



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

Number: **201729022**
Release Date: 7/21/2017

Date: April 27, 2017

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.03-00, 501.35-00

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.

We sent a copy of this letter to your representatives as indicated in your power of attorney.

Sincerely,

Stephen A. Martin
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*

cc:



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date: March 10, 2017

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

W =

X =

Y =

Z =

UIL:

501.03-00

501.35-00

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 your activities show you are operated for an exempt purpose under Treasury Regulation § 1.501(c)(3)-1(d)(1)? No, for the reasons stated below.

Do you meet the operational test under Treas. Reg. § 1.501(c)(3)-1(c)(1)? No, for the reasons stated below.

Facts

You were incorporated in State X on Date Y.

Your articles state you will provide colleges and universities with the ability to engage in science and engineering studies and research in the submarine environment, including the ability to acquire by purchase, lease, gift, loan or by other means, vessels, vehicles and ancillary equipment pertaining to marine science and engineering; provide advice and consulting services to such colleges and universities; and engage in any other lawful related purposes.

An attachment to your application states you are a not-for-profit corporation based in W specializing in Z services to the international marine science community. Your mission is to provide a state-of-the-art ability to conduct science and engineering in the submarine environment at an affordable cost. You represent the world-leading Z and its highly skilled multidisciplinary support team who have over two decades of experience in a wide variety of scientific missions around the world. Both user fees and support from scientific research funding institutions enable the development and maintenance of the Z facility. Services offered will include high-resolution digital still photography, HD video imagery, instrument/composite instrument frame emplacement/recovery, cable connections, precise cable laying up to 25 km, short sediment cores, biological sampling, water sampling, water column measurements, seafloor system/package design, and mission planning.

In response to our request for additional information, you state you conduct the following activities:

- a. You provide free subsea engineering details to arrange future contracts or services. These engineering details, basically describe the services you can offer and the price you can offer your prospective clients. For example, initial discussions of project scope, recommendations on subsea engineering, and suggestions on the most cost-effective method to execute the project will be provided free of charge. Also, initial project or experiment designs, execution considerations, and recommendations on best practices will be provided free of charge.
- b. You charge fees for specific subsea services. You bill clients, such as subcontractors, on a time-and-material basis with a built-in, variable fee to help cover the cost of overhead expenses. At times, you may elect to charge a flat fee to help cover your overhead costs. For example, if you hire a vessel and crew for use by a client/customer, you will charge for the cost of the vessel/crew plus a percentage of the overhead costs, or the cost of the vessel/crew plus a flat amount which is intended to cover your administrative and overhead costs.
- c. You state you do not have a set fee schedule as fees are quoted on a case-by-case basis and that, in general, fees are determined by the cost of the services required plus a built-in fee to cover the project's share of administration and overhead costs.
- d. You state your services differs from other service providers in that you focus on providing cost-effective, efficient, and comprehensive ways to execute operations while maximizing outcomes for grant-funded and low-resource academic/research groups. Additionally, you state there are few competitors in the industry that can provide the scope and breadth of services you intend to provide. You indicate a commercial entity may charge a substantial fee or percentage on top of a supplier's cost (which incorporates a substantial profit margin), you will charge no fee for the initial stages of the project, and only charge a smaller percentage on the actual project where it will cover its basic operating/overhead costs.
- e. You indicate you do not provide services yourself but rather hire independent third-party contractors to conduct services as necessary. You further state you may elect to perform more work "in-house" in the future but this is dependent on you developing the economic means to support regular staffing levels.
- f. Selection of your clients is done on a project-by-project basis.

- g. You currently have one contract with a university. This was assigned to you after you completed your start-up operations.

You maintain there are no planned donations at this time. Initial funding has been obtained via loan and additional funding in the future will be from the revenue earned on services provided.

You enable academic or research institutions to execute their specific research project while your organization facilitates project logistics, finds potential suppliers, and finds the lowest cost and most reliable methods to execute the project within the academic grants and research budget.

Generally, fees are determined by the cost of the services required plus a built-in fee to cover the project's share of administrative and overhead costs. Generally, this built-in fee is between and % of the total costs of services.

Law

Section 501(c)(3) of the Code provides for the exemption from federal income tax organizations that are organized and operated exclusively for exempt purposes.

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

Treas. Reg. § 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 exempt purposes specified in section 501(c)(3) of the Code. It is not operated for exempt purposes if more than an insubstantial part of its activities do not further an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1) states an organization may be exempt under section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational or prevention of cruelty to children or animals.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; and promotion of social welfare.

Rev. Rul. 71-529, 1971-2 C.B. 234, held that an organization controlled by a group of exempt organizations and providing investment and management services for a charge substantially less than cost to that group qualifies for exemption under section 501(c)(3) of the Code.

In Rev. Rul. 72-369, 1972-2 C.B. 245, an organization was formed to provide managerial and consulting services for section 501(c)(3) organizations 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. The Service held that providing managerial and consulting services on a

regular basis for a fee is a trade or business ordinarily carried on for profit and accordingly, was not exempt under section 501(c)(3) of the Code. Further the service stated that furnishing the services at cost lacks the donative element necessary to establish the activity as charitable.

In *Better Business Bureau of Washington, DC v. United States*, 326 U.S. 279 (1945), the Supreme Court stated that 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.

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services did not satisfy the operational test under section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the typical section 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C., 2003), the court concluded that the Foundation was operated for a substantial non-exempt purpose. It based this conclusion on the manner in which the organization managed a conference center. "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, *inter alia*, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations." Thus, the court looked at the business methods of the organization as a method of inferring whether its purpose was to serve the public or whether there was a substantial non-exempt purpose of operating a business for profit.

Application of law

You do not meet the operational test under Treas. Reg. § 1.501(c)(3)-1(c)(1). As stated in Treas. Reg. § 1.501(c)(3)-1(a)(1), an organization must be both organized and operated exclusively for one or more exempt purposes. You do not engage primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3) of the Code and Treas. Reg. § 1.501(c)(3)-1(d)(1).

Your activities do not further a charitable purpose as that term is defined in Treas. Reg. § 1.501(c)(3)-1(d)(2) such as relief of the poor and distressed, advancement of education or science or the lessening of the burdens of government.

You do not meet the operational test under Treas. Reg. § 1.501(c)(3)-1(c)(1) because you do not engage in activities that accomplish one or more exempt purposes specified in section 501(c)(3) of the Code. Because you do not meet the operational test, you cannot be exempt under section 501(c)(3). (See Treas. Reg. § 1.501(c)(3)-1(a)(1)). You hire independent third-party contractors to provide Z services including engineering and scientific studies in an underwater environment. Although you state you may elect to perform more work "in-

house” in the future, your primary activities still do not further an exempt purpose. Per Treas. Reg. § 1.501(c)(3)-1(c)(1), an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

Very little of your activities accomplish a charitable purpose under Treas. Reg. § 1.501(c)(3)-1(d)(1). As stated above, the term charitable is to be used in its generally accepted legal sense (Treas. Reg. § 1.501(c)(3)-1(d)(2)) and the presence of a single non-exempt purpose, if substantial in nature, will destroy an exemption (*Better Business Bureau v. U.S.*).

You are dissimilar to the organization in Rev. Rul. 71-529 in that the organization in that ruling charged fees that were substantially below cost. In contrast, you state your fees are determined by the cost of the services required plus a built-in fee to cover the project’s share of administration and overhead costs. You state this built-in fee is between % and % of the total cost of services, depending on the scale of the project, the history with the client/customer, and whether there is a history (or future probability) of longer-term future work.

You are similar to the organization described in Rev. Rul. 72-369 which furnished managerial and consulting services at cost and was held not to be exempt under section 501(c)(3). The organization in the ruling earned revenues from the services rendered; expenses were for operating expenses. As stated in the ruling, the services furnished “... at cost lack(s) the donative element necessary to establish (the) activity as charitable.”

Analogous to the organization in *B.S.W. Group v. Commissioner*, your purposes are not charitable, educational or scientific. You have not solicited nor received voluntary contributions from the public. A substantial amount of your of income is from fees from services.

You are similar to *Airlie Foundation* in that you operate in a commercial manner. In *Airlie Foundation*, the court listed several factors indicative of a commercial purpose:

- 1) Competition with for profit commercial entities;
- 2) Extent and degree of below cost services provided;
- 3) Reasonableness of financial reserves;
- 4) Use commercial promotional methods (i.e., advertising);
- 5) Extent to which the organization receives charitable contributions.

You meet a number of the above criteria including the extent and degree of below cost services provided and the extent to which the organization receives charitable contributions.

Although you state you provide free subsea engineering details to arrange future contracts or services, such details are incidental and do not accomplish an exempt purpose.

Conclusion

In summation: You have failed to establish that you are operated exclusively for charitable or educational purposes. You are operated in a manner not significantly distinguishable from a commercial enterprise. By operating in such a manner, you are furthering a substantial nonexempt purpose.

Your activities show you are not operated for an exempt purpose as required under Treas. Reg. § 1.501(c)(3)-1(d)(1) and the administrative record shows you do not meet the operational test under Treas. Reg. § 1.501(c)(1)-1(c)(1) because your primary activities do not accomplish one or more exempt purposes. More than an insubstantial part of your activities are not in furtherance of an exempt purpose.

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.

We sent a copy of this letter to your representatives as indicated in your power of attorney.

This letter supersedes our letter dated January 12, 2017.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892

cc: