



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201128030**
Release Date: 7/15/2011

Date: April 19, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.03-24; 501.33-00;

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.

Letter 4038(CG) (11-2005)
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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: March 1, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

- C= Applicant's Founder
- D= Name of Program
- E= For-Profit Company
- F= State
- G= State
- H= Ocean Region
- I= City and State
- J= Geographic Area
- K= For-profit Grant Company
- L= Museum
- N= Educational Institution
- w= Date
- x= Date
- y= Date
- z= Date

UIL:

- 501.03-24
- 501.33-00
- 501.36-00
- 501.36-01

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.

This letter supersedes our previous letter dated July 19, 2009, and considers your response to the proposed adverse letter and information supplied during the appeals process.

Issue

Do you meet the qualifications for exemption under section 501(c)(3) of the Internal Revenue Code? No, for the reasons described below.

Facts

You were originally incorporated in the State of F on w. A Form 1023 Application requesting Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code was filed on x. While the application was under consideration, you dissolved this organization on y and incorporated pursuant to the nonprofit laws in the State of G on z. The name of the G corporation was identical to the F corporation. The application Form 1023 was amended to reflect a new federal employer identification number. The applicant verified that the narrative descriptions and operations described in the Form 1023 remained the same.

Article III of your Articles of Incorporation states that you are organized and shall be operated for exclusively religious, charitable, scientific and educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986.

You are governed by a board of directors. The board includes seven individuals. Four of the seven are related family members listed as husband, wife and two daughters. The two daughters are non voting board members. Therefore, of the five board members with voting rights three are not related. All four related board members are also listed as the officers of the corporation. The corporations officers are President, Treasurer/Secretary and the two daughters are Jr. Vice Presidents.

The Form 1023 states that your purpose is to "promote economic development and community improvement through organizations and individuals whose mission is related to reducing humanity's dependence on fossil fuel." Your "overarching goal is to demonstrate that marine transportation can be operated reliably and economically while free of fossil fuel."

You were formed initially to manage the D program. The goal of the D program is to demonstrate that marine transportation can be operated reliably and economically while free of fossil fuel. To achieve this goal you will accept grant funding, assemble the required team of individuals and businesses, manage the program and have full responsibility for the use and distribution of program funding.

The D program, you are to manage is to be completed in three major phases.

"Phase One will (a) build and deliver at least one and possibly six 45' boats with matching D package for commercial and/or government use in the H region, will (b) operate a similar D package on an 85' waterborne moored test platform in I on a 24/7 schedule to document the feasibility of attempting Phase Three of the project, and will (c) provide the preliminary planning and engineering for Phases Two and Three."

"Phase Two will convert the 85' test platform into the D driven 125' operating craft, install larger equipment, and make the craft ready for service in Phase Three."

"Phase Three will be a three year period of continuous operation of the 125' test craft that will include supporting the operating crew, hauling dead weight cargo, all-weather operation, and planned maintenance periods. The goal is to experience the normal operating life cycle of a cargo carrying craft, collect operational and maintenance data and demonstrate the reliability and feasibility of the D package as a credible means of propulsion for marine transportation. The operational, maintenance and environmental impact data from this phase will be made

available to interested government agencies, educational institutions and industry segments for future development.”

Your President and founder is C. Prior to your incorporation, C entered into negotiations and contracted with a for-profit company in F named K to obtain funding for the D program. Initially the D program was to be operated by C's for-profit company E. E operates a shipyard on a waterfront site in I. E is in the marine transportation business and primarily repairs commercial and military vessels that are used in the bays and rivers and along the coast.

K submitted a list of potential grantors to C who were interested in the D project. The potential grantors required that grant recipients should have an IRS letter of determination. C then entered into a second agreement with K. This agreement was for services to establish a nonprofit corporation and to facilitate the completion of the Form 1023 application request for recognition of exemption.

The Form 1023 application explains that you have “entered into this world of nonprofit organizations for a very specific initial purpose and effort....to demonstrate marine propulsion powered by an alternative form of energy.” “The immediate beneficiaries of your activities will be individuals and businesses in the J area....providers of goods and services associated with your projects and activities will realize direct economic benefit.” If the projects are successful this will be an opportunity for new businesses and economic development.

“During the construction periods it will be necessary for businesses and individuals to train and improve their skills in the areas of aluminum boat building and alternative power which will include trade skills of welding, ship fitting, pipe fitting, electrical power collection, distribution and management, electrical and electric alarms and controls, and navigational electronics.”

“During operational periods data will be collected and transmitted for evaluation in developmental ways that will allow educational institutions to participate; data will be shared with the public so that individuals and organizations can make independent determination of the value and future of fossil fuel free propulsion; and other experimentation involving energy collection, consumption and management, environmental impact, and operational economics can/ will be performed.”

“The expectation is that these results will be positive and when they are, educational institutions and businesses and government research and development agencies will begin to incorporate the real time operational proof of the reliability and feasibility of the fossil fuel free concept into their programs.”

You will begin to manage the D program when fully funded. You plan to receive funds from various grant making organizations and foundations. Once funded you will identify the suppliers of goods and services, enter into contractual agreements with individuals and organizations for services, distribute funds, monitor the progress of the projects and post results on your website.

The Form 1023 application included a list of probable providers of goods and services for all three phases of the D program. E is one of the potential service suppliers in the J area who may receive distributions from you for goods and services. You have not entered into any agreements for goods or services. However, any transactions between you and any of your officers or directors must follow the adopted conflict of interest policy. This policy is to be

followed when contemplating any transactions or compensation arrangements with a director, officer or interested person.

The application also reports that officers, directors and trustees will be compensated when funds are available. The budgets estimated that officers and directors would receive compensation at approximately 20% of total revenue. Salaries have not been set, but the policies to decide compensation has been determined to ensure they are negotiated at arms length.

In addition to the D program, you will in the future manage other programs to promote economic development through organizations and individuals whose mission is related to reducing humanity's dependence on fossil fuel. You were "formed to accomplish the D program initially...and to make projects possible that, so far, have not been attractive to for-profit organizations because of the effort-risk-reward ratios."

The projected percentage of time and funds used for your initial activities are estimated as follows:

- | | |
|--|-------------------------------|
| • D program- Purchase of goods and services to execute project. | 55% of time and 65% of funds |
| • Direct Educational Program- Working with educational institutions. | 8% of time and 5% of funds |
| • Selecting, distributing, and following up on contributions to charities. | 7% of time and 9% of funds |
| • Requesting and reviewing possible future projects . | 5% of time and 1% of funds |
| • Business management and support | 25% of time and 20% of funds. |

The founder explained that you "do not intend to be the originator of new thought or design that would have rights of ownership. You have no intention of holding or sharing any patent or copy rights that might result from their projects. A producer of solar collectors may be encouraged to build a better collector as a result of the research and opportunities provided through you and the D program. If a better collector is the result, then the manufacturer is the owner and beneficiary of rights of ownership. You will have served one of its purposes; supporting the improvement of technology to come closer to fossil fuel independence."

Law

Section 501(c)(3) of the Code provides for exemption from federal income tax for organizations that are organized and operated exclusively for charitable, educational, religious, or scientific purposes, no part of the income of which inures to the benefit of private individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations states that an organization is not operated exclusively for one or more exempt purpose unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

Section 1.501(c)(3)-1(d)(2) of the Regulations states that the term 'charitable' is used in section

501(c)(3) of the Code in its generally accepted legal sense. Such term includes relieving the poor and distressed or the underprivileged, combating community deterioration, lessening neighborhood tensions, and eliminating prejudice and discrimination.

Section 1.501(c)(3)-1(d)(5) *Scientific defined*. (i) a 'scientific' organization must be organized and operated in the public interest. Research when taken alone is a word with various meanings; it is not synonymous with "scientific"; and the nature of particular research depends upon the purpose which it serves.

Section 1.501(c)(3)-1(d)(5)(ii) of the Regulations further provides that scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, as, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc.

Rev. Rul. 65-1, 1965-1 C.B. 226, describes the operations of an organization formed to foster the development and design of labor saving agricultural machinery, including the development of new labor saving methods and ideas. The organization conducted studies to determine the need for mechanization of planting, cultivation, and harvesting which were generally performed manually by agricultural laborers. If an opportunity for successful machine utilization appeared to be possible, the organization determined whether work on such a machine was being undertaken by any public or private institution. If not, the organization made a grant to an appropriate public or private agency to develop the necessary machinery. If the prototype of the machine performed well, the organization sought a patent in its name and licensed a manufacturer to build the device on an exclusive or non-exclusive basis. Any royalties received by the organization are then used to develop additional machines for other projects.

The revenue ruling reasoned that the development of machinery was equivalent to the "designing or construction of equipment" that is incident to a commercial operation and does not constitute scientific research within the meaning of Reg. 1.501(c)(3)-1(d)(5)(ii).

Rev. Rul. 72-369, 1972-2 C.B. 245, describing an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations. The ruling held that the organizations did not qualify for exemption under section 501(c)(3) of the Code. The ruling states that "an organization is not exempt merely because its operations are not conducted for the purposes of producing a profit...providing managerial and consulting services of a regular basis for a fee is a trade or business ordinarily carried on for profit."

Rev. Rul. 74-587, 1974-2 C.B. 162 held that an organization that devoted its resources to programs to stimulate economic development in economically depressed, high-density, urban areas, inhabited mainly by low-income minority or other disadvantaged groups, qualified for exemption under IRC 501(c)(3). The organization made loans and purchased equity interests in businesses unable to obtain funds from conventional sources because of financial risks associated with their location and/or because of being owned by members of a minority or other disadvantage group. The organization established that its investments were not undertaken for profit or gain, but to advance its charitable goals. Funds for its program were obtained from foundation grants and public contributions.

Revenue Ruling 78-426, 1978-2 C.B. 175 describes a nonprofit organization whose activities include the inspection, testing and safety certification of cargo shipping containers and research,

development, and reporting of information in the field of containerization. It is not operating exclusively for the purpose of testing for public safety or scientific purposes. The containers are tested against voluntary standards issued by a federal agency. The testing and certification serve the private interest of the container manufacturers and shipping by facilitating their international operations; they only serve the public interest incidentally. The testing and research activities are of a type ordinarily carried on as a commercial industrial operation. The organization fails to qualify for exemption under section 501(c)(3) as it is not operated exclusively for the purpose of testing for public safety or for scientific purposes.

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

In Consumer-Farmer Milk Cooperative, Inc. v. Commissioner of Internal Revenue 186 F. 2d 68, (2d Cir. 1950) the Court denied exemption under the predecessor to section 501(e) of the Code because the organization's purposes is primarily to benefit its members economically and only incidentally to further larger public welfare.

In IIT Research Institute v. United States, 9 Cl. Ct. 13(Cl. Ct. 1985), a U.S. Claims Court reviewed the activities of an organization exempt under section 501(c)(3) of the Code. The organization contracted with a variety of industry members to perform research for them. The court defined the term "scientific" to include "the process by which knowledge is systematized or classified through the use of observation, experimentation, or reasoning." The court found that the organization was not involved in the commercialization of the products or process developed as a result of its research. IIT Research Institute only developed a project to the point where the research principles were established. At this point, the sponsors would make the principles available to different customers, usually in the form of newly developed products or equipment. The court found significance in the fact that IIT Research Institute did not engage in any consumer or market research or ordinary testing of the type which is carried on incident to commercial operations. The court therefore found that the organization's activities were research and not ordinary testing carried on as an incident to commercial or industrial operations.

Application of Law

Your initial and primary activity is to manage a program known as the D program. The goal of the D program is to demonstrate that marine transportation can be operated reliably and economically by solar power. To achieve this goal at least one prototype vessel must be constructed and operated in the public eye. The application for exemption explains that you will begin managing the D program when fully funded. You will then contract with individuals and organizations that provide goods or services to them. The application also claims that you will further economic development and the immediate beneficiaries will be individuals and businesses in the J area.

To be recognized as exempt an organization must demonstrate that it is both organized and operated exclusively for one or more purposes as defined under section 501(c)(3) of the Code. Exempt economic development organizations that fund for-profit businesses qualify for exemption if the benefits to a charitable class out weigh the private benefit to businesses. The

organization described in Rev. Rul. 74-587, *supra*, qualified as an exempt economic development corporation because their programs helped to stimulate the economy of an economically depressed area. You indicated that immediate beneficiaries of your activities will be individuals and businesses in the J area. There is no evidence to show that stimulating the J economy would benefit a charitable class or further charity in the manner described in Treas. Reg. section 1.501(c)(3)-1(d)(2). In addition, the founder's own for-profit business, E, could be one of those beneficiaries. The financial benefits to E would also constitute private benefit to your founder. As a result, under section 1.501(c)(3)-d(1)(ii) of the regulations, you do not meet the requirements of section 501(c)(3) of the Code. See Consumer-Farmer Milk Cooperative v. Commissioner, *supra*.

Further, your managerial and consulting services that are conducted to achieve the goals of the D program are considered activities associated with a trade or business ordinarily carried on for profit. See Rev. Rul. 72-369, *supra*. You will begin activities when fully funded and can pay their expenses including compensation to the officers for managing the D program. The business of managing the D program constitutes a substantial amount of your activities. You are similar to Better Business Bureau v. United States, *supra*, in that while some of the activities are educational your substantial purpose was to promote business.

You also anticipate raising funds and managing future projects that "so far, have not been attractive to for-profit organizations because of the effort-risk-reward ratios." Similar to these future projects the D program had difficulty attracting investors. The costs associated with the D program were a risk to the marine industry especially if a ship capable of transporting cargo were not produced. You were formed with the assistance from a company hired to apply for charitable grants. This shows that one of the purposes you were formed was to reduce the risks to for-profit companies who would otherwise budget expenses for research and development costs. Even if the D program was not successful the providers of goods and services in the J area would realize direct economic benefit through you. Your management activities and funding services furthers the private benefit of the service providers in the J area. Providing funding and management to future projects further demonstrates that you are performing commercial services in a manner that is similar to the organization in Rev. Rul. 72-369.

