



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201126037**
Release Date: 7/1/2011

Date: April 5, 2011

UIL: 501.03-02; 501.03-05

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

1120

Tax Years:

All 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.

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Catalog Number 47632S

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 Lerner
Director, Exempt Organizations



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: February 24, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = President/Founder
D = Related For-profit Company
E = For-Profit Company
M = For-Profit Company
X = Date
Y = State
Z = State

UIL:

501.03.02
501.03.05

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issues:

Are you operated exclusively for purposes described in IRC section 501(c)(3)? No, for the reasons set forth below:

Facts:

Your board of directors consists of your founder, B, and a related individual. B is also the founder and owner of D, a for-profit business that engages in the sale of electrical materials, aggregates, supplies, and rental equipment. Through the company D, B began a process to obtain substantial grant funding by entering into a contract with E, a for-profit grant company. In the contract, B agreed to pay E \$7,500 for their service and requested a grant of \$1,000,000.

The contract in pertinent part stated:

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The service provided by E, with this agreement is for research, letter writing, and grant writing. This service is for a consecutive twelve month period beginning on the date on this agreement or the date on the Client's check, whichever date comes first. If E does not generate a grant within twelve months for the above mentioned client, E will provide a second consecutive twelve months of service at no additional charge. The total cost of this service is \$7500.00 also referred as the "RETAINER" amount. The total grant amount awarded must be a minimum of \$100,000.00, for the balance to be due. You, the client, agree to all of the terms of this agreement in its entirety, as for governing law, both parties agree that this is a business transaction, and that this agreement shall be construed and enforced according to the laws of the State of Y and any dispute under this agreement must be brought in this venue and no other, if the Client requests supplementary services, additional cost/charges may apply. The retainer fee is non-refundable due to the nature of the services provided by E.

During the contract period, B was told by E that in order to receive the grant funding, a non-profit organization would have to be formed to receive 5% of the grant. E told B that after the non-profit was formed, a grant in the amount of \$450,000 would be released. B then entered into a second agreement with E to form you, and paid E an additional \$6,200.

This agreement stated in pertinent part:

Non-Profit Corporation: We will prepare and file with the Secretary of State, Articles of Incorporation (including the filing fee for the articles), as well as we will serve as your Resident Agent for one year. You will receive your Corporate Charter, your filed articles, a corporate minutes book that includes your By-laws, some sample minutes, the corporate seal and your corporate EIN.

Application Form 1023 Completion: We will facilitate the completions of all necessary documents and forms (the primary form is the 1023) and submit them on your behalf to the Internal Revenue Service. You will be responsible for any IRS filing fees. We will provide counseling, guidance and support throughout the process and after filing with the IRS will interact with them on your behalf answering any questions they pose. We will also file with the state of Y. A "How to Use Your Non-Profit" CD will also be sent to you.

Paralegal Services: We will provide consulting and guidance to show you how to operate your corporation. This includes documentation as well as a manual on how to maximize the benefits of your corporation and keys to help you function within the corporate environment.

The agreement was also accompanied by the following statement:

I hereby understand and agree that E cannot provide me with tax advice. I further agree that I am not applying for non-profit status for the purposes of a tax shelter or tax avoidance purposes. I understand and agree that these services I am purchasing are not consumer purchases regulated under state/federal consumer fraud statutes nor are these services a product/service that can be returned for a refund. Therefore, all sales are final. I also understand and agree that E is not responsible for any illegal acts, misuse, or abuse of the corporation to be formed on my behalf.

The agreement was signed by B.

As a result of the agreement, you were incorporated under the laws of the state of Y on X. Your Articles of Incorporation state that your purpose is to be a nonprofit public benefit entity that is not organized for the private gain of any person. Your operations will be conducted in the state of Z.

Your initial application for exemption describes your purpose as being to strengthen communities, focusing on families, children, and education. You provide financial resources to non-profit organizations in the area, and fund projects that enhance the community and small businesses. You continued by stating you are located in a rural area that does not have resources for community centers, playgrounds and educational needs and you will provide funds to assist in the development of these types of programs and projects. You have no plans to be involved with any other non-profit organization but you may consider giving donations to two organizations in your area in the future. You also stated that you will only give funds to other 501(c)(3) organizations.

Your application showed anticipated revenue of \$600,000 annually from grants. Your projected expenses were substantially lower than anticipated revenue and showed that your main expenses were for compensation to officers and occupancy expense. When you were asked for more information regarding these expenses, you stated that the financial data was prepared by E, that you had no intention of paying salaries, and that you do not have a facility. However, you intend to use the non-profit funds you receive to reimburse B the \$6200.00 that was spent in filing fees to create you.

You stated that you only applied for tax-exempt status under the instructions of E for the purpose of securing grant money for D. According to you, E said the IRS wants 5% of the grant money to go to non-profit organizations, and this could not be accomplished unless you were created. You made it clear during the application process that you were formed in order to enable D to receive grant funding. D will receive 95% of grants awarded, and you will receive the other 5%.

