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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201115026**
Release Date: 4/15/2011
Date: January 19, 2011
UIL Code: 501.32-01
501.33-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

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.

Since 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.

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, you should 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,

Rob Choi
Director, Exempt Organizations
Rulings & Agreements

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

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UIL Nos:
501.32.01
501.33.00

Legend:
M = organization
B = individual
C = individual
D = city/state
E = for profit entity
F = for profit entity
G = registered agent
H = organization
J = individual
K = individual
L = individual
N = date
X = date
Y = state
Z = state

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). 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.

ISSUES:

a. Are you formed as a vehicle to obtain grants and charitable contributions for the benefit of B, C, and B and C's for-profit photography and heating and cooling service businesses, resulting in inurement? Yes, for the reasons described below.

b. Are you formed as a means to obtain charitable contributions for the benefit of H, resulting in inurement and/or impermissible private benefit? Yes, for the reasons described below.

c. Have you met the burden of proof that you are operated exclusively for tax exempt purposes under section 501(c)(3) of the Internal Revenue Code? No, for the reasons described below.

FACTS:

Your founders, **B and C, who are husband and wife**, own F, a for-profit heating and air conditioning business in the State of Z. You stated that B and C have successfully operated F, since early 1983. Your founders B and C, also own and operate E, a for-profit photography business. You currently use the same facility as the for-profit heating and air conditioning business, F and the for-profit photography business, E.

Your Strategic Plan states that B's goal was to build a full-time business in 2000.

> **He did not want to incur indebtedness by obtaining loans; therefore, it has been difficult to expand without additional financing for advertising, vehicles, a warehouse/office building, additional employees, etc. He needs to hire at least one or two service men to keep up with the customer calls he receives. He has operated the business from home and now needs additional space and a different location…[C] has served as office manager/bookkeeper. At least 1 additional office employee is needed at the present time, as business grows**.

You stated that C found **H, a for-profit fundraising consulting firm**, on the internet and contacted the firm. You stated that B and C were influenced by statements provided by H including the following:

> You can receive money from private foundations and government programs for virtually any type of business. Whether it is to start a business or expand your existing business, there is money waiting for you. Private foundations and the federal government provide this money to help existing small business owners and those who want to start their own business [to] change their lives and achieve financial independence…many private foundations and government programs are available to stimulate small business. As a business owner or future entrepreneur, **you may qualify for a variety of programs from public sources designed to enhance, expand, or initiate your business**.

You further explained that "[H] first said that they had $ to $ funding available. **Then they told us that they could get us well over a Million if we had a non-profit company. That is why we signed the non-profit service contract.** They instigated and completed the filing for tax exemption." B and C signed a service contract (on behalf of their privately owned businesses, F and E) and paid a fee of $ to H to solicit for grant funding in the amount of $. The contract between B and C (on behalf of E and F) with H stated that the business intent of the contract was to "Expand, Staffing, Facility, Equipment, Advertising, Transportation, and Operating & Reserve."

You also submitted a copy of a second contract B and C have with H, which stipulated that H is to file the necessary legal documents to establish you as a non-profit corporation with the appropriate state officials, serve as your Resident Agent for one year, complete the Form 1023 application on your behalf, assist you with the Form 1023 determination process as well as provide you with counseling and guidance to show you how to operate your corporation. B and C paid H a sum of $ for the services covered under the second contract. You indicated that the fundraising expenses projected on your budgets of $ in 20 , $ in 20 and $ in 20 were funds allocated for H's compensation. When we asked about how the income and expenses on your budgets were determined, you indicated that H had entered the financial information for you on your application.

You provided to us a copy of a letter from company H explaining the firm's contractual duties relating to the photography business, E and your founder, C. "**There are several different processes that [H] will be performing that are crucial in attaining any grant for E and C.**" H stated that they will provide the following:

> 1st Step – Research
> Matching individuals with for-profit businesses and non-profit 501(c)(3) organizations or private foundations that are dispersing funds for your type of project and current location.
>
> 2nd Step – Letter Writing - Letter of Intent (L.O.I.)
> We will draft a L.O.I. on behalf of [E and C] for the foundations you match with. The purpose of this letter is to explain your situation and what you will be doing with any grant money you receive.
>
> 3rd Step – Request for Proposal (R.F.P.)
> Should any foundation or organization request for a formal application (grant), they will send both of us a R.F.P. [E and C] will be assigned to a grant writer who will write the actual grant to be received for the foundation or organization.
>
> Finally, if the foundation is willing to fund your project, the grant money will be dispersed to you or your company.

