



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Number: **201306026**  
Release Date: 2/8/2013

Date: November 15, 2012

UIL: 501.30-01; 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.

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.

Letter 4038 (CG) (11-2005)  
Catalog Number 476328

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,

Holly O. Paz  
Director, Exempt Organizations  
Rulings and Agreements

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



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: September 25, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**Legend:**

B = state  
C = date  
D = department  
f = dollar amount  
u = dollar amount  
w = dollar amount  
X = individual  
Y = individual  
Z = individual

**UIL:**

501.30-01  
501.35-00

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.

**Issues**

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons set forth below.

Do you operate in a substantially commercial manner, which would preclude exemption? Yes, for the reasons set forth below.

**Facts**

You filed Articles of Incorporation in the state of B and were incorporated on C. Your Articles indicate your purpose is "to support and conduct bill payments for individual

Letter 4036 (CG) (11-2005)  
Catalog Number 47630W

whom are beneficiary's (sic) of social security or supplemental security income" and to "help them to be more self-sufficient in there (sic) everyday lives by prevention of delinquent accounts".

In order to accomplish your mission, you will act as a representative payee organization for D recipients. You will represent any individual who seeks a representative payee regardless of the amount of benefits they receive. Funds you receive are paid directly from D, and any fees you charge are preset by D. D refers five cases per year to nonprofit organizations. You will receive your clients from D; however, you will also approach members of the community if they need help. These persons may not be required to pay any money for services, but can give a free will donation. You provided no further information regarding fees, reduced fees or fee waivers.

Originally, X was your only governing body member. She was and is your president. You have since added two more governing body members. Now your governing body consists of X, Y and Z. X and Y are related.

X has been a representative payee for several family members in the past at no charge, and recognized a community need for this service. To obtain necessary funding and receive client referrals, 501(c)(3) status had to be requested.

X is your only employee. Originally, X's salary was set at w dollars. This amount was determined through discussions with an outsider who assisted in completing the original Form 1023 application. After realizing D will only refer five clients, which will result in income of u dollars annually, you changed X's salary to u dollars. You later indicated that X's salary was set in an informal discussion with your governing body. You have no conflict of interest policy in place.

All of your income will come solely from D. D provides payments for a representative payee when the payee is part of a nonprofit organization. The fees provided by D vary by case. Your budgets show that X will be compensated the same amount that you receive from D. You do not expect any other expenses, but any that arise will be approved by your governing body. Your only anticipated expense at this point is X's salary.

You also intend to compensate your employees through non-fixed payments as well. Upon reaching at least \$5,000 in your bank account, X will be issued a one-time payment of 10% of that amount. Similar payments will occur at each \$5,000 interval. However, in no event will X's compensation exceed f dollars (including salary payments) in a given year.

**Law**

Section 1.501(c)(3)-1(a) of the regulations states that 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 section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Regulation section 1.501(c)(3)-1(d)(1)(ii) provides 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.

In Revenue Ruling 69-266, 1969-1 CB 151, an organization formed and controlled by a doctor of medicine, "hired" to conduct research programs consisting of examining and treating patients who are charged the prevailing fees for services rendered, is not exempt under section 501(c)(3) of the Code.

In Revenue Ruling 72-369, 1972-2 CB 245, an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. The ruling found that providing managerial and consulting services on a regular basis for a fee was a trade or business ordinarily carried on for profit. The fact that the services in this case were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish an activity as charitable.

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 B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation organized to provide counseling services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is

ordinarily carried on as a commercial venture organized for profit. The corporation's primary purpose was not charitable, educational or scientific, but rather commercial in nature. Further, the court found that the organization's financing did not resemble that of a typical 501(c)(3) organization as it had not solicited, nor had it received voluntary contributions from the public. Its only source of income was from the fees for services that it collected. Those fees were set high enough to recover all projected costs and produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost."

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test under section 501(c)(3). Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. The case noted that among the major factors that courts have considered in assessing commerciality are competition with for-profit entities, pricing policies, the extent and degree of below cost services provided and the reasonableness of financial reserves. Additional factors include whether the organization uses commercial promotional methods (such as advertising) and the extent to which the organization receives charitable donations.

### **Application of Law**

You are not 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) of the Income Tax Regulations and therefore fail to meet the operational test. Specifically, the facts above indicate that you are not operated for exempt purposes but that you are operated in a commercial manner by providing a fee for service. You are not distinguishable from any commercial operation in that you charge fees for all of your services and are carrying on similar operations to a for profit entity.

You are not described in section 1.501(c)(3)-1(c)(1) of the regulations because you are not primarily engaged in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. You are primarily engaged in offering a fee for service indistinguishable from any commercial operation.

You are not described in section 1.501(c)(3)-1(d)(1)(ii) of the regulations because you serve the private interest of X. You are controlled by interested parties (X and Y) and you are organized to create an employment opportunity for X, which serves to her private benefit. Further, it is noted that the reason you are requesting exemption is so that you can receive compensation from D (as they require nonprofit distinction in order for payments to be made in return for services rendered) in order to pay X.

You are similar to the organization denied exemption in Revenue Ruling 69-266. Like that organization, you are formed and controlled by X, your only employee is X, and the

entire fee you receive from D is paid to X.

Similar to the organization denied exemption in Revenue Ruling 72-369, you are operated to provide a service for a fee, which is similar to a trade or business ordinarily carried on for profit. Furnishing services at market rates lacks the donative element to be considered charitable. Rather, such a pricing policy is commercial in nature.

As noted in B.S.W. Group and Airlie Foundation, *supra*, operations which have a commercial undertone exclude exemption under section 501(c)(3) of the Code. You have not, thus far, received any contributions from private or public sources. Your only source of income is fees for services. X will be paid the market rate received from D. Although you intend to provide some services at a reduced price or free, no information on how fee reductions or who qualifies for free services was provided. Providing some free or reduced cost services does not change the commercial manner in which you operate.

Since your operations are commercial in nature, they are distinguishable from an exclusively charitable and educational program, which would be exempt in nature. This underlying commercial motive is similar to what caused denial of exemption in Better Business Bureau of Washington D.C., *supra*. Although elements of your proposed operations are aimed at helping those who need assistance in managing their funds, which could be construed as charitable, your overriding purpose is that of providing employment to X. This precludes exemption under section 501(c)(3) of the Code.

#### **Applicant's Position**

You indicated that X "would like to be considered for an opportunity for a career as a representative payee". You feel that your operations are charitable in nature and exemption under section 501(c)(3) of the Code should be granted.

#### **Service Response to Applicant's Position**

Although your intention may be to help those in need, your proposed operations are commercial in nature and serve to financially benefit X. Because you are primarily operating in a commercial manner, that also directly benefits X, you are not serving public interests and do not qualify for exemption.

#### **Conclusion**

Based on the facts, we conclude that you are not in compliance with the above stated laws and precedence. You have not provided information regarding how you meet the operational test under section 501(c)(3) of the Code. Further, there is evidence of a private benefit being served through your operations. You have not provided evidence to the contrary. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code. Contributions to your organization are not deductible under section 170 of the Code.

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

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

Holly O. Paz  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure, Publication 892