



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Release Number: **201221023**  
Release Date: 5/25/2012  
Date: March 1, 2012  
501.00-00  
501.03-00  
501.33-00  
501.35-00

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.

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

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

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

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



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Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

Taxpayer =  
Company =  
Industry =  
Service =  
Products =  
Related Company 1 =  
Related Company 2 =  
Related Company 3 =

Dear

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

Facts

You, Taxpayer, are a nonprofit corporation organized under the laws of the state in which you reside. Your Articles of Incorporation state that you "may not carry on any . . . activities not permitted to be carried on by: (a) A corporation exempt from Federal Income Tax under Section 501(c)(3) of the [Internal Revenue] Code . . . ; or (b) A corporation, contributions to which are deductible under Section 170(c)(2) of the Code . . ." Your Articles also provide for the proper distribution of your assets upon your dissolution.

Your specific purpose, according to your narrative description of activities, is "to promote eco-friendly Products by commercial Service companies." You state that you "seek[] to mitigate . . . emissions [generated by Service companies] through the purchase of carbon offsets via a partnership with Company . . ." Company is a for-profit retailer of carbon offsets. Company is not related to you through common control or otherwise. Based on the financial data you submitted with your Form 1023 application, you predict that between 60 and 80 percent of your

total revenues will be paid directly to Company for the purchase of carbon offsets. The remainder of your expenses are for professional fees and occupancy expenses.

You “plan[] to provide partner Service businesses with proprietary software that will calculate the carbon footprint of a [Service] job. The software will then tell the [Service] company how much of a carbon offset they should purchase to make up for the ecological impact of the [Service] project. If a job has its carbon impact appropriately mitigated, it will qualify to display a special . . . logo [owned by you] that certifies that the job was carbon neutral.”

You stated that Industry organizations who apply to have their projects certified by you as carbon neutral “are required to complete the . . . Business Carbon Audit form. Once this form is completed, [you] send[] this form to Company where the amount of carbon emitted by the Service establishment is calculated. Applicants are [then] asked to pay a Certification fee, which is based on the [size of the organization.]”

Your office space is provided by Related Company 1, pursuant to a “verbal lease” with no set term. In your original application for recognition of tax-exempt status, you state that you will pay a rent of \$ \_\_\_\_\_ per year to Related Company 1. However, in your response to our additional questions about the lease, you stated that you do not pay any rent. Additionally, you stated that Related Company 1 is responsible for all utility payments, taxes and improvements of the facility, and that in exchange, you provide carbon neutral certification for projects performed at Related Company 2. Although you stated that your landlord is not related to you in any other way, your President is the Managing Partner of Related Company 1. Your President is also the President of Related Company 2 and Related Company 3.

In addition, one of your other two directors serves in an executive capacity at Related Company 2 and Related Company 3, and the third serves in an executive capacity at Related Company 2. In your application for recognition of tax-exempt status, you concede that you, Related Company 2 and Related Company 3 are under common control. None of your personnel, including members of your Board of Directors, are compensated by you.

When you were asked to provide a list of all your activities and how much time you will devote to them, you stated that you will spend 70 percent of your time “marketing to [Industry] companies and [Industry] purchasers throughout the United States encouraging them to purchase carbon offsets for their Service projects.” You stated that 20 percent of your time would be spent on administration and billing, and the remaining 10 percent of your time would be spent “auditing” companies seeking to purchase offsets from you to determine their offset requirements. You estimate that between \_\_\_\_\_ and \_\_\_\_\_ percent of your total revenue will be spent on advertising, although your statement of revenues and expenses does not reflect any advertising costs.

### Law

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

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, in order to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 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(d)(1)(i) of the regulations states that an organization may be exempt as an organization described in § 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes under § 501(c)(3) unless it serves a public interest rather than a private interest.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term “charitable” as used in § 501(c)(3) as including the relief of the poor and distressed or of the underprivileged, advancement of education, combating community deterioration and lessening the burdens of government.

In Rev. Rul. 73-567, 1973-2 C.B. 178 a medical specialty board did not meet the requirements under § 501(c)(3) because it was not organized and operated for exempt purposes. The organization’s certification activities primarily served the private interests of the medical profession rather than providing a public benefit. The organization was instead recognized as exempt under § 501(c)(6).

In Rev. Rul. 76-204, 1976-1 C.B. 152, an organization was formed for the purpose of preserving the natural environment. The organization accomplished this purpose by acquiring and maintaining ecologically significant and undeveloped land such as swamps, marshes, forests, wilderness tracts, and other natural areas. The organization worked closely with Federal, state, and local government agencies, and private organizations that were also concerned with environmental conservation. The ruling reasoned that by preserving “ecologically significant undeveloped land, the organization is enhancing the accomplishment of express national policy of conserving the nation’s unique natural resources.” Thus, the ruling concluded that the “organization is advancing education and science and is benefiting the public in a manner that the law regards as charitable.”

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under § 501(c)(3), regardless of the number or importance of statutorily exempt purposes. Thus, the operational test standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations that further nonprofit goals outside

the scope of § 501(c)(3).