You, M, filed Form 1023 application requesting recognition of tax exemption under Section 501(c)(3) of the Internal Revenue Code. You were incorporated on X as a Y corporation that operates in Z. Your Articles of Incorporation state that you are organized exclusively for charitable, religious, educational and scientific purposes. The registered agent listed on the Articles of Incorporation is G, an entity affiliated with H, a for-profit fundraising consulting firm. Article 9 of your Bylaws states that you will not issue shares of stock and that you are an entity without shareholders. However, other parts of your Bylaws including Article 2 and Article 6 state that you do have shareholders.

You are governed and managed by two related individuals, B and C. Your application lists B as your President/Director. C is listed as your Secretary/Treasurer. Your application describes B and C as volunteers. **However, your Strategic Plan indicates that B is to be compensated $ per year as your General Manager, and C is to be compensated $ per year as your Office Manager**. You further explained that H, your fundraising consultant, told you "that to start out, until any funding was received, [B and C] had to be volunteers and could take no salary or expense reimbursements. After funding is received...officers could receive a salary of up to $ a year." **You indicated that you have recruited individuals J, K and L as unrelated, outside business people to sit on your Board of Directors for a period of one**

year as uncompensated advisors. J, K and L submitted signed letters agreeing to serve on your Board of Directors.

You described that you are formed to provide heating and cooling equipment service and repair at **low**-to no-cost fees to low-income families, seniors, and individuals in the D area. You will receive customer referrals from local and community organizations. In addition to providing HVAC repairs and services, you will also provide on-the-job training to college students and individuals. You clarified that the on-the-job training will take place where the services are needed, which does not require a facility until grant funding is received. You expressed that until you receive funding, HVAC assistance will be very limited. At the current time, you have no established hours because you are still in the pre-opening stages.

You stated that your founder and President, B, will be a working supervisor for all projects, providing training for others who want to learn the trade. These training programs will be offered to those in need of job training, or those who cannot afford to attend classes at other facilities. You stated that your founder and Treasurer, C, will act as administrative and operations manager, developing programs, providing oversight of all projects, and creating the clerical and administrative arm of the company, inclusive of accounting, purchasing and customer service departments. C will also conduct training classes for community people in need of job training. You stated individuals B and C will **devote full time efforts** to the projects once funding is acquired. "**The funding will also allow for hiring of full-time service and maintenance employees to provide the services in the community**." However, you subsequently provided that the funds raised through the receipt of grants would enable you to recruit experienced volunteer service technicians and supervised college students to perform the HVAC services.

You will market your HVAC services through word of mouth by friends and family as well as distributing pamphlets at local establishments that may offer additional help to those seeking supportive assistance programs.

Your budgets show the following projected income and expenses:

Income
Gift, grants and contributions
Total Income
Expenses
Fundraising expenses
Compensation of officers & directors
Occupancy
Professional fees
Total Expenses

The following is your funding forecast based on your Strategic Plan:

Funding Forecast	**Year 1**	**Year 2**	**Year 3**
Funding			
Grant			
Donations			
Total Funding			
Direct Cost of Funding			
Material			
Labor Cost			
Subtotal Cost of Funding		$	

According to your Strategic Plan, your labor costs are projected at approximately $ per year. This will involve five positions: B serving as your general manager, C as your office manager, two service managers and a receptionist/assistant. The two service managers and the receptionist positions are yet to be filled.

Your Strategic Plan provide that your start-up financial requirements are approximately $, which include the purchase of property (two trucks, truck tools, inventory, warehouse), all deposits and office equipment to enable the organization to open its doors for business.

