



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

Release Number: **201818018**
Release Date: 5/4/2018

Date:
February 6, 2018
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.03-00, 501.03-24, 501.35-00, 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,

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*



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date:

November 22, 2017

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date of formation
C = State of incorporation
D = Technology transfer forum
G = CEO and inventor of technology
H = Coinventor of technology
J = Name of technology
K = Country pioneering applications of technology
y = Estimated months from prototype to market

UIL:

501.03-00

501.03-24

501.35-00

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 stated below.

Facts

You incorporated on B in the state of C. Your Articles of Incorporation state the purpose for which you were formed is for fuel and coal energy research.

Your purposes, as stated in your Bylaws, are:

To support commercialization of advanced residential, commercial, and industrial energy products by supporting marketplace demonstrations; and, including but not limited to, providing information, training and related market entry services to the energy industry, equipment suppliers and the customers, in order to create a greater role for natural gas energy.

Your Bylaws provide for D. D shall be the primary means for your membership to:

(1) learn about new energy and process equipment, (2) identify new markets for gas-fueled, hybrid, and thermally-activated equipment, and (3) develop strategies to provide customers with energy-efficient solutions. D shall be responsible for planning, overseeing, and implementing equipment and market entry programs including establishment and management of market-focused consortia, fund raising for equipment demonstration and market entry projects, development of partnerships to bring customers innovative solutions, and other program related activities.

Your Board of Directors shall consist of appointees from all 'corporate members' who are qualified, and in good standing in the Corporation. Each corporate member shall have the right to appoint one Director from the member company with responsibility for sales and marketing, customer relationship management, or product development and commercialization, or an appropriate designee. Directors shall serve at the pleasure of the member appointing them until their successors are appointed or until their earlier resignation or removal.

The Board of Directors shall include the Chair and Vice Chair of D as non-voting liaisons between the Board and D.

Your Form 1023 application lists four individuals who comprise your governing body. The person who signed your application, G, was not listed as part of the governing body. You later included G as your CEO, describing him as "founder and the first patent pending inventor, who will retire from his profit company," and stated he will not request a salary. H is your research director and co-inventor of the energy fuel saving patent pending. You stated that the positions of CEO and research director are to be held exclusively by these individuals. The voting rights and privileges of the members are limited because the President and CEO is the final arbitrator in all issues.

Along with your application, you provided several pages of information entitled "Research Product". The information included descriptions of a fuel stack and fuel processor, research and development goals, and commercialization of scientific research. It discussed different ways to engage in the commercialization of research and development as well as marketing objectives and strategies, and a sales plan to grow your number of clients and income per year.

In response to our request for additional information about your activities and how they further your purposes, you stated that your company has been researching energy systems since you began working with mining machine companies to improve the battery life of mining machines and personal transports. Your CEO has a patent pending on J. Your activities build on this technology. You will develop prototypes of highly efficient engines utilizing J based internal combustion engine technology for automobiles of all sizes, trucks modified for very high miles per gallon, and power generators for home use.

While you are in the process of obtaining the patent, you continue to work with your partners in K as they develop a prototype high mileage vehicle. You are also working with partners in the mining industry and a small synthetic oil company in K. Your long-term goals include licensing agreements for new prototypes, new patents, and new experimental energy systems.

Internet research indicates that your CEO will own the rights to J; your application indicates that you own no intellectual property, and it is nowhere suggested that the patent will be transferred to you. Your CEO will retain ownership while you will promote and market the products resulting from his patent.

You will not be mass producing any products yourself. You will license the specialized prototypes you develop to manufacturers for fees. You will market the prototypes to potential partners, demonstrating them in their facilities, or to an agent of theirs who has come to you. Your marketing specialist would arrange the meeting while your researchers and CEO would conceptualize prototypes and work with their teams to create actual products for mass production. Currently, the only prototype you have developed is in K, which you indicate will go on the market within the next y months.

Any results of your research will be patented and will be marketed to manufacturers through a licensing agreement to mass produce the prototypes based your patents, as described above. You currently have no plans to make the results of your research available to the general public, although your patent pending explains the concept behind your research. Control and ownership of the results of your research depends on who works with you.

Law

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

Treasury Regulation Section 1.501(c)(3)-1(a)(1) provides that, 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) states: An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one of 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.

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, 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.

Treas. Reg. Section 1.501(c)(3)-1(d)(5)(ii) further provides that scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, as, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc.

Treas. Reg. Section 1.501(c)(3)-1(d)(5)(iii) provides in pertinent part that research will be regarded in the public interest if the results of such research (including any patents, copyrights, processes or formulae resulting from such research) are made available to the public on a non-discriminatory basis.

Revenue Ruling 65-1, 1965-1 C.B. 226, describes an organization which undertakes to determine the need for the development of agricultural machinery which can plant, cultivate or harvest crops of the type which are normally planted, cultivated or harvested manually by agricultural laborers. Upon identifying a suitable project, the organization consults with various public institutions, agricultural colleges, and engineers to ascertain if any similar projects are in process. If not, a grant is made by the organization to an appropriate public agency or

firm to develop the necessary machinery. The machinery is then tested under actual field conditions during the agricultural season. If a machine proves successful, a patent is sought in the organization's name and a manufacturer is licensed to build and sell the machine or device on an exclusive or non-exclusive basis. The Revenue Ruling concludes that the development or designing of machinery under the circumstances present in the instant case is incident to a commercial operation and does not constitute "scientific research" within the meaning of section 1.501 (c) (3)-1 (d) (5) of the regulations; that the organization's primary activity of aiding in the development of the particular farm machinery by the disbursement of grants likewise does not constitute scientific research within the meaning of the above regulations; and finally that the development of a new machine, the patents of which may be licensed on a restrictive basis to selected manufacturers, is directed toward benefiting those particular manufacturers and any benefit to the public must be considered indirect. Under these circumstances the organization cannot qualify for exemption from federal income tax under Section 501(c)(3) of the Code.

In Better Business Bureau of Washington, D.C. Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court determined that, while some activities of the organization were educational, a substantial purpose of the organization was to promote business, and thus the organization was not operating exclusively for educational purposes. It held 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.

The Court of Appeals in Parker v. Commissioner, 365 F.2d 792. 799 (8th Cir. 1963) affirmed the findings of Tax Court that foundation was pursuing a substantially nonexempt purpose in the publication and commercial exploitation of the writings of the founder, director and prime functionary of foundation. The founder had control of the foundation's day to day activities, complete control of its finances and the founders personal funds were to a degree commingled with the funds of the foundation, and that the evidence clearly supported the finding that the foundation was pursuing a substantial non-exempt purpose.

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 IIT Research Institute v. United States, 9 Cl. Ct. 13 (Cl. Ct. 1985), a U.S. Claims Court reviewed the activities of an organization exempt under Section 501(c)(3) of the Code. The organization contracted with a variety of industry members to perform research for them. The court defined the term "scientific" to include "the process by which knowledge is systematized or classified through the use of observation, experimentation, or reasoning." The court found that the organization was not involved in the commercialization of the products or process developed as a result of its research. IIT Research Institute only developed a project to the point where the research principles were established. At this point, the sponsors would make the principles available to different customers, usually in the form of newly developed products or equipment. The court found significance in the fact that IIT Research Institute did not engage in any consumer or market research or ordinary testing of the type which is carried on incident to commercial operations. The court therefore found

that the organization's activities were research and not ordinary testing carried on as an incident to commercial or industrial operations.

Application of law

You are not described in Section 501(c)(3) of the Code because you are not operated exclusively for 501(c)(3) purposes and because you have failed to establish your earnings do not inure to the benefit of insiders.

Specifically, your operations are consistent with a commercial business and your founder benefits from your operations.

You are not as described in Treas. Reg. Section 1.501(c)(3)-1(a)(1) because you are not operated exclusively for one or more of the purposes specified in such section. The production, marketing and/or sale of products are not among the purposes described in the regulations.

You are not described in Treas. Reg. Section 1.501(c)(3)-1(c)(1) because more than an insubstantial part of your activities is not in furtherance of an exempt purpose. Your activities are primarily commercially motivated.

You are not organized or operated exclusively for one or more exempt purposes, because you do not serve a public rather than a private interest, as required by Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii). You have not established that you are not organized or operated for the benefit of private interests. Specifically, it appears that your founder G, owning the J patent and controlling your finances and day to day activities, is in a position to benefit more than incidentally from your operations.

You are not engaged in scientific research within the meaning of Treas. Reg. Section 1.501(c)(3)-1(d)(5)(ii) because any research you do is incidental to a commercial activity, the development, testing and marketing of commercial applications of J, your founder and CEO's patent-pending invention. You are unlike IIT Research Institute v. United States and like the organization described in Rev. Rul. 65-1, in that your activities go well beyond developing a project only to the point where the research principles are established, then leaving it to the sponsors to develop the products or equipment for the market, but you yourself develop the particular applications to the point of having tested prototypes ready for licensing to manufacturers, and marketing them.

Likewise, your research cannot be regarded as carried on in the public interest as required by Treas. Reg. Section 1.501(c)(3)-1(d)(5)(iii) since the results of your research (including any patents, copyrights, processes or formulae resulting from such research) are not made available to the public on a non-discriminatory basis, as through a treatise or trade publication. In any case you have not substantiated your ownership of any J based patent and therefore it is unclear if you even have the authority to make the patent and corresponding research results public. Furthermore, you state you will license the prototypes and/or patent to interested parties but did not provide any information on the terms of the sale and therefore were unable to substantiate the sale would be in the interest of the public. Furthermore, although scientific research may be carried on in the public interest even though a commercial sponsor retains the rights to any intellectual property produced by the research, you do not conduct sponsored research, only research furthering your own commercial projects, which benefits only the patent holder of J, G, and your customers, the manufacturing businesses that license the applications of the J technology that you have developed for them.

Like the organization in B.S.W. Group, Inc., you do not satisfy the operational test under Section 501(c)(3) of the Code because your activities constitute the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. You are similar to Better Business Bureau of Washington, D.C. Inc. because you too have a substantial non-exempt purpose. Even though the J technology may benefit end users,

the facts overwhelmingly show that, as in Parker v. Commissioner, you operate for a substantial non-exempt commercial purpose, the commercial exploitation of the intellectual property of your founder,

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 exempt purposes. The facts show you are operated in a commercial manner as you were formed to conduct research, develop prototype devices, market the devices, and license out the research products for commercial purposes. In addition, the results of your research are not make available to the general public. Finally, the facts show your operations inure to the benefit of insiders, most notably your founder. Accordingly, we conclude you do not qualify for exemption under Section 501(c)(3).

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,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892