



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
January 17, 2014

Release Number: 201415006

Release Date: 4/11/2014

UIL Code: 501.03-00

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 under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(3).

We made this determination for the following reason(s):

You are not operated exclusively for exempt purposes within the meaning of Code section 501(c)(3).

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.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date that we mailed this letter to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

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.

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
May 25, 2012

Uniform Issue List Numbers:

501.03-00
501.32-00
501.33-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

A =
B =
C =
D =
F =
W =
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 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.

FACTS

Your articles of incorporation provide that you are organized for charitable purposes, and specifically to preserve and develop digital resources (e.g., websites) that provide valuable scientific and educational information on A.

According to your bylaws, your particular primary objective and purpose is to identify important digital A resources that are run on a not-for-profit basis and offer to at least preserve and, when possible, develop the content of these resources. Owners of such resources that agree to such an offer (a "member resource") would be expected to transfer ownership or to provide sufficient license to their resources so that you could maintain, enhance, copy or move the resources even in the owner's absence.

Further, your bylaws state that one of your primary goals is to raise money to maintain the member resources. According to the bylaws, you would expect each owner of a member resource to raise the money necessary to maintain that resource plus a small additional amount that would go into a common fund for shared services or to help cover potential financial shortfalls incurred by other resources. You plan to provide the financial umbrella for these transactions. You plan to raise money through gifts, donations, or other means. Funds you raise through a particular resource would go to you and be used for the preservation and development of that particular resource.

According to your application, you expect your first member resource to be B. B has been developed and is owned by W and X, both whom are your directors and founders. B contains over 150,000 images contributed by over 2400 people. Formerly, all expenses for this resource have been paid by W, essentially as a hobby. However, since your formation you have raised approximately \$2500 to pay for B's webhosting costs. You will execute a Memorandum of Understanding (MOU) between you, W, and X for a licensing agreement which includes maintenance of B. Once the MOU is signed, and contingent on your receipt of § 501(c)(3) status, B will develop pages within the site for requesting donations, add support for E, and create a page of recommended A related equipment that will earn referral fees from appropriate commercial entities. W and X will continue to maintain B.

You expect other digital A resources to apply to become member resources once you have been recognized as a § 501(c)(3) organization. One potential member resource is C. Y and Z created and developed C. Y is one of your directors. Y and Z have paid C's expenses to date out of pocket and through advertising revenue from E. You have not worked out an arrangement for the maintenance of C, but you anticipate the arrangement to be similar to the one with B. Another digital A resource that you anticipate will become a member resource is D, which is currently under development by X. Should C and D become member resources, you would expect to provide them, first, with webhosting funds. Then, if sufficient funds are generated through donations and other funding mechanisms, you might also provide them with funding for new software development. You plan to take an active role in identifying additional resources that meet the criteria for membership and invite those resources to apply to become member resources.

You expect the primary form of fund raising to be donations from the users of member resources, grants, and, to a lesser extent, advertising revenue or referral fees from commercial websites such as E. You will allow a donor to specify which member resources will receive a portion of their donations. Your board will specify a percentage of each donation to go towards the common fund, to be added to amounts contributed by the owners of the member resources. Your website will include pages for requesting donations and is likely to add support for E. Money raised through your website will go into a general fund to support your expenses and, if additional funds remain, to support

the member resources on an as-needed basis at the discretion of your board of directors.

You expect to receive donations in the form of copyrights for photographs, text, or other media used in the various supported digital resources. Donors will be encouraged to make restriction-free contributions of copyrighted material. However, if the donor is concerned about the commercial use of their contributions, they can request commercial-free licensed use of their copyrighted material.

In the event you receive a grant or other money for improving one or more of the digital resources, the person who maintains or owns the resource will be the person to make the improvements. It is also possible that one of your directors or officers will also maintain the site. You will select individuals to receive benefits from your services based solely on the merit of the A resource they have supported and after review by your board of directors. Should you generate sufficient financial resources to support a software developer, you want an individual skilled with the existing software even if they are on your board of directors. The software developer's expected rate of pay would be at or below the current market price regardless of the skills needed to maintain a digital A resource.

It is expected that people associated with the individual resources will retain rights to some or all of a given resource. However, you expect the owners of member resources to grant you licenses that allow individuals of your choosing to maintain and develop those resource sites. For example, W and X hold all images, text, and software copyrights for B's website. However, W and X provided you with licenses for the software they have created, which allow you to maintain and develop B's website.

You may take ownership of the copyrights for at least some of the photographs, text, or other media used in the various supported digital resources, particularly in the event of the death of the copyright holder. You plan to make available to the public in digital form all copyrighted materials owned by you. Some copyrighted materials may only be available to the public for non-commercial purposes. Other copyrighted material available to the public will be licensable for commercial purposes using criteria established by the board of directors. In addition, higher quality versions of the images or other media may only be available under a commercial license.