Your Strategic Plan indicates the following market segmentation of your potential customers:

Potential Customers	Year 1	Year 2	Year 3	Year 4	Year 5
Low-Income					
Senior Citizens					
Other					

Based on the market segmentation, low-income customers will comprise approximately 34 to 35 percent of your total number of customers. The senior citizen population you serve may or may not be low-income individuals. Other individuals and families (not designated as low-income) will comprise 11 to 14 percent of your total number of customers. You also pointed out that you will target your services to nonprofit customers. If sufficient funds are not available, you will ask non-profit organizations to pay for equipment at your cost. However, the labor will be provided free of charge. You stated that "Though [your] primary focus…is targeted to providing assistance to economically disadvantaged low-income families and senior citizens, [you] are positioned as a premier source of providing services for the communities of [D]." You stated that will select individuals to receive services based on their true need. However, you did not specify the financial requirements you use to assess the financial need of individual customers. You provided that a local community group will screen applicants prior to making referrals to you.

You share a telephone number and address with for-profit HVAC business, F. When we asked how the public can differentiate between your services and those provided by the for-profit business, F, you stated that people will know based on their ability to pay for HVAC services. You will provide heating, air conditioning and related services, at no charge, to people in the community that are in need of these services. You indicated that F will be serving customers who can afford to pay for their services. You provided that you are a separate and distinct new business, not associated with any existing business, with the exception of the officers. You stated there will be no commingling of funds, employees, facilities, or any other materials by the companies. The services will be provided by qualified service technicians that donate their time and skills to the foundation as well as by supervised HVAC students as a part of their training. You provided that F will not be hiring any students from the on-the-job training program. F uses experienced subcontractors when needed. You further stated that the advertising and bookkeeping system for the for-profit organization F will continue as it has since inception.

During a telephone call on N with your founder, C, it was stated that the for-profit business**, F, will provide the HVAC services and then charge you for the services performed**. C further indicated that this will enable F to continue to perform the services and receive revenue, even if the low-income individuals are unable to pay. Subsequently, you reiterated that you are formed to provide HVAC services to those in need.

When we inquired if you were created to benefit F, you responded by stating that:

> [W]hen we applied for grants a year ago, we did not fully understand what was involved. We just knew that there was a need for assistance to people who could not afford to pay for heating/cooling repair/replacement services. [F] attempted to meet these needs in the course of their daily business, but found that with the rising costs of the expenses involved in the efforts, they could not continue to provide services free of charge. The foundation was created to fulfill the needs of the general public...
>
> [N]one of the grant funding will be given to [F] or any service people. We had some confusion on how [the organization] was to operate, as it has been so long since we applied for the grants. After reviewing all the rules and regulations, and after speaking with people who are familiar with non-profit company operations, we understand the distinctness of each business...

When we asked if B and C expect repayment of the $ they paid to H, you stated that B and C thought that the grants you receive would provide them with financial assistance in expanding their business, hiring, service and office personnel and enabling them to help more low income families with their heating and cooling needs. You recognize now that is not how "non-profit" grant funding works. You indicated that you have been trying to comply with the rules and procedures since they were explained to you. You also stated that "it seems reasonable to us that [F] should be reimbursed $ that it paid to [H], however, if [you] ever [get] funded, it can absorb the loss, if that is acceptable to the IRS. If there is some way for [B] and [C] to recoup the $ fee paid to [H] that too would help compensate for our lost time and money."

LAW:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of corporations **organized and operated** exclusively for charitable, educational, and other exempt purposes, provided that **no part of the net earnings inure to the benefit of any private shareholder or individual**.

Section 1.501(a)-1(c) of the Income Tax Regulations provides that the words "**private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.**

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, 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 regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that 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(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(d)(1)(ii) of the regulations **assigns the burden of proof to the applicant organization to show that it serves 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.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the relief of the poor and distressed or of the under privileged as well as the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

The applicant for tax exempt status under section 501(c)(3) has the burden of showing it "comes squarely within the terms of the law conferring the benefit sought." Nelson v. Commissioner, 30 T.C. 1151, 1154 (1958).

Leon A. Beeghly Fund v. Commissioner, 35 T.C. 490 (1960) held that inurement occurred when organization entered a transaction to benefit the *stockholders* of a particular business corporation, not to benefit the charity, even though corporation suffered no financial loss. Where an exempt organization engages in a transaction with an insider and there is a *purpose* to benefit the insider rather than the organization, inurement occurs even though the transaction ultimately proves profitable for the exempt organization. The test is not ultimate profit or loss but whether, at every stage of the transaction, those controlling the organization guarded its interests and dealt with related parties at arm's-length.

In Birmingham Business College, Inc. v. Commissioner, 276 F.2d 476 (5th Cir. 1960), the court denied tax exemption to an organization, in part because its net earnings were distributed to its shareholders for their personal benefit. **The founder of the organization and his two sisters were the only shareholders**; these three and two of their spouses were the organization's trustees. **The court found that the organization was operated as a business ultimately producing substantial revenues for its operators.**

For an organization claiming the benefits of section 501(c)(3), "exemption is a privilege, a matter of grace rather than right." Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849, 857 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1973).

In Harding Hospital, Inc. v. United States, 505 F2d 1068 (1974), the court held that **an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute**. Whether an organization has satisfied the operational test is a question of fact.

The petitioner in est of Hawaii, 71 T.C. 1067 (1979), conducted training, seminars and lectures in the area of intrapersonal awareness. Such activities were conducted under licensing arrangements with various for-profit corporations. The licensing agreements were conditioned on the petitioner maintaining tax exempt status. The petitioner argued that it had no commercial purpose of its own and that its payments to the for-profits were just ordinary and necessary business expenses. The Court did not agree.

> To accede to petitioner's claim that it has no connection with International (the for-profit licensor of the educational program) is to ignore reality. While it may be true that the same individuals do not formally control them, International exerts considerable control over petitioner's activities. It sets the tuition for the standard training and requires a minimum number of such trainings. It requires petitioner to conduct regular seminars and to host special events. It controls the programs conducted by petitioner by providing trainers who are salaried by and responsible to est, Inc., and it further controls petitioner's operations by providing management personnel who are paid by and responsible to est, Inc. In short, petitioner's only function is to present to the public for a fee ideas that are owned by International with materials and trainers that are supplied and controlled by est, Inc. Moreover, **we note that petitioner's rights vis-à-vis est, Inc., International, and PSMA are dependent on the existence of its tax-exempt status--an element that**

> **indicates the possibility, if not the likelihood, that the for-profit corporations were trading on such status...**

The question for the court was not whether the payments made to the for-profit were excessive, but whether it benefited substantially from the operation of the applicant. The court determined that there was a substantial private benefit because the applicant "was simply the instrument to subsidize the for-profit corporations and not *vice versa* and had no life independent of those corporations."

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), an organization operated bingo at a bar (a for-profit enterprise) for purposes of raising money for scholarships. The board of directors included the bar's owners and accountant, and two other persons. The court reasoned that, because the bar owners controlled the organization and appointed its directors, the organization's fundraising activities could be used to the advantage of the bar owners, and thus, provide them with a maximum private benefit.

The organization claimed that it was independent because there was a separate accounting and that no payments were going to the bar. **The court maintained that the organization's and the bar's activities were so interrelated as to be "functionally inseparable."** A separate accounting did not change that fact. Thus, **the organization did not operate exclusively for exempt purposes, but rather benefited private interests – the bar owners.** Exemption was properly denied.

In Church by Mail, Inc. v. Commissioner, (1985) the Court affirmed a Tax Court decision. Church by Mail sent out sermons in numerous mailings. This required a great deal of printing services. A for-profit company, controlled by the same ministers, provided the printing and the mailing. This company also employed family members. The services were provided under two contracts. The contracts were signed by the two ministers for both the organization and the for-profit company. The organization's business comprised two-thirds of the overall business done by the for-profit company. The court determined that there was ample evidence in the record to support the finding that the organization was operated for the substantial non-exempt purpose of providing a market for the services of the for-profit company. The employees of the company spend two-thirds of their time working on the services provided to the church. The majority of the Church's income is paid to the for-profit company to cover repayments on loan principal, interest, and commissions. Finally, the potential for abuse created by the ministers' control of the Church requires open and candid disclosure of facts bearing upon the exemption application. Moreover, **the ministers' dual control of both the Church and the for-profit company enables them to profit from the affiliation of the two entities through increased compensation.**

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36, the Tax Court concluded that **when a for-profit organization benefits substantially from the manner in which the activities of a related nonprofit organization were carried on, the latter organization was not operated exclusively for exempt purposes** within the meaning of section 501(c)(3), even if it furthers other exempt purposes.

