



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: 201405022

Release Date: 1/31/2014

Date: November 8, 2013

UIL Code: 501.03-00

501.36-00

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,

Karen Schiller
Acting Director, Exempt Organizations
Rulings and Agreements

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: September 27, 2013

UIL: 501.03-00
501.36-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

State:

Date 1:

Date 2:

Project:

Letter 1:

Letter 2:

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code § 501(a). 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 organized as a nonprofit corporation under the laws of State on Date 1. You filed Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, on Date 2. You state that you are not actively operating pending recognition under § 501(c)(3).

Your Certificate of Incorporation states that you are organized exclusively for charitable, religious, educational, and scientific purposes under § 501(c)(3). Specifically, your purpose is to provide internet technology (IT) "security expertise in creating and managing IT infrastructures for a broad range of organizations and companies that need advanced scalability and information security." Additionally, your Certificate provides that you "shall not carry on any activities not permitted to be carried on by" a § 501(c)(3) organization and prohibits private inurement, political activities, and substantial lobbying activities. Upon dissolution, your assets shall be distributed for one or more § 501(c)(3) exempt purposes or shall be distributed to the Federal, state, or local government for a public purpose.

You describe your vision as "a world where civil society organizations can operate and speak

freely." Accordingly, you state that your mission is "to uphold the human rights enshrined in the Universal Declaration of Human Rights and other international human rights instruments" by "protect[ing] civil society organizations online and promot[ing] free speech through media." You intend to accomplish this goal by conducting "citizen-media" campaigns conducted via pictures, videos, and blogs; and by protecting websites and services from government interference "particularly in countries where governments attempt to shut-down websites, blogs, social media sites and other tools used for communication and education on the web." You provide no other information about your "citizen-media" campaigns.

You intend to operate in foreign countries. Specifically, your goal is "to provide independent bloggers and civil society organizations in democratizing countries with cyber-security." You state that you will provide following services:

- Securing websites;
- Protecting against hacker attacks;
- Prevention of website shutdowns and content filtering;
- On-demand emergency cloud servers;
- Assistance in establishing internet connectivity during outages; and
- Assistance in obtaining videos and pictures from citizen journalism.

Your goal is to help non-governmental organizations (NGOs) in foreign countries establish or reestablish their websites and block attempts by outsiders, including foreign governments, to obstruct access to those websites and the internet. You state that these activities further exempt purposes because they promote free speech, access to the internet "which was recently added as a fundamental human right by the United Nations," and freedom from persecution.

You describe yourself as an internet security company. Accordingly, your intended activities include reviewing and analyzing existing IT infrastructures, developing new IT infrastructures, managing IT infrastructures, and developing new IT security solutions. With respect to existing IT infrastructures, you will perform the following services:

- Adjusting server and application settings to increase security blocking unused ports and services, setting up firewall rules, restricting access to admin panels, and implementing 2-factor authentication for administrators;
- Log monitoring ranging from daily review of security records to 24/7 proactive application monitoring to predict user trends and detect early states of attacks;
- Setting up host and cloud-based firewalls, channeling traffic through them, and setting up policy rules for different ports and applications; and
- Setting up web-application firewalls and intrusion detection systems to detect unauthorized access to protected data.

With respect to developing IT infrastructures you will perform the following services:

- Providing customers with a CMS-based website on a cloud server with modified security settings, preinstalled security plug-ins, two-factor authentication for administrators, and custom design themes;
- Copying content and design themes of existing websites on a different server running a secure version of the same CMS;

- Isolating a website or an application on a cloud server, monitoring content to cloud-based storage, and installing load balancers to evenly distribute traffic between multiple servers;
- Installing web-application firewalls to protect from SQL injections, XSS, DDoS, and other types of attacks;
- Channeling traffic through content-delivery systems that can act as a proxy server, taking significant load off web servers by caching static content while providing additional layer of security to protect from government censorship and hacker attacks;
- Deploying various communication applications such as MS Exchange, Google Apps for Business, and custom secure XMPP voice/video communication systems;
- Mitigating connectivity outages caused by government censorship and infrastructure shutdowns by establishing communication channels over alternative transmission mediums (ex. Cellular and landline phone lines); and
- Hiring and supervising work of various IT professional including programmers, designers, systems administrators, security professionals, etc.