LAW

I.R.C. § 501(c)(3) provides exemption from federal income tax for organizations that are organized and operated exclusively for religious, educational, charitable, or other specified exempt purpose, no part of the net income of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(a)-1(c) states 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(a)(1) states that an organization is not described in § 501(c)(3) unless it is both organized and operated exclusively for one or more of the purposes specified in such section.

Treas. Reg. § 1.501(c)(3)-1(c)(1) states 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) states 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) states that an organization is not organized or operated exclusively for one or more of the purposes specified in § 501(c)(3) 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.

Rev. Rul. 55-231, 1955-1 C.B. 72, holds that an organization whose primary purpose is to promote the circulation of books of one of its incorporators and whose activities consist of purchasing such works and making them available for public use, is not organized and operated exclusively for educational purposes within the meaning of § 501(c)(3).

Rev. Rul. 55-610, 1955-2 C.B. 262, holds that an organization formed to operate the activities which its principal founder conducted as his personal undertaking or hobby in prior years, and which plans to reimburse its founder for the expenses incurred by him in prior years in the conduct of these activities, is not entitled to exemption from income tax under § 501(c)(3) because a portion of its net earnings will inure to the benefit of its founder.

Rev. Rul. 70-186, 1970-1 C.B. 129, concerns an organization formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. It is financed by contributions from lake front property owners, from members of the community adjacent to the lake, and from

municipalities bordering the lake. The organization's principal activity is to treat the water, to remove algae, and to otherwise improve the condition of the water for recreational purposes. The ruling finds that the benefits to be derived from the organization's activities flow principally to the general public through the maintenance and improvement of public recreational facilities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners. Accordingly, the organization is exempt under § 501(c)(3).

Rev. Rul. 75-286, 1975-2 C.B. 210, concerns an organization that was formed by the residents of a city block to preserve and beautify that block, to improve all public facilities within the block, and to prevent physical deterioration of the block. Its activities consist of paying the city government to plant trees on public property within the block, organizing residents to pick up litter and refuse on the public streets and sidewalks within the block, and encouraging other activities to beautify the block. Much of the public area improved by the organization is part of the public roadway lying between the sidewalk and the street in front of private property owned by members of the organization. Membership in the organization is restricted to residents of the block and those owning property or operating businesses there. The ruling holds that the restricted nature of the organization's membership and the limited area in which its improvements are made indicate that it is organized and operated to serve the private interests of its members within the meaning of § 1.501(c)(3)-1(d)(1)(ii). By enhancing the value of the roadway sections abutted by property of its members, the organization is enhancing the value of its members' property rights. Accordingly, the organization does not qualify for exemption under § 501(c)(3).

Rev. Rul. 76-206, 1976-1 C.B. 154, considered an organization formed to promote broadcasting of classical music in a particular community. The organization carried on a variety of activities designed to stimulate public interest in the classical music programs of a for-profit radio station, and thereby enable the station to continue broadcasting such music. The activities included soliciting sponsors, soliciting subscriptions to the station's program guide, and distributing pamphlets and bumper stickers encouraging people to listen to the station. The organization's board of directors represented the community at large and did not include any representatives of the for-profit radio station. The revenue ruling concludes that the organization's activities enable the radio station to increase its total revenues and therefore benefit the for-profit radio station in more than an incidental way. Therefore, the organization is serving a private rather than a public interest and does not qualify for exemption.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court held that in order to fall within the claimed exemption from social security taxes as a corporation organized and operated

exclusively for scientific or educational purposes within the meaning of § 811(b)(8) of the Social Security Act, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes. It thus becomes unnecessary to determine the correctness of the educational characterization of petitioner's operations, it being apparent beyond dispute that an important if not the primary pursuit of petitioner's organization is to promote not only an ethical but also a profitable business community. The exemption is therefore unavailable to petitioner.

In Founding Church of Scientology v. United States, 188 Ct. Cl. 490, 412 F.2d 1197 (1969), cert. denied, 397 U.S. 1009 (1970), the organization derived more than 90% of its income from the sales of services, tapes, and books. The founder was paid a salary at first and later received 10% of the organization's gross income in lieu of salary. The organization provided an automobile and housing for the founder. He also derived royalties from books, lecture fees, and commissions, and members of his family received loans and rental income from the organization and payments for services never rendered. On these facts the court held that inurement was present, justifying denial of exemption.

In B.S.W. Group, Inc. v. Comm'r, 70 T.C. 352 (1978), the Tax Court said that, under the operational test of § 1.501(c)(3)-1(c), the purpose toward which an organization's activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a § 501(c)(3) organization. Although the petitioner is engaged in only one activity, it is possible for such an activity to be carried on for more than one purpose. The critical inquiry is whether petitioner's primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for petitioner.

