will be derived from fees for service. You have cited the following examples; information search and delivery service, development and implementation of the digital libraries, educational programs, and from development and distribution of educational printing matter."

In your submission to the Service, Form 1023, Attachment 5 (Response to Service Fee Schedule, Part II, Activities and Operational Information) line 12(a) you state: "[The] following products and services have been developed as initial functions of the [REDACTED]. Charges for the below products and services, although at present undetermined, will be

reasonable, less than commercial enterprises for similar products and services, and related to the cost of the service to be provided. 1. Database development in the areas of significant, universally recognized, humanitarian concerns:... 2. Educational Development... 3. Digital Library Development. 4. Document Delivery Service. 5. Development of new technologies for the electronic document development... 6. Translation Service.

In your [redacted] response to the Service [redacted] you quote the following "charges/fees for information and services". Document Delivery: searching - \$ [redacted] per document, delivery - \$0. [redacted] per page. Database Search: analysis - \$ [redacted] per request, result - \$ [redacted] per hit. Information Consulting: analysis - \$ [redacted] per topic. OCR services: scanning - \$ [redacted] per page, proofing - \$ [redacted] per page. Conferences/Seminars: fee to be determined. Semi-Monthly Alert Services: Publication - free, full-text delivery - \$ [redacted] per page.

Section 501(c)(3) of the Code provides for the exemption from federal income tax or organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(c)(1) of the 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). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term 'charitable' includes the advancement of education.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) 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 or purposes and if the organization is not organized or operated for the primary purpose for carrying on an unrelated trade or business, as defined in section 513.

Section 513 of the Code defines a trade or business as "...any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501...".

A "trade or business" is defined in section 1.513-1(b) of the regulations as having the same meaning it has for purposes of section 162, and "generally includes any activity carried on for the production of income from the sale of goods or performance of services".

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities have a causal relationship to the achievement of exempt purposes (other than the production of income); and that it is "substantially related."

Better Business Bureau v. United States, 316 U.S. 279 (1945), holds that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption under section 501(c)(3). 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 purposes.

B.S.W. Group, Inc., v. Commissioner, 70 T.C. 352 (1978), holds that an organization that

planned to offer consulting services for a fee to a class of nonprofit (but not all tax-exempt) organizations did not qualify as a charitable entity but was taxable as a business.

The Council for Bibliographic and Informational Technologies, v. Commissioner, T.C. MEMO 1992-364; 1992 Tax Ct. Memo LEXIS 387; 63 T.C.M. (CCH) 3186, it was held that where a group of tax exempt organizations form a cooperative to provide services exclusively to those tax exempt organizations, and the services provided are necessary and indispensable to the operations of the tax exempt organizations, the cooperative is a tax exempt organization.

Rev. Rul. 72-369, 1972-2 C.B. 245 holds that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 81-75, 1981-1 C.B. 356 holds that a translation service provided by an exempt trade association that promotes and develops trade relations between business entities located in the U.S. and the government of a foreign country is unrelated trade or business within the meaning of section 523 of the Code.

You stated in your [redacted] response submitted to the Service; "All [redacted] services are exclusively related to the education, research and development activities as stated in the Articles of Incorporation...". But then you go on to list the activities of the organization as: document delivery, database search, information consulting, OCR services, semi-monthly alert services, translation services, programming, and internet development. These listed services are all substantial in nature, are activities which produce income, but not all are charitable in nature.

Your corporation is distinguishable from true "user groups", where members share problems, information, and experiences, because you engage both in a consulting-type of business, and a fee for services, which provides specific services to clients. See *Rev. Rul. 72-369, 1972-2 C.B. 245*, and *B.S.W. Group, Inc., v. Commissioner*, 70 T.C. 352 (1978), *supra*.

You stated in your submission to the Service, [redacted] "At present [redacted] is soliciting its services to several Federal and local government agencies. [redacted] is planning to offer its services to...". This is strongly indicative of a profit motive. Further you have stated in your [redacted] submission to the Service, *supra*; "Some services will be above cost, which will allow company growth", indicating that you are receiving considerable financial benefit. This also indicates the desire to expand the organization and a profit motive. The expenditure of fees for the expansion of a business is a general characteristic of a trade or business.

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test' the organization's resources must be devoted to purposes that qualify as exclusively charitable with the meaning of section 501(c)(3) of the Code and the applicable regulations. See *Rev. Rul. 72-369, supra*.

The cited case of *The Council for Bibliographic and Informational Technologies, supra*, is distinguishable from your organization because in that case, the computerized library system was owned and operated by all the members and "necessary and indispensable" to the operations of member libraries. This case has also been distinguished from the holding in *B.S.W. Group, Inc., supra*, by pointing out that the Applicant, as here, was not formed or controlled by tax exempt organizations and intended to offer its services for a fee to taxable organizations as well.

From the facts provided by the Applicant to the Service, this organization enters into consulting agreements with unrelated nonprofit organizations on a cost or below commercial rate

basis. This consists of "information counseling" and is designed for the individual needs of each client organization. Receipts of the organization are from fees for services rendered. Disbursements are for operating expenses. This is analogous to the decision in Rev. Rul. 72-369, *supra*.

From facts provided by the Applicant to the Service, this organization also provides translation services for a fee. The operation of a translation service has been found to constitute a 'trade or business', *see*, Rev. Rul. 81-75, *supra*. A translation service conducted by an organization does not contribute importantly to the development and promotion of efficient business practices in respect to the business community as a whole. Instead, it is the regular operation of trade or business for the benefit of the individual business concerns. The fact that the service requires a high level of expertise that is not readily available elsewhere does not alter its commercial nature or the fact that the service relates to individual business needs of the business concerns involved. The operation of the translation service constitutes unrelated trade or business within the meaning of section 513 of the Code.

It appears that your activities do not further "public" purposes, but rather commercial interests, you have the general characteristics of a trade or business and the facts and circumstances indicate that you are operating a trade or business for designated individuals or for the persons who created it.

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 judgement 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 EP/EO key district 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, EP/EO 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).

[REDACTED]

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

Internal Revenue Service
[REDACTED], OP:E:EO:T:4, Room 6238
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,
Gera:

Gerald Sack
Chief, Exempt Organizations
Technical Branch 4