

Internal Revenue Service
Director, Exempt Organizations
Rulings and Agreements

Department of the Treasury
P.O. Box 2508 - EODQA RM 7008
Cincinnati, OH 45201

Date: [REDACTED]

Employer Identification Number:

Person to Contact - I.D. Number:

Contact Telephone Numbers:

Phone
FAX

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.

[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 judgement 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,

[REDACTED]

[REDACTED]

Director, Exempt Organizations
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Enclosures: 3

Enclosure I

BACKGROUND:

You were incorporated on [REDACTED] in the State of [REDACTED] under the general not for profit corporation act of [REDACTED]. Your articles of incorporation provide that you are organized exclusively for charitable, religious, scientific, literary, cultural and educational purposes that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or any successor section.

You do not have members. In describing your activities on Form 1023, you stated, "[REDACTED], President of the Foundation, is a psychiatrist and psychoanalyst who has practiced for many years in [REDACTED]. She is on the faculty of [REDACTED] and the [REDACTED]. In recent years, she has developed a new technique (known as the [REDACTED]) that she has used very successfully with her patients. It involves using self-hypnosis in a new, very specific way to develop a special part of the mind, which she has named "[REDACTED]"; a mental pathway that allows an individual to attain emotional comfort and develop his or her full potential. [REDACTED] has developed a new theory of mental functioning that explains this phenomenon, and has presented it to her colleagues. She is presently completing a book (working title: [REDACTED]) that will provide the general public with information about this technique. Individuals will be able to learn the technique by reading the book, but will require additional reinforcement in order to persist with the technique long enough to get the results they seek."

You stated that you were formed for the purposes of 1) helping individuals who wish to use the self-hypnotic technique, 2) undertaking projects to further study the self-hypnotic process, and to offer it to various specific groups, and 3) providing education to the public about this technique.

You began publishing a bi-weekly Letter on [REDACTED] for the purpose of providing support, stimulation, and additional information to those who are using the self-hypnotic technique. The Letter, written by [REDACTED], is sent free of charge at this time; as of [REDACTED], there were [REDACTED] recipients. As more people learn about the technique and begin using it, the list of subscribers will grow.

In describing your first project, you stated that most of the information about self-hypnosis gathered by [REDACTED] so far has come from her work with her patients. You would like to study more about how people outside of a therapeutic situation can learn and use the [REDACTED], and has initiated a project for this purpose. You stated that people who wish to participate in this yearlong study are offered an individual session with [REDACTED] at the Foundation office, to learn the technique. After the session, they may consult with [REDACTED] by e-mail (or by post) with any questions they have. The participants also receive the bi-weekly Letter for additional support. You stated that all teaching and assistance are provided without cost to the participants. Once a month, the participants are asked to provide answers to a brief set of questions. At first,

they are asked about the experience of attaining comfort and confidence in practicing self-hypnosis. Then, they are asked about the all-important step of following a reliable routine. After these steps are mastered, the participants are asked to describe the kinds of experiences that occur along the way as they continue with the technique. You stated that the Foundation hopes to learn more about the wide variety of problems that can be solved as participants become increasingly emotionally comfortable. You also stated that the findings would be published without disclosing the identity of the participants.

[REDACTED] began this first project in [REDACTED], and as of [REDACTED] there were [REDACTED] participants. Your intention is to study a total of [REDACTED] participants

As time allows, you plan to offer classes explaining the technique to all groups that are interested in learning about it. You are specifically interested in bringing knowledge of the technique to schools and prisons. Initially, [REDACTED] would do the teaching. However, as more individuals master the technique, they might become involved in promulgating it in their milieus. You stated that when necessary, you might pay consultation fees to those who teach.

Your present and future sources of support will consist of contributions from [REDACTED] and possibly from subscriptions to the bi-weekly [REDACTED]

Your expenses include occupancy, depreciation, legal fees, supplies, postage and shipping, advertising, insurance, office, computer support, signage, website, and miscellaneous expenses.

