



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200644048**
Release Date: 11/3/2006

Date: 01/11/06

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Uniform Issue List:

501.03-02

509.01-01

Legend:

A =

B =

Dear _____ :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: November 15, 2005

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Uniform Issue List:

501.03-02

509.01-01

Legend:

A =

B =

Dear _____ :

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) of the Code. 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.

Your application, Form 1023, and attachments state that you were formed by a declaration of trust pursuant to the laws of the state in which you are located.

Your application states that you were formed to provide financial support to the organizations identified in your trust document. The organizations are exempt from federal income tax under section 501(c)(3) of the Code and are recognized as publicly supported organizations described in section 509(a)(1) or (2). You are requesting

classification as an organization described in section 509(a)(3). You represent that you meet the requirements of section 509(a)(3) based on your relationship with A.

You are funded by contributions from your founders along with interest and investment income.

You are governed by five trustees. Your trustees were appointed by your founders. In the future, your founders will appoint two of your trustees and representatives of A will appoint two of your trustees. The fifth trustee will be appointed by your founders and the trustees appointed by A.

Your application states that your founders contributed \$ _____ to you in 2001, \$ _____ in 2002 and \$ _____ in 2003.

Pursuant to the terms of a Trust Deed Note entered into five and one-half months after your creation, you loaned \$ _____ to your founders in the form of a mortgage on their home. This loan amounted to approximately _____ of the total contributions from your founders during 2001.

On page 3 of Form 1023, you indicate that you were formed to support and benefit A. In 2002, you distributed no funds to A. In 2003 and 2004, you distributed \$ _____ and \$ _____, respectively, to A. Your total distributions to A amount to less than _____ of the total contributions from your founders during the years 2001 – 2004.

In 2003, the funds you distributed to A were earmarked for furnishing the playground at A's facility. You did not respond to our request for the total budget of A and the portion of the budget dedicated to the playground. These figures are necessary to determine whether you met the integral part test with respect to A in 2003. In 2004, the funds you furnished to A were not earmarked and were placed into A's general funds. You did not respond to our request for the total budget of A information needed to determine whether you met the integral part test in 2004.

In 2002, you distributed \$ _____ to B. You made additional contributions of \$ _____ and \$ _____ to B in the years 2003 and 2004, respectively. These contributions were made to satisfy the personal financial obligations of your founders with respect to tithes owed to B. You did not respond to our request for information regarding whether you feel these distributions serve as a basis for determining that you meet the integral part test with respect to B.

501(c)(3):

Law

Section 501(a) of the Code provides, in part, that organizations described in section 501(c) are exempt from federal income tax. Section 501(c)(3) describes, in part, an

organization that is organized and operated exclusively for religious, charitable, 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)(1) of the Income Tax Regulations provides that in order for an organization to be exempt under section 501(c)(3) of the Code it 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 or 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 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 regulations 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.

Section 1.501(c)(3)-1(c)(2) of the regulations 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. Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization must be organized and operated to serve a public rather than a private interest and specifically 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.

In Rev. Rul. 67-5, 1967-1 C.B. 123, the Service found that an organization controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the organization. The organization owned common stock that paid no dividends of a corporation controlled by the organization's creator and his family. The Service held that the foundation was operated for a substantial non-exempt purpose and served the private interest of the creator and therefore, was not entitled to exemption under section 501(c)(3) of the Code.

The "not more than an insubstantial part of its activities" standard of section 1.501(c)(3)-1(c)(1) of the regulations can be understood by reference to Better Business Bureau v. United States, 316 U.S. 279 (1945) which held that an organization which engaged in some educational activity but pursued nonprofit goals outside the scope of the statute

was not exempt under section 501(c)(3) of the Code. The Court stated that an organization is not operated exclusively for charitable purposes if it has a single noncharitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. Thus, the operational test standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations which further nonprofit goals outside the scope of section 501(c)(3).

In Best Lock Corporation v. Commissioner, 31 T.C. 620 (1959), the court upheld the denial of recognition of section 501(c)(3) status of an organization that loaned funds to members of the founder's family, even though the loans were repaid. The court determined that loans to family members and unsecured loans to friends of the founder and his family promoted private rather than charitable purposes.

In Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969) and in Church in Boston v. Commissioner, 71 T.C. 102 (1978), the courts found that the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement.

