

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - EP/EO
Cincinnati, OH 45201

Date:

Employer Identification Number:

[B]

[A]

Person to Contact - I.D. Number:

Contact Telephone Numbers:

Phone

FAX

UIL 501.03-05
501.33-00

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[G]

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. However, we have concluded that you do not qualify under another subsection.

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 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 office 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.

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. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

Martha Sullivan
Director, Exempt Organizations

Enclosures: (3)
Attachment I
Publication 892
Form 6018

Attachment I

Issues

1. Does the applicant, formed to provide aid to a pre-selected individual, qualify for exemption under section 501(c)(3) of the IRC?
2. Does the intent to broaden the recipients to unrelated individuals, after the pre-selected individual no longer needs financial aid from the organization remedy the prior distribution?

Facts

You were formed on [D], in the state of [H] and subsequently incorporated [E]. The initial three officers of the organization included the mother and grandfather of the pre-selected individual as well as one other parent of a child attending the same daycare facility. The initial governing body also had two voting directors who are also parents of children attending the same daycare facility.

Subsequent to the incorporation date, the two relatives of the pre-selected individual were removed from the governing body and presently there are three unrelated Board members.

The Articles of Incorporation contain standard language concerning the organization and operation for exclusively section 501(c)(3) charitable purposes.

According to information submitted with Form 1023, the stated reason for forming the organization was to continue the ongoing fundraising activities for the benefit of one child, who was diagnosed with leukemia in late 2003. Some parents whose children attend the same daycare facility as the pre-selected recipient become aware of her diagnosis and began soliciting financial support for the ill child from other parents at the daycare and from local businesses. The fundraising efforts began in late 2003, and continue today with all proceeds benefiting the pre-selected individual and her family. Once the organization determines that the pre-selected child is no longer in need, they will select another family to support.

The schedule of fund disbursement in the administrative file indicates that as of [F], [G] has been distributed to the pre-selected recipients' family.

Besides direct solicitation of funds from the public, the organization also conducts other fundraising activities such as a silent auction of donated goods.

Law

The Internal Revenue Code of 1986, (hereinafter Code) section 501(c)(3), states in part ..."Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literacy, 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 shareholder or individual,..."

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (hereafter Regs), states:

"In order to be exempt as an organization described in section 501(c)(3), 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 test or the operational test, it is not exempt."

Section 1.501(c)(3)-1(c)(1) of the Regs states in part ..."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(c)(2) of the Regs states regarding the distribution of earnings ..."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 Income Tax Regulations (hereafter Regs) states:

"An organization is not organized or 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 designated individuals or the persons who created it."

Section 1.501(c)(3)-1(c)(2) of the Regs 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. The definition of "private shareholder or individual" is defined in paragraph of (c) of section 1.501(a)-(1) of the Regs. Regs section 1.501(a)-1(b)(2)(c) defines the words "private shareholder or individual" in section 501 refers to persons having a personal and private interest in the activities of the organization. Revenue Ruling (hereafter Rev Rul) 1956-403, 1956-2 CB 307 states the awarding of scholarships by a foundation solely to undergraduate

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members of a designated fraternity will not preclude it from exemption from Federal income tax under section 501(c)(3) of the Code as an educational organization.

"The fact that the foundation's scholarships are limited to a particular group would not preclude its exemption as an educational organization inasmuch as there is not specific designation of persons eligible for scholarships and purposes of the foundation are not so personal, private, or selfish in nature as to lack the elements of public usefulness and benefit which are required of organizations qualifying for exemption under section 501(c)(3) of the Code."

Rev Rul 1967-367, 1967-2 CB 188 states ... "A nonprofit organization whose sole activity is the operation of a "scholarship" plan for making payments to pre-selected, specifically named individuals does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code."

Rev Rul 69-545, 1969-2 C.B. 117, states that the promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, providing that the class is not so small that its relief is not of benefit to the community.

Also included is the following extract from Scott on Trusts; *Restatement (second), Trust, § 378 and § 372; IV Scott on Trusts (3rd ed. 1967), §. 368 and §. 372. A nonprofit organization whose purpose and activity are providing hospital care is promoting health care and may, therefore, qualify as organized and operated in furtherance of a charitable purpose. If it meets the other requirements of section 501(c)(3) of the code, it will qualify for exemption from Federal income tax under section 501(a)."*

In *Carrie A. Maxwell Trust, Pasadena Methodist Foundation v. Commissioner*, 2 TCM 905 (1943) a trust established for the benefit of an aged clergyman and his wife was a private trust and not an exempt activity despite the fact that the two individuals served were needy.

