



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Date: January 7, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Number: **201514011**
Release Date: 4/3/2015

UIL: 501.03-00; 501.32-00; 501.33-00

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) 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 the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Director, Exempt Organizations

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: October 16, 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = officer
C = officer
D = officer
E = officer
F = officer
N = related for-profit organization

x = date
y = number

UIL:

501.03-00
501.32-00
501.33-00

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issues

Do you qualify for exemption under section 501(c)(3) of the Code?

No, for the reasons outlined below.

Facts

You stated you were formed as a corporation on x, though you did not provide copies of any organizing documents with your application. You also indicated you have Bylaws, though you did not provide a copy.

You are a volunteer organization formed to help students attend N, a private for-profit academy

Letter 4036(CG) (11-2011)
Catalog Number 47630W

started by B, your officer. N provides classical art training with real world job skills to aspiring sculptors. N is a small school with a maximum of y students. Your officers, who also established you, include B, C, D, E, and F. B will be the primary sculpture teacher at N. C and D will teach some art and foundry classes for N. E will be involved in teaching and information technology at N. F helps manage the real estate and business side of N.

Your specific purposes are as follows:

- To promote student art programs at N;
- To promote the educational welfare and bright academic future of students at N, including assisting the administration and teaching staff in meeting the academic and cultural needs of their students by providing additional financial resources for books, supplies, technology, and other identified needs;
- To enrich the physical environment of N by helping fund upkeep and improvements to school facilities;
- To promote the growth and development of art programs in the area that help provide diverse and enriching opportunities for N students to interact with the broader professional art community.

You want to see N become a successful school and recognize that going to school can be expensive. Therefore, you plan to raise scholarship money for students and to purchase special tools or equipment for N that enhance student education, such as a new furnace and computer equipment. You may also support art programs in the community to provide a broader education for students, though you have no current plans to give to any other organization as you want the funds to provide scholarships for students at N. You state you all benefit when N succeeds.

Your scholarship program will benefit students attending N. It will provide a partial waiver of tuition fees and be awarded based on need and merit. You will also provide grants to students for enrichment activities related to educational goals. Any student admitted to N will be eligible to apply, though you have not yet developed application forms. The selection committee will be unrelated to applicants. You will maintain records of scholarships given. Scholarship funds to pay tuition will be paid directly to N, and grant funds will typically be paid directly to sponsors. You will also have a process to handle students who violate terms of the scholarship or grant.

You indicated that there is no intent at this time to provide compensation through your organization to your board members, however you acknowledged that the founding members of your board may benefit through salaries at N being paid by scholarship money.

Your funding will come from donations and gross receipts from various fundraisers. Your expenses are primarily for contributions paid out for student scholarships. Your other budgeted expenses are for extra equipment or services for the benefit of students, such as a new kiln, a new set of power tools, or books for the library. However, such special equipment will remain at N and will not be the personal property of a student.

Law

Section 501(c)(3) of the Code provides for the recognition of exemption of organizations that are organized and operated exclusively for religious, charitable, or other purposes as specified in the statute. No part of the net earnings may inure to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations ("regulations") provides that the terms "private shareholder or individual" in Section 501 of the Code refer to persons having a personal and private interest in the activities of the organization.

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

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 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.

Section 1.501(c)(3)-1(c)(2) of the regulations provides 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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized and operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. The organization must establish that it is not organized or operated to benefit private interests such as designated individuals or the persons who created it.

Revenue Ruling 76-206, 1976-1 C.B. 154, held that a nonprofit organization formed to promote the retention of music programs of a local for-profit radio station by seeking program sponsors, urging the public to patronize the sponsors, and soliciting subscriptions to the station's program guide, all of which activities tended to increase the station's revenues, did not qualify for exemption under section 501(c)(3) of the Code. The organization's board of directors represented the community at large and did not include any representatives of the for-profit radio station. It was held that the activities resembled a public relations campaign designed to enable the for-profit radio station to continue broadcasting classical music. The organization's efforts enabled the radio station to increase its total revenues. The increase in listening audience that may occur as a result of the organization's activities would enhance the value and salability of the station's airtime. A similar enhancement was derived through the sale of the station's program directories. Thus, the organization's activities would benefit the for-profit radio station in more than an incidental way.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt

purposes. The petitioner's activities were largely animated by non-exempt purposes directed fundamentally to ends other than that of education.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), several for-profit organizations exerted significant indirect control over est of Hawaii, a nonprofit 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 nonprofit. The Tax Court concluded that the for-profits were able to use the nonprofit 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) of the Code.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo. 1989-36 (1989), the Tax Court considered whether a nonprofit corporation that conducted continuing medical education tours qualified for exemption under section 501(c)(3) of the Code. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded that when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code, even if it furthers other exempt purposes.

In Salvation Navy v. Commissioner, T.C. Memo. 2002-275 (2002), the Tax Court found that one of the reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that it was not organized to serve the private interests of its founder.

Application of Law

Section 501(c)(3) of the Code sets forth two requirements for an organization to be recognized as exempt. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). You have not substantiated whether you are organized exclusively for purposes described in section 501(c)(3) because you did not provide copies of your organizing documents.

You are not described in section 501(c)(3) of the Code or section 1.501(c)(3)-1(a)(1) of the regulations because you are not operated exclusively for purposes described in section 501(c)(3).

The facts indicate all officers may benefit either directly or indirectly from your operations. You will direct funds to N, a for-profit company where your officers teach and have a relationship. Your funds will be used to increase enrollment through scholarships as well as to make capital improvements to the facility and to purchase tools and supplies. N would otherwise be responsible for these costs. Accordingly, your officers benefit from the funds you direct to N's operations. Since your earnings inure to the benefit of private individuals, you do not meet the requirements of section 1.501(c)(3)-1(c)(2) of the regulations. Your officers are private shareholders or individuals as described in section 1.501(a)-1(c) of the regulations because they have a personal and private interest in your activities.

Section 1.501(c)(3)-1(c)(1) of the regulations states an organization will not be exempt if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. You are paying tuition for students to attend N, as well as helping fund upkeep and improvements to school facilities at N. N is a related for-profit school that was started by B, one of your officers. As a result, your operations are providing a substantial private benefit to N, a substantial non-exempt purpose which disqualifies you from exemption.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized and operated exclusively for exempt purposes unless it serves a public rather than a private interest. You are formed to provide scholarships to students of N, as well as fund purchases of special equipment for N's students. Thus, as a result of N's relationship with you, N receives the benefit of tuition funds from students who may not otherwise be able to afford to attend the academy. N also realizes the benefit of receiving specialized equipment free of charge that it would otherwise have to purchase. Therefore, you are operating for the private interests of N, rather than public interests.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations also provides that the organization must establish that it is not organized or operated to benefit private interests such as designated individuals or the persons who created it. By providing scholarships to students of N and funding purchases of special equipment that will be installed at N, you are benefitting the private interests of B, one of your creating officers who started N as a for-profit, as well as your officers who teach at N.

You are similar to the organization described in Rev. Rul. 76-206 because this ruling involved a nonprofit whose activities helped a for-profit radio station increase its total revenues. You are helping a for-profit school increase its total revenues by providing scholarship funds to pay tuition for students at N. Your activities enable needy students to attend N which enables N to increase its student body. The fact that the organization in the ruling had a board of directors from the community at large who did not include any representatives of the for-profit radio station did not strengthen their claim to exemption. It is even more clear that you were formed to benefit N in more than an incidental way because your governing body consists entirely of the founder of N, teachers at N, and individuals managing the business of N.

As held in Better Business Bureau of Washington, D.C., Inc. v. United States, a single non-exempt purpose, if substantial, will preclude tax exemption under section 501(c)(3) of the Code. Your activities result in substantial private benefit to N, and your earnings inure to the benefit of your officers. Like the organization described in the court case, this single, substantial nonexempt purpose destroys your claim to exemption under section 501(c)(3) of the Code.

You are similar to est of Hawaii v. Commissioner and International Postgraduate Medical Foundation v. Commissioner, because N's for-profit operations benefit from your operations. Essentially all of your funds will be given to N, either in the form of scholarship tuition payments or purchasing equipment for the school. You are serving as an "instrument" to further the purposes of N. You have no plans to assist any other organization aside from N, as you want to see N become a successful school. Because your related for-profit organization, N, benefits substantially from the manner in which you operate, you are not operated exclusively for exempt

purposes and you do not qualify for exemption under section 501(c)(3) of the Code.

You are comparable to the organization described in Salvation Navy v. Commissioner because you have failed to prove you are not organized to serve the private interests of B and the other officers who established you.

Conclusion

Based on the facts and circumstances presented, you do not qualify for recognition of exemption from federal income tax as an organization described in section 501(c)(3) of the Code. You are not operated exclusively for exempt purposes as set forth in section 501(c)(3) of the Code.

Your net earnings inure to the benefit of your officers, who are private individuals. In addition, it is clear that your operations result in substantial private benefit to N.

As a result, we conclude that you are not operated exclusively for public rather than private purposes. We conclude based on the stated facts that you do not qualify for tax exemption because more than an insubstantial part of your activities is not in furtherance of exempt purposes.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of why you disagree. Your protest statement must be filed within 30 days of the date of this letter and should include:

- Your organization's name, address, EIN number and a daytime phone number.
- A statement that the organization wants to protest the proposed determination.
- A copy of this letter showing the findings that you disagree with (or the date and IRS office symbols from the letter.
- An explanation of your reasons for disagreeing including any supporting documents.
- The law or authority if any, on which you are relying.

The protest statement may be signed by one of your officers or your representative. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

The protest statement should also include the following declaration.

"Under penalties of perjury, I declare that I have examined this protest 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."

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 signs and submits the protest, a substitute declaration must be included stating that the representative prepared the protest and any accompanying documents; and whether the representative personally knows (or does not know) that the statement of facts in the protest and any accompanying documents are true, correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. In that case you must file a 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 seek a declaratory judgment in court at a later date because the court requires that you first exhaust administrative remedies at the IRS. 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