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 a 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. 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 to 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: "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.

In Salvation Navy v. Commissioner, T.C.M. 2002-275 (2002), the court found that one of the reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that its net earnings would not inure to the benefit of a private individual, its founder.

The courts have repeatedly upheld the Service's determination that an organization has failed to establish exemption where the organization fails to provide requested information. "[Applicant] has, for the most part, provided only generalizations in response to repeated requests by [the Service] for more detail on prospective activities....Such generalizations do not satisfy us that [the applicant] qualifies for the exemption." Peoples Prize v. Commissioner, T.C. Memo 2004-12 (2004).

New Dynamics Foundation v. United States, 70 Fed.Cl. 782 (2006), was an action for declaratory judgment that the petitioner brought to challenge the denial of its application for exempt status. The court found that the administrative record supported the Service's denial on the basis that the organization operated for the private benefit of its founder, who had a history of promoting dubious schemes. The organization's petition claimed that the founder had resigned and it had changed. However, there was little evidence of change other than replacement of the founder with an acquaintance who had no apparent qualifications. The court resolved these questions against the petitioner, who had the burden of establishing it was qualified for exemption. If the petitioner had evidence that contradicted these findings, it should have submitted it as part of the administrative process. "It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant."

APPLICATION OF LAW:

Based on our analysis of the information you submitted, we conclude that you do not satisfy the operational requirements of the Code and regulations to be recognized as exempt under section 501(c)(3) of the Code. You have not established that your income will not inure to your board member, B, and your officer, C. You have not shown that your operations will not result in impermissible private benefit and/or inurement to the for-profit fundraising consulting firm, H. Moreover, you have not met your burden of proof that you are formed exclusively for an exempt purpose under section 501(c)(3) of the Code.

Section 501(c)(3) of the Code and section 1.501(c)(3)-1(c)(2) of the regulations provide that no part of the net earnings may inure to the benefit of any private shareholder or individual. The prohibition of inurement means that a private individual cannot pocket the organization's funds except as reasonable payment for goods or services. Prohibited inurement refers to transactions between a tax-exempt organization and an individual who can be considered an "insider." The private individual (insider) to whom the benefit inures has the ability to control or otherwise influence the actions of the tax-exempt organization so as to cause the benefit. As a general rule, an insider is referred to as an organization's trustee, officer, member, founder, or contributor.

You have not shown that your organizational structure and manner of operation do not result in inurement to your founders B and C and their for-profit HVAC and photography businesses in the form of compensation, financing through public donations and an increase in service revenue. B serves as your sole director. B's wife, C, is the only other officer. Despite this lack of independent oversight, you will compensate B approximately $ to $ per year as your General Manager once funding becomes available. C is to be compensated $ per year as your Office Manager. Compensation paid to your director and officers do not appear to be made in an unbiased manner. Since B is your sole board member, it appears that he has determined his own compensation as well as that of his wife, C. Your other board members, J, K, and L, serve only on an advisory capacity and only for one year. Akin to the organization described in KJ's Fund Raisers, Inc. v. Commissioner, *supra*, your sole director is free to set policy for his own benefit without objection from disinterested members of the community.

A substantial portion of your income will be returned to your board member B and his wife, C, in the form of compensation, payments to B and C's for-profit HVAC and photography businesses, resulting in prohibited inurement under section 501(c)(3) of the Code. Based on the information within your Strategic Plan, B's goal is to expand F, a for- profit HVAC company owned by B and C, into a full-time business. However, B did not want to incur indebtedness by obtaining loans. Influenced by statements from H that financing of over a million dollars were available, B and C signed the consulting service contract with H. Therefore, B and C, with assistance from H, created you as a non-profit entity to obtain public financing to enable F to advertise, purchase vehicles, obtain a warehouse/office building and hire additional employees as part of an overall planned business expansion. Your start-up financial requirement of approximately $ on your Strategic Plan included the purchase of property (two trucks, truck tools, inventory, warehouse), the same properties needed for F's business expansion. In addition, H's letter explaining the firm's contractual duties confirmed that H's was retained to use your non-profit status to obtain business grants on behalf of E and C. In effect, the intended recipients of your public donations are your director/officer, B and your officer, C and their photography and HVAC businesses, E and F. Thus, it appears that your purpose is to serve as a means to procure public financing for the private enrichment of your director/officer, B and your officer, C.

Moreover, according to a telephone conversation on N with C, it was stated that F will provide the HVAC services and then charge you for the services performed. C further indicated that this will enable F to continue to perform the services and receive revenue, even if the low-income individuals are unable to pay. It appears that you are formed to function as a means to generate public donations for the benefit of F, a business owned by your director/officer, B and your officer, C, in the form of increased service revenues. By having you supply the public financing necessary to pay for the cost of services for individuals who are unable to pay, F will continue to perform the HVAC services and receive an increase in revenues due to an expanded client base. You resemble the organization described in Birmingham Business College, Inc. v. Commissioner and Salvation Navy v. Commissioner, *supra*, in that you have not proved that your net earnings would not inure to the benefit of private individuals, your board member and officers. Hence, it appears that a substantial purpose of your organization is to serve the private benefit of B and C and their HVAC and photography businesses, F and E, resulting in prohibited inurement under section 501(c)(3) of the Code.

Furthermore, there does not appear to be a clear separation between your operations and those of F, the for-profit HVAC business owned by B and C. You and F provide virtually indistinguishable HVAC services. You are managed by the same operators, B and C and utilize the same facility. Since you do not report any service, repair and equipment sales revenues on your financial information, it is unclear if the service/sales revenues are reported on the financial statements of F instead. Although you claim that F is an independent for-profit entity, your operations are comparable to the organization described in P.L.L. Scholarship Fund v. Commissioner, *supra*, in that your activities and those of F, are so interrelated as to be functionally inseparable. When we inquired if B and C expect repayment of the $ they paid to H, you stated that B and C thought that the grants you receive would provide them with financial assistance in expanding their business, hiring, service and office personnel and enabling them to help more low income families with their heating and cooling needs. You also stated that "it seems reasonable to us that [F] should be reimbursed $ that it paid to [H]..." Additionally, you indicated that you are seeking for a way for [B] and [C] to recoup the $ service fee they paid to H to compensate for their lost time and money. Similar to the organization described in Church by Mail, *supra*, the dual control of your organization and the for-profit HVAC business enables B and C to profit from the affiliation of the entities such as through increased compensation and financing through receipt of tax deductible contributions. Your operations ultimately produce substantial revenues for your operators, B and C. Like the organization described in International Postgraduate Medical Foundation v. Commissioner, *supra,* the for-profit HVAC business, F, benefits substantially from the manner in which the activities of your organization are carried on in the form of receipt of public donations for business expansion purposes. Therefore, you are not operated *exclusively* for exempt purposes within the meaning of section 501(c)(3) of the Code.

A fundamental requirement for an organization that seeks exemption from federal income taxes is that it benefits the public rather than its creator, shareholders, or persons having a personal or private interest in the activities of the organization. (See section 1.501(c)(3)-1(d)(1)(ii) of the regulations.)

You have not shown that you are not formed to serve the impermissible private benefit of H, a for-profit fundraising consulting firm. B, C and H all had a role in your creation and are deemed founders. You state that H instigated the creation of your organization. You provide that H informed B and C that they could get them a million dollars if they formed a non-profit entity. This was the reason that B and C signed the service contract with H. Thus, the idea to create your organization originated from H, a fundraising consultant. When asked about how the income and expenses on your budgets were determined, you indicated that H had made these estimates for you. Under the consulting agreement, H is to advise you on the operation of your corporation. It appears that H, one of your founders, asserts significant control over your operations. The reason for your creation as a non-profit entity was to enable you to function as a means of obtaining public financing for B, C and H. B and C paid H $ to establish you as a non-profit entity. Through the service agreement, H is expected to continue to receive service fees from you for financial and fundraising services. Specifically, under the consultation agreement, H is to file the necessary legal documents to establish you as a non-profit corporation with the appropriate state officials, serve as your Resident Agent for one year, complete the Form 1023 application on your behalf, assist you with the Form 1023 determination process, provide you with counseling and guidance to show you how to operate your corporation and to fundraise on your behalf. G, a company associated with H, is your registered agent on your Articles of Incorporation. Upon receipt of funding, H is also to be paid an additional sum of $. It appears that you intend to continue your relationship with H into the future. You allocated consulting service fees specifically for H of $ in 20 , $ in 20 , and $ in 20 on your budgets. You have not provided any evidence that your agreement and relationship with H has been discontinued. You were created for the purpose of providing a funding stream not only for B, C and their for-profit businesses, E and F, but also as a continued revenue source for the for-profit consulting firm, H. Contrary to section 1.501(c)(3)-1(d)(1)(ii) of the regulations, you were formed to serve a private, rather than, a public interest.

Leon A. Beeghly Fund v. Commissioner, *supra*, held that where an exempt organization engages in a transaction with an insider and there is a *purpose* to benefit the insider rather than the organization, inurement occurs even though the transaction ultimately proves profitable for the exempt organization. The test is not ultimate profit or loss but whether, at every stage of the transaction, those controlling the organization guarded its interests and dealt with related parties at arm's-length. Analogous to the organization described in Leon A. Beeghly Fund v. Commissioner, *supra*, the purpose of your formation appears to be for the financial gain of B, C and H. Prohibited inurement and/or impermissible private benefit occur even if your transactions with the for-profit entity, H, do not produce a loss for you. Like the organization described in est of Hawaii v. Commissioner, *supra*, you are established as a recipient for charitable funds to enable B, C and H to trade on your status as a non-profit organization. The benefits derived from your contractual arrangement constitute impermissible private benefit and/or inurement to H, which precludes your qualification for recognition of tax exemption under section 501(c)(3) of the Code.

Finally, you have failed to describe your HVAC services and job training program in sufficient detail to show that you are furthering an exclusively educational and or charitable purpose. As described in Peoples Prize v. Commissioner, Harding Hospital, Inc. v. United States, Nelson v. Commissioner, Christian Echoes National Ministry, Inc. v. United States, and New Dynamics Foundation v. United States, *supra,* the burden is on the applicant organization to demonstrate that it has met the operational test as specified under section 501(c)(3) of the Code. You have not shown that your HVAC services are provided solely to a charitable class of recipients. You have not provided the criteria you use in selecting recipients to receive your services. Based on your market segmentation, you do not limit your services to low-income individuals. Your largest segment of potential customers is senior citizens who may or may not be low-income individuals. In addition, approximately 11 to 14 percent of your potential customers are any members of the community without regard to income restrictions. In addition, you have provided contradictory information regarding your fee structure and manner of operation. On the one hand, you state that your HVAC services will be provided free of charge. On the other hand, you state that you will charge **low** to no-cost fees for your HVAC services, and that you will charge non-profit customers at your cost for equipment sales. Moreover, you indicated that funds raised would enable you to recruit experienced volunteer technicians and supervised college students to perform your HVAC services. However, you also provided that grant funding would allow you to hire full-time service and maintenance employees to provide the services in the community. Based on your Strategic

Plan, your labor costs will include five positions: B serving as your general manager, C as your office manager, two service managers and a receptionist/assistant.

You have not shown that you operate a substantive educational job training program. You state that you will provide on-the-job training to college students and individuals in need or those who cannot afford to attend classes at other facilities. You will not require a facility for your job training program because the training will take place at the various service sites. You have not provided any materials or curriculum you use to train your trainees. You have not presented the criteria you use to select trainees for your job training program or demonstrated that you have a regular turn-over of trainees, whereby one set of trainees are recruited once another set of trainees have completed your program. You have not provided any flyers or advertisement distributed to the public regarding the availability of your job training program to college students or unemployed individuals. You indicated that F will not be hiring students from your job training program. However, you have not demonstrated that you have established a placement program for your trainees to obtain employment upon completion of your job training program. Thus, you have not established that you operate a substantive educational job training program. You have failed to describe your HVAC services and job training program in sufficient detail to show that you are furthering an exclusively educational and/or charitable purpose. As provided in section 1.501(c)(3)-1(d)(1)(ii) of the regulations, you have not demonstrated that you met the burden of proof that you are exclusively operated for exempt purposes under section 501(c)(3) of the Code.

APPLICANT'S POSITION:

You assert that you are not formed to serve the private benefit of B, C, and F. You state that B and C thought that the grants you receive would provide them with financial assistance in expanding their business, hiring, service and office personnel and enabling them to help more low income families with their heating and cooling needs. However, you recognize now that is not how "non-profit" grant funding works. You indicate that you have been trying to comply with the rules and procedures since they were explained to you. You further explained that "when we applied for grants a year ago, we did not fully understand what was involved. We just knew that there was a need for assistance to people who could not afford to pay for heating/cooling repair/replacement services. [F] attempted to meet these needs in the course of their daily business, but found that with the rising costs of the expenses involved in the efforts, they could not continue to provide services free of charge. The foundation was created to fulfill the needs of the general public."

You claim that you are a separate and distinct business from F. You state that you are not associated with any existing business, with the exception of your officers. You provide there will be no commingling of funds, employees, facilities, or any other materials by the two entities. You maintain that F will be serving HVAC customers who can afford to pay for their services, whereas you will be offering services to those who can not pay. You further state that the advertising, and bookkeeping system for the for-profit organization F will continue as it has since inception. In addition, F will use experienced subcontractors when needed, and will not be hiring any of your trainees to provide HVAC services. You also provide that you had some confusion on how you were to operate. You state that after reviewing all the rules and regulations and after speaking with people who are familiar with non-profit company operations, you understand the distinctness of each business.

SERVICE'S RESPONSE TO APPLICANT'S POSITION:

You are formed to serve a private, rather than, a public purpose. On your last response, you acknowledged that B and C sought financial assistance in order to expand their for-profit businesses. You now know that is not how non-profit funding is to be used. You explained that once the regulations were explained to you, you have been trying to comply with them. However, even as you were expressing that you now know how non-profit funds are to be used, you were focused on finding some way for B and C to recoup the $ fee paid to H to establish you as a non-profit entity to solicit public donations on behalf of the for-profit businesses, E and F. Your organizational structure and manner of operation still suggest that you are formed for the purpose of providing public funding to benefit B, C, their for-profit businesses, E and F, and H. In addition, despite your assertions to the contrary, you have not established that your operations are separate and distinct from that of F. B and C will work for you full-time as well as for F. B and C will also function as your officers and that of F. You and F share the same physical location. You provide the same HVAC service to the public as F, except your services will be provided to those who can not afford to pay. And with regard customers who are unable to pay, you indicated that F will perform the HVAC services and bill you for the performance of those services. By having you supply the public financing necessary to pay for the cost of services for individuals who are unable to pay, F will continue to perform the HVAC services and receive an increase in revenues due to an expanded client base. Rather than being formed to serve a charitable purpose, you are formed to benefit, B, C and their for-profit businesses, E and F, and H.

Conclusion:

In summary, you have not satisfied the operational requirements of the Code and regulations to be recognized as exempt under section 501(c)(3) of the Code. You have not established that your income will not inure to your board member/officer, B, your officer, C, and their for-profit businesses, E and F. In addition, you have not established that you are not formed to provide inurement and/or impermissible private benefit to the fundraising consulting firm, H. Furthermore, you have not met your burden of proof that you are formed exclusively for an exempt purpose under section 501(c)(3) of the Code. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, based on the information that you have submitted, we cannot find that you are entitled to exempt status under section 501(c) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892; *Exempt Organization Appeal Procedures for Unagreed Issues.*

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative,* if you have not already done so. You can find more information about representation in Publication 947, *Practice before the IRS and Power of Attorney.* All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree 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 all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:
Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201
Attn: Faye Ng

Deliver to:
Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202
Attn: Faye Ng

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements