



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: 201535019
Release Date: 8/28/2015
Date: June 5, 2015

Contact Person:
Identification Number:
Contact Number:
FAX Number:
Employer Identification Number:

LEGEND:

B = President
Q = Date
T = State

UIL:

501.36-01
501.33-00

Dear Applicant:

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 described below.

Facts

You were incorporated on date Q, in the state of T.

Article 5 of your Articles of Incorporation states you are organized for the provision of mediation services; quality management consulting; hospital accreditation preparation services; miscellaneous uplifting services for the elderly veterans of military service; and research and development services. Your amended Articles of Incorporation state you are organized exclusively for charitable, religious, educational, and scientific purposes.

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Your narrative description of activities states you will provide mediation services, quality management consulting, hospital accreditation preparatory services, and miscellaneous uplifting services for the elderly and veterans of military services. Further, you will provide internal auditing services. Your consulting services target proactive risk management for patients, health care facilities, and health care providers. You work to improve the safety of patients through patient safety initiatives as mandated under the Patient Safety and Quality Improvement Act of 2005. You explain that the patient safety act applies to both non-profit and for-profit organizations. You will provide consulting services to individuals and organizations regardless of their tax-exempt status. You will not refuse to assist any organization that strives to improve its quality of patient care. You will offer free introductory consultations to potential clients. You will operate throughout the continental United States and globally. You state that the bulk of services provided will be delivered by your president.

You claim that all management and consulting services provided under the auspices of the Patient Safety Act are tax exempt qualified services because they are the propagation of a government program.

You indicate you provide services to any organization that strives to improve its quality of patient care.

You will participate in research activities to facilitate economic development of small veteran owned businesses in need. Activities may include clinical studies, academic reviews, contributing to ongoing studies, or providing general business consulting services. You claim this lessens the burden of government. You will conduct fundraising through solicitation of vehicles, boats, planes, or similar donations; foundation grant solicitations; and government grant solicitation. You are currently receiving your funding from B, your president; who is your only officer. You will charge fees for services. You price services with market circumstances in mind and strive to remain competitive by the quality of service provided and not by underpricing or undercutting competitors. Your fee structure depends on the nature of the project and the level of expertise required. You charge approximately \$350 per hour for consulting services. Consulting services are billed at the remuneration rate of the consultant providing the services. Auditing fees are determined based on the core competencies required and the auditor's salary determined using a salary survey.

Your expenses include contributions, compensation for your president, occupancy, depreciation, and other program service expenses. B will receive compensation over \$200,000 per year (over \$340 per hour for services rendered). You explain B operated in prior years with yearly compensation in arrears as a collectable debt. In addition to salary payments, you will provide performance bonuses not to exceed approximately \$100,000 per annum. You may make interest free educational, career improvement or other technical loans to officers, directors, or employees. Further, you will award revenue based payments when an employee participates in auditing, streamlining or process improvement activities where the client agrees to pay a percentage of money saved. The employee will receive approximately 3% of the proceeds if the employee is the originator of the account. Revenue based payments will not exceed the amounts statutorily allowed by law.

Law

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

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states 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 that 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(d)(1)(ii) of the regulations provides that in order to be exempt under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term 'charitable' is used in section 501(c)(3) of the Code in its generally accepted legal sense. Such term includes relief of the distressed.

In Revenue Ruling 69-266, 1969-1 C.B. 151, an organization was formed and controlled by a medical doctor. The doctor transferred assets, including his medical practice, his home, and his automobile to the organization. In return, the organization "hired" the doctor and charged prevailing fees for services rendered. The Service held that the operation of the medical practice did not differ significantly from the private practice of medicine for profit. In essence, the organization was operated by its creator as an attempt to reduce his personal federal income tax liability. Thus the organization's primary function was to serve the private interests of its creator rather than a public interest.

Revenue Ruling 71-529, 1971-2 C.B. 234, found that a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption under section 501(c)(3) of the Code. Membership in the organization is restricted to colleges and universities exempt under section 501(c)(3) of the Code and its board of directors was composed of representatives of the member organizations.

Revenue Ruling 72-369, 1972-2 C.B. 245, found that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code.

Revenue Ruling 74-587, 1974-2 C.B. 162, found that a nonprofit organization formed to relieve poverty, eliminate prejudice, reduce neighborhood tensions, and combat community deterioration through a program of financial assistance in the form of low cost or long-term loans to, or the purchase of equity interests in, various business enterprises in economically depressed areas is exempt under section 501(c)(3) of the Code.

Revenue Ruling 76-419, 1976-2 C.B. 146, found that a nonprofit organization that purchases blighted land in an economically depressed community, converts the land into an industrial park, and encourages industrial enterprises to locate new facilities in the park in order to provide employment opportunities for low income residents of the area, is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single non-charitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. See Better Business Bureau of Washington, D. C., Inc. v. United States, 326 U.S. 279 (1945), which held activities that were in part aimed at promoting the prosperity and standing of the business community were held to serve a substantial non-exempt purpose.