As part of your IT infrastructure management activities, you protect staff members and end-users by requiring the use of certain security features such as encryption technology and two-factor authentication when connecting to websites and email accounts. You also state that you will educate users on transmitting data over the Internet. However, you provide no information about these educational activities. Additionally, you do not manufacture USB flash drives, MicroSD cards, or other hardware required for your projects, but, as part of your IT security solutions activities, you develop secure, encrypted hardware devices such as USB flash drives and MicroSD cards. These devices circumvent government-powered password-cracking supercomputers by providing an additional layer of undetectable encryption.

Your most recent IT security solution is Project. Project's main component is an encrypted mini-camcorder. The camcorder's footage can only be retrieved using software you created. Otherwise, the camcorder appears to contain no footage. Furthermore, rather than downloading the camcorder's footage to the user's desktop, your software automatically uploads the footage to YouTube. You state that the purpose of Project is to provide journalists and other individuals in conflict zones with a secure medium to film armed conflicts and other events. You state that "[w]e strongly believe that seeing the extent of violence happening in multiple regions around the world can have a strong effect on how people perceive wars and eventually stop armed conflicts at the financing stage." You intend to raise money to manufacture and send camcorders to areas with ongoing conflicts. You will accomplish distribution of the camcorders with the help of NGOs and independent journalists. However, in Letter 2, you state that "although we intended to distribute [Project], it proved to be costly (without funding) and difficult to organize." Furthermore, you state that you do not have a plan describe how you intend to distribute Project in the future. Rather, you state that you "have not been able to find a feasible means of access."

When asked what percentage of your time and money you spend conducting these activities, you were unable to provide an answer because you stated that "it is extremely difficult to separate these activities from each other and estimate timing and resource allocation."

You state that your chief technology officer (CTO) conducts these activities. Your CTO is not compensated for his services. In the event that additional technical expertise is required, you

state that you will contract with freelancers to work those projects under your CTO's direct supervision.

In Letter 1, you stated that your goal was "to provide IT security services to those who can not afford it." Your clients "only cover expenses directly associated with . . . the project, such as equipment, shipping, software licenses, etc." You do not charge for your services. You further explain that "[b]eing a non-profit organisation [sic] providing services for other non-profits, these costs are often reduced or not existent." Furthermore, you state that you do not require your clients to sign service contracts. You explain that your operations differ from a for profit IT company because you intend to fund your activities through contributions and grants. In Letter 2, you state that you do not limit your services to § 501(c)(3) organizations. Rather, you "are willing to provide [your] services to any entities including individuals within the legal framework of the United States and whatever country we may be operating in."

In Letter 2, you state that you do not own any intellectual property (IP) and do not intend to file for any patents or trademarks. You stated that your intent is to "allow others [to] build their own systems on top of [yours]." You describe your software and hardware as "open source," but, in Letter 2, you state that you have yet to adopt an open source license. Specifically, you state that you "do not bind [your] partners or customers by any software licenses and do not plan to enforce any software licensing in the future." However, you state that you would be willing to limit distribution of your open source software to § 501(c)(3) purposes.

LAW

I.R.C. § 501(c)(3) exempts from taxation any corporation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) 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 or operational test, it is not exempt.

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(d)(2) provides that the term "charitable" is used in I.R.C. § 501(c)(3) in its generally accepted legal sense and includes, among other things, lessening the burdens of government, relief of the poor and distressed or of the underprivileged, advancement of education or science, erection or maintenance of public buildings, monuments, or works, and promotion of social welfare by organizations designed to accomplish any of the above purposes, or to defend human and civil rights secured by law.

Treas. Reg. § 1.501(c)(3)-1(e)(1) provide that an organization may meet the requirements of § 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in § 513.

Rev. Rul. 68-438, 1968-2 C.B. 209, determined that a nonprofit organization formed and operated to lessen racial and religious prejudice in housing and public accommodations by disseminating the results of its investigations and research defended human and civil rights secured by law.

Rev. Rul. 71-529, 1971-2 C.B. 234, determined that an organization that provided assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualified for recognition under § 501(c)(3). The organization restricted its membership to § 501(c)(3) organizations, and its board of directors was composed of representatives from member organizations. The organization obtained grants from independent charitable organizations to cover operating expenses and only charged members a nominal fee representing less than 15% of the total costs of operation for its services. The ruling found that, by providing the services described above, the organization performed an essential function for charitable organizations. Furthermore, by performing this function at substantially below cost, the organization performed a charitable activity within the meaning of § 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245, determined that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for recognition under § 501(c)(3). The organization provided managerial and consulting services for § 501(c)(3) organizations at cost. The ruling found that providing managerial and consulting services on a regular basis for a fee was a trade or business ordinarily conducted for profit. Furthermore, the ruling explained that an organization does not qualify for recognition merely because its operations are not conducted for the purpose of producing a profit. Rather, providing services at cost lacked the donative element necessary to establish the activity as charitable. Accordingly, the ruling held that the organization did not qualify for recognition under § 501(c)(3).

Rev. Rul. 73-285, 1973-2 C.B. 174, held that an organization that provided funds to defend members of a religious sect in legal actions involving substantial constitutional issues was defending human and civil rights secured by law and thus was exempt as a charitable organization under I.R.C. § 501(c)(3).

Rev. Rul. 80-278, 1980-2 C.B. 175, held that an organization formed to protect and restore environmental quality and whose principal activity consisted of instituting litigation as a party plaintiff to enforce environmental legislation qualified for recognition under § 501(c)(3). The ruling stated the consideration of whether an organization's activities are consistent with § 501(c)(3) required application of a three-part test. Specifically, an organization's activities are considered permissible if:

- (1) The purpose of the organization is charitable;

- (2) The activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions; and
- (3) The activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.

It is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public constitute a charitable purpose within the meaning of § 501(c)(3). Furthermore, litigation as a party plaintiff is not illegal, contrary to clearly defined and established public policy, or violative of an express statutory limitation. The organization preserved and protected the environment by enforcing through private lawsuits. Therefore, the organization qualified for recognition as a charitable organization.

Rev. Proc. 2013-9, § 4.03, 2013-2 I.R.B. 255, provides that exempt status may be recognized in advance of the organization's operations if the proposed activities are described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption pursuant to the section of the Code under which exemption is claimed.

- (1) A mere restatement of exempt purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement.
- (2) The organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.
- (3) Where the organization cannot demonstrate to the satisfaction of the Service that it qualifies for exemption pursuant to the section of the Code under which exemption is claimed, the Service will generally issue a proposed adverse determination letter or ruling.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court determined that the presence of a single non-exempt purpose, if substantial in nature, will destroy exemption under § 501(c)(3) regardless of the number or importance of any other exempt purposes.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court determined that an organization that sold consulting services to nonprofit and exempt organizations interested in rural-related policy and program development operated a trade or business ordinarily carried on for profit. The burden rested on petitioner to prove that it did not operate "a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit." The court stated that "[c]ompetition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes." Accordingly, the court determined that petitioner "completely failed to demonstrate that its own services, or the services provided by its consultants, [were] not in competition with commercial businesses such as personnel agencies, consulting referral services, real estate agents, housing rental services, banks, loan companies, trash disposal firms, or environmental consulting companies." Furthermore, petitioner did not conduct other substantial charitable activities. Other factors that counted against petitioner included that

petitioner's financing did not resemble that of a typical § 501(c)(3) organization and that petitioner failed to limit its services to § 501(c)(3) organizations. Therefore, the court determined that petitioner failed to qualify for recognition under § 501(c)(3).

RATIONALE

An organization may be recognized as tax-exempt prior to beginning operations. However, the organization must describe its proposed activities in sufficient detail to permit the conclusion that the organization will clearly meet the requirements for exemption pursuant to § 501(c)(3). Rev. Proc. 2013-9, § 4.03 (updated annually). Specifically, an organization seeking tax-exempt status under § 501(c)(3) must demonstrate that it is organized and will be operated exclusively for charitable or other exempt purposes with no part of its net earnings inuring to the benefit of any private shareholder or individual. See Treas. Reg. § 1.501(c)(3)-1(a)(1). An organization is "operated exclusively" for one or more exempt purpose only if it will engage primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1). The presence of a single, substantial non-exempt purpose will destroy the exemption regardless of the number or importance of any truly exempt purposes. Better Business Bureau v. United States, 326 U.S. 279 (1945). The materials you submitted state that you are seeking recognition of tax-exempt status under § 501(c)(3) as a charitable, religious, scientific, or educational organization. However, you perform no religious, scientific, or educational activities. Based on a review of your proposed charitable activities, you are not described in § 501(c)(3) because you will operate for substantial non-exempt purposes.

Your primary activity is providing computer security services, which is a trade or business ordinarily carried on for profit. See B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978). An organization may be recognized as tax-exempt even though it operates a trade or business as a substantial part of its activities if certain conditions are met. Treas. Reg. § 1.501(c)(3)-1(e). For example, management and consulting services are trades or businesses ordinarily conducted for profit. Rev. Rul. 72-369; Rev. Rul. 71-529; B.S.W. Group, 70 T.C. 352. Nonetheless, Rev. Rul. 71-529 held that an organization that provided assistance in the management of participating colleges and universities' endowment or investment funds for a charge substantially below cost qualified for recognition under § 501(c)(3). However, unlike this organization, you intend to provide your services to all organizations, not just § 501(c)(3) organizations. Furthermore, you fail to establish that you provide your services at substantially below cost. You provide no information about the cost of your services; you state only that you do not charge for your services. Providing a service without charge does not necessarily mean that the service is provided at substantially below cost. For example, a service that costs the organization nothing to provide is not provided at substantially below cost even if the organization provides the service without charge. In your case, your CTO provides his services without compensation. Additionally, you require your clients to pay for the costs associated with the project, which includes software, shipping, and licenses. You do not state whether you require your clients to pay for contracted labor. Accordingly, you appear to provide your services at cost, which is not sufficient to characterize this activity as "charitable" within the meaning of § 501(c)(3). Rev. Rul. 72-369. Therefore, you are operated for the substantial non-exempt purpose of conducting a trade or business ordinarily carried on for profit.

Furthermore, even if you did not conduct a trade or business ordinarily carried on for profit, your activities fail to further one or more exempt purposes. The term "charitable" is used in § 501(c)(3) in its generally accepted legal sense and, therefore, is not to be construed as limited

by the separate enumeration in § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(d)(2). The term "charitable" includes promotion of social welfare by organizations designed to defend human and civil rights. *Id.* For example, Rev. Rul. 73-285 held that an organization formed to provide funds to defend individuals in legal actions involving substantial constitutional issues defended human and civil rights secured by law. Additionally, Rev. Rul. 68-438 held that an organization formed and operated to lessen racial and religious prejudice in housing and public accommodations by disseminating the results of its investigations and research defended human and civil rights secured by law. Both rulings involved U.S. citizens bound by U.S. law.

However, unlike Rev. Rul. 73-285 and Rev. Rul. 68-438, you help individuals and organizations in foreign countries maintain access to the internet, which you state is a fundamental human right under the United Nations Universal Declaration of Human Rights. However, the United Nations Universal Declaration of Human Rights is a declaration, not a treaty or a law, and therefore does not elevate internet access to the level of a human and civil right secured by law. On the other hand, you also state that your activities promote free speech. Freedom of speech is one of the fundamental freedoms guaranteed by the United States Constitution. *See* Rev. Rul. 73-285 (finding freedom of religion to be one of the fundamental freedoms guaranteed by the United States Constitution). Nonetheless, the United States Constitution applies only to U.S. residents and citizens, not residents or citizens of foreign countries. Finally, you provide no information indicating that your activities in foreign countries are legal under those countries' laws. *See* Rev. Rul. 80-278 (stating that an organization's activities under § 501(c)(3) are permissible, in part, if the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restriction). Accordingly, your activities do not defend human and civil rights secured by law.

CONCLUSION

Based on the above, we have determined that you fail to meet the requirements necessary to be recognized as a tax-exempt organization under § 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.

This declaration must be signed by an elected officer, a member of the board of directors, or a trustee rather than an attorney or accountant.

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, 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. 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

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,

Karen Schiller
Acting, Director,
Exempt Organizations
Rulings and Agreements