



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

Release Number: **201844013**
Release Number: 11/2/2018

Date:
August 8, 2018
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.03-30, 501.33-00, 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.

We sent a copy of this letter to your representative 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:
June 5, 2018
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

UIL:

501.03-30
501.33-00
501.36-00

B = Conversion date
C = State
D = Incorporation date
E = C court with specific jurisdiction
F = Related non-profit corporation
G = Trade publication
I = Chief city of C
n dollars = Amount of administration fee
p dollars = Amount of hourly fee
q dollars = Income from dispute resolution services, year 1
r dollars = Income from dispute resolution services, year 2

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 incorporated as a stock corporation on D in C and filed Forms 1120 until converted from a for-profit to a non-profit corporation on B. The Articles of Non-profit Conversion state that your corporate purpose is "to serve as a supporting organization for F," a C non-profit corporation exempt under Section 501(c)(6) of the Internal Revenue Code; "to provide various dispute resolution services to the business, legal and real estate communities as well as the general public; to engage in any other lawful act or activity...which may be lawfully carried on by a corporation organized under...C laws; and to qualify as a non-profit corporation under Section 501(c)(3) of the Internal Revenue Code. Said organization is organized exclusively for charitable purposes, including, for such purposes, the making of distributions to organizations described under Section 501(c)(3) of

the Internal Revenue Code or shall be distributed to the federal government, or to a state or local government, for public purposes. Any such assets not disposed of shall be disposed of by a court of competent jurisdiction in the county in which the principal office of the organization is then located, exclusively for such purposes or to such organizations, as said court shall determine, which are organized and operated exclusively for such purposes.”

F advances the practice of real estate law

Your Articles of Incorporation and Bylaws indicate that stock was issued. The Articles of Non-Profit Conversion make no reference to stockholders. The disposition of the outstanding stock is unknown.

F elects the majority of your governing board. Your sole activity is to offer alternative dispute resolution services in business and real estate disputes to clients of members of F and other lawyers throughout C, providing them with an efficient and cost-effective alternative to costly and time-consuming litigation. The program includes neutrals on the primary panel and an additional on a secondary panel. The neutrals -- retired judges and distinguished senior practitioners -- offer mediation, arbitration and case evaluation services. Your program is one of five approved by the E and many referrals come directly from the Court.

While most of the program’s mediation cases are held at F’s headquarters in I, many are hosted at law offices and courthouses in other C communities to accommodate the parties and counsel. You hold from five to ten mediations a month. The program charges a pre-session administration fee of n dollars per party plus an hourly rate of p dollars per hour, per party. Discounts and special fee arrangement are offered for disputes of limited monetary consequences and pro bono options are also available in appropriate circumstances.

F promotes you through all-member email blast, member messaging, F e-NEWS, advertising in G magazine, its website and blog, and a newspaper, F News, published five times yearly as an insert to G. G is read by virtually every lawyer in the State of C. F also has an active presence on social medial platforms, including LinkedIn, Facebook and Twitter. F also promotes the program through on-site presentations to the litigation practice areas of larger law firms, real estate broker groups, title insurance underwriters, and at F’s semiyearly all-day conferences.

Your gross receipts derive exclusively from your dispute resolution services, at q dollars and r dollars in and respectively. Your primary expenses are for compensation and professional fees. Your operations are profitable. You distribute all your net profits to F to help cover its expenses. These distributions account for about nine percent of F’s revenue.

Law

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

Section 501(c)(6) provides for the exemption of business leagues, chambers of commerce, real estate boards, and boards of trade which are not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in § 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.

Reg. Sec. 1.501(c)(3)-1(b)(1)(i) provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes and do not expressly empower it to engage, otherwise than as an insubstantial part, in activities which in themselves are not in furtherance of one or more exempt purposes.

Reg. Sec. 1.501(c)(3)-1(b)(1)(iv) provides that in no case shall an organization be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which it is created are broader than the purposes specified in § 501(c)(3).

Reg. Sec. 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in Section 501(c)(3) of the Code. An organization will not be operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Reg. Sec. 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of IRC 501(c)(3) even though it operates a trade or business as a substantial part of its activities, unless its primary purpose is carrying on of a trade or business that does not further charitable purposes. An organization operated for the primary purpose of carrying on an unrelated trade or business is not exempt under Section 501(c)(3).

Rev. Rul. 69-161, 1969-1 C.B. 149, states that providing legal services to persons financially incapable of paying for them is a form of relief of the poor and distressed. Thus, a non-profit legal aid society providing free legal services to indigent persons may be exempt under IRC 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245 states that an organization that furnishes managerial and consulting services on a cost basis to unrelated non-profit organizations does not qualify for exemption under Section 501(c)(3). The organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the "operational test" the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of Section 501 (c) (3) of the Code and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of Section 501 (c) (3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Rev. Rul. 78-428, 1978-2 C.B. 177, amplifying Rev. Rul. 69-161, provides that an organization providing legal services to indigents for a fee may qualify for exemption under IRC 501(c)(3) if the fees are based on the indigent clients' ability to pay rather than the type of services rendered.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the taxpayer was a corporation formed to provide consulting services in the area of rural-related policy and program development to tax-exempt and not-for-profit clients. The court found that the taxpayer did not meet the "operational" test under Section 501(c)(3) because it was primarily engaged in an activity which was characteristic of a trade or business, finding that several of the taxpayer's planned service areas, such as alternative housing, financing, solid waste management, and environmental impact programs, were of the sort ordinarily carried on for profit by commercial businesses such as banks, personnel agencies, and trash disposal firms. In its ruling the court stated that "factors such as the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits are relevant evidence of a forbidden predominant purpose."

Application of law

Based on the information you provided in your application and supporting documentation, we conclude that you are neither organized nor operated exclusively for exempt purposes under § 501(c)(3) of the Code as required by Reg. Sec. 1.501(c)(3)-1(a)(1).

In meeting the organizational test, the organization's purposes, as stated in its articles, may be as broad as, or more specific than, the purposes stated in Section 501(c)(3). An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in Section 501(c)(3). (Reg. Sec. 1.501(c)(3)-1(b)(1)(i) and (iv)). Thus, an organization that is empowered by its articles to engage in non-exempt activity does not meet the organizational test regardless of the fact that its articles may state that such organization is created "for charitable purposes within the meaning of Section 501(c)(3) of the Code."

You do not meet the organizational test because the specific purposes of your organization, as stated in your Article of Conversion, are overly broad and expressly empower you to carry on activities that are not in furtherance of one or more exempt purposes. Your purposes include (1) supporting F, an entity described in Section 501(c)(6) of the Code, whose purpose it is to serve business interests of its members; and (2) providing services to the business, legal and real estate communities as well as the general public. These purposes -- providing service to parties, which are not part of a charitable class, and supporting an organization described in Section 501(c)(6) -- are broader than the purposes specified in Section 501(c)(3). Your purpose provision also expressly empower you "to engage in any other lawful act or activity...which may be lawfully carried on by a corporation organized under...C laws," including activities that are in furtherance of no exempt purpose.

You do not satisfy the primary activity requirement of the operational test in Reg. Sec. 1.501(c)(3)-1(c)(1) because you do not engage primarily in activities that accomplish exempt purposes specified in Section 501(c)(3). Your primary activities are to provide dispute resolution services in a manner indistinguishable from a commercial enterprise, and to turn over your profits to F, an organization described in Section 501(c)(6), without restricting use of the funds to programs in furtherance of charitable or education purposes.

Like the organizations described in Rev. Rul. 69-161 and Rev. Rul. 78-428, your primary activity is to provide legal services to the public. However, your purpose in so doing is to carry on a trade or business that does not further charitable purposes. You are therefore distinguishable from the legal service organizations described in Rev. Rul. 69-161 and Rev. Rul. 78-428 in that they serve indigent clients without charge or at charges based on

their ability to pay. Rather your charges are set at a level that insures a net profit to you. Your alternative dispute resolution program is indistinguishable from one conducted for profit on a commercial basis. It is an unrelated trade or business, as defined in Section 513. In accordance with Reg. Sec. 1.501(c)(3)-1(e)(1) you are not exempt under Section 501(c)(3) because you are operated for the primary purpose of carrying on an unrelated trade or business.

You are like the organizations described in Rev. Rul. 72-369 and BSW Group, Inc., which both provide services on a regular basis for a fee which are a trade or business ordinarily carried on for profit. Neither organization qualifies for exemption under Section 501(c)(3), even though the organization in the Revenue Ruling is operated on a non-profit basis. You, however, provide dispute resolution services on a regular basis for fees in the same manner as commercial businesses and with the purpose of making a profit.

Conclusion

Based upon the information provided, you do not qualify for exemption under Section 501(c)(3) since you do not meet the organizational test for exemption under Section 501(c)(3) of the Code; are operated for the substantial non-exempt purpose of providing legal services to the general public in a manner indistinguishable from a commercial legal services entity; and turn over your net profits to F, an association described in Section 501(c)(6), to support its general operations, rather than for any exempt purpose 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.

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

Sincerely,

Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892

cc: