



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

Date:
January 6, 2015
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Number: **201514013**
Release Date: 4/3/2015

UIL: 501.33-00; 501.36-00

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

Enclosure:

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: January 6, 2015

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = individual
C = individual
D = individual
E = product 1
F = company
G = product 2
O = llc
P = company
Q = state
R = date

UIL:

501.33-00
501.36-00

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons indicated below.

Facts

You were incorporated in Q on R. Your specific purpose, as shown in your Articles of Incorporation, is to equip small businesses, entrepreneurs and not-for-profit

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

organizations with capacity-building strategies for growth, effectiveness, and sustainability. You will provide resources to your members including software tools, articles, tutorials and online instruction, access to information such as consultations, written communications, funding and networking. You will offer members workshops and seminars teaching business planning, management and other strategies, aiding them in developing business proposals, marketing plans and other business related documents.

You indicate in your bylaws you will provide small to medium-sized non-profit agencies and businesses with P's software designed for grant purposes (F), along with discounted monthly subscriptions to internet cloud consulting and advisors to assist them in using and developing P's software packages to their own purposes. You also desire to provide educational workshops and seminars that teach these small and medium-sized organizations strategic planning, management and other strategies which will aid them in developing effective proposals, marketing plans and other related documents.

You are an offshoot of P, a for-profit company owned and operated by B, your executive director. P works with O in a joint venture to develop and distribute grant writing software language and provide consulting services to grant seekers under the aegis of (you). B is projected to receive a salary from you for services.

P has been developing and marketing software and applications for building and managing small and midsize businesses for over 20 years. P's flagship product, E, is used by over 150 schools and business consultants. You submitted an expansion and renewal plan with your application for P. P is seeking up to \$2,000,000 to expand its current software into a full service business platform. The majority of this plan speaks of P and its products, history and development. The plan refers to the final aspect of P's expansion project, which is providing software and services at a discount rate to you for the benefit of small to medium sized foundations and agencies. The software will allow for subsidizing agencies and non-profits that do not have access to grant writers or templates by providing a grant-based E platform along with discounted subscriptions for the additional services and professionals integral to the success of the program. Part of the funding requested as part of the expansion of P would be used to develop the software and templates for these purposes – creating F. The plan also refers to additional marketing initiatives including specialty vertical market versions sold for non-profit organizations along with medical, retail, restaurants, services, real estate, etc. P's plan includes a summary of future products which lists the F and G lines, those that would be given to you for distribution, with comments that there is a big demand for a 501(c)(3) version of this business plan including individual and professional editions.

O is a writing, editing and research company that has specialized in grant writing and consulting since its existence. You will receive documents and consultation for

proposals and P will receive grant template design and consultation from O. O is owned by C and D, who are your secretary/COO and treasurer/CFO, respectively. Both C and D are projected to receive a salary from you for services.

Although you have indicated a joint venture with two for profit operations, P and O, you submitted no contracts or agreements with either of these entities.

You will equip small business, entrepreneurs and not-for-profit organizations with capacity-building strategies for growth, effectiveness, and sustainability. Your development efforts will include providing a database of resources for your members, offering software tools, a marketplace, consultant directory and a library of practical information for starting, building and running a successful company. You will offer business planning, strategic planning, management, workshops and other business assistance strategies to aid in developing effective marketing plans, strategies, procedures and management strengths. Initially, P's software will be especially developed for grant writing purposes including additional software tools to serve small to medium-sized non-profits. These entities will receive donated versions of the software and then be offered a discounted subscription. The subscription will include online "cloud" activities, which includes back-up of plans, hiring a business consultant to guide them through the intricacies of grant applications, or enabling users to hire (at a discount) grant writing professionals to complete their proposals.

P will sell F to you at no cost; you will in turn distribute F to non-profit organizations. You must then fundraise enough to create an endowment fund to supplement this through the discounted subscriptions for cloud services.

This partnership will enable P the ability to provide a comprehensive level of services through subscriptions on the internet for all facets of creating and managing a non-profit, with the core piece being the grant writing language and expertise provided by O. Per P's business plan for expansion and renewal, non-profit organizations and small businesses are one of the markets of its software products and services expansion and renewal target goals.

You will provide one unit of software to each small non-profit and a two month subscription to cloud services. For small non-profits on a case by case basis, the product will be donated and the non-profits may subscribe to all features of the internet site at a discounted fee in order to maintain your ability to distribute and afford more donations. You did not submit further details as to the amount of this fee, however, continued subscriptions will be prorated up to 50% off SRP (currently valued between \$20 and \$50) as well as consulting services. You will also provide writing, consultation and preparation services for non-profit organizations and small business owners.

Non-profit organizations and small business owners will be selected based on recommendations at monthly meetings of your board after the applications have been reviewed and determined the level of need that should be granted. No further details were provided on who may qualify for the discounted or free services, what criteria are used or evaluate in determining who receives your free product, or what information is collected on the application for the product.

You eventually plan to provide the products and services internationally, but currently concentrate more in North American markets. Products and services will be tailored to each country's needs.

To date, you have sold no products. You have projected both donations and membership fees as sources of income, with the membership fees originating from cloud subscriptions and additional services. Your biggest expense is compensation for your directors, followed by professional fees and occupancy.

Law

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (regulations) states that to be tax exempt, an organization must be both organized and operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code. 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) of the Code. 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(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for charitable purposes unless it serves a public rather than a private interest.

In Revenue Ruling 72-369, 1972-2 C.B. 245, an organization was formed to provide managerial and consulting services to organizations exempt under section 501(c)(3) of the Code to improve the administration of their charitable programs. The organization enters into agreements with unrelated section 501(c)(3) organizations to furnish managerial and consulting services on a cost basis. This revenue ruling stated that:

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test,' the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and the applicable regulations. Providing managerial and consulting services on a regular basis for

a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Court stated that “the presence of a single...[nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly...[exempt] purpose.”

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. The Tax Court stated: “We must agree with the Commissioner that petitioner's activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit.”

In Living Faith Inc. v Comm'r, 60 T.C.M., 710, 713(1990), aff'd 950 F.2d 365 (& Cir. 1991) the court wrote that the activities were conducted as a business and the organization was in direct competition with other restaurants and health food stores; thus it did not qualify for exemption under Section 501(c)(3). The appellate court stated the factors that the court relied on to explain commerciality included:

- 1) The organization sold goods and services to the public.
- 2) The organization was in direct competition with for profit businesses (Food stores and restaurants).
- 3) The prices set by the organization were based on pricing formulas common in retail food businesses.
- 4) The organization utilized promotional materials and “Commercial catch phrases” to enhance sales.
- 5) The organization advertised its services and food.
- 6) The organization did not receive any charitable contributions.

Application of Law

Section 1.501(c)(3)-1(a)(1) of regulations states that to be tax exempt, an organization must be both organized and operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code. 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). You offer subscription services to your members through a for profit entity (P) that is owned and operated by your executive director. More than an insubstantial amount of your time is spent on activities that are commercial in nature and serve the private interests of not only your board, but also those members who are paying a fee for services. For these reasons, you are not operating exclusively for educational or charitable purposes under section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for charitable purposes unless it serves a public rather than a private interest. Accordingly, the regulations provide 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. You have negotiated for the use of products created and sold by companies owned by members of your board. You advertise, market and sell the products and services provided by your founders. You submitted no documentation on how these decisions were reached, how compensation or payments for these products and services were determined, or how any of these transactions occurred arms-length without conflict of interest. The use of the products of P and O further the private interests of B, C and D rather than serving a public purpose.

You are similar to the organization described in Revenue Ruling 72-369. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. You provide software with a subscription service enabling organizations to prepare grant applications. You also offer either consulting services or recommendations on consulting. The fact that the product in this case is provided at cost and solely to exempt organizations is not sufficient to characterize this activity as charitable. Furnishing services at cost lacks the donative element necessary to establish this activity as charitable. The organization described in the revenue ruling was conducting commercial services only for organizations exempt under section 501(c)(3) and was still found to be conducting commercial activities. While you offer services to non-profits, these are insufficient to be characterized as exempt.

You are operating like the organization in B.S.W. Group, Inc. v. Commissioner because you are substantially engaged in the commercial activity of marketing and selling software packages, internet services and consulting services. Your resources are either directly or indirectly targeted at the promotion and sales of business plan templates and monthly subscriptions to internet cloud services and consulting services. Your activities are conducted in a commercial manner and you are not operated exclusively for charitable purposes. Your activity constitutes the conduct of a commercial business of the sort which is ordinarily carried on by commercial ventures organized for profit.

You are also like the organization in Living Faith Inc. v Commissioner because you operate as a business and are in direct competition with all other businesses that sell software products, internet services, and consulting services. You submitted a plan for growth and expansion with your application for exemption of the for-profit entity, P, detailing how you intend on using seed money to create, market and sell future products, including the one you are distributing for free to select non-profit entities. The distribution of F is part of a larger plan for expansion of P, not a charitable activity. You demonstrate other similarities to the ruling in exhibiting commerciality. You sell goods and services to small businesses, individuals and non-profits. You compete directly with for-profit businesses providing similar services. You price products and services similar to other like for-profit businesses. Your services are described as part of the marketing plan of P. Even though you indicate income will include contributions, fees for products and services will be substantial. Your activities are like a commercial business.

As stated in Better Business Bureau of Washington v US, a single non-exempt purpose, if substantial, will preclude tax exemption under section 501(c)(3) of the code. Despite providing software to some organizations at no cost, sell subscription services through entities owned by your board. Further, these products are not available to all non-profit entities, only those selected by you. You serve the private interests of your board and their related companies P and O instead of a public purpose precluding you from exempt status.

Applicant's Position

You have clarified the intentions are distinct from those of P in that you are aiming to provide software and services to not for profit organizations enabling others to donate and contribute to helping not for profits succeed.

Service Response to Applicant's Position

While you provide services to not for profit organizations, your activities are commercial in nature and further the private interests of your founders and governing body, thereby disqualifying you from exemption.

Conclusion

You fail the operational test and conduct more than an insubstantial amount of commercial activities. You serve the private interests of your governing body rather than the general public. Therefore, you do not qualify for exemption under section 501(c)(3) of the Code.

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. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. 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*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court

at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

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

U.S. mail:

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

Street address for delivery service:

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

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.

Sincerely,

Director, Exempt Organizations

Enclosure:
Publication 892