B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), describes an organization whose sole activity was to provide consulting services for a fee to nonprofit organizations. It provided qualified persons to perform research projects for its clients. The fees charged by the organization were set at or close to cost but were not less than the organization's full cost of providing its service. The organization was denied exemption because it operated in a commercial, nonexempt manner. The provision of managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The court held that the organization was not operated exclusively for charitable, educational or scientific purposes within the meaning of section 501(c)(3) of the Code.

In Airlie Foundation v. Internal Revenue Service, 283 F. Supp. 2d 58 (D.D.C., 2003), the district court relied on the "commerciality doctrine" in applying the operational test. The operational test requires both that an organization engage "primarily" in activities that accomplish its exempt purpose and that not more than an "insubstantial part of its activities" further a non-exempt purpose. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. The court stated:

Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.

In Asmark Institute, Inc. v. Commissioner of Internal Revenue, T.C. Memo. 2011-20, aff'd, 486 Fed. Appx. 566 (6th Cir. 2012), the appeals court upheld the Tax Court decision that Asmark Institute is not entitled to exempt status under section 501(c)(3) of the Code because the institute's operations were commercial rather than charitable. Its activities consist mainly of compliance services for a fee. The court also found that Appellant's free services are relatively small in relation to all of its services and are, in fact, tied in some manner to fee-based membership. The court also found that the appellant's largely fee-based business plan and its competition within a for-profit market were also strong evidence of the predominance of their nonexempt commercial purposes. The Tax Court concluded it was apparent from the record that appellant's consulting services are mainly associated with the fees appellant receives through its various retainer agreements, membership agreements, and service packages. The sale of services, including consulting services, is commonly considered to be a non-exempt, commercial purpose.

In Harding Hospital, Inc. v. United States, 505 F.2 1068 6th Cir. (1974), the court held that an organization seeking a ruling as to recognition of its exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute.

Application of Law

You are not described in section 501(c)(3) of the Code and section 1.501(c)(3)-1(a)(1) of the regulations. You fail the operational test for exemption under 501(c)(3) because you are operated in a commercial manner.

A substantial part of your activities are commercial. You provide internal auditing services, quality management consulting, hospital accreditation preparatory services, and consultation services to veterans and the elderly for a fee. Fees charged are at market rates. These services are provided to individuals and organizations regardless of their tax-exempt status. You are in competition with other individuals and organizations who provide similar services on a for-profit basis. These facts demonstrate a commercial and substantially non-exempt purpose inconsistent with section 501(c)(3) of the Code and Section 1.501(c)(3)-1(c)(1) of the regulations.

You also operate for the private interest of B and potential employees, who are eligible for revenue based payments and performance bonuses. Therefore, you are not organized or operated exclusively as described in section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

Your services are not designed for the relief of the poor and distressed, to lessen the burdens of government, or the promotion of social welfare. Your services are not provided exclusively to the poor, distressed or underprivileged nor are they directed to an economically depressed community. Even though some of your services are directed to veterans or the elderly or are provided in response to government programs, the manner in which you operate is commercial and you are structured to benefit B. Therefore, your activities are not charitable as described in section 1.501(c)(3)-1(d)(2) of the regulations.

Your fee-based service activities are similar to those described in Rev. Rul. 72-369 and in the

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court cases BSW Group, Inc., Airlie Foundation, and Asmark Institute. As in these four situations, you operate in a commercial manner. You provide management and consulting services to both for-profit and non-profit health care facilities. Your fees are not substantially below cost. As stated above, you are operating a trade or business similar to and in competition with commercial operations providing similar management and consulting services.

You are not similar to the organization described in Rev. Rul. 71-529 because you are not providing services for a fee substantially below cost. You are also not similar to the organizations described in Rev. Rul. 74-587 or Rev. Rul. 76-419 because you do not operate in an economically depressed area or a distressed area. You provide management and consulting services throughout the United States and globally. You provide services to any organization that strives to improve its quality of patient care.

You are similar to the organizations in Better Business Bureau of Washington, D. C., Inc. and Rev. Rul. 69-266 because you too have a substantial non-exempt purpose. The facts show you operate for a substantial non-exempt commercial purpose and you also operate for the benefit of B.

As in Harding Hospital, Inc. v. United States, you have the burden of proving that you satisfy the requirements for tax exemption. You have failed to provide enough information to prove to us that you are organized and operating in a manner appropriate under section 501(c)(3) of the Code.

Conclusion

Based on the above facts and analysis, you do not qualify for exemption under section 501(c)(3) of the Code because you are not operated exclusively for a 501(c)(3) purpose. The facts show you operate for a substantial non-exempt commercial purpose as well as for the benefit of B. Accordingly we conclude you do not qualify for exemption under section 501(c)(3).

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 (4th bullet) 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 protest and in any accompanying schedules and statements and, to the best of my

knowledge and belief, they are true, correct, and complete."

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. To be represented 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. For more information about representation, see Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications. If you do not 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 to you. 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 also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Director, Exempt Organizations

Enclosure: Publication 892