



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201451045**
Release Date: 12/19/2014
Date: September 24, 2014
UIL Code: 501.32-00
501.33-00
501.33-01

Contact Person:
Identification Number:
Contact Number:
Employer Identification Number:
Form Required To Be Filed:
Tax Years:

Dear

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

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

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

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

Letter 4038 (CG) (11-2005)
Catalog Number 47632S

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Director, Exempt Organizations

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: June 26, 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B =
C =
D =
F =
G =
H =
J =

UIL Numbers:

501.32-00
501.33-00
501.33-01

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

Does the presence of inurement and private benefit preclude you from qualification under Section 501(c)(3)? Yes, for the reasons described below.

Facts

You were incorporated in the State of B on C. You were previously granted exemption under section 501(c)(3) of the Code more than 25 years ago. Your exempt status was

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

revoked due to non-filing of Form 990 for three consecutive tax years. You have requested reinstatement by submitting Form 1023, Application for Recognition of Exemption on D.

You were formed to provide classroom and experiential summertime educational opportunities to adolescents through the study of the scientific, historical, and cultural features of specific regions of the world and the undertaking of challenging, active, small group trips that place an emphasis on personal responsibility, group cooperation and consideration for others. You subsequently amended your Articles of Organization to indicate that you will not engage in any activity or exercise any power which would deprive you of exemption under Section 501(c)(3) of the Internal Revenue Code.

You are governed by your board of directors. You identified F, G, and H as your directors. F is the President and sole shareholder of J, a for profit company that was incorporated 4 years after you were formed. G is F's wife. Both G and H are employees of J.

J is the only service provider for your programs at this time. There are no written contract agreements with J. As the program evolves you will seek similarly qualified service providers.

You award scholarships to qualified applicants to participate in programs which include outdoor service, learning, and leadership programs for young adults up to age 19. The current programs include summer camps in the US and trips to several foreign countries. Per your application, you expected to award more than \$60,000 in scholarships in 2011. Donations from businesses and individuals will be accepted on your future website, as well as on the website of J.

J serves as the third party to administer all of the program activities for the scholarship recipients. Fees for the programs are determined by the staff of J. Fees are set at a level to allow J to maintain profitability and to continue as a going concern. Students unable to pay the required fee to J may qualify for financial aid through your scholarship program. Financial aid awards cover 10% to 50% of the J program fee.

J solicits scholarship applications via its website. The selection process is based on financial need. "The only condition is that the awardee participates in the program identified in the application." The qualified applicant information is provided to J's current admissions team. J's team selects scholarship recipients.

When asked to provide itineraries for your programs, you listed only one program. J's charge to participate in that program was more than \$4,000 per person. Because J is currently your only provider, there are no written contract agreements with your providers.

In all the years from 1/1/2007 to 12/31/12:

- Only one scholarship, covering less than 40% of the admission cost was offered,
- The recipient of the scholarship applied to and was selected by an outside foundation;
- You received no income or contributions other than the scholarship paid by the outside foundation toward the recipient's cost;
- No financial information was available for any other applicants because only one scholarship was offered.

Law

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax to organizations organized and operated exclusively for charitable, religious or educational purposes, where no part of the net earnings inures to the benefit of any private shareholder or individual.

Income Tax Regulations ("Regulations") § 1.501(a)-1(c) define a private shareholder or individual as a person having personal and private interest in the activities of the organization.

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

Section 1.501(c)(3)-1(c)(2) of the Regulations 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."

Regulation §1.501(c)(3)-1(d)(1)(ii) also relates to operations of an organization by stating: that an organization is not organized or operated exclusively for one or more of the purposes specified unless it serves a public rather than a private interest. Thus, to meet the requirement it is necessary for an organization to establish 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 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. The Court found that the trade association had an

"underlying commercial motive" that distinguished its educational program from that carried out by a university.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), several for-profit est organizations exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The question for the court was not whether the payments made to the for-profits were excessive, but whether they benefited substantially from the operation of the applicant. The Tax Court concluded that the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in section 501(c)(3).

