



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201507025**
Release Date: 2/13/2015
Date: November 18, 2014
UIL Code: 501.04-00

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)(4).

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

You are not described in § 501(c)(4) because you are not operated exclusively for the promotion of the social welfare.

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,

Tamera Ripperda
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
1111 Constitution Ave. NW
Washington, D.C. 20224-0002

Date: September 8, 2014

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

UIL: 501.04-00

Legend:

Customer =
Date =
OS =
State =
x =
y =

Dear t:

We considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code (the Code or I.R.C.). Based on the information provided, we determined that you don't qualify for exemption under section 501(c)(4) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Facts:

You are a State non-profit non-membership corporation incorporated on Date. You are governed by a board of directors and managed by officers appointed by the board. Your Articles of Incorporation as amended state a general § 501(c)(4) social welfare purpose and the activity of researching, developing, and distributing, free of charge, computer software that facilitates uncensored and secure communications by human rights activists, journalists, and civil society. You intend to promote communication security for journalists reporting from authoritarian countries by increasing both supply and demand for encrypted internet services.

Your sole activity is developing server side and client side software, for human rights activists and journalists but freely available to the general public, designed to promote human rights online through encryption of digital communications. The server side software is a secure cloud platform. It consists of packages and recipes that commercial or nonprofit service providers can use in a hardened OS environment to automate the maintenance of secure communications services such as e-mail, text, chat, internet proxy, cloud storage, and VOIP. You partner with service providers to help them deploy secure communications services and maintain regular security audits. You help commercial, nonprofit, and tax-exempt communications service providers regardless of tax status.

Your client side software is to be installed on end users' OS computers. The software performs the communication services implemented by the cloud platform. The client side software improves the user experience, fixes security problems, and ensures seamless compatibility with your cloud platform.

You will also "have an education and outreach component to our work to guide our development. We will put the experience and needs of real-world users at the forefront of our development process." You state that you will create educational materials and promote educational events that spread awareness of the benefits of using secure communication. These materials are limited to software documentation and tutorials you post on your website. You plan to assist two nongovernmental organizations (NGOs) develop training programs and material that incorporate your software. However, you state that the NGOs will provide direct training. You will not support the training directly, other than allocating staff time towards aiding these groups to incorporate your software into their curriculum. If you received a grant, you would be open to provide training yourself. This component will comprise about x% of your total activities.

Your state that your software differs from commercial products in that it is:

- 1) designed to work in countries governed by oppressive regimes and limited access to the internet,
- 2) published under open source compatible licenses that make switching from other service providers easy when end users are dissatisfied with these security policies of their current service provider,
- 3) a complete turn-key system for the adopting service providers,
- 4) you distribute it without charge and anyone can modify the code and redistribute their own applications based on your code, and
- 5) a better quality product.

You may operate a test service where you install the cloud platform on your servers and allow end users to subscribe. The purpose of this test service is to test the reliability of the service side and client side software you develop. Most client side users on your test service will not be charged a fee but you may in the future charge heavy users a fee for some premium services to offset your test service expenses. Because your software federated architecture requires adoption by many service providers you will limit number of end users on your test network so it does not grow too large.

You publish the source and object code of all of your software subject to open source compatible licenses such as Affero GPL, GNU GPL, GNU Lesser GPL, Apache, and MIT licenses. These licenses generally allow any person to download and use the software for any purpose, and the only restriction the licenses place on recipients is that they cannot place further restrictions on the distribution of the code. No licenses limit use of the software to § 501(c)(3) or (4) exempt purposes. Most of your licenses permit anyone to use some or all of your code to produce income. You work with commercial, nonprofit, and tax-exempt internet service providers and other communication service providers to install the software. Those service providers can charge users a fee for using of the software without violating your licenses.

Substantially all of your present income originates from software development work done under contract with Customer, a § 501(c)(3) public charity under § 509(a)(1). The contract is described as a Consulting Agreement. You are the Contractor who "purports to have certain expertise and can provide services..." The services are developing software, and these services are consideration for Customer payments. There is a very detailed scope of work and schedule of deliverables. You are obligated to provide progress reports, and Customer may

audit your work. Appendix A is Standard Provisions For U.S. Government Funded Agreements. Your fees are equal to or greater than your costs. In future years, Customer will generate about y% of your income and a few other public charities will generate the remainder for software services you provide at equal to or greater than your costs.

You also provide technical services to non-profit organizations at cost: i.e. the actual hourly rate of relevant staff time. Your consulting services are limited to § 501(c)(3) or (4) organizations or "foreign non-profits that fall under similar statutes in the country in which the organization is located." You provide consulting service without charge as time and resources permit. You would be open to providing services to non-profit or for-profit news organizations. You expect these consulting services to comprise about x% of your total activities.

Law:

I.R.C. 501(a) exempts from federal income tax organizations described in § 501(c)(4).

I.R.C. 501(c)(4)(A) describes civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. Section 501(c)(4)(B) indicates that subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) states that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community, such as bringing about civic betterments and social improvements.

Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) provides that the promotion of social welfare does not include carrying on a business with the general public in a manner similar to organizations which are operated for profit.

In Rev. Rul. 62-167, 1962-2 C.B. 142 a nonprofit organization formed for the purpose of providing television reception for the community as a whole by the process of retransmitting television signals in an area not adaptable to ordinary reception is entitled to exemption under § 501(c)(4) as an organization operated exclusively for the promotion of social welfare.

Rev. Rul. 65-195, 1965-2 C.B. 164 held that a junior chamber of commerce operated exclusively for the purpose of rendering civic services for the promotion of the welfare of the community and its citizens is exempt under § 501(c)(4). The facts showed that the organization was primarily engaged in bringing about civic betterments and social improvements by its activities on behalf of youth, community benefit programs, and community leadership training. These youth activities consisted, in part, of free instruction in sports and the organization of contests, and conducted other projects for the youth of the community. In addition to its youth programs, the organization conducted numerous other programs for the benefit of the community at large, including improvement of health and safety, conservation, city beautification, promotion of patriotism, and entertainment at hospitals and veterans homes. The organization also conducted training designed to teach techniques of effective public speaking, and in the rules of parliamentary procedure.

Rev. Rul. 70-4, 1970 1-C.B. 126 provided exemption under § 501(c)(4) to an organization engaged in promoting and regulating a sport for amateurs. The organization's primary activities are directed toward

reviving and promoting a sport by circulating printed material about the sport, by conducting exhibitions to introduce the sport to the public, by conducting tournaments, and by giving occasional instructive clinics. The organization also sets the standards for the equipment to be used, establishes the official rules of the games, and prescribes the official size of the playing area. By promoting and regulating a sport for amateurs, the Service ruled that the organization is providing wholesome activity and entertainment for the social improvement and welfare of the community, which promotes the common good and general welfare of the people of the community.

Rev. Rul. 70-535, 1970-2 C.B. 117, describes an organization formed to provide management, development and consulting services for low and moderate income housing projects for a fee. The revenue ruling held that the organization did not qualify under § 501(c)(4). The revenue ruling stated "Because the organization's primary activity is carrying on a business by managing low and moderate income housing projects in a manner similar to organizations operated for profit, the organization is not operated primarily for the promotion of social welfare. The fact that these services are being performed for tax exempt corporations does not change the business nature of the activity."

Rev. Rul. 72-369, 1972-2 C.B. 245, described an organization formed to provide management and consulting services at cost to unrelated exempt organizations. The organization applied for exemption under § 501(c)(3). In holding that the organization did not qualify for exemption, the ruling stated, "An organization is not exempt merely because its operations are not conducted for the purposes of producing a profit [P]roviding managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit."

In Rev. Rul. 74-99, 1974-1 C.B. 131, the IRS held that for a homeowners association to qualify for exemption under § 501(c)(4), it must: (1) must serve a 'community' which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) it must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public.

Rev. Rul. 74-361, 1974-2 C.B. 159, held that an organization that was organized as a nonprofit volunteer fire company to provide fire protection and ambulance services for a community could be held as exempt from Federal income tax as a social welfare organization described in § 501(c)(4) because its activities promote the common good and general welfare of the community. By carrying on these activities, including the contracting for security patrols designed to increase public safety and reduce crime in the community, the organization is promoting the common good and the general welfare of the people in the community.