Law:

Section 501(c)(3) of the Internal Revenue Code provides, in part, for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, religious 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 Federal 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)(2) of the regulations provides 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 provides an organization is not organized and operated exclusively for one or more exempt purposes unless it serves a public rather than private interests. Thus, to meet the requirement it is necessary for an organization to establish that it is not organized and 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.

Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes.

Leon A. Beeghly Fund v. Commissioner, 35 T.C. 490 (1960) held that inurement occurred when an organization entered a transaction to benefit the *stockholders* of a particular business corporation, not to benefit the charity, even though the 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 International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under section 501(c)(3) of the Code of a nonprofit corporation that conducted continuing medical education tours. The petitioner had three trustees. Mr. Helin, who was a shareholder and the president of H & C Tours, a for profit travel agency. Mr. Regan, an attorney, and a third director who was ill and did not participate. Mr. Helin served as executive director. The petitioner used H & C Tours exclusively for all travel arrangements. There is no evidence that the petitioner ever sought a competitive bid. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded that:

When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes.

Application of Law:

You are not described in section 501(c)(3) of the Code because you are not operated exclusively for religious, charitable, or other purposes specified in the statute, and your net earnings inure to the benefit of private individuals.

Although you meet the organizational test, you do not satisfy the requirements of section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you do not meet the operational test.

You are not "operated exclusively for one or more exempt purposes" as set forth in section 1.501(c)(3)-1(c)(2) of the regulations because your net earnings inure to the benefit of D and therefore, D's shareholders. The facts show that your president and founder, B, is also the owner of D. As a result of your activities and grant funding, D is receiving substantial private benefit in the form of 95% of the grant funds intended for you. D will use these funds to increase revenue and grow its business. Thus, as a result of D's relationship with you, D receives the benefit of increased revenue. This situation leads to inurement of earnings accruing to B through D.

You are not operating exclusively for exempt purposes as described in Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations because you serve private interests, including benefiting the persons who created you. As explained above, the fact that 95% of the grant funding intended for you will go to D, clearly shows that your activities substantially serve private interests. Moreover, since your founder is also the owner of D, your activities directly benefit the person who created you.

You are similar to the organization in Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), in that you are not "operated exclusively" for exempt purposes. Although you do have some charitable activities in the form of providing funds to other 501(c)(3) organizations, you are substantially involved in furthering the private interests of your president and founder B, through his for-profit company D. In fact, only 5% of grant funding will be available to be used for your charitable purposes because 95% of grant funds will go directly to D. Like the organization in the court case, this single nonexempt purpose destroys your claim for exemption under section 501(c)(3) of the Code.

You are like the organization in Leon A. Beeghly Fund v. Commissioner, 35 T.C. 490 (1960). While it is true that receiving 5% of the grant funding ultimately proves profitable to you, it is obvious you have a purpose to benefit an insider, B. The fact that 95% of grant money is forwarded on to the related for-profit company shows that you are not guarding your own interests at every stage of the transaction as described in the above court case. All of this is substantiated by your statement that you were only formed to enable D to receive grant funding.

You are similar to the organization in International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989) in that you have a substantial purpose of benefiting a related for-profit company. Because you were formed for the substantial purpose of enabling D to receive grant funding, D benefits substantially from the manner in which your activities are carried on. Therefore, you are not operated exclusively for exempt purposes as described in section 501(c)(3).

Applicant's Position:

You stated you filed everything under the direction of E and the actual Form 1023 was completed by M. Your main purpose is to be a resource for people, small businesses and communities. You state you will provide financial resources to non-profit organizations in your area. You will fund projects that enhance the community, focusing on small businesses, children, families, health and education. You continued by stating your small businesses will benefit from your assistance by providing the support to grow and create jobs for individuals.

Service Response to Applicant's Position:

Even if a portion of your activities are deemed charitable, you have a substantial non-exempt purpose of providing funding to a for-profit company. Substantially all of your grant revenue (95%) will go directly to D, which is owned by your founder, B. Not only is this a substantial non-exempt activity, but it also provides direct private benefit to D, and therefore B. Since B is your founder and president, this constitutes inurement. Therefore, you are precluded from exemption under section 501(c)(3) of the Code.

It is important to note that B established you with the sole intention of receiving grants earmarked for you and forwarding 95% of those funds on to his for-profit company, D.

Conclusion:

Your primary purpose and reason for existence is to obtain grants for D, a for-profit organization owned and operated by your founder, B. This constitutes a substantial non-exempt activity and provides private benefit and inurement to D and B. Accordingly, you are not operated exclusively for purposes described in IRC section 501(c)(3) and you do not qualify for exemption.

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". The statement of facts (item 4) must be accompanied by the following 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."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

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

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

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 S. Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure, Publication 892

Letter 4036 (CG) (11-2005)
Catalog Number 47630W