In Christian Manner Int'l, Inc. v. Comm'r, 71 T.C. 661, the petitioner, which was organized for religious and educational purposes, published and sold books that were written by its founder, Willie D. Smith. Looking at the purposes served by the petitioner's primary activity, the publication of Smith's books, the Tax Court found that the actual purpose for the organization of petitioner was for the private benefit of Smith, i.e., to publish Smith's books and provide him with an outlet for the exposition of his theories on "the end of time." The court concluded that, even if it was assumed that the publication of Smith's books was in part in furtherance of religious or educational purposes, petitioner would still not qualify for exemption under § 501(c)(3) because a substantial part of the activity it engaged in was in furtherance of a purpose to benefit Smith personally rather than to benefit the public at large.

In Wendy L. Parker Rehab. Found., Inc. v. Comm'r, T.C. Memo. 1986-348, an organization that was established to help coma victims anticipated disbursing thirty percent of its funds to its founder to be used to pay for the founder's daughter's medical care. The court said that the distribution of funds for the benefit of the founder's daughter assists her family in providing for her care and thus relieves the family of the economic burden of providing such care. Consequently, the court found that there was a prohibitive benefit from the organization's funds that inures to the benefit of private individuals. The court said that the founder's control over the organization was not in itself fatal to its cause, but that the organization's selection of the founder's daughter as a substantial beneficiary of its disbursements was the determinative factor in the case. Inurement of a benefit to "private individuals," whether monetary or not, as a result of contributions made to a purportedly exempt organization is proscribed.

In Easter House v. United States, 12 Cl. Ct. 476, 488-89 (1987), the plaintiff provided loans to three organizations which the Plaintiff's founder was either employed by or owned. Though the plaintiff argued that the loans should not disqualify it from exempt status because they were made for charitable purposes, the Court said that the fact that the loans were made shows that companies controlled by the founder had a source of loan credit in plaintiff. The existence of a source of credit is what is important. Under the totality of facts, the court concluded that plaintiff's net earnings inured to the benefit of its founder.

ANALYSIS

Based on the information you have submitted in support of your application for recognition of exemption, we have determined that you do not qualify as an organization described in § 501(c)(3). Rather, we find that you are precluded from exemption both because your net earnings inure to the benefit of private shareholders or individuals within the meaning of § 1.501(c)(3)-1(c)(2) and because you are organized and operated for the benefit of private interests within the meaning of § 1.501(c)(3)-1(d)(1)(ii).

Inurement

To qualify for exemption as an organization described in section 501(c)(3), you must be organized and operated exclusively for a purpose described in § 501(c)(3). Section 1.501(c)(3)-1(a)(1). You will be regarded as "operated exclusively" for an exempt purpose only if you engage primarily in activities which accomplish an exempt purpose specified in § 501(c)(3). You will not be so regarded if more than an insubstantial part of your activities is not in furtherance of an exempt purpose. Section 1.501(c)(3)-1(c)(1).

You are not operated exclusively for exempt purposes if your net earnings inure in whole or in part to the benefit of private individuals. Section 1.501(c)(3)-1(c)(2). A "private individual" is a person having a personal and private interest in your activities. Section 1.501(a)-1(c). The most obvious class of persons who will be regarded as private individuals are the members of the board of directors of a nonprofit organization. Those persons are in control of the organization and can, because of their positions and legal authority under state law, influence the use or distribution of its assets, even for purposes that would not otherwise further the charitable purposes of the organization. See, e.g., Founding Church of Scientology v. United States, 412 F.2d at 1201.

Inurement of "net earnings" includes more than a benefit derived from net profits. Inurement of contributions is as fatal to exempt status as inurement of "net earnings." Wendy L. Parker Rehab. Found. v. Comm'r, T.C. Memo 1986-348.

Net earnings may inure to an individual in ways other than the payment of excessive salaries. Inurement of net earnings can result from non-fair market value or noncompensatory transactions that result in economic benefits flowing from the exempt organization to a private individual or persons related to that individual. Easter House v. United States, 12 Cl. Ct. at 488-89.

As we understand your application, one of your purposes is to raise funds that will be used to maintain and develop member resources. You will develop pages within the member resource's website for the purpose of soliciting contributions and earning referral fees from commercial entities. You will use these contributions and fees to pay the webhosting fees of the member resources and for software development and resource improvement. These payments will be made to the owner of the resource. Your first member resource is B. B is owned, operated, and maintained by W and X. You anticipate that C and D will also become member resources. C is operated and maintained by Y and Z. D is operated and maintained by X. W, X, and Y are your founders and directors.