In Church by Mail, Inc. v. Commissioner, T.C. Memo 1984-349, *aff'd* 765 F. 2d 1387 (9th Cir. 1985), the Court affirmed a Tax Court decision. Church by Mail sent out sermons in numerous mailings. This required a great deal of printing services. A for-profit company, controlled by the same ministers, provided the printing and the mailing. The services were provided under two contracts. The contracts were signed by the two ministers for both the organization and the for-profit company. The organization's business comprised two-thirds of the overall business done by the for-profit company. The court determined that there was ample evidence in the record to support the finding that the organization was operated for the substantial non-exempt purpose of providing a market for the services of the for-profit company. The Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church." Moreover, the ministers' dual control of both the Church and the for-profit company enables them to profit from the affiliation of the two entities through increased compensation.

In Housing Pioneers, Inc. v. Commissioner, 58 F.3d (1995), the court affirmed the judgement of the trial court that the organization was not entitled to tax-exempt status as a corporation operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. The court found that the organization's substantial purpose of helping a for-profit business take advantage of its tax-exempt status was a non-exempt purpose even if it had the effect of making housing more affordable.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36, the Tax Court concluded that when a for-profit organization benefits substantially from the manner in which the activities of a related non-profit organization were carried on, the latter organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.

Application of Law

You do not meet the operational test under section 501(c)(3) of the Code because you have not established that you are not operated for the benefit of private interests. On the contrary, all members of your governing body profit from your existence. The facts you provided show:

- All your current board members receive compensation from J;
- J is currently your exclusive service provider;
- You pay rates that insure J profits from providing those services; and
- Only applicants for J programs are eligible for your scholarships.

Like est of Hawaii, a for-profit organization exerts significant control over you and can benefit substantially from your operations.

You are similar to Church by Mail, Inc. because you are controlled by the same persons who control the for-profit company which conducts your programs. Your directors maintain dual control over both you and J. This enables them to profit from the affiliation of the two entities through increased compensation.

Like Housing Pioneers, Inc., you are not entitled to tax-exempt status because you are helping a for-profit business take advantage of your tax-exempt status. This is a non-exempt purpose even if it has the effect of making your programs more affordable.

Just as in International Postgraduate Medical Foundation, when J, a for-profit organization, benefits substantially from the manner in which your activities are carried on, you are not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if you further other exempt purposes.

You are like Better Business Bureau of Washington D.C., Inc. because you have an "underlying commercial motive." This substantial nonexempt purpose has destroyed your claim for exemption.

Applicant's Position:

You were organized as a conduit by which J could reach underprivileged children to provide them with the opportunity to participate in the programs offered by J. This can only be accomplished by the provision of scholarships through your close connection with J.

You differ from a for-profit organization because the applicants will not be expected to pay full price for the programs conducted by J, and the fees are set by J at a level above cost sufficient for J to maintain an acceptable level of profitability. The fees charged by J are not based on an individual's ability to pay.

While J is currently the sole provider of these programs, numerous organizations other than J, will provide similar programs in the future.

Any Board member offering their business services to this organization, that would create a conflict of interest, would be excused from the meeting to discuss the proposal.

Service's Response to Applicant's Position:

Your close connection to J results in additional income to J through the funds you secure and pass through to J. Your reduced fee structure continues to ensure J profits.

There is no evidence that you have ever directly funded any scholarships for underprivileged children. Only one scholarship has been provided in your entire history. You had no role in the selection process. Instead, a donor offered the scholarship, selected the recipient and paid the funds to you.

You claim to focus on underprivileged children, but your only "scholar" was required to raise 60% of J's more than \$4,000 fee. And, as shown above, you cannot provide a history of having directly awarded any scholarships.

You do not maintain an arm's length relationship with J. Instead, J controls every aspect of your operations, and you serve as conduit to your founder's for-profit company.

- J's founders, officers and directors serve as your governing body
- J solicits the scholarship applications via its website.
- J's admission team identifies qualified applicants and selects scholarship recipients.
- The recipient must participate in the program identified in the application.
- J is the only current provider of your programs.
- And, your conflict of interest policy cannot be enforced with respect to J because all members of your board are insiders who profit from your relationship with J.

Conclusion

Based on the facts, we have concluded that you have not shown that you have or will meet the operational test under section 501(c)(3) of the Code. 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 that 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, *How to Appeal an IRS Decision on Tax Exempt Status*.

Types of information that should be included in your protest can be found on page 1 of Publication 892, under the heading "Filing a Protest." The statement of facts must be declared true under penalties of perjury. This may be done by adding to the protest the following signed declaration:

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

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your protest will be considered incomplete without this statement.

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

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

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure

to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

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

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

Mail to:

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

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

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

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

Sincerely,

Director, Exempt Organizations

Enclosure, Publication 892