

**Internal Revenue Service**

Appeals Office  
San Jose Appeals, MS-7100  
55 S. Market St., Suite 440  
San Jose, CA 95113

**Department of the Treasury**

**Employer Identification Number:**

**Date:** MAY 26 2016

**Person to Contact:**

**Number:** 201634029  
**Release Date:** 8/19/2016

**Employee ID Number:**  
**Tel:**  
**Fax:**  
**Contact Hours:**

**UIL:**

0501.09-03

**Certified Mail**

Dear :

This is a final adverse determination regarding your exempt status under section § 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section § 501(c)(3) of the Code effective January 1, 2010.

The revocation of your exempt status is made for the following reason(s):

You are not operated exclusively for exempt purposes within the meaning of Internal Revenue Code § 501(c)(3) and Treasury Regulation § 1.501(c)(3)-1. You are operated for substantial private and commercial purposes, rather than exclusively for public purposes.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit [www.irs.gov](http://www.irs.gov).

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for

filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit [www.irs.gov/advocate](http://www.irs.gov/advocate) for more information.

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

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Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892 and/or 556

cc:



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities Division

Date: **JAN 12 2015**

Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:

Phone:

Fax:

Manager's name / ID number:

Manager's contact number:

Response due date:

**Certified Mail - Return Receipt Requested**

Dear \_\_\_\_\_:

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the



IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

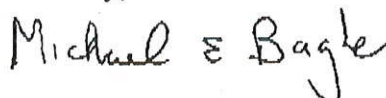
Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,



for Margaret Von Lienen  
Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>		Schedule number or exhibit
Name of taxpayer  ORG	Tax Identification Number		Year/Period ended  <b>December 31, 20XX</b>

### ISSUES

1. Should the IRC section 501(c)(3) tax exempt status of the taxpayer, ORG ("TP"), be revoked because it is not operated exclusively for tax exempt purposes?

TP was incorporated December 21, 20XX, pursuant to the provisions of the Nonprofit Corporations Act of the State of State ("State"). TP's original and amended Articles of Incorporation ("AOI") filed with the State provides, in part, that its purpose is to receive and administer funds for the Foundation of Southeastern State ("FDNSS") and to contract with a third party business to raise funds and awareness of the FDNSS. The FDNSS is a 501(c)(3) public charity that provides temporary housing for families of hospitalized children. In December, 20XX, TP filed Form 1023, *Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code*, with the IRS. In August, 20XX, pursuant to a ruling issued by the IRS, TP was granted exemption from federal income taxation as an organization described in IRC section 501(c)(3). The organization was expected to be a publicly supported charity within the meaning of IRC sections 170(b)(1)(A)(vi) and 509(a)(1).

An examination of TP's 20XX, 20XX, and 20XX Form 990 returns, along with oral testimony provided by TP's founder and president during the course of the examination disclosed the following:

1. TP's only activity is the administration of a corporate sponsorship program ("CSP") whereby TP partners with CO-1 ("CO-1"), a State for-profit home improvement company specializing in home replacement windows. TP disclosed during the examination that it also plans to expand its CSP in the future to include other for-profit organizations.
2. TP's board of directors consists of three individuals, two of whom are related by marriage. TP's founder/president and its secretary are married to principal officers of CO-1 (who are also related). TP's treasurer is not related to any parties affiliated with either TP or CO-1.

TP's only source of income is derived through its CSP with CO-1, which administers a telephone solicitation program on behalf of TP using its own employees. TP has no employees or volunteers (other than board members) and engages in no other activities other than its CSP with CO-1. Further, TP did not solicit, nor did it receive, contributions from the general public or any governmental entities during the periods under examination. Gross receipts generated from TP's CSP during the 20XX, 20XX and 20XX tax periods totaled \$0, \$0, and \$0 respectively.

Based on interviews with TP's founder/president, as well as a review of telephone solicitation scripts used by CO-1, the operation of TP's CSP is as follows:

1. CO-1 uses an automatic/ predictive dialer to place phone calls to potential customers of CO-1. Hundreds of phone calls are placed by the auto dialer each day.
2. Once a live pickup is detected, the auto dialer either plays a recorded message or connects the call to an available live operator.
3. Once connected, the live operator, an employee of CO-1, identifies themselves by first name and conveys to the prospective customer that they are calling on behalf of TP.
4. The live operator then informs the prospective customer that TP sponsors home improvement companies for the purpose of helping local children's charities and that TP receives a donation from CO-1 for every home owner that accepts a product demonstration and free estimate.
5. If successful, the live operator schedules an appointment with the prospective customer for a free in-home product demonstration and estimate by a representative of CO-1.



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6. Between 6 and 20 in-home appointments per day are normally scheduled with prospective customers through this program. CO-1 makes a donation to TP for each potential customer contacted and an additional \$0 for each successful in-home appointment scheduled.
7. TP remits all donations from CO-1, minus general and administrative expenses, to FDNSS.

It should be noted that TP's activities related to its CSP during the tax periods under examination were not materially different from the description of planned activities it provided to the IRS as an addendum to its Form 1023 application.

**LAW**

Internal Revenue Code ("IRC") section 501(a) exempts organizations described in IRC 501(c) from federal income taxes.

An organization exempt under IRC section 501(a) and described in IRC section 501(c)(3), must be both organized and operated exclusively for one or more of the purposes specified in such Code section. If an organization fails to meet either the organizational test or the operational test, it is not exempt (Treasury Regulation ("Treas. Reg.") section 1.501(c)(3)-1(a)(1)).

An organization is organized exclusively for one or more 501(c)(3) exempt purposes only if its organizing documents: limits the purposes of such organizations to one or more exempt purposes; does not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes, and; permanently dedicates the organization's assets to 501(c)(3) purposes upon dissolution unless the operation of state law or court action produces the same result (Treas. Reg. section 1.501(c)(3)-1(b)).

Organizations described in IRC section 501(c)(3) must: absolutely refrain from participating in any political activities; not engage substantially in legislative activities; not permit its earnings to inure to the benefit of any private individual or shareholder; not substantially engage in a trade or business that is not related to its exempt purpose; and must not engage in any activities that are illegal or violate fundamental public policy (Treas. Reg. section 1.501(c)(3)-1).

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 (Treas. Reg. Section 1.501(c)(3)-1(c)).

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 (Treas. Reg. Section 1.501(c)(3)-1(c)(2)).

The words 'private shareholder or individual' in Section 501 refer to persons having a personal and **private** interest in the activities of the organization (Treas. Reg. Section 1.501(a)-1(c)).

An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subsection, the burden of proof is on the organization to show 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 (Treas. Reg. Section 1.501 (c)(3)-1 (d)(1)(ii)).



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The presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes (Better Business Bureau of Washington. D.C. v. United States, 326 U.S. 279, 283, 66 S. Ct. 112, 90 L. Ed. 67, 1945 C.B. 375 (1945)).

When an organization operates for the benefit of private interest, the organization by definition does not operate exclusively for exempt purposes. Prohibited private benefits may include an advantage, profit, fruit, privilege, gain, or interest (American Campaign Academy v. Commissioner, 92 T.C. 1053, 1065-1066 (1989)).

Operating under the control of one person or a small, related group suggests that an organization operates primarily for non-exempt private purposes, rather than exclusively for public purposes (Rev. Rul, 55-656, 1955-1 C.B. 262).

Although control by a small group may not necessarily disqualify [an organization] for exemption, it provides an obvious opportunity for abuse of the claimed tax-exempt status (Church of Ethereal Joy, 83 T.C. 20 at 23 (1984). See also: United States Fifth Circuit Court of Appeals case St. David's Health Care System v. U.S., 349 F.3d 232 (2003)).

In *EST of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), several for-profit organizations exerted significant indirect control over a non-profit entity through contractual arrangements. The Tax Court concluded that the for-profits were able to use the nonprofit as an "instrument" to further their for-profit purposes. Consequently, the Tax Court held that the non-profit was operated for private and commercial purposes and therefore did not qualify as an organization described in section 501(c)(3).

Operating for the benefit of private parties constitutes a substantial non-exempt purpose (*Old Dominion Box Co. v. United States*, 477 F.2d 344 (4<sup>th</sup> Cir. 1973) cert. Denied 413 U.S. 910 (1973)).

A nonprofit organization may form partnerships, or enter into contracts, with private parties to further its charitable purposes on mutually beneficial terms, "so long as the nonprofit organization does not thereby impermissibly serve private interests." The operational standard is not satisfied merely by establishing "whatever charitable benefits [the partnership] may produce," (*Redlands Surgical Services*, 113 T.C. 47, 92-93 (1999), *aff'd* 242 F.3d 904 (9th Cir. 2001)).

Under the Do-Not-Call Implementation Act of 2003 (Public Law No. 108-10), telemarketers are required to stop calling consumers within 31 days of the consumer registering their phone number with the National Do-Not-Call Registry. Telemarketers are required to search the registry every 31 days and delete from their call lists phone numbers that are in the registry. Exceptions to the law includes calls from or on behalf of charities; political organizations; telephone surveyors; companies with which registered consumers have an existing business relationship; or companies to whom the consumer has provided an express agreement in writing to receive their calls.

### **GOVERNMENT'S POSITION**

Based on an examination of TP's 20XX and 20XX Form 990, oral testimony provided by TP's Founder during the course of the examination, and the application of the provisions at law cited above to the facts and circumstances of the case, TP is not operated exclusively for purposes described in section 501(c)(3) of the Code and in accordance with section 1.501(c)(3)-1(a)(1) of the regulations. Accordingly, TP no longer qualifies for exemption as an organization described in IRC 501(c)(3). An analysis of this finding is as follows:

1. TP is governed by a small group of individuals in which two of the three officers are related by marriage. While this fact alone may not necessarily disqualify TP for exemption, it provides an opportunity for abuse



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of the claimed tax-exempt status and suggests that TP operates primarily for non-exempt private purposes, rather than exclusively for public purposes (Church of Ethereal Joy, 83 T.C. 20 at 23 (1984), see also: Rev. Rul. 55-656, 1955-1 C.B. 262).

- Two of TP's three officers are married to two principal officers of CO-1, who are also related. Accordingly, the two principal officers of CO-1 are in a position to exert indirect control over TP's activities through their relationships with their spouses. CO-1 is therefore in a position to use TP as an instrument to further its own for-profit purposes to a substantial and impermissible degree. We find that such indirect control has taken place during the years under examination (see item# 3 below) and CO-1 has effectively been able to use the tax-exempt status of TP to further its own private and commercial interests to a substantial and impermissible degree. Accordingly, TP is operated for private and commercial purposes and therefore does not qualify as an organization described in IRC section 501(c)(3) (EST of Hawaii v. Commissioner, 71 T.C. 1067 (1979)).
- TP appears to be operating in a manner designed to allow its for-profit corporate sponsors to avoid regulation under the Do Not Call Registry laws. Under Public Law No. 108-10, telemarketers and for-profit companies are expressly prohibited from cold calling consumers listed in the National Do-Not-Call-Registry. PL 108-10 does not apply to several types of organizations, including public charities. As a for-profit organization, CO-1 does not qualify for any of the exceptions listed in PL 108-10 other than circumstances where it has a prior business relationship with the registered consumer or has obtained prior written permission to call the registered consumer.

CO-1's affiliation with TP therefore allows it to circumvent the provisions of PL 108-10 and gain access to an extensive prospective consumer base it would not otherwise have. This arrangement gives CO-1 a significant and unfair competitive advantage over similar companies in its industry that must otherwise comply with the provisions of the Do Not Call Registry laws.

TP's CSP therefore allows CO-1 (and any other corporate sponsor under a similar arrangement) to exploit TP's exempt status to further its own private and commercial interests to a substantial degree. Accordingly TP's activities in this capacity serve an impermissible private, rather than public, interest. TP, therefore, does not operate exclusively for exempt purposes and accordingly does not qualify for exemption as an organization described in IRC 501(c)(3) (Treas. Reg. Section 1.501 (c)(3)-1 (d)(1)(ii)).

- The IRS recognizes that TP's remittance of all proceeds from its corporate sponsorship program to a bona-fide 501(c)(3) organization may serve a truly exempt purpose. However, the presence of the substantial, non-exempt activities it engages in relative to its affiliation with CO-1 precludes it from being recognized as exempt as an organization described in IRC 501(c)(3) (Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283, 66 S. Ct. 112, 90 L. Ed. 67, 1945 C.B. 375 (1945)).

### TAXPAYER'S POSITION

TP has taken action to replace the two board members that are related by marriage and are also related to principal officers of CO-1. TP contends that with these changes, no member of its board is related to any member of CO-1. TP also contends it is operated solely as a non-profit as these changes have eliminated any perception that any for-profit entity is in a position to use TP as an instrument to further its own private and commercial purposes.



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### GOVERNMENT'S REBUTTAL

We concur that the changes TP made to its board of directors reduces the perception that members of CO-1 are in a position to further their own private and commercial purposes by exerting indirect control over TP. Notwithstanding the changes to TP's governance structure, the primary issue remains that TP is operating in a manner that appears to be designed to specifically allow CO-1 (and potentially other for-profit organizations) to avoid regulation under the Do Not Call Registry laws. Further, the substantial private and commercial benefits of TP's CSP to CO-1 (with respect to having the ability to circumvent regulation under PL 108-10) are prevalent irrespective of whether CO-1 is in a position to directly or indirectly control TP. Hence, TP no longer qualifies for exemption as an organization described in IRC 501(c)(3) as it continues to operate and engage in activities that serve a substantial, impermissible, and non-exempt purpose that benefits the private and commercial interests of a for-profit corporation.

### CONCLUSION

TP no longer qualifies for exemption because it is not operated exclusively for IRC § 501(c)(3) purposes as required and defined by Treasury regulation § 1.501(c)(3)-1(d)(1)(i). TP is operated to serve the private and commercial interests of a for-profit corporation to a substantial and impermissible degree, and more than an insubstantial part of its activities is not in furtherance of an exempt purpose (Treas. Reg. Section 1.501(c)(3)-1(c).

We are therefore proposing revocation of TP's exempt status under IRC section 501(c)(3). Should the proposed revocation be upheld, TP may be eligible for discretionary relief under IRC section 7805(b). If relief under IRC § 7805(b) is granted, retroactivity of the revocation, and the required annual filing of Form 1120, will be limited to a date not earlier than that on which the original ruling or determination letter was revoked.