Rev. Rul. 75-386, 1975-2, C.B. 211 provided that a nonprofit organization formed for the purpose of promoting the common good and general welfare of the residents of a community and which carries on activities in the general areas of public safety and crime prevention, housing and community development, recreation, and community services, qualifies for exemption under § 501(c)(4). With regard to its recreational activities, the organization held various holiday programs for local residents and sponsored a community basketball league.

In Rev. Rul. 78-69, 1978-1 C.B. 156, a nonprofit organization that provides rush-hour bus service to members of the general public on a "first-come, first-served" basis constitutes a social welfare activity where all passengers are charged the same rate. The ruling concludes that providing to all members of the community on

an equal basis a useful service that is not commercially available and is subsidized by governmental financial assistance is a § 501(c)(4) activity.

In Rev. Rul. 78-429, 1978-2 C.B. 178, a nonprofit organization formed to operate an airport that is located on land owned by a municipality that supervises its overall operation, is used by the general public and key local businesses essential to the economy of a four-county rural area having no other airport facilities, uses volunteers to provide administrative and maintenance services for the organization, and uses income derived from government grants, hangar rentals, and the sale of gasoline and oil for permanent improvements, maintenance, and daily operations qualifies for exemption under § 501(c)(4). The ruling holds that the organization is meeting a community need. The overall supervision and control exercised by the city council ensures that the organization is responsive to the community. The use of volunteer services and receipt of government grants are indicative of the fact that the organization is not carrying on a business with the general public in a manner similar to organizations operated for profit. Therefore, the organization is promoting the common good and general welfare of the people of the community within the meaning of Treas. Reg. § 1.501(c)(4)-1(a)(2).

Rev. Rul. 79-316, 1979-2 C.B. 228, found that a nonprofit organization whose purpose is to prevent liquid spills, primarily oil spills, within a city port area and to develop a program for the containment and cleanup of liquid spills that do occur is entitled to exemption as a social welfare organization under § 501(c)(4) provided that its services are equally available to members and nonmembers and both members and nonmembers are charged on the same basis for the cleanup services rendered. There are no commercial cleanup companies operating in the entire geographical region where the port is located. Although there are a few commercial organizations providing similar services in other geographical areas, previous studies show that operation of a commercial cleanup organization is not economically feasible in the port area served by the organization. By preventing and cleaning up liquid spills that endanger marine life and foul recreational beaches and shorefront property in the port area, the organization is primarily engaged in activities designed to benefit all inhabitants of the community served by it.

Commissioner v. Lake Forest, Inc., 305 F.2d 814, 818 (4th Cir. 1962), stated that while a social welfare organization necessarily benefits private individuals in the process of benefiting the community as a whole, even when the benefits are confined to a particular group of individuals, the organization may be exempt if the general community derives a substantial benefit. Conversely, an organization that benefits a large number of people will not necessarily be organized for social welfare purposes within the meaning of § 501(c)(4) because numbers are not necessarily determinative of social welfare objectives. Social welfare is the well-being of persons as a community and classification depends upon the character as public or private — of the benefits bestowed, of the beneficiary, and of the benefactor. In finding that Lake Forest was not exempt, the court also concluded that Lake Forest did not meet the dictionary definition of “social” or “welfare,” stating:

It does not propose to offer a service or program for the direct betterment or improvement of the community as a whole. It is not a charitable corporation in law or equity, for its contribution is neither to the public at large nor of a public character. Lake Forest does, of course, furnish housing to a certain group of citizens but it does not do so on a community basis. It is a public-spirited but privately-devoted endeavor. Its work in part incidentally redounds to society but this is not the “social welfare” of the tax statute.

In Erie Endowment v. United States, 316 F.2d 151, 156 (3d Cir. 1963), the court held that to qualify for exemption within the meaning of § 501(c)(4), "the organization must be a community movement designed to accomplish community ends."

United States v. Pickwick Electric Membership Corp., 158 F. 2d 272, 276 (6th Cir. 1946), the Court stated that a civic organization is described as embodying "the ideas of citizens of a community cooperating to promote the common good and general welfare of the community." The organization was an electricity cooperative service organization bringing electricity to rural areas otherwise without electricity.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978) the Court stated that free or below cost service is only one of several factors to consider in making a determination. Others include the particular manner in which the organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. All of these must be considered, for no single factor alone is determinative. The Court concluded that the petitioner is not an organization described in § 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial.

Rationale:

Section 501(c)(4) provides, in part, for the exemption from federal income taxation of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) states that an organization will be considered to be operated exclusively for social welfare purposes if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community, i.e. primarily for the purpose of bringing about civic betterments and social improvements. An organization is not operated exclusively for the promotion of social welfare within the meaning of § 501(c)(4) if its primary activity is carrying on a business with the general public in a manner similar to organizations that are operated for profit. Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii). You are not operated for § 501(c)(4) exempt purposes because developing and distributing open source software does not promote the social welfare of a community. Even if open source software development and distribution did promote the social welfare of a community you are precluded from exemption because your primary activity is selling software services at cost which is a trade or business ordinarily carried on for profit.

A. Developing and Distributing Open Source Software Does Not Promote Social Welfare Within The Meaning of § 501(c)(4).

Software development and distribution is ordinarily a commercial activity and not an exempt purpose. Section 501(c)(4) exempts civic leagues, certain social welfare organizations, and certain local associations of employees. There is no official Congressional or Service pronouncement construing the terms "civic league" or "social welfare" as embodied in § 501(c)(4). However, in United States v. Pickwick Electric Membership Corp., the Court stated that a civic organization is described as embodying "the ideas of citizens of a community cooperating to promote the common good and general welfare of the community." Pickwick Electric Membership Corp., 158 F. 2d at 276. In C.I.R. v. Lake Forest, Inc., the court described a civic organization as being "a movement of citizenry or the community," whereas the court in Erie Endowment v. United States, while acknowledging the difficult task in arriving at a specific definition of "civic organization," stated that, "the organization must be a community movement designed to accomplish community ends." Lake Forest, Inc., 305 F.2d at 818; Erie Endowment, 316 F.2d at 156.

The Lake Forest court more specifically identified benefits to citizens that are municipal or public in their nature. Lake Forest, Inc., 305 F.2d at 817 (“1. Of, pertaining, or proper to citizens. 2. Of or pertaining to a city, borough, or municipality. 3. Of or pertaining to citizenship.”). Open source licensed software is not municipal or public in nature nor does it provide the kind of benefit to citizens required of civic organizations.

Webster's New World Dictionary defines the term "social welfare" as "any service or activity designed to promote the welfare of the community and the individual, as through counseling services, health clinics, recreation halls and playgrounds ..." This definition aligns with the broad concept of "social welfare" as provided in Treas. Reg. § 1.501(c)(4)-(a)(2)(i). Additionally, the court in Commissioner v. Lake Forest, Inc., in discussing the activities of Lake Forest stated:

“[s]ocial” is defined as: ‘Concerned with, interested in, the constitution of society and the problems presented (thereby) * * *’. Oxford Dictionary, supra, Vol. IX. “Society” is ‘the aggregate of persons living together in a more or less ordered community. A collection of individuals composing a community or living under the same organization or government.’ Ibid. “Welfare” means ‘Well-being (of a person, community, or thing).’ Id., Vol. XII. In short, ‘social welfare’ is the well-being of persons as a community.

Commissioner v. Lake Forest, Inc., 305 F.2d 814, 818 (4th Cir. 1962). The crucial factors are the type of benefit provided and the class of eligible recipients as a community.

Developing software is ordinarily a commercial activity. It is not like the kinds of activities that promote the social welfare. See Rev. Rul. 65-195, 1965-2 C.B. 164 (youth activities; improvement of health and safety; conservation; city beautification; promotion of patriotism; and entertainment at hospitals and veterans homes; training of effective public speaking, and in the rules of parliamentary procedure); Rev. Rul. 70-4, 1970 1-C.B. 126 (promoted and regulated a sport for amateurs); Rev. Rul. 74-361, 1974-2 C.B. 159, (volunteer fire company to provide fire protection and ambulance services for a community; Rev. Rul. 75-386, 1975-2, C.B. 211 (public safety and crime prevention, housing and community development, recreation, and community services).

The IRS has ruled that ordinary activities can promote social welfare in very limited circumstances. See Rev. Rul. 62-167, 1962-2 C.B. 142 (television service); Rev. Rul. 78-69, 1978-1 C.B. 156, (rush-hour bus service to members of the general public); Rev. Rul. 78-429, 1978-2 C.B. 178 (operate a rural airport); Rev. Rul. 79-316, 1979-2 C.B. 228 (prevent and cleanup toxic spills in a city port area). The common circumstance is there are no competitors, generally due to some factor of geography. You are not like any of the organizations described in the foregoing rulings. Each of these organizations operated only in geographical locations where no competition existed. Your users are located everywhere in the world; each has internet access, and therefore has access to your competitors’ products. You point out that your software is specifically designed to work in countries with oppressive regimes and limited internet access, implying (without proving) that your competitors’ software is not. Even if your competitors’ software is not so designed that difference in features is a difference in degree and not kind: you and your competitors are developing communications encryption software. Volunteers perform a significant part of the operations of organizations described in these favorable rulings or their operations were subsidized by the government. Moreover, unlike these organizations, you benefit a narrow class of people; users of the OS controlled computers.

You point to several characteristics of open source licenses that you believe transforms otherwise commercial software development and distribution into a community benefit of the kind that promotes the social welfare. The first is that as a practical matter such software is distributed without charge. Second, open source compatible licensing of source and object code confers rights to everyone to use, modify, and redistribute modified or unmodified code, and prohibiting imposition of additional restrictions on derivative works. Third, switching from other service providers to your software is easy. Fourth, you claim the quality is better.

Each of these characteristics makes your software more competitive. The fact that you license the software for use without charge does not reduce its competitive nature but in fact increases it. Likewise, if you are correct that the open source licensing makes your software a better product than your competitors then that too increases its competitive nature, as does the ease of users switching from competitors products to yours. You list several other competitive advantages (such as avoiding vendor lock-in) that open source software enjoys over closed development and proprietary licensed software: in short, you have built a better product. Creating a competitive product does not transform a commercial activity into a community benefit of the kind that promotes the social welfare.

Because your software competes with other commercial products, does not serve a community within the meaning of § 501(c)(4) (analyzed *infra*), and benefits a narrow class of people, then you are unlike the organizations described in our favorable rulings. Accordingly, your development and distribution of open source software does not promote the social welfare and you are not operated for § 501(c)(4) exempt purposes.

B. The World Is Not A Community Within The Meaning Of § 501(c)(4).

Section 501(c)(4) also requires that social welfare organizations must promote the social welfare of a community. In Rev. Rul. 72-102, 1972-1 C.B. 149, the IRS states "a neighborhood, precinct, subdivision, or housing development may constitute a community." We expand and clarify that definition of community in Rev. Rul. 74-99, 1974-1 C.B. 131 stating:

Although an exact delineation of the boundaries of a "community" contemplated by section 501(c)(4) is not possible, the term as used in that section has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof.

While there is no minimum number of people required to comprise a community, mere large numbers do not transform a group of people into a community. See Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962). The only common connection between all of your users is that they are users of the OS operating system. They are located everywhere in the world. Everyone with an OS controlled computer and internet access may use your software without regard to citizenship or location. The world is a geographical unit but does not bear a recognizable relationship to an area ordinarily identified as a governmental subdivision or unit or district. Accordingly, the world is not a community within the meaning of § 501(c)(4) and you are not operated to promote the social welfare of a community.

C. Your Primary Activity Is Selling Software Services At Cost Which Is A Trade Or Business Ordinarily Carried On For Profit.

Your primary activity is selling software services in a manner materially identical to for-profit organizations. You develop and publish software that encrypts digital communications. Nearly all of your income comes from service contracts with organizations to develop, install, and service the software. You charge the organizations fees intended to cover your costs but not generate a profit.

Nonprofit commercial activities, although obviously beneficial to the community in one sense, do not promote social welfare within the meaning of the statute. The activities of the organization seeking exemption under § 501(c)(4) should not duplicate services or facilities provided by commercial entities. See United States v. Pickwick Electric Membership Corp., 158 F.2d 272 (6th Cir. 1946). We must determine whether this constitutes carrying on a business with the general public in a manner similar to organizations which are operated for profit, or whether it is distinguishable from ordinary commercial activities and are designed to confer some unique, recognizable benefit on the people of the community. Providing services on a contract basis at cost is not unique. The question is whether your services are in some way unique so that a community benefits from their availability. On the basis of the facts presented thus far, we are unable to find any meaningful distinction between your services and those provided by your for-profit counterparts.

The fact that you provide services at cost and not for the purposes of profit is not unique and does not transform a trade or business ordinarily carried on for profit into an exempt social welfare organization. In Rev. Rul. 72-369, 1972-2 C.B. 245, the IRS held that an organization formed to provide management and consulting services at cost to unrelated exempt organizations did not qualify for exemption under § 501(c)(3). This ruling stated, "An organization is not exempt merely because its operations are not conducted for the purposes of producing a profit [P]roviding managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit."

The fact that you primarily sell your services to tax-exempt organizations is not unique and does not transform a trade or business ordinarily carried on for profit into an exempt social welfare organization. In Rev. Rul. 70-535, 1970-2 C.B. 117, the IRS held that an organization formed to provide management, development and consulting services for low and moderate income housing projects for a fee, did not qualify under § 501(c)(4). The revenue ruling stated that because "the organization's primary activity is carrying on a business by managing low and moderate income housing projects in a manner similar to organizations operated for profit, the organization is not operated primarily for the promotion of social welfare. The fact that these services are being performed for tax exempt corporations does not change the business nature of the activity."

Your royalty free distribution of the software under open source licenses is also not unique. In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Court stated that free or below cost service is only one of several factors to consider in making a determination. There are numerous private companies providing royalty free software under open source licenses and even two public companies: i.e. Red Hat Linux, and VA Software and its successors. A number of other public companies include open source software as part of their business model. Distributing software without charge is part of your business model. Distributing software without charge does not change your business nature: you are paid to develop the software and paid to for installation, customization, and consultation services. Each of these services is a trade or business ordinarily carried on for

profit, whether conducted together or carried on alone. Giving away software under open source licenses does not transform a business into a social welfare organization.

Furthermore, your operation of an encrypted communications service for purposes of testing the reliability of your software where heavy users may be charged or subscribers to premium services may be charged is not unique.

An organization carrying on a trade or business with the general public in a manner similar to organizations operating for profit cannot qualify for exemption under § 501(c)(4). Accordingly, you are not operated exclusively for the § 501(c)(4) promotion of social welfare because your development, distribution, and software services at cost for your open source licensed software is carrying on a trade or business ordinarily carried on for profit.

Conclusion:

Because developing and distributing open source software does not promote the social welfare of a community you are not operated for § 501(c)(4) exempt purposes. Even if open source software development and distribution did promote the social welfare of a community you are precluded from exemption because your primary activity is selling software services at cost, which is a trade or business ordinarily carried on for profit. Additionally, providing software to commercial companies that helps them operate their businesses is a private benefit that is not incidental. Accordingly, you are not operated to further § 501(c)(4) exempt purposes.

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. You also have a right to a conference after you submit your statement. If you want a conference, you must request it when you file your protest statement.

You can also ask the Office of Appeals to review your application for tax-exempt status. Your right to request Appeals review is in addition to your right to a conference, as outlined in Revenue Procedure (Rev. Proc.) 2014-4 and Rev. Proc. 2014-9. You must notify us in writing if you want us to forward your case to the Appeals Office. You can find more information about the process and the role of the Appeals Office in Section 7 of Rev. Proc. 2014-9 and Publication 4227, *Overview of the Appeals Process*.

If the person representing you in this process is not an officer, director, trustee, or other official who is authorized to sign for the organization, he or she must file Form 2848, as explained above, and otherwise meet the requirements in Publication 216, *Conference and Practice Requirements*.

Where to send your protest

Please send your protest statement, any request for consideration by the Office of Appeals, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:3)
Gregory Schantz (NCA534-27)
1111 Constitution Ave, N.W.
Washington, DC 20224

Street address for delivery service:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:3)
Gregory Schantz (NCA 534-27)
1111 Constitution Ave, N.W.
Washington, DC 20224

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Michael Seto
Manager, EO Technical

Enclosure:
Publication 892

cc: