



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201233018**

Release Date: 8/17/2012

Date: May 22, 2012

UIL Code: 501.03-05

501.05-01

501.32-00

501.33-00

501.50-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

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

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

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 G. Lerner
Director, Exempt Organizations

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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: **April 5, 2012**

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B = Officer

C = Officer

H = Professional Business Services Enterprise

J = Professional Grant Writing Company

K = Employee of H

M = For-profit Business

p = Dollar amount

q = Dollar amount

x = Date

y = State

z = State

UIL Nos:

501.03.05

501.05.01

501.32.00

501.33.00

504.50.00

Dear

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

Issues

Were you formed for the non-exempt purpose of obtaining grant funding for the primary benefit of B and C? Yes, for the reasons stated below.

Do your activities serve a substantial, non exempt purpose contrary to Section 501(c)(3) of the Code? Yes for the reasons stated below.

Facts

You were incorporated on x as a z corporation.

Individuals B and C are listed as your officers and directors. B and C are married, and B serves as both the President and Treasurer.

Your Articles of Incorporation state that you are organized as a public benefit corporation and you are not organized for the private gain of any person.

Your Narrative Description states you are organized exclusively for charitable purposes. Specifically you will help local non-profit organizations in your area. These organizations help people get back on their feet and back into the work force to become productive members of your community. You state that you will establish agreements with non-profit agencies for the purpose of providing assistance for the elderly, mentally ill, poverty stricken and disabled. You will provide grant funding for local, non-profit, social service agencies to be used directly for the purpose of supporting, educating and servicing the disadvantaged populations in your community. You state that your funding will be provided through private business grants, with an approximate \$14,000 anticipated funding that will be granted upon approval of your non-profit status. Specifically, you state that the funding will come through M.

B and C own and operate M, a for-profit business facility. B and C have operated M for 43 years, in the state of z.

B was contacted by J, a professional grant writing company based in y, in July 2010, about opportunities to pursue business grants for M in amounts exceeding \$100,000.

In August 2010, B signed a contract with J and has stated that \$q was paid for J's services to prepare a business plan, and for grant research/grant writing services.

In December 2010, B signed a contract with H, a for-profit business services enterprise that prepares corporate documents and applications, and paid \$p (with an additional \$p due in January 2011) for services to apply for tax exempt status by preparing and filing Articles of Incorporation and Form 1023, and preparing customized by-laws.

All fees paid to H and J were paid by M.

You provided a description of the grants for which you seek to qualify and the grant application process you will follow as directed by H and J.

You indicated that you will not receive any funding from the grant directly. M will receive the funds and dispense 5% to you. The grants would be for more than \$275,000 and would need to be spent in one year or be given back. The funds will be used for:

- a) All renovations
- b) Hiring – (B works the business facility 7 days a week 12 hours a day. The grant will allow for 2-4 individuals to be hired to reduce B's workload.)
- c) Purchasing machinery, equipment, etc

- d) Advertising
- e) Operating - rent, utilities, day to day expenses
- f) Five percent of funding for non-profit organization

K, an employee of H, gave B specific instructions for opening two non-interest bearing checking accounts. K informed B and C that they would need to have a non-profit registered in order to receive the grant. K said that this non-profit must be registered with the State and the Internal Revenue Service in order to meet the requirements of the grant. This was to ensure that five percent of the grant would be properly distributed to a non-profit organization and the money would be legal and traceable for the State and the Internal Revenue Service for any tax purposes. K explained to B that if they did not have a non-profit, they would no longer be eligible for the grant.

K directed that B and C were to fax their determination letter, received from the Internal Revenue Service for the non-profit (assuming approval), to K, and the information would be sent to the grant foundation, which would then release the funds.

B stated that company M is in desperate need of upgrading the building, and the equipment. B indicated that M was considering closing down due to lack of business. M desperately needs upgrading to compete with other facilities in the area. B notes months of work with the two companies, H and J to get to the point of applying for the non-profit exempt status with the Internal Revenue Service. B indicated that without an exempt non-profit determination from the Internal Revenue Service they will not get the grant and will have to close M.

Law

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

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

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized and operated exclusively for charitable purposes unless it serves a public rather than a private interest. To meet this requirement that it serve a public purpose, an organization must establish that it is not organized or operated for the benefit of private interests.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In KJ's Fund Raisers, Inc. v. Commissioner, T.C. Memo 1997-424 (1997), affirmed 82 AFTR 2d 7092 (1998), the Tax Court found that a gaming organization was not exempt. While the organization raised money for charitable purposes, it also operated for the substantial benefit of

private interests. The organization's founders were the sole owners of a bar, KJ's Place. The organization, through the owners and employees of KJ's Place, sold lottery tickets exclusively at KJ's Place during regular business hours. While in KJ's Place, the lottery ticket purchasers were sold beverages. The initial directors were the two founders and a related individual. The initial board was replaced several times until the two founders were no longer on the board. At all times these two individuals were the organization's officers. Salaries had been paid to them and rent had been paid to KJ's Place. The organization maintained that the fact that salaries and rent were no longer paid in this fashion indicated the independence of the board. The Court took another view: "Although those practices ceased and are not an issue here, the current board of directors is composed of at least the majority of the same members who allowed those amounts to be paid."

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

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

In Rev. Rul. 61-170, 1961-1 C.B. 112, an association composed of professional private duty nurses and practical nurses that supported and operated a nurses' registry primarily to afford greater opportunities for its members was not entitled to exemption under section 501(c)(3) of the Code. Although the public received some benefit from the organization's activities, the primary benefit of these activities was to the organization's members.

Application of Law:

You are not organized and operated exclusively for charitable, educational, or religious purposes consistent with Section 501(c)(3) of the Code nor Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations. Specifically, you were formed for the purpose of obtaining non-profit grant funding to be used to make capital improvements to M, owned by B and C. This fact pattern constitutes inurement to insiders and precludes exemption under 501(c)(3) of the Code.

You have failed to meet the burden of proof prescribed in Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations. You were formed to serve the private interests of B and C as well as their for-profit company M by obtaining and expending non-profit grant monies for the purpose of improving M.

You are operated for substantial non-exempt commercial purposes consistent with Better Business Bureau of Washington D.C., Inc. v. United States. Your purpose of obtaining grant funding for the purpose of improvement and upgrading the equipment for B and C's for-profit company, M, in order to be able to continue operating a for-profit business facility constitutes a substantial non-exempt commercial purpose.

You are similar to organizations described in the court cases KJ's Fund Raisers, Inc. v Commissioner, and Church by Mail v. Commissioner. Your operations are comparable to the operations of the organizations described in these rulings. Just as for-profit entities are the main beneficiaries of these organizations' funds, your primary purpose is to receive funds to improve the for-profit company, M. This constitutes a substantial non-exempt purpose which is commercial in nature and which serves the private interests of M's owners, B and C.

You also are similar to the organization in the court case New Dynamics Foundation v. United States. Consistent with the cited case, you were formed for the private benefit of your founder B through the planned expenditure of non-profit grant funding directed to you to make substantial capital improvements to the for-profit business facility owned by B and C. This fact pattern is consistent with the cited ruling and further substantiates lack of a substantial exempt purpose consistent with Section 501(c)(3) of the Code.

In addition, your activities are similar to the activities described in Rev. Rul 61-170, 1961-1 C.B. 112. Your mission to obtain and expend non-profit grant monies to substantially improve the for-profit business facility owned by B and C serves to the primary benefit of B and C and not to the public at large.

Conclusion:

In summary, you do not meet the requirements under section 501(c)(3) because you failed the operational test. Your primary purpose is to receive grants to improve B and C's for-profit business, M. You operate for non-exempt commercial purposes and for the private interests of B and C. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

Consideration was given to whether the applicant organization qualifies for exemption under other subsections of section 501(c) of the Code. However, based on the information that you have submitted, you are entitled to exempt status under section 501(c) of the Code because you are operating for a significant non-exempt commercial purpose and for the private interests of B and C.

Based on the above facts and law, you do not qualify for exemption under section 501(c) of the Internal Revenue Code.

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

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

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

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

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

Your appeal will be considered incomplete without this statement.

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

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

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

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

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

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

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 G. Lerner
Director, Exempt Organizations

Enclosures
Publication 892