Your response to our request for additional information dated [REDACTED] stated that [REDACTED] owns the copyright to the book, (working title: [REDACTED]). The book is not being published under the auspices of the Foundation and that it is a separate for-profit endeavor. [REDACTED] will receive the royalties from the book as she wrote it in its entirety. She will also own the publishing and selling rights to the book and the distribution of the book will not differ from ordinary publishing practices.

The response also stated that the work is conducted in [REDACTED] private practice office. You also provided two copies of your newsletter dated [REDACTED] and [REDACTED]. The [REDACTED] newsletter described how self-hypnosis works and includes a question and answer section. The [REDACTED] newsletter described the initial results of your first project and a question and answer section.

Your website stated that you were created to help those who are using the new self-hypnotic technique described in [REDACTED] by [REDACTED]

It also stated, "Self-hypnosis is easy to learn; [REDACTED] has found that most people are able to achieve this state in one session. However, she has also found that because it takes some time before results are seen, people have needed periodic contact with her in

order to receive the necessary stimulation to continue practicing self-hypnosis regularly. Realizing that this technique can be useful not only for patients, but for most people who would like to eliminate stress, attain emotional comfort and liberate their creativity, she has written the book to enable people to learn this technique on their own. Realizing also that those who learn from the book would not have the kind of regular access to her that her patients do, she decided to provide support by a different means. The [REDACTED] [REDACTED] was formed to publish a biweekly Letter that provides the necessary stimulation for those who learn self-hypnosis from the book..."

It also stated, "[REDACTED] will also initiate various projects to bring knowledge of this technique to various groups who can benefit from it. Because it can be of great help to almost everyone, the Foundation hopes that eventually self-hypnosis will become universally practices. When this comes to pass, most people will become optimally comfortable, and their enhanced energy and creativity can be directed toward solving the problems of our society..."

Your website also stated, "If you would like to eliminate stress, correct emotional imbalance, increase your creativity and energy, and achieve serenity, [REDACTED] by [REDACTED] will show you how. Self-Hypnosis explains [REDACTED] new way of understanding the causes of emotional discomfort, and the new technique she has developed for eliminating stress and developing one's creativity. Many people already do self-hypnosis and meditation, but [REDACTED] new technique incorporates an important difference! It is easy to learn, as the simple steps are described in detail; and [REDACTED] published a biweekly Letter, which provides follow-up information and assistance. The book, to be published by [REDACTED], will be available later this year..."

[REDACTED] response to our request for additional information dated [REDACTED] stated, "When I discovered the new technique for attaining emotional comfort that has been so helpful to me, my patients, and some of my friends and relatives, I felt that I should share it with everyone. I wrote a book for that purpose, which will be published in [REDACTED] (I originally planned, [REDACTED] but that date has been moved forward). I realized that people who read the book could learn the technique from it, but would need some kind of ongoing support in order to persist with the technique long enough to achieve results. At the end of the book, I suggest that readers can contact the foundation, or me personally, for help. I also wanted to offer my help, free of charge, to such institutions as prisons, schools, etc. Future projects will involve these organizations. My co-directors and I created the foundation for these non-profit purposes. ... My concept is that my endeavor will have a for-profit component, the book, and a non-profit component, the foundation. I have tried to keep everything separate. There will be a separate website, [REDACTED] which is currently under construction, to advertise the book and my services as a consultant. (The visual design has been completed, but the text has yet to be created.) This preliminary design can be viewed at [REDACTED]"

The response also stated, "I have to own the copyrights for the book because book sales and consultant fees are how I will make my living."

In response to your letter dated [REDACTED] a follow-up call was made to [REDACTED] on [REDACTED] to discuss our concerns that the organization did not appear to serve public interest. During that discussion, [REDACTED] stated that she would be promoting her book by going around the country and conducting workshops. Ninety-five percent of the people who learn about the book would learn about it from the tours and workshops. The Foundation would be providing support to readers of [REDACTED] book and to people who may have been to her office for a session and have learned about the book. Most people would learn of the Foundation after reading the book. The Foundation would initiate various projects such as the opportunity for [REDACTED] to go into prisons and teach the technique. The Foundation's purpose is to spread knowledge of the procedure, (which is trademarked by [REDACTED]), as much as possible. The Foundation will publish a newsletter bi-weekly that will discuss various techniques that will encourage and help individuals understand the procedure (owned by [REDACTED]) better. To date, [REDACTED] has funded the Foundation using her own funds. [REDACTED] does not want public contributions, but tax-exempt status is desired so that she could claim a deduction for the funds spent on the organization thus far.

LAW:

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

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 test or the operational test, it is not exempt.

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 of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the 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, to meet the requirement of this subdivision, 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 his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Revenue Ruling 76-206, 1976-1 C.B. 154, considered an organization formed to promote broadcasting of classical music in a particular community. The organization carried on a variety of activities designed to stimulate public interest in the classical music programs of a for-profit radio station, and thereby enable the station to continue broadcasting such music. The activities included soliciting sponsors, soliciting subscriptions to the station's program guide, and distributing pamphlets and bumper stickers encouraging people to listen to the station. The organization's board of directors represented the community at large and did not include any representatives of the for-profit radio station. The revenue ruling concludes that the organization's activities enable the radio station to increase its total revenues and therefore benefit the for-profit radio station in more than an incidental way. Therefore, the organization is serving private rather than public interest and does not qualify for exemption.

Revenue Ruling 71-395, 1971-2 C.B. 228 considered a cooperative art gallery formed and operated by a group of approximately 50 artists for the purpose of exhibiting and selling their works. Additional artists are admitted to membership by approval of the existing members. The gallery is open to the public six days a week and does not charge an admission fee. Works of the member artists are exhibited and offered for sale. A panel chosen by the members selects those works for exhibition that in its opinion meet certain minimal artistic standards. The public may purchase all works and many may be rented. The gallery retains a commission from sales and rental sufficient to cover the cost of operating the gallery. Any deficits that occur are covered by special assessments of the members. The revenue ruling concludes the cooperative gallery is engaged in showing and selling only the works of its own members and is a vehicle for advancing their careers and promoting the sale of their work. It therefore serves the private purposes of its members, even though the exhibition and sale of paintings may be an educational activity in other respect.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

Operating for the benefit of private parties constitutes a substantial non-exempt purpose. Old Dominion Box Co. v. United States, 477 F. 2d 340 (4th Cir. 1973), cert. Denied 413 U.S. 910 (1973).

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The board was self-perpetuating. The Court reasoned that since the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The Court was not persuaded, stating:

“A realistic look at the operations of these two entities, however, shows that the activities of the taxpayer and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accountings of receipts and disbursements does not change that fact.”

The Court went on to conclude that the organization had a substantial nonexempt purpose.

In KJ's Fund Raisers, Inc. v. Commissioner, T.C. Memo 1997-424 (1997), affirmed 82 AFTR 2d 7092 (1998), the Tax Court found that another gaming organization was not exempt. While the organization raised money for charitable purposes, it also operated for the substantial benefit of private interests. The organization's founders, Kristine Hurd and James Gould, were the sole owners of a bar, KJ's Place. The organization, through the owners and employees of KJ's Place, sold lottery tickets exclusively at KJ's Place during regular business hours. While in KJ's Place, the lottery ticket purchasers were sold beverages from the bar. The initial directors were Hurd, Gould, and a related individual. The initial board was replaced several times until Hurd and Gould were no longer on the board. At all times Hurd and Gould were the organization's officers. Salaries had been paid to Hurd and Gould and rent had been paid t KJ's Place. The organization maintained that the fact that salaries and rent were no longer paid in this fashion indicated the independence of the board. The court took another view, stating:

“Although those practices ceased and are not in issue here, the current board of directors is composed of at least the majority of the same members who allowed those amounts to be paid. This strongly suggests that Hurd and Gould are free to set policy for their own benefit without objection from the board. Nothing in the record since July 1, 1994, indicates otherwise.”

The Court concluded that K.J.'s Fundraisers was operated for substantial private benefit and did not qualify for exemption. The Court of Appeals affirmed the decision. It found that the organization had served the private interests of its directors in maintaining and augmenting their business interests.

ANALYSIS:

Section 501(c)(3) of the Code sets forth two main tests for qualification for exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3).

The regulations under section 501(c)(3) expand on the requirements for satisfaction of the operational test. The key requirement is that an organization be operated exclusively for one or more exempt purposes. To determine whether this test is satisfied, section 1.501(c)(3)-1(c)(1) of the regulations directs the Service to determine if the organization engages primarily in activities, which accomplish one or more exempt purposes. Section 1.501(c)(3)-1(d)(1)(ii) of the regulations expands on the operated exclusively concept by

providing that an organization is not operated exclusively to further exempt purposes unless it serves a public rather than a private interest. Based on the facts that you have provided in your application for recognition of exemption, we are not able to conclude that you are operated exclusively for public rather than private purposes.

You were incorporated to help individuals who wish to use the self-hypnotic technique developed by [REDACTED] to undertake projects to further study the self-hypnotic process, and to offer the technique to various specific groups such as prisons and schools, and to provide education to the public about this technique. These activities, apart from the relationship with [REDACTED], may further an educational purpose within the meaning of section 1.501(c)(3)-1(d)(3)(i) of the relations. However, to satisfy the operational requirements under section 501(c)(3), you must also establish that your operations serve public rather than private purposes. If even one of your substantial activities has a private purpose, such as benefiting private parties, you will not qualify for exemption. See, Better Business Bureau, supra.

The information you submitted discloses that [REDACTED] is the president of your board of directors, and she is a psychiatrist and psychoanalyst in private practice. She has developed the technique known as the [REDACTED] that she has used successfully with her patients. She is presently completing a book that will provide the general public with information about the technique. Individuals outside of her practice will learn about the technique after reading her book and will require additional reinforcement in order to persist with the technique long enough to get the results they seek. Therefore, you were formed to provide the needed support and reinforcement as well as to spread knowledge about [REDACTED] procedure. In addition, you will publish a bi-weekly newsletter that will discuss various techniques that will encourage and help individuals understand the procedure. [REDACTED] will conduct your activities in the office of her private practice. In this regard, the influence that [REDACTED] maintains over your operations, (by virtue of the fact that she is the creator and owner of the procedure for which your organization is named and she conducts your activities in her private practice), is similar to the control exercised by the bar owners in P.L.L. Scholarship v. Commissioner, supra, and K.J.'s Fund Raisers, Inc. v. Commissioner, supra. In P.L.L. Scholarship v. Commissioner, supra, the Court concluded that the activities of the organization and the creator's bar where the activities took place were so intertwined as to be "functionally inseparable." Your organization is similar to this in that [REDACTED] stated that that her concept was that her endeavor would have a for-profit component, the book, and a non-profit component, the Foundation. Maintenance of separate records and Websites does not eliminate the interconnection between these endeavors.

Your organization is similar to the one described in Revenue Ruling 76-206, supra. Your activities augment the private practice of [REDACTED] and are thus serving a private rather than public interest.

Like the organization described in Revenue Ruling 71-395, your organization is a vehicle for advancing the career of [REDACTED] and promoting the sale of her book. Although the

activities you described may be otherwise charitable, the manner in which you operate leads us to conclude that your organization bestows significant private benefit on [REDACTED]
[REDACTED]

Based on the information you provided, we conclude that you do not qualify for exemption as an organization described in section 501(c)(3) of the Internal Revenue Code.