

Internal Revenue Service

Department of the Treasury

District
Director

Delaware-Maryland District

31 Hopkins Plaza, Baltimore, MD 21201

[REDACTED]

Person to Contact:

[REDACTED]

Contact Telephone Number:

[REDACTED]

In Reply Refer to:

[REDACTED]

Date: MAR 27 2000

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

You incorporated in [REDACTED] for charitable, religious, educational and scientific purposes, including for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue code, or corresponding section of any future federal tax code.

In describing your activities, you stated that [REDACTED] % of your time is devoted to retreats, [REDACTED] % to arts/crafts/cooking classes; [REDACTED] % of your time to children arts/crafts, games, sports and stories; [REDACTED] % of your time to bible teachings and [REDACTED] % of your time to a coffee house. Attachments to your Application 1023 and in your mission statement disclosed that you have a chapel, children's ministry, coffeehouse, and gymnasium.

An attachment to Form 1023, Part II, and page 2 items 2 & 3, stated: "[REDACTED] will seek financial help for the ministry in two ways. One will be to find individual donors willing to support the ministry with regular monthly gifts. Secondly, to seek out churches with the heart for missions and ask for their financial support as well. Individual donor will be asked at their church gatherings to help support the ministry and mission of [REDACTED] by committing to a regular monthly gift. We will inform them of what we are doing to further the kingdom of God through monthly newsletters mailed directly to them. [REDACTED], seeking financial help from these organizations will visit pastors and churches. Video of what is currently happening with the work of the ministry will be shown to encourage the churches to get involved. After showing the video, we will encourage the congregation to support our ministry."

[REDACTED]

[REDACTED]

A newsletter states: "Many know we were able to purchase a property [REDACTED]. We would like to thank every one of you for your prayers and support. On [REDACTED] we made our second payment of three. We are preparing to construct a [REDACTED] ([REDACTED]) and we are also building a house for us on the property."

[REDACTED] states: "[REDACTED] The [REDACTED] provide a source of income for some of the poor in [REDACTED] and has helped many people with [REDACTED]. We have over [REDACTED] many are located in a home to [REDACTED]."

[REDACTED] states: "This is our little school and we are privileged to teach the children of Pastors and missionaries. There are now [REDACTED] students and after [REDACTED] years of home schooling, my daughters are now in school. This school is to help the parents by educating the children not only academically but also spiritually. If there is anyone that would be interested in teaching, we are in need of teachers that know the Lord and want to serve the Lord. All of this could not have been done without your prayers, your love, your financial support, and your spiritual support."

Income is derived from donations and expended for the purchase of land, rent, loans and capital to the president.

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Federal income tax for organizations which are organized and operated exclusively for charitable, religious, and educational purposes, 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 qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Regulations 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 such purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Thus, in construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States stated, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

[REDACTED]

The inurement proscription contained in Regulations 1.501(c)(3)-1(c)(1) states 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. Inurement is likely to arise where the financial benefit represents a transfer of the organization's financial resources to an individual solely by virtue of the individual's relationship with the organization, and without regard to the accomplishment of exempt purposes.

Inurement of income is strictly forbidden under section 501(c)(3) without regard to the amount involved. This proscription applies to persons who because of their particular relationship with an organization have an opportunity to control or influence its activities. Such persons are considered "insiders" for purposes of determining whether there is inurement of income. Generally, an organization's officers, directors, founders, and their families are considered "insiders". This private benefit prohibition applies to all kinds of persons and groups, not just to "insiders" subject to the stricter inurement proscription.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations states that an organization is not organized or operated for any purpose under section 501(c)(3), unless it serves a public rather than a private interest. Thus to meet the requirements of this subparagraph, 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. Moreover, even though an organization may have exempt purposes, it will not be considered as operating exclusively for such purposes, if more than an insubstantial part of its activities serve private interests.

In general, an organization that applies for recognition of exemption has the burden of proving that it clearly meets all the requirements of the particular Code section under which it has applied. See Kenner v. Commissioner, 318 F. 2d 632 (7th Cir. 1963), and Cleveland Chiropractic College v. Commissioner, 312 F. 2d 203, 206, (8th Cir. 1963)

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980) an organization was formed to operate as a church. The founders and incorporators had total control over the management of the organization's affairs and determined how the organization's money was spent. Services for the organization were held in the personal residence of the founder who held title to all property, both real and personal, in his own name. The organization also showed liability for an automobile loan and expenses for utilities and other items that were directly related to the personal residence where the services were held.

The court ruled that although the organization was serving religious and charitable purposes, it also served to benefit the founders of the organization since few disbursements were shown to be used exclusively for exempt purposes. It was also noted that when a small group controls an organization's affairs and they are recipients of funds distributed by the organization, prohibited inurement is strongly suggested. The court concluded that this organization was not entitled to exemption since it was not operated exclusively for an exempt purpose and served the private interests of its founders rather than public purposes.

In Bubbling Well Church of Universal Love v Commissioner, U.S. Court of Appeals 9th Circuit No. 80-7358 11-27-81 affirmed 74 TC 531, the tax court reviews an organization that states it is a church operating exclusively for religious purposes. The church was established by three members of one family, who also serve as the sole members of the Board of Trustees and/or directors. The organization had no affiliation with any denomination or ecclesiastical body and was not subject to any outside influence in the control of the organization's affairs.

The organization received income of approximately \$61,000 during a one-year period. Of this amount approximately \$37,000 was directly returned to the family in the form of living allowance, parsonage allowance, medical expenses, medical insurance and travel expenses. This amounted to 61 percent of the organization's income that directly benefited the founding family.

The court stated that under the circumstances described, the family was in a position to perpetuate control of the organization's operations indefinitely, prepare its budget and had complete control of the organization's finances and made the decisions on how the funds were spent. Since the organization had no connection with any denomination or outside body, it was not subject to any outside influence in the conduct of the church's affairs.

Concerning the amount of compensation paid to family members, the court stated that the applicant organization has the burden of proving that the compensation paid its officers is reasonable and comparable to salaries paid for similar positions within a particular industry. In denying exemption to this organization, the court stated that the organization had not shown that no part of the net earnings did inure to the family members and that the organization was operated for the private benefit of the family rather than public purposes.

Revenue Ruling 76-91, published in Cumulative Bulletin 1976-1, on page 140, provides that where the purchaser is controlled by the seller or there is a close relationship between the two at the time of the transaction, the presumption is that the agreement cannot be made because the elements of an arm's length transaction are not present.

Revenue Ruling 78-232, published in Cumulative Bulletin 1978-1, page 69, holds that an individual who claims to be a minister, forms an organization under the name ABC Church, deposits salary checks for salary earned from outside employment in the organization's bank account, and uses the funds of the account for personal living expenses is not entitled to a charitable deduction under section 170 of the Internal Revenue Code for the amount of the salary checks.

Although the expectation of a *quid pro quo* would preclude the allowance of a deduction under section 170 of the Code even if the donee were an organization described in section 170(c)(2), it should be noted that, in this case, the ABC church is not such an organization. On the facts stated above, the ABC church is operated for the private purposes of the taxpayer and thus is not operated exclusively for religious or other charitable purposes as required by the statute. Moreover, since the funds of the ABC church are used by or on behalf of the taxpayer, there is inurement of the type proscribed by the statute.

[REDACTED]

Further clarification of your activities revealed: "The video in question is owned by [REDACTED] in lieu of, attached, please find, our brochure from [REDACTED]." "The land purchased for the center will be separated from [REDACTED] personal property. It will be owned by [REDACTED] in the future. The problem is that [REDACTED] does not own the property free and clear yet. He has one more payment due in [REDACTED]. At that time [REDACTED] plans to survey the [REDACTED] and have it's own land title under [REDACTED]." "The vehicle owned was purchased with [REDACTED] personal funds and he wishes to keep it in his own name." "[REDACTED] will be sole owners of the home and remaining property. We realize that this is contradictory to question # [REDACTED] of page [REDACTED], but [REDACTED] wishes to have the home in his name." "There must be some mistake, as Carlos does not plan to sell or buy [REDACTED] [REDACTED] was a place that [REDACTED] had helped in the past but doesn't have anything to do with their ministry plans."

A modified financial statement was submitted in which the loan payment, automobiles/trucks and land were removed as liabilities and assets, respectively. In addition, the expense annotated "[REDACTED]" was reduced by \$ [REDACTED]. "[REDACTED]" is money invested from the personal savings of [REDACTED] to cover miscellaneous like corporation legal fees, legal advise processing documentation and accounting.

Although you have a religious purpose as described in [REDACTED], the control over the funds by the President/Pastor is evidence that there are no arm-length transactions when dealing with the organization's funds. You previously stated that the organization purchased the property and would build the President's house but now you state that the President purchased the property and will build the home. In fact, he owns the land, which was purchased with the organization's income.

Based on the evidence submitted and cited published precedence, we have determined that you have not met your burden of proof to show that you are operated exclusively for an exempt purpose and that you do not serve the private interests of your creators and founders.

Therefore, we have concluded that you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Code. In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

Contributions to your organization are not deductible by donors under section 170(c)(2) of the Code.

In accordance with the provisions of section 6104(c) of the Code, a copy of this letter will be sent to the appropriate State officials.

If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office. If someone who is not one of your principal officers will represent you, that person will need to file a power of attorney or tax information authorization with us.

[REDACTED]

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

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

Sincerely,

Steven T. Miller

Steven T. Miller
Director, Exempt Organizations

Enclosure: Publication 892

cc: State Attorney General (FL)