Section 1.501(c)(3)-1(d)(5)(ii) of the Regulations provides that scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations. In managing the D program, you are involved in testing and demonstrating the feasibility of solar powered marine transportation. These activities are similar to the organization described in Rev. Rul 78-426, *supra*, in that the testing and research activities are of a type ordinarily carried on as a commercial manufacturers operation. Also, facilitating the design or construction of solar powered boats, where the manufacturers retain the patents, rights and benefits that might result, facilitates a trade or business. See Rev. Rul. 65-1, *supra*. Unlike IIT Research Institute v. United States, *supra*, your activities to maintain and monitor the test craft are incidental to commercial or industrial operations.

Applicant's Position

You explained that your mission is to advance science and education in the public sector using a process that will demonstrate the possibility of replacing fossil fuel with other forms of energy to support marine transportation. Initially the effort will be focused on collection of solar energy for the D program.

You will use scientific research to develop a body of knowledge to share with the public in an effort to demonstrate that there is at least one alternative to fossil fuel that is operationally practical, system reliable, and economically feasible.

You will gather, collect and analyze the data from each phase of the D program. The data will be maintained in an event diary and a data log. The data collected will be published and made available to the public. The public including manufacturers may improve upon the process and retain rights to any improvement of technology. You have no intention of holding or sharing any patent or copy rights that result from their projects.

In addition to sharing the results with the public, you will approach high schools and colleges with offers to provide opportunities for educational experiences. The D program would encourage further scientific research and education. You will assist teachers in developing science projects and supporting curriculum that identifies alternate energy uses from fossil fuels. Universities and technological institutions will be involved to work towards making alternative energy sources feasible.

You will also erect and maintain floating platforms for public use. A solar powered boat will be built and provided free of charge to non-profit public organizations and government agencies such as L and N. While these agencies utilize the platforms for their work, you will collect and evaluate the data to determine the economic feasibility and reliability of alternate energy technologies for marine transportation. These activities show that you operate for the benefit of the general public and furthers educational and scientific purposes.

Your activities will also require additional skilled and semi skilled labor to construct, monitor and maintain the floating platforms. A larger work force will benefit the public with less unemployment and more revenue flowing into the local economies. The public good would outweigh any benefits to private companies used in the D program. If successful, new jobs and education would not be limited to the J area.

You will also improve environmental quality by facilitating projects that encourage the use of alternative energy sources. This would also contribute towards lessening our dependency on foreign oil.

Service Response to Applicant's Position

As the regulations indicate, conducting scientific research is not sufficient to qualify an organization for IRC 501(c)(3) status. The scientific research must be in the public interest as described in Treas. Reg. section 1.501(c)(3)-1(d)(5). The goal of the D program is to demonstrate that a solar powered boat can be used as a cargo carrying craft. Each phase of the D program will increase the size of the test craft. The data collected and shared with the public will report the operational, maintenance and environmental impact of the craft. The desired outcome from the D program is that the public demonstration and data published will prove that this technology is feasible and reliable "for commercial and/or government use in the H region." If successful, the public demonstration of the test craft serves to benefit the ship building companies already producing these boats. By forming your organization as a non profit company the financial risk has been shifted from the ship building industry in the J area. Therefore, you are serving the private interests of the for-profit marine transportation businesses

in the J area. Your founder is also in the marine transportation business and has a company in this same area. Therefore, any private benefit to the founder even if indirectly through the E company would disqualify you from qualifying for exemption under IRC 501(c)(3) of the Code. Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not serving public interests if it is operated for the benefit of designated individuals or the persons who created it.

Applicant's Response to Proposed Adverse Letter

In the written response to the proposed adverse letter you stated that you are requesting exemption under IRC section 501(c)(3) as a charitable organization engaged in advancing education, science and industrial development through the pursuit of environmental conservation and protection.

The basis for protest was presented as paragraphs and views summarized in part below:

1. You are organized and will be operated for the purposes of being useful to individuals and providing benefit to the general public by protecting the environment through the exploration of possible alternatives to fossil fuel.
2. You will advance education and science while working to identify feasible applications of the sciences of energy conversion and environmental protection which will result in conserving fossil fuel and preserving air and water quality.
3. You advance industrial development (in the context of scientific research directed toward benefiting the public) which will most likely occur in the communities of for-profit and non-profit organizations that provide the services and supplies necessary to complete various research projects conducted by you.
4. You benefit the public by improving natural and social environmental conditions through shared information.
5. You advance education, science and industrial development for the benefit of the general public, not the creator's financial benefit.
6. You are a charitable organization for the purposes of protecting the environment and producing advances in education and science with associated advancements in industrial development. All project results will have value that is directed toward a charitable benefit to the general public.

You disagreed with the application of the following tax law as follows:

a. Revenue Ruling 65-01:

- i. You are not requesting exemption as a scientific organization but as an organization that advances science.
- ii. You do not develop machinery that will save labor.
- iii. You have no financial interest in promoting beyond education any outcome that may result from a particular project.
- iv. You will have no financial interest in or claim to any patents or licenses that may result from a particular project.

b. Revenue Ruling 78-426:

- i. You are not requesting exemption as an organization testing for public safety or scientific purposes.
- ii. You will not test equipment for the benefit of public safety.

- iii. Your projects will not work toward the promotion of any existing or future products. Your purpose of the applied research and experimentation is to demonstrate to the general public that some, maybe more than one, approach to energy conversion is feasible and reliable. The public is then responsible to express their desire, personal and collective, to use the new source in their daily lives.
- c. IIT Research Institute v. United States.
- i. To the extent that the case is described in the Law section of reference (a), it seems to support some of your activities.
 - ii. To the extent that the case is used in the Application of the Law section of reference (a) presents a connection with you that is incorrect.
- d. Better Business Bureau v. United States.
- i. You are not an educational organization, but an organization that advances education.
 - ii. You are not requesting exemption exclusively for educational purposes.
 - iii. You do not intentionally promote business.
 - iv. Advancement of education is more than an incidental activity.
 - v. Business promotion, if it occurs, is a consequence of efforts to enhance the natural and social environment by sharing information with the general public and it will be driven by public interest not by you.
 - vi. Business promotion and job creation are not synonyms. You are about job creation and directing benefit toward the public by attracting new or encouraging existing industry in the community to search for energy conversion solutions.
 - vii. You have a primary focus and an intentional organizational structure to protect the environment, to preserve natural resources (fossil fuel) and to conserve natural resources (air and water).
- e. Consumer-Farmer Milk Cooperative, Inc. v. Commissioner
- i. You are not a cooperative and have no membership.
 - ii. You do not operate incidentally for educational purposes.
 - iii. You are not organized for the economic benefit of your creator or interested individuals. This is stated in your Articles of Incorporation and Bylaws.
 - iv. You are organized and operated for charitable purposes which include the preservation/conservation of the natural environment and the advancement of education, science and industrial development.
- f. Revenue Ruling 72-369.
- i. You are not requesting exemption as a charitable organization engaged in improving any aspect of an existing organization.
 - ii. You do not provide managerial or consulting services.
 - iii. The services you provide are not normally carried on by any ordinary business, whether for profit or not.
 - iv. The services you provide are directed toward interested individuals and the general public in an effort to enhance awareness of the need for

protecting the environment, preserving and conserving natural resources, and encouraging public support of pursuing alternative forms of energy.

g. Revenue Ruling 74-587

- i. You are not an economic development corporation.
- ii. You do not fund for-profit organizations. You purchase specific goods and services to support and further your purposes.
- iii. You will not loan funds for practical development regardless of the potential risk, and
- iv. You will not hold any equity interest (directly or indirectly) in any business or organization that interacts with you.

7. You stated your purpose is to protect the environment and to produce advances in education and science with associated advancements in industrial development.

You cited the following four "substitute" Revenue Rulings to support your position:

- a. Revenue Ruling 79-018, 1979-1 C.B. 194, holds that an organization that provides specially designed housing to elderly persons at the lowest feasible cost and maintains in residence those tenants who subsequently become unable to pay its monthly fees is an organization operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. The organization described in this Revenue Ruling was formed under the sponsorship of community leaders to meet a community need for an elderly housing facility.

You stated you are compared to the organization in Rev. Rul. 79-18 because you "will provide your services by advancing education and science through demonstration on scale platforms and then providing the results (knowledge and use) to the public."

- b. Revenue Ruling 76-204, 1976-1 C.B. 152
Environmental conservancy. A nonprofit organization formed for the purpose of preserving the natural environment by acquiring, by gift or purchase, ecologically significant undeveloped land, and either maintaining the land itself with limited public access or transferring the land to a government conservation agency by outright gift or being reimbursed by the agency for its cost, qualifies for exemption under section 501(c)(3) of the Code.

You stated you are compared to the organization described in Rev. Rul. 76-204 because you "will provide services by advancing education, science, and industrial development through demonstrations that, when successful, will protect the environment by conserving the natural resource, fossil fuel, and preserving the quality of the precious resources, air and water."

- c. Revenue Ruling 76-37, 1976-1 C.B. 149
Construction trades training center; sale of homes. A nonprofit organization that purchases building lots, furnishes funds to a public vocational training center for use in its on-the-job home construction training program, sells the completed homes to the general public at fair market value, and uses the income from home sales to finance new projects and obtain vocational training equipment for the public school system, qualifies

for exemption under section 501(c)(3) of the Code. The income from the sale of the homes is not unrelated business income.

You stated you are compared to the organization in Rev. Rul. 76-37 because you "do not provide instructors for the program but your activities contribute importantly to the overall program of the center and promote education."

d. Revenue Ruling 71-506, 1971-2 C.B. 233

An engineering society formed to engage in scientific research in the areas of heating, ventilating, and air conditioning for the benefit of the general public qualifies for exemption under section 501(c)(3) of the Code.

You stated that you are similar to the organization in Rev. Rul. 71-506 because the results of your research are shared with the general public and made available to all who are interested.

8. You disagreed that the earnings from your work inures to the founder and your position is that you are not operating in a commercial or for-profit manner.

You provided the following eight Revenue Rulings as "examples of non-profit organizations qualifying for tax exemption even though very similar specific issues seem to exist, for example: the creator is a board member, the organization may conduct transactions that require close scrutiny as 'arms length', the creator owns a substantial portion of stock in an associated business, typically commercial work is conducted but in a non-commercial way, a portion of the non-profits work supports commercial or private interests."

a. Revenue Ruling 86-49, 1986-1 C.B. 243

The purpose of the organization in this case is to educate and otherwise benefit the public by restoring and preserving historically or architecturally significant properties through the acquisition, occasional restoration, and disposition of such properties at fair market value on arm's length terms. The continued preservation of such properties after their sale by the organization is guaranteed by means of restrictive covenants that are reasonably suited to preserving the historic or architectural character of the structures and community involved.

b. Revenue Ruling 76-91, 1976-1 C.B. 150

Proprietary hospital acquired by nonprofit corporation. The purchase, in a transaction not at arm's length, of all of the assets of a profit-making hospital by a nonprofit hospital corporation at a price that includes the value of intangible assets, determined by the capitalization of excess earnings formula, does not result in the inurement of the hospital's net earnings to the benefit of any private shareholder or individual or serve a private interest precluding exemption under section 501(c)(3) of the Code.

c. Revenue Ruling 76-158, 1976-1 C.B. 354

Private foundation; control of corporation. A private foundation, owning 35 percent of the voting stock of a corporation and having a foundation manager personally owning the remaining 65 percent but not holding a position of authority in the corporation by virtue of being foundation manager, does not control the corporation for purposes of the self-

dealing provisions of section 4941 of the Code.

- d. Revenue Ruling 76-443, 1976-2 C.B. 149
A nonprofit organization that makes facilities and equipment available to the public to produce noncommercial educational or cultural television programs for communication to the public via public and educational channels of a commercial cable television company, qualifies for exemption under Code section 501(c)(3).
 - e. Revenue Ruling 73-045, 1973-1 C.B. 220
A nonprofit organization created to foster the development in a community of an appreciation for drama and musical arts by sponsoring professional presentations qualifies for exemption under section 501(c)(3) of the Code.
 - f. Revenue Ruling 71-413, 1971-2 C.B. 229
A nonprofit organization acting as a clearinghouse and course coordinator by bringing together instructors and interested students in a community for purposes of instruction is exempt under section 501(c)(3) of the Code.
 - g. 70-79, 1970-1 C.B. 127
A nonprofit organization assisting local governments of a metropolitan area by conducting research to develop solutions for common regional problems, but not advocating any legislative action to implement its findings, qualifies for exemption under section 501(c)(3) of the Code.
 - h. 65-60, 1965-1 C.B. 231
An organization was formed for the primary purpose of developing and disseminating a body of new knowledge relating to the social sciences. The organization's professional research staff consists of persons qualified by education and experience to perform scientific research in these fields. Activities of the organization consist of the performance of scientific research under the contracts with governmental agencies and the conduct of seminar courses attended by qualified members of the public. Results of the organization's research activities are communicated to the public through seminar courses, lectures, and public discussions, and through publications distributed free to depository libraries. Held, the organization qualifies for exemption from Federal income tax as an educational and scientific organization described in section 501(c)(3) of the Internal Revenue Code of 1954.
9. You stated that the proposed denial of exemption has misunderstood your goals and purposes. You claim that your purposes are charitable within the meaning of the Regulations and Code sections previously cited. The proposed denial has misunderstood your goals and purposes and you are "disadvantaged for the unfortunate interaction with an organization that was later to be investigated for possible unfair and illegal dealings with its clients, customers and the government as well as the connection of the founder to dealings of the organization."
 10. Your conclusion is that you qualify as a charitable organization because you "will advance education, science and industrial development for the benefit of individuals and the use of the general public by developing and utilizing various research programs and projects as instruments through which the science of energy conversion will be explored to aid the

environment by conserving the natural resource, fossil fuel, and preserving the quality of the natural resources, air and water.”

You also stated “Using the four substitute Revenue Rulings in their entirety and the eight Revenue Rulings in part we can see more clearly and objectively that we are organized and will be operated in a manner that meets the Code and Regulations for a charitable organization.”

Service’s Response to Applicant’s Protest to Proposed Adverse Letter

Your activities remain the same, but we disagree with the application of tax law. Organizations that are organized and operated exclusively for charitable, religious, educational, or scientific purposes can qualify for exemption under section 501(c)(3) provided no part of the income inures to the benefit of private individuals.

You disagreed with Revenue Ruling 65-1 since you are not requesting exemption as a scientific organization, but as an organization that advances science. You have no financial interest or claim to any patents that may result from the development of new machinery. However, the companies who participate with you in the development of new machinery will retain the patents and licenses that may result from a particular project. Therefore, you are promoting the advancement of products that benefit private companies. Similar to Revenue Ruling 65-1 the designing or construction of equipment that benefits private individuals is consistent with a commercial operation and does not constitute scientific research, nor qualify for exemption.

You disagreed with Revenue Ruling 78-426 since you are not testing for public safety or scientific purposes. This revenue ruling described an organization whose activities test and certify cargo shipping containers that serve the private interest of the container manufacturers. You are similar to Revenue Ruling 78-426 because your testing and research activities also serve to benefit the commercial operations of the participating companies.

IIT Research Institute v. United States, also defined the term “scientific” and found significance that IIT Research Institute did not engage in any consumer or market research or ordinary testing of the type which is carried on incident to commercial operations. We feel that your public testing of the solar powered boats is carried on as more than an incidental part of commercial operations and does not meet the definition of “scientific” purposes that can qualify for exemption under section 501(c)(3).

You claim that you are not similar to the court case Better Business Bureau v. United States. We believe that you are similar to this court case because a substantial purpose of your organization is to promote business and not to operate exclusively for educational purposes.

Consumer-Farmer Milk Cooperative, Inc. v. Commissioner of Internal Revenue. Although you are not a cooperative your activities economically benefit the businesses that participate in your commercial operations.

You disagreed that you are providing managerial or consulting services similar to the organization described in Revenue Ruling 72-369. We disagree because you have developed the D program and will manage this program in three major phases. The management of the D program is for a fee and will begin upon receipt of public funding.

You disagreed with Revenue Ruling 74-587 since you are not an economic development corporation. However, you also claim that your organization helps create jobs. As described in this Revenue Ruling, an organization with programs that help stimulate the economy can be charitable within the meaning of IRC section 501(c)(3) provided the area where the programs take place is economically depressed. There is no evidence that the area where you operate will promote jobs that benefit a charitable class similar to the organization described in Rev. Rul. 74-587.

You provided the following four substitute Revenue Rulings to support your position:

Rev. Rul. 79-18 explains how housing for the elderly can qualify for exemption. We disagree that your activities benefit a charitable class similar to the organization described in this Revenue Ruling. You do not have provisions for those that cannot pay for your services.

You compared your organization to Revenue Ruling 76-204 since this organization was formed for the purpose of preserving the natural environment. We agree that cargo ships operated by solar energy would aid in the preservation of the natural environment. However, the manner in which your D program will operate will result in more than incidental private benefit to the businesses that participate.

We disagree that you are similar to the organization described in Revenue Ruling 76-37 because you are not organized and operated exclusively for the purpose of training and educating students. The students who participate in your programs may receive some educational benefit. However, this educational benefit is incidental since the for-profit businesses who participate in the D program retain patent rights to any inventions developed. This constitutes a substantial business purpose.

Like the organization in Revenue Ruling 71-506, you will post the testing results on your website and share the results with the public. However, you are unlike the organization described in this revenue ruling because the patents and copyrights resulting from your research are retained by the businesses who participate in your programs.

You cited eight additional Revenue Rulings that involve organizations formed and operated by their creators. The circumstances in each of these rulings show that the organizations were not providing substantial private benefit or inurement. You stated that you will operate under a conflict of interest policy and that you will work with for-profit businesses that may include the founder's own company. Even if a conflict of interest policy is used to select companies to participate in the D program, the selected companies would still benefit from the commercial operations of developing and building solar powered cargo ships. The research conducted by you would have to be funded and performed by the for-profit companies if it were not for you and your research activities. The benefits to the commercial companies show that you are not operating exclusively for exempt purposes. Any benefit to the founders own company, even if selected under the conflict of interest policy, would constitute inurement since you are operating for a substantial business purpose.

Applicant's position provided during the appeals process

During the appeals process you reiterated that you expect to achieve charitable purposes by

conducting projects that offer a fossil fuel substitute.

Each project is anticipated to further charitable purposes as follows:

- 16% of the time devoted to a typical project will further economic development by creating new jobs and the purchasing of new materials and components.
- 34.5% of the time on a typical project will give to students and researchers of science the opportunity to plan and execute experiments on systems; outside of the traditional laboratory, in real time, and with natural obstacles as well as some uncontrollable variables. Thus furthering the advancement of science and education.
- 34.5% of each project's time will also advance education by giving students and researchers in science and engineering disciplines, the opportunity to document the events occurring during the experiments and to record the data on your website which is accessible by the general public.
- 15% of a typical project's time utilizes existing resources from the industrial and commercial community to create the structure that, in various ways, supports the project and makes it possible. Existing resources are those that would be used one way or another and probably would not contribute to any new economic development. The structure supports the project physically and organizationally and could possibly be applicable to a range of projects.

You disagreed that the typical project is an activity incident to commercial or industrial operations because:

- You will normally assemble products manufactured by others in a manner that will be suggested by students, researchers and engineers in their attempt to do something in a different way for the purpose of testing, learning, and researching about its qualities of feasibility, reliability and practicality as an alternative energy source.
- You will not apply for any patents or hold any license authority on anything resulting from the experimentation and study.
- You will not sell anything resulting from the experimentation and study.
- You will make all resulting data available to the general public and maintain a library of archived data for future use by students and researchers.

Service response to applicant's arguments to appeals

The primary purpose for your formation was to secure grants for the D program, which was to be conducted by the for-profit company E, owned by your founder C. It is evident that the purpose of the D program was to create a new way to conduct marine transportation which would substantially benefit E, and thereby E's owner and your founder C. This is evidenced by the events that led to your creation. C, as the owner of E, entered into negotiations with the for-profit grant company named K in order to receive grant funding for the D program. K supplied C with a list of potential grantors, but also informed C that the potential grantors required the grant recipient to have an IRS determination letter. C then entered into a second agreement with K to form you and facilitate the completion of your application for exemption.

We acknowledge that you have made changes since your original formation; most notably that the D program will now be conducted by you and that C is now a minority stock holder of E. However, the facts still show that for-profit companies in the J area will participate in the D program and that E may be one of those companies. Therefore, your activities will provide

substantial private benefit to the participating for-profit companies, including E. Even though C is now a minority stock holder, any private benefit received by E will in turn inure to the benefit of C. Since C is your president and founder, this benefit constitutes inurement which is strictly prohibited under section 501(c)(3) of the Code.

E and C are not the only parties who will receive substantial private benefit from your activities. The D program is a research and development activity, the results of which will be used to further the business purposes of the for-profit shipping companies in your area. Even if E is not a participating company, other unrelated participating for-profit companies will substantially benefit. Grant funding received by you will be used to conduct the D program. The results will then be used by the participating for-profit companies to further their business endeavors. If it were not for your activities conducted with grant funding, the participating for-profit shipping companies would have to expend their own funds to receive the same results. Therefore, your activities provide substantial private benefit to all participating for-profit companies in the J area.

To clarify your activities, you verified that your initial and primary project is to manage and solicit funds for the D program. You also clarified that any idea that offers a fossil fuel substitute is a candidate for future projects.

These projects you manage involve the assembly of products manufactured by for-profit companies. The for-profit companies will retain the patent rights for any products invented. Therefore, your testing and publishing the results of the D program and other future projects will demonstrate the results of the assembled product. This testing and public demonstration also helps promote the products produced by the for-profit companies who own the manufacturing rights to the products used in the projects. The assembly, testing and promotion of products substantially benefit the participating for-profit companies.

You also indicated that 16% of a project's time will further economic development by creating new jobs and the purchasing of new materials and components. The D program will benefit for-profit companies in the J area. The J area is not considered economically depressed or blighted and furthering for-profit businesses in the J area will not further a charitable purpose.

Finally, you do not have an on-going job training program or a direct jobs program. Instead, any jobs that are created will be done so through the for-profit manufacturers that are also benefitting as a result of your activities.

Conclusion

You have confirmed that your activities remain the same. Your initial and primary activity is to manage and solicit funds for the D program. This activity provides substantial private benefit to the for-profit businesses in your area including E, which is partially owned by your founder, C. This shows that you are not organized and operated exclusively for charitable, scientific or educational purposes as defined in Section 501(c)(3) of the Internal Revenue Code. Accordingly, you do not qualify for exemption under section 501(c)(3) 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*.

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,

Lois Lerner
Director, Exempt Organizations

Enclosure:
Publication 892