Rationale

Your founders serve as two of your five trustees. Your founders and the other two trustees appoint the fifth trustee. Your founders have the power to veto any recommendations regarding the selection of your fifth trustee. Your founders through their power to veto any candidate to nominated to serve as the fifth trustee, indirectly control your assets and operations. Your founders' indirect control over your operations caused you to act as a mortgagee with respect your founders. You provided no data to evidence that the interest rate charged was at fair-market value. No financial information was provided evidencing that your founders have the financial resources to make the monthly mortgage payments. Further, you are used by your founders to make distributions to satisfy their personal responsibility for the payment of tithes to B. See Rev. Rul. 67-5, supra, regarding an organization controlled by the creator's family that was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the organization.

In the four years that you have operated, _____ of your assets were used to provide a loan in the form of a mortgage to your founders' and to satisfy their financial obligations to B. Thus, you do not satisfy the "not more than an insubstantial part of its activities" standard of section 1.501(c)(3)-1(c)(1) of the regulations. You have a noncharitable purpose that is substantial in nature. Further, less than _____ of your assets were used to further your charitable purpose, supporting A. See Better Business Bureau v. United States, supra.

Your founders indirectly control your operations by virtue of their influence over two of your trustees who are their personal friends and their voting power with respect to appointment of your fifth trustee. You serve the private interest of your founders through your provision of a loan to them and the payment of tithes to satisfy their financial obligations to B. See Founding Church of Scientology v. United States, supra, and Church in Boston v. Commissioner, supra, where the courts found that the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement. See also Best Lock Corporation v. Commissioner, supra, in which the court determined that the fact that a loan has been repaid is not relevant.

You made a loan to your founders and satisfied your founders' financial obligations by making payments on their behalf. Through their 50% voting power, your founders can block any decision regarding the appointment of your fifth trustee. Thus, your founders have indirect control of your assets and operations. You have failed to show that your founders qualified for the loan, that the rate of interest was at fair-market value, and whether your founders have made timely payments regarding the loan. As indicated in Best Lock Corporation, supra, loans to family members and to other entities might be considered as being made for the personal purposes of the founder. Further, of your total assets were use to benefit your founders. Thus, your primary purpose results in private benefit and inurement to your founders. Accordingly, you serve a private rather than public purpose.

An organization must establish that it operates exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3) if it has a single non-charitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. An organization is not operated exclusively for exempt purposes if its net earnings inure in whole or in part to the benefit of private individuals.

Based on the information provided in your Form 1023 and supporting documentation, we conclude that you are not operated exclusively for purposes described in section 501(c)(3) of the Code. You have not shown that your assets do not inure to any private individual. In fact, your application demonstrates you operate for the benefit of your founders.

Section 509(a)(3):

Law

Section 509(a) of the Code defines the term "private foundation" as an organization described in section 501(c)(3) other than organizations described in section 509(a)(1), (2), (3), or (4). Section 509(a)(3) provides that the term "private foundation" does not include an organization that:

(A) is organized and operated exclusively for the benefit of, to perform the function of, or to carry out the purposes of one or more organizations described in section 509(a)(1) or (2);

(B) is operated, supervised or controlled by, or in connection with, one or more organizations described in section 509(a)(1) or (2);

(C) is not be controlled, directly or indirectly, by one or more persons who would be disqualified persons as defined in section 4946 if the organization were a private foundation, other than foundation managers as defined in section 4946(a)(1)(B) and organizations described in section 509(a)(1) and (2).

Section 1.509(a)-4(c)(1) of the regulations provides that an organization is organized exclusively for one or more purposes specified in section 509(a)(3)(A) of the Code only if its articles of organizations: (i) limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A); (ii) do not expressly empower the organization to engage in activities which are not in furtherance of purposes set forth in section 509(a)(3)(A); (iii) state the specified publicly supported organizations; and (iv) do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations stated in its articles of organization.

Section 1.509(a)-4(e)(1) of the regulations provides that a supporting organization must engage solely in activities that support or benefit the specified publicly supported organizations. These activities may include making payments to or for the use of, providing services or facilities for, individual members of a charitable class benefited by the publicly supported organizations.

Section 1.509(a)-4(f)(1) of the regulations provides that an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. The requirements for “operated in connection” type relationship are set forth in section 1.509(a)-4(i).

Section 1.509(a)-4(i)(1)(i) provides that an organization must meet both the “responsiveness test” of section 1.509(a)-4(i)(2) and the “integral part test” of section 1.509(a)-4(i)(3) to be operated in connection with one or more specified publicly supported organizations.

Section 1.509(a)-4(i)(3)(i) of the regulations provides that the “integral part test” is considered to have been satisfied if the supporting organization maintains a significant involvement in the operations of one or more publicly supported organizations and the publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. In order to meet the integral part test, either

section 1.509-4(i)(3)(ii) or (iii) must be satisfied.

Section 1.509(a)-4(i)(3)(ii) of the regulations provides that the activities engaged in for or on behalf of the publicly supported organizations must be activities to perform the functions of, or to carry out the purposes of, such organizations and, but for, the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves.

Section 1.509(a)-4(i)(3)(iii)(a) of the regulations provides that a supporting organization coming under the “operated in connection with” status must make payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations must be sufficient to assure the attentiveness of such organizations to the operations of the supporting organizations. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations that meet the attentiveness requirement of this subdivision with respect to such supporting organization. Except as provided in (b) of this subdivision, the amount of support received by a publicly supported organization must represent a sufficient part of the organization’s total support so as to assure such attentiveness.

Section 1.509(a)-4(i)(3)(iii)(b) of the regulations provides that even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary’s total support, the amount of support received from a supporting organization may be sufficient to meet the requirements of this subdivision if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization’s primary program or activity so long as such program or activity is a substantial one.

Section 1.509(a)-4(j)(1) of the regulations provides that an organization will be considered “controlled,” for purposes of section 509(a)(3), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of a substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization. Thus, if the governing body of a foundation is composed of five trustees, none of whom has veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered controlled, directly or indirectly, by one or more disqualified persons by

reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting right with respect to stocks in which members of the governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

Rev. Rul. 80-207, 1980-2 C.B. 193, held that an organization with a 4-person-board consisting of a substantial contributor and two employees of a corporation owned (over 35 percent) by the substantial contributor was indirectly controlled by disqualified persons and was not a supporting organization under section 509(a)(3) of the Code. The Service stated that because one of the organization's directors was a disqualified person and neither the disqualified person nor any other director had a veto power over the organization's actions, the organization was not directly controlled by a disqualified person under section 1.509(a)-4(j) of the regulations. However, in determining whether an organization is indirectly controlled by one or more disqualified persons, one circumstance to be considered is whether a disqualified person is in a position to influence the decisions of members of the organization's governing body who are not themselves disqualified persons.

Rationale:

OPERATIONAL TEST

In each year of your existence you expended substantial funds to satisfy your founders' need for a loan and the payment of their financial obligations. Thus, you do not meet the operational test since you do not engage solely in activities that support or benefit A. Further, in 2002, although you had \$ _____ in assets, you made no distributions to A, the organization you claim to support. Accordingly, you fail to meet the operational test. See section 1.509(a)-4(e)(1) of the regulations.

RELATIONSHIP TEST

You claim to satisfy the relationship test because you are operated in connection with A. In order to be described as an "operated in connection with" section 509(a)(3), an organization must satisfy the (1) a responsiveness test and (2) integral part test. Although requested, you failed to furnish financial information needed to determine whether A is dependent upon you for the support you provide and whether the support you provide to A is sufficient to insure the attentiveness of A to your operations. Accordingly, you have not established that you satisfy the integral part test. Thus, you do not satisfy the requirements of section 1.509(a)-4(i) with respect to the "operated in

connection with" relationship.

CONTROL TEST

Your founders are substantial contributors and disqualified persons as defined by section 4946 of the Code. Your founders serve as two of your five trustees. With respect to the selection of your fifth trustee, your founders have the power to veto any nominations made. Your founders' veto power with respect to your fifth trustee indicates that you are indirectly controlled by disqualified persons within the meaning of section 509(a)(3)(C) of the Code.

Based on the following analysis of the information provided in your Form 1023 and supporting documentation, we conclude that you are not a supporting organization under section 509(a)(3). You fail the requirements for supporting organization status for a number of reasons. You cannot be classified as a supporting organization because we have determined you are not an organization described in section 501(c)(3). Even if we had determined that you are described in section 501(c)(3), you have not established that you meet the requirements of section 509(a)(3). You have not established that you are organized and operated exclusively for the benefit of specified publicly supported organizations. You have failed to establish that you have a sufficient relationship with specified publicly supported organizations. Finally, you have not established that disqualified persons do not control you.

Conclusion:

Based on our analysis of your activities and, in light of the applicable law, we have determined you do not qualify for tax exemption as an organization described in section 501(c)(3) of the Code. Even if we determined that you were described in section 501(c)(3), you would be a private foundation and not a supporting organization under section 509(a)(3) of the Code. 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 judgment 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 Tax Exempt and Government Entities (TE/GE) 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, TE/GE 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).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If it is convenient, you may fax your reply using the fax number shown in the heading of this letter.

Internal Revenue Service
TE/GE
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437