



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

Number: **201652029**
Release Date: 12/23/2016

Date: September 26, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.00-00, 501.03-22, 501.33-01

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,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

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**

P.O. Box 2508
Cincinnati, OH 45201

Date: August 1, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = High School
C = College
D = Board member
E = Board member
F = Scholarship recipient
G = Date of formation
H = State
j dollars = Amount
k dollars = Amount

UIL:

501.00-00
501.03-22
501.33-01

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 stated below.

Facts

You were formed by Articles of Incorporation on G in the State of H. Your articles, in part, state that your purpose is to distribute an annual educational scholarship to graduating seniors of B high school who are incoming freshman to C College, assuming certain underlying merit-based criteria are met.

You are seeking exemption as a private foundation. Your governing body members are D and E, husband and wife. D and E are also your selection committee. Relatives of the selection committee, officers, directors and substantial contributors are eligible for your scholarship. D and E anticipate spending approximately one hour each per year on operating the scholarship program. Their duties include writing checks to C College and interacting with the high school counselor's office.

To qualify for a scholarship, an applicant must be a graduating senior from B high school who has been selected as a National Merit Finalist and are newly admitted to C College. C College is approximately 3000 miles from B high school.

The scholarship may be awarded for four years of undergraduate studies or completion of baccalaureate degree requirements, whichever occurs first. Recipients must enter C College no later than the fall following graduation from B high school. Scholars must remain in good academic and disciplinary standing at C College. Transfer students are not eligible.

You will pay the funds to C College over four years with the award amount to be established in the first of the four years as to each recipient. You will fund a minimum of j dollars per year, per recipient. The amount of the recipient's first year award shall be renewed in subsequent years if the fund has sufficient value, except that the award will be reduced by j dollars per each additional recipient. Despite indicating a minimum award of j dollars and indicating that "ideally" you would fund the scholarship for j dollars, your expenses for last year show a distribution of k dollars, the entirety of your income. Further, no projections were given for the current year and beyond even though this is a four year award.

B high school has a graduating class which fluctuates yearly but is usually approximately 500 students. Two years ago there were four individuals graduating from B high school that were National Merit Finalists. You do not know if any attended C College. Last year there were two individuals graduating from B high school who were National Merit Finalists. One was F, the son of founders D and E. The other individual was not related to the founders. F went on to attend C College and was awarded your scholarship. The other individual did not attend C College and, therefore, did not meet the qualifications for your scholarship.

This year there was one individual graduating from B high school who was a National Merit Finalist. It is unknown if he will attend C College. If he attends C College, he will be awarded a scholarship.

Based on historical data, you said that between 1- 4 students annually will be National Merit Finalists graduating from B high school, of which 0-1 will apply to C College. You said that C College historically admits about 10% of their applicants. Therefore, there will be between 0-1 eligible applicants annually.

A student must apply for the scholarship at least two business days before B high school's award night, which is typically a few weeks prior to graduation. To apply, the applicant must email you with proof of graduating senior status from B high school, proof of National Merit Finalist status, and proof of enrollment at C College. The proof of graduating senior status and National Merit Finalist status can alternatively verified through B high school's counseling office. You indicated the scholarship is publicized through the high school counselor's office and there is no actual application form.

You are funded by your founders, D and E. You will only exist as long as the donors, in their discretion, fund the award; it is not a perpetual fund. As was indicated earlier all your funds were paid out last year for the scholarship awarded to F.

Law

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

Treasury Regulation Section 1.501(c)(3)-1(a)(1) 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.

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

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

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not operated exclusively for one or more exempt purpose unless it serves a public rather than a private interest.

Rev. Rul. 67-5, 1967-1 C.B. 123, describes a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from federal income tax under Section 501(c)(3).

In Charleston Chair Company v. United States, 203 F. Supp. 126 (E.D.S.C. 1962), exemption was lost by a foundation that spent a large part of its funds on a scholarship grant to the son of a foundation trustee, which resulted in inurement.

In Wendy Parker Rehabilitation Foundation, Inc. v. Commissioner, T.C. Memo 1986-348, 52 T.C.M. (CCH) 51 (1986), the organization was created by the Parker family to aid an open-ended class of "victims of coma." However, the organization stated that it anticipated spending 30 percent of its income for the benefit of Wendy Parker, significant contributions were made to the organization by the Parker family, and the Parker family controlled the organization. Wendy Parker's selection as a substantial recipient of funds substantially benefited the Parker family by assisting with the economic burden of caring for her. The benefit did not flow primarily to the general public as required under Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii). Therefore, the Foundation was not exempt from federal income tax under Section 501(c)(3).

Application of law

You are not as described in Section 501(c)(3) of the Code and Treas. Reg. Section 501(c)(3)-1(a)(1) because you do not satisfy the operational requirements. More than an insubstantial part of your activities do not further exempt purposes.

You do not meet the provisions of Treas. Reg. Section 1.501(c)(3)-1(c)(1) because more than an insubstantial part of your activities are not in furtherance of an exempt purpose. You are operating to pay the tuition of the child of your founders. This arrangement affords substantial tax benefits to your founders who are obligated as parents to pay these expenses and serves private rather than public purposes.

You are not described in Treas. Reg. Section 1.501(c)(3)-1(c)(2) because your net earnings inure to the benefit of your founders. Last year 100% of your income was awarded as a scholarship to the family member of an insider. This is illustrated by the fact you are funding a scholarship only benefitting the child of your founders. Your founders are also your donors and will realize significant tax benefits to pay their child's tuition.

You are not described in Treas. Reg. Section 1.501(c)(3)-1(d)(ii) because you are serving the private interests of your founders. Your selection criteria are so narrow that only one applicant qualified and was awarded the

scholarship since your formation, and over the study of a four year period only one would qualify. It is apparent from the criteria you have been established to award the scholarship to F.

Like the organization described in Rev. Rul. 67-5, you are controlled by your founders and operated for their benefit. You are operated for a substantial non-exempt purpose, precluding you from exemption. D and E fund you, set scholarship criteria, control the total amount of funds awarded any oversight of the award. The criteria created to award the scholarship are so narrow that only one individual, the son of the founders, has qualified for the scholarship. Even if a graduating senior of B high school is a National Merit Finalist and wishes to attend C College, which is approximately 3000 miles away, there is only a 10% admittance rate by C College. The pool of eligible applicants annually is virtually zero. Your founders are also your selection committee and they selected their own son as the recipient of the award. This creates private inurement, precluding you from exemption.

You are similar to Charleston Chair Company because all of your funds since your inception have been expended for a scholarship granted to the son of your founders. This results in inurement and precludes you from exemption under Section 501(c)(3) of the Code.

Like the organization described in Wendy L. Parker, you are not exempt because your selection of a family member as a substantial beneficiary of your disbursements violates the prohibition against using the funds of a tax-exempt organization to inure to the benefit of private individuals.

Conclusion

Based on the facts presented, you are operating for the substantial non-exempt purpose of operating a scholarship program with selection criteria which are too narrow to benefit the general public. Your scholarship program was set up to benefit the founders, as their son was the only recipient since your inception. Therefore, your earnings inure to the benefit of your founders and you do not qualify for exemption as an organization described in 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,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892