In Church by Mail v. Commissioner, 765 F.2d 1387, 1392 (9th Cir. 1985), the court in determining that a non-profit was operated for substantial non-exempt purposes and that income inured to the benefit of private persons stated that “[t]he critical inquiry is not whether particular . . . payments to a related for-profit organization are reasonable or excessive, but whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the [non-profit].” The court additionally upheld the Tax Court’s determination that the church was operated for substantial nonexempt purpose of providing a market for services of advertising agency, a for-profit organization owned and controlled by ministers of church.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C. 2003), the court concluded that an organization did not qualify for tax-exemption under § 501(c)(3) because it was operated for nonexempt commercial purposes rather than for exempt purposes. Among the major factors the court considered in reaching this conclusion was the organization’s competition with for-profit commercial entities, the extent and degree of below cost services provided, the pricing policies, and the reasonableness of financial reserves. Additional factors included whether the organization used commercial promotional methods, such as advertising, and the extent to which the organization received charitable donations.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under § 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial.

In addition, the court found that the organization’s financing did not resemble that of the typical § 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than “cost.” And finally, the corporation did not limit its clientele to organizations that were § 501(c)(3) exempt organizations.

In Indiana Crop Improvement Association, Inc. v. Commissioner, 76 T.C. 394 (1981), the organization was the official seed certifying agency for the State of Indiana and conducted a seed certification program pursuant to the delegation of authority by the state legislature. The Tax Court found that as the official seed certifying agency for the state, the organization directly assisted the United States Department of Agriculture in enforcing the standards and procedures established under federal statute. Thus, the Tax Court found that the organization lessened the burden of the government.

### Analysis

Organizations described in § 501(c)(3) must be both organized and operated exclusively for one or more of the purposes specified in such section. § 1.501(c)(3)-1(a)(1). Pursuant to §



1.501(c)(3)-1(c)(1), an organization will only be regarded as “operated exclusively” for charitable purposes if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). Similarly, Better Business Bureau v. United States, 326 U.S. 279 (1945) held that a single substantial non-exempt purpose precludes exemption.

You stated that 70 percent of your time will be spent on marketing, 20 percent on administration and billing, and 10 percent on “auditing.” You also stated that between 20 and 80 percent of your revenue will be spent on advertising. Advertising and marketing are not exempt purposes specified in § 501(c)(3). Since advertising and marketing constitute your primary activities, you are not operated exclusively for charitable purposes.

Your certification of Service projects as carbon-neutral is also not an exempt activity. Certification of organizations and products is generally not considered an exempt activity. See e.g. Rev. Rul. 73-567, supra. Exceptions exist when an organization is testing products for public safety, and when an organization is lessening the burdens of government. §§ 1.501(c)(3)-1(d)(1)(i); 1.501(c)(3)-1(d)(2). You are not testing products for public safety purposes. Moreover, you are unlike the organization described in Indiana Crop Improvement Association, Inc. v. Commissioner, 76 T.C. 394 (1981), because you are not performing a governmental function. Instead, you are engaged in the resale of a commercial product.

Your activities do not preserve the natural environment in a way that qualifies you for recognition as an organization described in § 501(c)(3). Unlike the organization in Rev. Rul. 76-204, supra, you do not engage in any activities that generate environmental benefits. Instead, you act as an intermediary that purchases carbon offsets from a commercial enterprise and resells them to Service businesses. None of your activities actually cause a reduction in carbon emissions.

The sale of carbon offsets is a trade or business ordinarily conducted by commercial ventures organized for profit. Such activity is in fact carried on by your partner, Company, for profit. Thus, like the organizations described in B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 and Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58, you were formed to conduct a venture ordinarily conducted for profit. Your primary purpose is not charitable, educational, or scientific, but rather commercial.

An organization will also not be organized and operated exclusively for exempt purposes if it is 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. § 1.501(c)(3)-1(d)(1)(ii). You are operated primarily to benefit private parties.

You benefit Company by purchasing its carbon offsets to be resold to for-profit organizations. More than 60 percent of your gross receipts are paid to Company. The resale of commercial products marketed by a for-profit company is not a charitable purpose. In fact, none of your revenues are devoted to charitable purposes, and are instead devoted entirely to advertising, purchasing carbon offsets, professional fees and occupancy.

You provide additional private benefit to Related Company 1. By entering into a “verbal lease” with Related Company 1 for occupancy expenses totaling \$10,000 per year, and with no evidence that the lease was negotiated at arms’ length or that \$10,000 per year is the market rate for similar space, it appears that the terms of this lease provide substantial rental income to Related Company 1 without regard to whether you are receiving a commensurate benefit.

You also provide impermissible private benefit to Related Company 2. You provide carbon neutral certification to Related Company 2 in exchange for utility payments, taxes and improvements of your facility. You submitted no evidence indicating that these transactions will occur at arms’ length, or that they will be commensurate with the needs of Related Company 2 for carbon offsets. Thus, after paying your taxes and other expenses, Related Company 2 may be left with excess carbon offsets, which it could sell for a profit. Furthermore, you provide substantial private benefit to the unrelated Service companies whose Service operations you plan to certify. The primary purpose of the certification is to market carbon-neutral Service through the licensing of your logo.

Based on the foregoing, you operate primarily to benefit private interests in various ways, contrary to the requirement set forth in § 1.501(c)(3)-1(d)(1)(ii). Various for-profit enterprises benefit substantially from your operations. Thus, you do not qualify for recognition as an organization exempt under § 501(c)(3). See Church by Mail v. Commissioner, 765 F.2d 1387.

### Conclusion

Based on the facts and information provided, you are not operated exclusively for exempt purposes as required by sections 1.501(c)(3)-1(a)(1) and 1.501(c)(3)-1(c)(1) of the regulations. You are operated for a substantial nonexempt purpose in contravention of section 1.501(c)(3)-1(c)(1) of the regulations. Any public purposes for which you may operate are only incidental to this primary nonexempt purpose. You do not serve a public rather than a private interest as required by section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Therefore, you are not described in section 501(c)(3).

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

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