By soliciting contributions and fees that you will pay to W, X, and Y to maintain and develop A resources that they currently own, operate, and maintain, you are allowing your "net earnings" to inure to the benefit of private individuals within the meaning of § 1.501(c)(3)-1(c)(2). Your operations are similar to those described in Rev. Rul. 55-231, Rev. Rul. 55-610, and Christian Manner Int'l v. Comm'r.

In Rev. Rul. 55-231 and Christian Manner Int'l v. Comm'r, it was ruled that an organization was not organized and operated exclusively for exempt purposes within the meaning of § 501(c)(3) because its primary purpose was to disseminate to the public books written by its incorporator. Similarly, you appear to be operated to provide funds to maintain and develop web sites created by your incorporators and directors.

In Rev. Rul. 55-610, it was ruled that an organization's net earnings inured to the benefit of a private individual – the organization's founder – because it assumed the activities which the founder conducted as a personal undertaking and hobby, and reimbursed the founder for the expenses he incurred in the conduct of those activities. Similarly, you plan to assume the costs of maintaining and developing B, C, and D, all of which are personal undertakings or hobbies of your founders and directors, W, X, and Y. You plan to use contributions to pay webhosting fees and development costs previously borne by W, X, and Y, while allowing them to retain ownership of those resources. You also may pay development fees to W, X, and Y to carry on the development of their own resources. As in Easter House and Wendy L. Parker Rehab., the determinative factor in finding inurement is not that you raise funds to cover the operating and development expenses of digital A-related resources, but that you have selected, or contemplate selecting, your founders' resources as the substantial beneficiaries of your operations.

Private Benefit

You are not operated exclusively for exempt purposes unless you serve "a public rather than a private interest." To meet this requirement, you must demonstrate that you are not operated for the benefit of private interests such as those of your creators. Section 1.501(c)(3)-1(d)(1)(ii).

Your purpose, rather than the nature of your activities, determines whether you are entitled to tax-exempt status. B.S.W. Group, Inc. v. Comm'r, 70 T.C. at 356-57. A single non-exempt purpose, if substantial in nature, will disqualify you from qualification under § 501(c)(3). Better Business Bureau v. United States, 326 U.S. at 283. Determining your purpose is a factual question which concerns both your actual as well as the stated purposes for the existence of your organization and the activities you engage in to accomplish those purposes. Christian Manner Int'l v. Comm'r, 71 T.C. at 668.

One of your primary purposes is to raise money to maintain your member resources, and one of your primary activities is to provide the financial umbrella for these transactions. You will raise funds through your members' websites by creating pages for requesting donations, adding support for E, and creating pages of recommended A-related equipment by which you will earn referral fees. You will use these donations and fees to pay the webhosting expenses of your member resources, B, C, and D, as well as to pay the owners of your member resources to develop and maintain their resources.

It is unclear that, by acting as a financial umbrella for A-related websites, you are necessarily operating in furtherance of any charitable or educational purpose. But even assuming that B, C, and D are educational resources, and that your support of those

resources is, in part, in furtherance of educational purposes, you still would not qualify for exempt under § 501(c)(3) because a substantial part of your activities is in furtherance of a purpose to benefit private persons, namely W, X, Y, and Z. See Christian Manner Int'l, Inc. v. Comm'r, 71 T.C. at 669-70.

While the organization described in Rev. Rul. 70-186 preserved and improved a lake for public recreational purposes, the benefits of which flowed principally to the public and only incidentally to lake front property owners, your activities do not patently improve the educational value or public availability of B, C, and D, but they do create fund raising opportunities to defray the personal expenses of W, X, Y, and Z. You are like the organization described in Rev. Rul. 75-286 which, although its activities ostensibly served to preserve public space, in large measure served to enhance the property rights of its limited number of members. You, too, affect to support publicly-available A-resources, although your activities principally serve the purpose of raising funds for a limited membership – B, C, and D.

Similarly, like the organization described in Rev. Rul. 76-206 that, in the course of promoting classical music, engaged in activities with the more than incidental purpose of benefitting the private interests of a for-profit radio station, you, in the course of promoting A-related resources, engage in activities with a more than incidental purpose of benefitting resources owned by particular private individuals, namely W, X, Y, and Z. Therefore, we find that you are organized and operated to serve the private interests of your members within the meaning of § 1.501(c)(3)-1(d)(1)(ii). Accordingly, you do not qualify for exemption from Federal income tax under § 501(c)(3) 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.

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, Forms and Publications.

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

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

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

Internal Revenue Service
TE/GE SE: T: EO: RA: T: 1
Exempt Organizations Technical Group 1

1111 Constitution Avenue, NW
Washington DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations