



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Release Number: **201215010**  
Release Date: 4/13/2012  
Date: January 17, 2012  
UIL: 501.03-00

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.

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

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

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

Initiator  
SE:T:EO:RA:T:1

Reviewer  
SE:T:EO:RA:T:1



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: November 17, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

UIL: 501.03-00

LEGEND

You:

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.

**FACTS**

Your Articles of Incorporation state that your purpose is to buy and sell stocks and options to provide funding to other charities. The donations you receive for funding will be "aggressively traded in the stock and option equity markets." You state that you will give a percentage of the net proceeds from the trading to other charitable organizations. The remaining proceeds will be retained for future trading and operating expenses.

You stated that your operation is very simple; to take donated funding and trade it in the stock market. You stated that once you develop a consistent history of profitable trading you will accept donations from the public. You indicated that with more money, the profits you receive from trading will be larger and thus donations to the other charities will also be larger. Initially you stated that there will be a four percent (4%) payout to charities once per year; however, you later amended the statement to say that the payouts would be whatever IRS determined would be appropriate. You stated that you will not require periodic or final reports on the use of donated funds to other charities.

You indicated that you will solicit funds for operations strictly through word of mouth advertising and this will be your only form of solicitation. Currently, the largest source of funding to your organization has come from related individuals. You have acknowledged that six out of eight of your board members are closely related to each other and to your officers by virtue of family ties.

You stated that all or part of your assets will be entrusted to your employees/volunteers for the purpose of actively trading donated funds in stocks and the options equity market. You stated that the employees/volunteers will be known as traders. The traders will be elected by a unanimous vote of the Board of Directors. The board members will meet once every six months or as needed in order to review the actions of each trader. The Board members, by a two thirds (2/3) vote, will select which charities will receive donations.

Your founder will retain the title of president and solely decide the compensation for any trader or employee. The board members, by a simple majority, will determine your compensation. The board will meet annually to determine the charities that will receive donations and to elect new traders. Your president will have the sole authority to hire employees other than traders and will also have the sole authority to fire traders. Any bylaw ratifications, articles of incorporation ratifications, or disputes of any kind will be settled by a unanimous vote by the Board.

## LAW

Section 501(c)(3) of the Internal Revenue Code (the Code) provides exemption from federal income tax for organizations that are "organized and operated exclusively" for religious, educational, or charitable purposes. The exemption is further conditioned on the organization being one "no part of the net income of which inures to the benefit of any private shareholder or individual."

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 1.501(a)-1(c) of the Income Tax Regulations (the Regs) states that "[t]he 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(c)(1) of the Regs states that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified

in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the Regs states 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 Regs states that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.502-1(a) of the Regs states that in the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the ground that all the profits of such organization are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501.

Rev. Rul. 67-5, 1967-1 C.B. 123, holds that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation. This resulted in the foundation's ownership of common stock of a corporation controlled by the foundation's creator and his family that paid no dividends. This prevented the foundation from carrying on a charitable program commensurate in scope with its financial resources. This ruling concluded that the foundation was operated for a substantial non-exempt purpose and served the private interest of the creator and therefore, was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 76-206, 1976-1 C.B. 154, considered an organization formed to promote broadcasting of classical music in a particular community. The organization carried on a variety of activities designed to stimulate public interest in the classical music programs of a for-profit radio station, and thereby enable the station to continue broadcasting such music. The activities included soliciting sponsors, soliciting subscriptions to the station's program guide, and distributing pamphlets and bumper stickers encouraging people to listen to the station. The organization's board of directors represented the community at large and did not include any representatives of the for-

profit radio station. The revenue ruling concludes that the organization's activities enable the radio station to increase its total revenues and therefore benefit the for-profit radio station in more than an incidental way. Therefore, the organization is serving a private rather than a public interest and does not qualify for exemption.

Rev. Rul. 98-15, 1998-1 C.B. 718, states that if a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be organized and operated exclusively for exempt purposes.

Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945) the Supreme Court held that in order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes.

Founding Church of Scientology v. United States, 188 Ct. Cl. 490, 498, 412 F.2d 1197, 1201 (1969), cert. denied, 397 U.S. 1009 (1970), the Court reasoned that the congressional intent behind the conditional language of section 501(c)(3) of the Code, coupled with the burden of proof placed upon the taxpayer in these circumstances, requires plaintiff to clearly demonstrate its right to exemption.

St. David's Health Care System v. U.S., 349 F.3d 232, (C.A.5 2003), the Court held that in order to ascertain whether an organization furthers non-charitable interests, the Service can examine the structure and management of the organization; including which individuals or entities control the organization.

University Hill Foundation, etc., v. C.I.R., 446 F.2d 701, (C.A. 9 1971) the Court held that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation.

Lowry Hosp. Ass'n v. Commissioner, 66 T.C. 850, 859-60, 1976 WL 3664 (1976) The Court concluded that a hospital could not be deemed to operate exclusively for charitable purposes, partly because of the "control and dominance" exercised by a single physician over the hospital's affairs. If private individuals or for-profit entities have either formal or effective control, one may presume the organization furthers the profit-seeking motivations of those private individuals or entities.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court stated that petitioner's activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit. The court also stated competition with commercial firms is strong evidence of the predominance of nonexempt commercial purpose. The court went further and stated that the conduct of a business with an apparently commercial character is the petitioner's sole activity, a fact that weighs heavily against exemption.

In Christian Manner Int'l, Inc., v. CIR, 71 T.C. 661, 1979 WL 3825 (1979), the court held that when an activity is engaged in to further both an exempt and nonexempt purpose, the Court must decide whether the nonexempt purpose was sufficient to deny the exemption or was so incidental to the exempt purpose as not to disqualify petitioner for exemption.

Greater United Navajo Enterprises v. CIR, 74 T.C. 69, 78-79 (1980) the Court interpreting Reg. 1.501(c)(3)-1(c)(1), held that some activity not serving an exempt purpose is permitted, but the organization's wholly nonexempt activities must be relatively insubstantial in comparison with the organization's activities serving an exempt purpose.

Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980) aff'd, 670 F.2d 104 (9th Cir. 1980), the Tax Court considered the qualification for exemption of an organization purporting to be a church. The Applicant was controlled by three family members. The court stated that, "While this domination of petitioner by the three family members, alone may not necessarily disqualify it for exemption, it provides an obvious opportunity for abuse of the claimed tax-exempt status. It calls for open and candid disclosure of all facts bearing upon petitioner's organization, operations, and finances so that the Court, should it uphold the claimed exemption, can be assured that it is not sanctioning an abuse of the revenue laws.

Church of Ethereal Joy v C.I.R., 83 T.C. No. 3, 83 T.C. 20, although control by ... a small group may not necessarily disqualify [an organization] for exemption, it provides an obvious opportunity for abuse of the claimed tax-exempt status.

American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), The Court explained that genuine public benefit often provides an incidental benefit to private individuals. But if private interests are served *other than incidentally*, exemption is precluded. *Qualitatively* incidental means that the private benefit is a mere byproduct of the public benefit. For private benefit to be *quantitatively* incidental, it must be insubstantial in amount. The private benefit must be compared to the public benefit of the specific activity in question, not the public benefit provided by all the organization's activities. The more exactly you can quantify the private benefit, the more likely it is to

be non-incident.

*Redlands Surgical Services v. Commissioner*, 113 T.C. 47 (1999) The Tax Court maintained that, where private individuals or for-profit entities have either formal or effective control of a non-profit organization, it may be presume that the organization furthered the profit-seeking motivations of those private individuals or entities.

## RATIONALE

An organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Section 501(c)(3) of the Code and Section 1.501(c)(3)-1(d)(1)(ii) of the Regs To meet the requirement, an organization must establish that it is not organized or operated for the benefit of private interests such as the creator or his family, or persons controlled, directly or indirectly, by such private interests. While you organized as a non-profit, family members overwhelmingly dominate your board. Your initial funding comes from these related parties. Your founder is president and makes exclusive decisions regarding employment and compensation of traders. A simple majority of the board, on which related parties comprise a substantial majority, determines the president's salary. Funding comes from the same related officers and directors. You anticipate soliciting donations from a broader group in the future, but only by word of mouth, so that all of your donors will have some connection to your officers and directors.

Your traders will receive substantial experience in trading securities with their compensation approved by your president. The brokerage houses will receive commissions for exercising trades. Your sole purported exempt activity of donating a small percentage of your net profits to charity once per year is insignificant and insubstantial as it relates to your year long trading activities. Your non-exempt activities are significant and substantially commercial in nature and promote private benefits to the traders and the brokerage houses doing business with you. In Better Business Bureau of Washington D.C., Inc. v. United States, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, would destroy the exemption regardless of the number or importance of truly exempt purposes. See also Section 1.501(c)(3)-1(d)(1)(ii) of the Regs.

In addition, since the initial funding comes from related parties, granting exemption would greatly benefit the related parties who would be entitled to charitable deductions under §170 of the Code. These benefits, which should be incidental in nature in comparison to the charitable endeavors, would greatly exceed any charitable benefits bestowed upon the public. See Rev. Rul. 67-5, 1967-1 C.B. 123, (foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them). See also Redlands Surgical



Services v. Commissioner (if private individuals or for-profit entities have either formal or effective control of a non-profit organization, it is presumed that the organization furthers the profit-seeking motivations of those private individuals or entities).

The Tax Court stated that a genuine public benefit often provides an incidental benefit to private individuals; however, the Court denies exemption if an organization benefits private interests other than incidentally. The principles set forth in Rev. Rul. 76-206, underscores that benefits to a private interest in more than an incidental way precludes exemption. See also American Campaign Academy v. Commissioner.

The control of an organization by related parties invites scrutiny regarding potential private benefits and abuse of its tax-exempt status. Bubbling Well Church of Universal Love, Inc. v. Commissioner, ("While this domination of petitioner by the three family members, alone may not necessarily disqualify it for exemption, it provides an obvious opportunity for abuse of the claimed tax-exempt status...."). See also Lowry Hosp. Ass'n v. Commissioner, (If private individuals or for-profit entities have either formal or effective control, we presume that the organization furthers the profit-seeking motivations of those private individuals or entities), and Church of Ethereal Joy v C.I.R., (although control by ... a small group may not necessarily disqualify [an organization] for exemption, it provides an obvious opportunity for abuse of the claimed tax-exempt status).

An organization operated for the primary purpose of carrying on a trade or business for profit, may not be recognized as exempt under § 501(c)(3) on the ground that all the profits of such organization are payable to one or more organizations exempt from taxation under § 501(c)(3) of the Code. Section 502 of the Code and §1.502-1(a) of the Regs. The Court in B. S. W. Group, Inc., relying on St. Louis Union Trust Co. v. United States, 374 F.2d 427, 431-432 (8th Cir.), reasoned that the fact that petitioner's activity may constitute a trade or business does not, of itself, disqualify it from classification under § 501(c)(3), provided the activity furthers or accomplishes an exempt purpose. The critical inquiry is whether petitioner's primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for petitioner.

You stated that your primary activity to generate funding and profits would be stock trading, a commercial activity that does not further an exempt purpose. Your premise for tax-exemption is that you will donate a portion of your revenue to a designated charity. Congress has specifically stated that even donating all of the profits of a trade or business is not sufficient grounds to recognize it as exempt, and you plan to donate much less than all of your profits.

You stated that you will donate a portion, initially four percent (4%), of your net proceeds from security trading to charity. You stated that you will not initially seek

contributions from the public until you have established a performance record in trading; but you will use the funds acquired from related parties for trading in securities. You stated that your contribution to charities would be dependent upon your trading performance. You did not indicate whether you would solicit funds directly for charities; but you would solicit funds for stock trading with portion of any profits going to charities. In Greater United Navajo Enterprises v. CIR, the Tax Court held that an organization's wholly nonexempt activities must be relatively insubstantial in comparison with the organization's activities serving an exempt purpose. Your primary activity, measured by the amount time your officers, directors, and employees devote to trading, is overwhelmingly and substantially commercial in nature.

In conclusion, you have not met your burden in demonstrating that your purpose and activities satisfy the standard for recognition as exempt under § 501(c)(3) of the Code. Your primary purpose of trading in stocks and options is commercial, not charitable, and it does not further an exempt purpose. You fail to qualify for exemption because the facts show that you primarily serve a private rather than a public interest.

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.

Your protest statement should be accompanied by the following declaration:

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see 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](http://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 protest 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 this address:

Internal Revenue Service  
TE/GE (SE:T:EO:RA:T:1)  
1111 Constitution Ave, N.W.  
Washington, DC 20224

You may also 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 G. Lerner  
Director, Exempt Organizations

Enclosure