



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: **201235021**  
Release Date: 8/31/2012  
Date: June 4, 2012  
UIL Code: 501.03-00  
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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

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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 17, 2012

UIL: 501.03-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B =  
C =  
D =  
State =  
Date1 =  
Date2 =  
Date3 =  
Foundation =  
LLC =  
X =  
Y =  
Z =

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 you provided, we conclude that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

FACTS:

You are a State not-for-profit corporation, incorporated on Date1. Pursuant to your application Form 1023 and supporting documentation, you state that your purpose is to "facilitate the identification of worthy charities and to foster giving by donors in a very timely and rapid response time" through online giving and mobile phone technology.

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response time" through online giving and mobile phone technology.

Pursuant to your Articles of Incorporation ("Articles"), your specific purposes include:

- a. To provide a means to support and contribute to other charitable organizations exempt under § 501(c)(3).
- b. To help meet, where possible, the physical, financial, medical and other needs of those in any place or location where such needs exist throughout the whole world and which are consistent with the underlying purposes of this corporation; and,
- c. To be operated in a manner consistent with the laws under § 501(c)(3).

Your Articles also state that you are a non-member entity. Three directors, B, C and D, manage your day-to-day affairs. Your conflict of interest policy, among other guidelines, bars and regulates transactions that might benefit the private interest(s) of any of your officers or directors.

Your bylaws provide that B is appointed Chairman of your Board of Directors ("Board") to honor his commitment and vision in founding you. The Board, with the concurrence of B, shall choose additional qualified individuals to serve on your Board. The term of each director including the Chairman is indefinite and in order to remove the Chairman, a vote of least 2/3 of your directors entitled to vote is required. The Chairman also has the deciding vote if the directors are deadlocked on any issue.

In order to encourage donation and also to make donations easier and quicker, you state that you plan to raise funds on behalf of § 501(c)(3) organizations using an online giving system through your website and mobile phone applications. You state that both your website and mobile phone application will contain information about selected § 501(c)(3) charities that operate in the areas of national/world disaster relief; children, community and families; health and environment; and health and wellness and will provide donors with the ability to make a donation through the website or through the mobile phone application to the charity of their choice.

You submitted a list of the § 501(c)(3) organizations on whose behalf you solicit charitable contributions. However, you were unable to submit proof or copy of any contract between you and any of these charitable organizations. You explained that you do not have a contract with any of these § 501(c)(3) organizations because none of the organizations would enter into such an agreement until you obtain § 501(c)(3) tax-exempt status from the Service. You did submit a copy of a "Memorandum of Understanding" between you and Foundation. You represent that the eventual contract between you and the charitable organizations shall include the charitable organizations' right to full disclosure of your financial statement and the right to audit you.

You have entered into a contract with LLC to provide all of your hardware, software and administrative services in the operation of your online giving system including your mobile phone application for a fee of 20% of donations ("Contract"). LLC is a for-profit entity owned by your directors in the following proportions: B (x%), C (y%) and D (z%) and shares a similar

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name with you. At the time you submitted your application, you stated that your directors “have a business relationship with each other as they work together in a business devoted to software applications, solutions and acquisitions all of which are designed to help other businesses including charities.” You state that LLC will initially provide its software application only to you. In the future, LLC will license the software to other organizations besides you.

The Contract provides that you will remit the remaining 80% of the donation to the selected charitable organizations. You state that you have implemented a “tier system,” whereby you will reduce the 20% fee, if and when donations reach a certain level. You also state that “[t]he 20% fee, after careful market analysis, is well below the average that charitable organizations spend in order provide funds directly to their program activities.” However, you did not submit a copy of the market analysis or any other documentation related to you arrived at this fee.

In your letter dated Date2, you state that because you want a board composed of individuals with no business or familiar relationship, C and D are no longer on your Board, and B is no longer a member of LLC’s Board of Executives. You also indicated that LLC will change its name in the future but has not done so. In addition, B remains your Chief Executive Officer (“CEO”), your Chairman, and x% owner of LLC.

You also included a copy of an amended contract (“Amended Contract”) dated Date3, between you and LLC. B, your Founder, CEO, Chairman of your Board, and x% owner of LLC, signed the Amended Contract on your behalf. D signed the Amended Contract on LLC’s behalf. You submitted a “conflict of interest policy and implementation in approval of agreement with the LLC” signed by B declaring that he “did not vote for and/or influence the confirmation of consideration of entering into the said agreement.”

Under the Amended Contract, the activities LLC shall perform include:

- a. “License to you certain hosted software that will run your donation website.”
- b. “Render all services, which include data import, export, monitoring, support, backup, recovery, change management, technology updates, and train you on how to productively use the software.”
- c. “Administrative services, which include, collection and remission of donations to section 501(c)(3) organizations. “

Pursuant to the Amended Contract, you are no longer using the “tiered” structure for fees. Instead, you state that you will charge a total transaction fee of 8% on all donations received. Of this 8%, you will pay LLC 5% for services rendered pursuant to the Amended Contract and the remaining 3% will be used by you for administration and marketing costs. There is no limit or cap on the total amount of fee charged to any one donor.

You attribute your ability to reduce the fee from 20% to 8% to your ability to subsidize your costs through private grants. You state that you are presently seeking private grants and individual donations, which you will use to cover operating expenses hoping to eventually eliminate the 8% transaction fee. At the end of every month, you will transfer to each charity monies you

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collected on their behalf less the 8% you charge for operational expenses. However, the monthly transfer will only occur if the donation(s) on behalf of such charitable organizations is at least \$100. For all other charitable organizations where the donation is less than \$100, you will transfer funds less the 8% transaction fee only yearly.

You were asked but failed to submit copies of any documents that memorialized the negotiations between you and LLC. You were also asked to submit a copy of the Board's meeting minutes reflective of the Board's approval of both the Contract and the Amended Contract considering the relationship between you, LLC, B, C and D. You stated that the "minutes of the Board of Directors in which the compensation agreement with the LLC was considered and approved have not been drafted yet."

LAW:

Section 501(a) provides that an organization described in subsection (c) or (d) or § 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under § 502 or 503.

Section 501(c)(3) provides that to merit tax-exempt status under § 501(a), an organization must be organized and operated exclusively for charitable or educational purpose(s), among others.

Section 501(c)(3) provides that an organization tax-exempt under § 501(a) shall make certain that no part of its net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(a)-1(c) provides that the words "private shareholder or individual" in § 501 refer to persons having a personal and private interest in the activities of the organization.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides 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 § 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.

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides 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.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that to satisfy the operational test, an organization must serve a public purpose rather than private interests. 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.

Rev. Rul. 69-383 1969-2 C.B. 113, provides that under certain circumstances, the use of a method of compensation based upon a percentage of the income of an exempt organization can

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constitute inurement of net earnings to private individuals.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of private benefit, if substantial in nature, will destroy an organization's tax-exempt status regardless of the organization's other charitable purpose.

Lorain Avenue Clinic v. Comm'r, 31 T.C. 141 (1958) provides that in order to qualify for exemption from tax, an organization has the burden of proving that it is both organized and operated exclusively for charitable purposes and that no part of its net earnings inures to the benefit of any private individual. Further, a ratio of income based compensation agreement that is tantamount to a joint venture between the organization and persons in control of the organization will disqualify such an organization from qualifying for tax-exempt status as an organization described under § 501(c)(3).

In Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash. 1963), the court held that even a small amount of private inurement is fatal to a § 501(c)(3) exemption.

In Beth-El Ministries v. U.S., 79-2 U.S. Tax Cas. (CCH) P9412 (1979), the court held that even if the benefit inuring to the members is small, it is still impermissible.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), the Tax Court concluded that taxpayer, a non-profit entity, cannot qualify for tax-exempt status under § 501(c)(3) because for-profit entities used taxpayer as an "instrument" to further their for-profit purposes. The for-profit organizations, several of them, exerted significant indirect control over taxpayer through contractual arrangements. The question for the court was whether they benefited substantially from the operation of the applicant not whether the payments made to the for-profits were excessive. The fact that the for-profits lacked structural control over taxpayer and the fact that amounts paid to the for-profit organizations under the contracts were reasonable did not affect the court's conclusion.

In P.L.L. Scholarship v. Comm'r, 82 T.C. 196 (1984), the Tax Court held that an organization that operated charitable bingo on the premises of a bar allowed the bar to increase its sales of food and drinks by its operations in the bar; thereby, benefitting the bar in more than an insubstantial way. The organization and bar were controlled by some of the same persons. The Court held that the operations of the organization and bar were so interrelated as to be "functionally inseparable," the effect of which was that any economic benefit the bar received was not incidental.

In Church by Mail, Inc. v. Comm'r, T.C. Memo 1984-349, aff'd 765 F.2d 1387 (9<sup>th</sup> Cir. 1985), the Court affirmed a Tax Court decision that there was ample evidence in the record to support the finding that Church by Mail, Inc. was operated for the substantial non-exempt purpose of providing a market for the services of the for-profit company. 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. 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.

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American Campaign Academy v. Comm'r, 92 T.C. 1053 (1989), the Tax Court defined private benefit as “nonincidental benefits conferred on disinterested persons that serve private interests.”

International Postgraduate Medical Foundation v. Comm'r, T.C. Memo 1989-36 (1989), an organization, whose activity was to conduct continuing medical education tours abroad, exclusively used one for-profit travel agency to arrange its travel tours. The same individuals controlled both the organization and for-profit travel agency, and the organization did not solicit bids from any other travel agency. Furthermore, both entities shared the same office. Because both entities were interrelated, the Court held that the organization was operated for the benefit of the for-profit travel agency.

In Salvation Navy v. Comm'r, T.C.M. 2002-275 (2002), the court found that one of the reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that its net earnings would not inure to the benefit of a private individual, its founder.

#### ANALYSIS:

Based on the facts provided, you have failed to establish that you operate exclusively for exempt purposes and not for private purposes under § 501(c)(3). To qualify for tax-exempt status as an organization described under § 501(c)(3), an organization must be organized and operated exclusively for charitable or educational purpose(s), among others. Such an organization must make certain that none of its net earning inures to the benefit of any private person(s) or entity and if the organization’s net earnings inure in whole or in part to the benefit of private shareholders or individuals, the organization is not operated exclusively for one or more exempt purposes. See § 501(c)(3). Your information indicates that you operate to benefit LLC, and its shareholders, B, C and D.

Your contract/business relationship with LLC confers more than insubstantial private benefit on LLC and its members. An organization that seeks qualification for tax-exempt status under § 501(c)(3) must operate to serve a public purpose rather than private purpose(s)/interest(s). See Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Substantial private benefit irrespective of an organization's charitable purpose will bar tax-exempt status. See Better Business Bureau v. United States, 326 U.S. 279 (1945) and American Campaign Academy v. Comm'r, 92 T.C. 1053 (1989).

Based on the information provided, neither the Contract nor was the Amended Contract between you and LLC is a product of an arms' length negotiation. At the time you entered into the Contract, B, C and D were all members of your Board serving indefinite terms. Your initial fee payable to LLC was 20% of your donation receipts. You stated that “[t]he 20% fee, after careful market analysis, is well below the average that charitable organizations spend in order provide funds directly to their program activities.” However, you failed to submit documentation or any other proof of the market analysis you claimed you conducted prior to awarding LLC, the contract to render software application services to you. Further, you will pay LLC a percentage of donation receipts, however you placed no cap or limit on the total amount LLC can receive



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from donation receipts. This lack of cap limit entails that LLC can receive unlimited income that will more than compensate LLC for the services LLC renders to you. Thus, rather than devoting substantially all your income towards a purpose tax-exempt under § 501(c)(3), your income will be inuring to the benefit of LLC.

You did not submit any information to show that the fee you paid/pay LLC equals the fair market value of the services LLC provided/provides to you. You also failed to submit comparable quotes indicative that the administrative fee you paid/pay LLC is comparable to the fee similar entities in your locale charge for similar services of such capacity. You also failed to submit a copy of your board meeting minutes reflective of the Board's approval of the Contract and Amended Contract after the Service requested this information from you.

To qualify for tax-exempt status, the organization seeking tax-exempt status has the burden of proving that it is both organized and operated exclusively for charitable purposes and that no part of its net earnings inures to the benefit of any private individual. The facts and circumstances surrounding the Contract, the Amended Contract and the relationship between you, LLC, B, C and D shows that this is an arrangement that is tantamount to a joint venture between you and persons who control you inclusive of B, and up to a certain time, C and D, to more than insubstantially benefit LLC. Such an arrangement cannot garner you tax-exempt status as an organization described under § 501(c)(3). See Lorain Avenue Clinic v. Comm'r, 31 T.C. 141 (1958). See also Church by Mail, Inc. v. Comm'r, T.C. Memo 1984-349, aff'd 765 F.2d 1387 (9<sup>th</sup> Cir. 1985) and est of Hawaii v. Commissioner, 71 T.C. 1067 (1979).

B as your Founder, CEO, and Chairman of your Board, holds a personal and private interest in you. See Treas. Reg. § 1.501(a)-1(c). In addition, B has the power to approve whomever you appoint to your Board. B also has the deciding vote if the directors are deadlocked on any issue. D, who until sometime before Date2 was on your Board and z% owner of LLC represented LLC and signed the Amended Contract on LLC's behalf. You submitted a "conflict of interest policy and implementation in approval of agreement with the LLC signed by B declaring that he "did not vote for and/or influence the confirmation of consideration of entering into the said agreement." However, you did not submit a conflict of interest declaration signed by D. Irrespective of the fact that D represented LLC and signed the Amended Contract on LLC's behalf after D resigned from your Board, a conflict of interest still existed between D and you because B, your CEO and Chairman of your Board, continues to be a member of LLC with D. Your information indicates that B orchestrated or otherwise influenced the Amended Contract between you and LLC, despite the fact he owns x% of LLC and signed a conflicts of interest policy.

The relationship between B and LLC and the manner in which you entered into the Amended Contract with LLC is such that the Amended Contract conveys an improper private benefit to B as B not only controls you but is also an x% owner of LLC. The Amended Contract is an indirect economic benefit to B, which is disallowed under Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) of the regulations. See Salvation Navy v. Comm'r, T.C.M. 2002-275 (2002).

Unlike the organization in Rev. Rul. 69-383, supra, the Contract and the Amended Contract were not products of arms' length negotiations. By failing to show that you have negotiated the contracts through arm's length negotiations, you have instead shown that you operate more

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than insubstantially to further the financial and business interest of LLC and its members rather than exclusively operate to benefit the public as required of an organization described under § 501(c)(3). See P.L.L. Scholarship v. Comm'r, 82 T.C. 196 (1984). See also International Postgraduate Medical Foundation v. Comm'r, T.C. Memo 1989-36 (1989). The burden of proving that you are not organized and/or operated for private benefits falls on you, however you failed to meet this requirement. See Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

The fact that this software service fee is only 5% of your total donors' contributions is immaterial. Any amount of inurement no matter how small shall bar tax-exempt status under § 501(c)(3). See Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash. 1963).

#### CONCLUSION:

Based on the information provided, you confer more than insubstantial benefit to LLC, and your income indirectly inures to the benefit of B, an insider, therefore, you are serving a private purpose rather than a public tax-exempt purpose, and we conclude that you are not an organization described under § 501(c)(3), and as such, you do not qualify for tax-exemption from Federal income tax under § 501(a).

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 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.

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Please send your protest statement and any supporting documents to this address:

Internal Revenue Service  
Attn:  
1111 Constitution Ave, N.W.  
Washington, DC 20224-0002

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