In *Wendy Parker Rehabilitation Foundation, Inc. v. Commissioner*, T.C. Memo 1986-348, the organization was created by the Parker family to aid an open-ended class of "victims of coma." However, the organization stated that it anticipated spending 30 percent of its income for the benefit of Wendy Parker, significant contributions were made to the organization by the Parker family, and the Parker family controlled the organization. Wendy's selection as a substantial recipient of funds substantially benefited the Parker family by assisting with the economic burden of caring for her. The benefit did not flow primarily to the general public as required under section 1.501(c)(3)-1(d)(1)(ii)

of the Regulations. Therefore, the Foundation was not exempt from federal income tax under section 501(c)(3) of the Code.

Commentary provided in the court case documentation states in part:

"The distribution of funds for the benefit of Wendy Parker assists the Parker family in providing for her care. These funds will be used to pay for the medical and rehabilitative care of Wendy Parker. This relieves the Parker family of the economic burden of providing such care. Consequently, there is a prohibitive benefit from petitioner's funds that inures to the benefit of private individuals. See *Founding Church of Scientology v. United States*, 188 Ct.Cl. 490, 412 F.2d 1197 (1969), cert. denied 397 U.S. 1009 (1970) (payments made to family members of organization's founder); *Charleston Chair Company v. United States*, 203 F. Supp. 126 (E.D.S.C. 1962) (scholarship aid given to son of officer and director); *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).

The Parker family's control over petitioner is not in itself fatal to petitioner's cause. However, 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. See *Lowry Hospital Association v. Commissioner*, supra at 857 n. 8; *People of God Community v. Commissioner*, supra at 133; *Horace Heidt Foundation v. United States*, 145 Ct.Cl. 322, 170 F. Supp. 634, 638 (1959). The benefit to the Parker family is no less tangible because payment is directed not to be Parkers but to others for Wendy Parker's care."

Application of Law

You were formed to continue the ongoing fundraising activities for the benefit of the pre-selected recipient. Section 501(c)(3) of the Code requires that an organization be organized and operated "exclusively" for designated exempt purposes. 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 designated individuals or the persons who created it. You were organized for the benefit of a designated individual and as such, not for a charitable purpose.

In order for an activity to be charitable, it must serve a charitable class. You are like the organization described in *Carrie A. Maxwell Trust*, (supra) a trust established to benefit a needy clergyman and his wife was not exempt. The trust benefited private individuals rather than the general public. This is also identified as not an exempt activity in Rev Rul 1967-367 (supra) where an organization paid scholarships to pre-selected individuals.

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You are unlike the organization in Rev Rul 69-545, where an organization that provided hospital care to members of the community, even though the class of beneficiaries eligible to benefit from its activities did not include all members of the community, was held to be serving a public interest provided that the class of persons that it serves is broad enough to benefit the community. Your activities are to provide benefits for an individual rather than a class of persons.

You are substantially similar to the *Wendy Parker (supra)* case. As in *Wendy Parker*, your organization wishes to confer substantial benefits on a pre-selected individual. The benefit does not flow primarily to the general public as required under *Section 1.501(c)(3)-1(d)(1)(ii)* of the regulations but to a private individual. This is an issue of private benefit. As such the subsequent expansion of the group of potential beneficiaries is inconsequential as the private benefit has happened, therefore, exemption is denied.

Applicant's Position

You believe that your formation by unrelated and independent individuals should cause their determination that Lydia Vigneau and her family needed assistance to reach a sufficient level of objectivity. You further believe that the appointment of related parties to the Board of Trustees did not cause control to pass to the private individuals.

You further believe that your community fundraising was sufficient to demonstrate that the general public was sufficiently interested to have created a public purpose. In compliance with our instructions, you have expanded the beneficiaries to include sick children within their state. You contend that no intention of private benefit has ever existed. It is your hope that you might find a manner of becoming compliant with our requirements. You have expressed an interest in pursuit of an appeal of our determination.

Service Response to Applicant's Position

Wendy Parker (supra) provides us with our standard for this type of case. The organization is designed to care for one individual, and benefits the parents and grandparents of the sick child. As such, no public purpose is served.

Conclusion

Based on the information submitted by you, there is no substantive differentiation between you and the *Wendy Parker (supra)* case. The benefits directed toward a pre-selected individual are examples of inurement and excess private benefit, therefore, preclude exemption under section 501(c)(3).

We have considered your proposed modification of activities, but the fact that almost 100% of your funds will be distributed to one individual for an indefinite period of time precludes exemption.

We have considered whether you would qualify for exemption under any other section of the Code and have determined that you do not.