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Date 5-11-93

Surname [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

MAR 31 1993

Employer Identification Number: [REDACTED]
Key District: [REDACTED]

Dear Applicant:

This letter is in further consideration of your application for recognition of exemption as an organization described in section 501(c)(3) of the Internal Revenue Code. On [REDACTED], we issued you a proposed denial of recognition of exemption. You submitted a protest to that letter dated [REDACTED]. We are reissuing the proposed denial, subject to the regular protest provisions. Our reasons for the conclusion that you are not exempt under section 501(c)(3) of the Code and the facts upon which it is based, as well as your protest rights, are explained below.

You were incorporated [REDACTED], under the laws of the State of [REDACTED]. You were incorporated for the following purposes: to encourage the participation of young women in the State of [REDACTED] in the [REDACTED] Pageant and to provide a program for issuing scholarships and/or cash or equivalent awards to young people based upon talent and character allowing them to further their educational and personal opportunities; and to affiliate with the [REDACTED] to allow [REDACTED] to participate in the national competition to select [REDACTED]. As amended, your Articles also provide that you are organized exclusively for charitable, educational, religious, or scientific purposes within the meaning of section 501(c)(3) of the Code. You also represent that you coach and assist in the preparation of the winner for competing in the annual [REDACTED] Pageant.

You are required to require all contestants in the state pageant and to cause contestants in the local pageants to sign a contestant contract. You, on behalf of [REDACTED], must cause your finalist to enter into a second contract. You provide the finalist with incidentals money, meal money, and round trip transportation to [REDACTED]. You require that your contestants have not entered into contracts to endorse products competitive with the sponsors of [REDACTED]

[REDACTED]. You represent that a contestant's breach of contractual provision will not result in a forfeiture of her scholarship, if she is otherwise entitled to the scholarship.

Whether a contestant signs a six-page local contestant contract or the ten-page state level contestant's contract, the contract includes a section devoted to "scholarship funds." The first sentence of this section states "I understand that the scholarship funds will be provided by certain prominent companies and by the Pageant itself, and I agree that at no time during the period I hold the [title] . . . will I endorse or permit my name or likeness to be used in connection with the endorsement or advertisement or any product or products competitive to the products of any of the major contributors to said scholarship fund."

Section 501(c)(3) of the Code provides for the exemption from federal income tax to organizations organized and operated exclusively for charitable purposes or educational 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(a) of the Income Tax Regulations provides that 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 purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(b)(1)(i) of the regulations states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes, and 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 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 regulations states that an organization is not organized or operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, to meet the requirements under section

501(c)(3), 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, or persons controlled directly or indirectly by such private interests.

Rev. Rul. 66-103, 1966-1 C.B. 134, states that an organization whose primary activity is to provide awards and grants, including scholarship and fellowship grants to needy individuals who would otherwise not be able to pursue their studies for lack of funds and with no monetary benefits to the donor organization, qualifies for exemption under section 501(c)(3) of the Code. The organization is primarily engaged in a charitable activity or providing relief of the poor.

Rev. Rul. 69-257, 1969-1 C.B. 151, states that an organization providing scholarships selected from a broad class of applications, on the basis of scholastic standing, qualifies for exemption under section 501(c)(3) of the Code. The organization was created for the purpose of advancing education.

In Better Business Bureau v. Commissioner, 326 U.S. 279 (1945), the Supreme Court determined that while some activities of the organization under consideration were educational, a substantial purpose of the organization was to promote business; thus, the organization was not operating exclusively for educational purposes.

In Bingler v. Johnson, 394 U.S. 741, 751 (1969), the Supreme Court stated that to be excluded from gross income under section 117, a scholarship must be a relatively disinterested, no strings educational grant, with no requirement of any substantial quid pro quo for the recipients.

Miss Georgia Scholarship Fund, Inc. v. Commissioner, 72 T.C. 267 (1979) involved an organization formed for the purpose of giving scholarships to contestants in the Miss Georgia Pageant. The participants were required as a condition for qualifying for scholarships to enter into a contract that would obligate them in the event they were selected to participate in the Miss America Pageant to abide by the rules and regulations of the pageant, including participation in public appearances and the like, under the sponsorship of Miss Georgia Pageant. These scholarships were unavailable to those contestants who failed to execute the contestant's contract. The Tax Court stated that the principal issue in its decision was whether the purported "scholarships" granted by the organization were exempt under section 117 or section 74 of the Code, or were compensatory in nature. The organization was not exempt under section 501(c)(3) because the organization was operated primarily for the purpose of providing compensatory payments to contestants in the pageants.

[REDACTED]

Your articles of incorporation fail to limit your organizational purposes to one or more exempt purposes. You are organized, inter alia to affiliate with [REDACTED] to allow [REDACTED] to participate in the national competition to select [REDACTED]. You are also organized to make non-scholarship cash payments to certain persons. There is nothing per se exempt in such purposes.

Section 117(a) of the Code provides, in relevant part, that gross income does not include any amount received as a qualified scholarship. Section 117(c) imposes a limitation thereon, however, and specifies that the exclusion for "qualified scholarships" shall not apply to that portion of any amount received which represents payment for teaching, research, or other services by the student required as a condition for receiving the qualified scholarship.

A scholarship or fellowship grant represents payment for services when the grantor requires the recipient to perform services in return for the granting of the scholarship or fellowship. A requirement that the recipient pursue studies, research, or other activities primarily for the benefit of the grantor is treated as a requirement to perform services. A scholarship or fellowship grant conditioned upon either past, present, or future services by the recipient, or upon services that are subject to the direction or supervision of the grantor, represents payment for services under this section.

Aside from your organizational defect, your activities reflect a substantial purpose of paying compensation. You represent that certain payments are scholarships. However, to the extent the payments are scholarships, the same issue presented to the Tax Court in Miss Georgia Scholarship Fund, Inc., supra, is present in your case. We must determine whether the scholarships you award to contestants in [REDACTED] Pageant are compensatory payments as defined in section 117(c) of the Code, and thus not excludable from income pursuant to section 117(a).

The information submitted indicates that each contestant of your contest is required to execute a contract before she participates in the local pageant and again before she participates in the state level pageant. These contracts merely confirm that each contestant is expected to render services to [REDACTED] by participating in the series of events leading up to the selection of [REDACTED] and [REDACTED]. Each contestant signs these contracts before she receives her scholarship. Both contracts require the pageant participants and winners to perform certain services and refrain

[REDACTED]

cc:

[REDACTED]

cc: State Officials

[REDACTED]
[REDACTED]
[REDACTED]
JUL 20 1990

Dear Applicant:

You were incorporated [REDACTED] under the laws of the State of [REDACTED]. You were incorporated for the following purposes: to encourage the participation of young women in the [REDACTED] Pageant and to provide a program for issuing scholarships and or the cash equivalent awards to young people based on certain objective criteria allowing them to further their educational and personal opportunities; and to affiliate with [REDACTED] to allow [REDACTED] to participate in the national competition to select [REDACTED]. You are also organized exclusively for charitable, educational, religious, or scientific purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code. You also represent that you coach and assist in the preparation of the winner for competing in the annual [REDACTED].

You are required to require all contestants in the state pageant and to cause contestants in the local pageants to sign a contestant contract. You, on behalf of [REDACTED], must cause your finalist to enter into a second contract. You provide the finalist with incidentals money, meal money, and round trip transportation to [REDACTED]. You require that your contestants have not entered into contracts to endorse products competitive with the sponsors of [REDACTED]. You represent that a contestant's breach of contractual provision will not result in a forfeiture of her scholarship, if she is otherwise entitled to the scholarship.

Whether a contestant signs a six page local contestant contract or the ten page state level contestant's contract, the contract includes a section devoted to "scholarship funds." The first sentence of this section states "I understand that the scholarship funds will be provided by certain prominent companies and by the Pageant itself, and I agree that at no time during the period I hold the [title] . . . will I endorse or permit my name or likeness to be used in connection with the endorsement or advertisement or any product or products competitive to the

products of any of the major contributors to said scholarship fund."

Section 501(c)(3) of the Code [herein "Code"] provides for the exemption from Federal Income Tax to organizations organized and operated exclusively for charitable purposes or educational 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(a) of the Federal Income Tax Regulations [herein "Regulations"] provides that to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(b)(1)(i) of the Regulations states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes, and 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 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 states that an organization is not operated exclusively for section 501(c)(3) purposes unless it serves a public rather than a private interest. Thus, to qualify under section 501(c)(3) an organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, or persons controlled directly or indirectly by such private interests.

In Better Business Bureau v. Commissioner, 326 U.S. 279 (1945), the Supreme Court determined that while some activities of the organization under consideration were educational, a substantial purpose of the organization was to promote business; thus, the organization was not operating exclusively for educational purposes.

Section 1.117-3(a) of the Regulations defines the term "scholarship" to generally mean an amount paid or allowed to, or for the benefit of, a student pursuing his studies.

Section 1.117-4(c) (1) of the Regulations provides that any amount paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research, shall not be considered to be amounts received as a scholarship grant under section 117 if such amount represents either compensation for past, present, or future employment services or represents payments for services which are subject to the direction or supervision of the grantor.

In Bingler v. Johnson, 394 U.S. 741, 751 (1969), the Supreme Court stated that to be excluded from gross income under section 117, a scholarship must be relatively disinterested, no strings educational grants, with no requirement of any substantial quid pro quo for the recipients.

Rev. Rul. 66-103, 1966-1 C.B. 134, states that an organization whose primary activity is to provide awards and grants, including scholarship and fellowship grants to needy individuals who would otherwise not be able to pursue their studies for lack of funds and with no monetary benefits to the donor organization, qualifies for exemption under section 501(c)(3) of the Code. The organization is primarily engaged in a charitable activity or providing relief of the poor.

Rev. Rul. 68-20, 1968-1 C.B. 55, states that under section 117, a scholarship is includable in the gross income of a beauty pageant winner as compensation for participating in the contest, playing a leading role in the televised pageant, and for performing subsequent services for, or at the direction of, the sponsoring corporation.

Rev. Rul. 69-257, 1969-1 C.B. 151, states that an organization providing scholarships selected from a broad class of applications, on the basis of scholastic standing, qualifies for exemption under section 501(c)(3) of the Code. The organization was created for the purpose of advancing education.

Miss Georgia Scholarship Fund, Inc. v. Commissioner, 72 T.C. 267 (1979) involves an organization formed for the purpose of giving scholarships to contestants in the Miss Georgia Pageant. The participants were required as a condition for qualifying for scholarships to enter into a contract that would obligate them in the event they were selected to participate in the Miss America Pageant to abide by the rules and regulations of the pageant, including participation in public appearances and the like, under the sponsorship of Miss Georgia Pageant. These scholarships were unavailable to those contestants who failed to execute the contestant's contract. The Tax Court stated that the principal issue in its decision was whether the purported "scholarships" granted by the organization were exempt under section 117 or section 74 of the Code, or were compensatory in nature. The

organization was not exempt under section 501(c)(3) of the Code, because the organization was operated primarily for the purpose of providing compensatory payments to contestants in the pageants.

Your articles of incorporation fail to limit your organizational purposes to one or more exempt purposes. You are organized, inter alia to affiliate with [REDACTED] to allow [REDACTED] to participate in the national competition to select [REDACTED]. You are also organized to make non-scholarship cash payments to certain persons. There is nothing per se exempt in such purposes.

Aside from your organizational defect, your activities reflect a substantial purpose of paying compensation. You represent that certain payments are scholarships. However, to the extent the payments are scholarships, the same issue presented to the Tax Court in Miss Georgia Scholarship Fund, Inc. is present in your case. We have to determine whether the award payments you characterize as "scholarships" are "scholarships" as defined by section 1.117-3(a) of the regulations or are an exclusion therefrom pursuant to section 1.117-4(c)(1) of the regulations.

The information submitted indicates that the winner of your contest is required to execute an agreement before she participates in the local pageant and again before she participates in the state level pageant. She signs these agreements before she receives her scholarship. Both agreements require the pageant participants and winners to perform certain services and refrain from certain activities. One such activity is endorsement or advertisement of any product competitive to the products of any of the major contributors to the scholarship funds. In light of this agreement (and other agreements required of all pageant contestants), and the provisions therein respecting personal service obligations on the part of contestants and selectees, we conclude that the "scholarships" awarded are clearly payments for past, present, and future services by the contestants, including participation in your scholarship program as well as other programs and activities. Your "scholarship" awards are simply additional prizes for executing contracts, and for entering, participating in, and winning your program. Under section 1.117-4(c)(1) of the regulations, such awards are not scholarships.

Because your substantial purpose is the provision of compensatory payments to contestants in the program, you are not operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code. See also section 1.501(c)(3)-1(c)(1) of the regulations.

See 1
501(4)
501(5)

Furthermore, by facilitating the girls' obligation to perform certain services for [REDACTED], you are serving private rather than public interests. Therefore, you have again shown that you are not operated exclusively for one or more exempt purposes under section 501(c)(3). See section 1.501(c)(3)-1(d)(1)(i) of the regulations.

We find you to be analogous to the taxpayer in Miss Georgia Scholarship Fund, Inc., supra. That taxpayer did not qualify for exemption under section 501(c)(3) of the Code.

Better Business Bureau, supra, instructs that, under the organizational test, it is not enough to have two purposes, one charitable and the other non-charitable, if the latter is substantially non-charitable. Your documents and contracts indicate that you are organized for a substantial non-charitable purpose, namely the provision of compensation. At best then, you are organized for two purposes. You assert that you are organized to promote education; and the record clearly evidences a substantial non-charitable purpose.

You are organized for at least two non-exempt purposes, including the selection of a [REDACTED] to participate in the [REDACTED] contest, section 1.501(c)(3)-1(b)(1). You have a substantial organizational and operational purpose of providing compensation to some of your contestants, see section 1.501(c)(3)-1(b)(1); section 1.501(c)(3)-1(c). Additionally, you operate to promote social purposes. Further, you serve the private interests mentioned above. See section 1.501(c)(3)-1(d)(1)(ii), supra.

Accordingly, we conclude that you fail to qualify for exemption from federal tax under section 501(c)(3) of the Code. You are required to file federal income tax returns on Form 1120.

You have the right to protest our ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed 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

judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the United States 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 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

When submitting additional letters with respect to this case to the Internal Revenue Service, you will expedite their receipt by placing the following symbols on the envelope: [redacted]. These symbols do not refer to your case but rather to its location.

Sincerely,

[redacted]
Chief, Exempt Organizations
Rulings Branch 2

7
cc: [redacted]

cc: [redacted]