[redacted]

[redacted]

CP:E:EO:R

SEP 5 1996

Employer Identification Number: [redacted]
Form: 1120
Tax Years: All years

Dear Applicant:

This is a final adverse ruling as to your exempt status under section 501(c)(3) of the Internal Revenue Code.

This ruling is made for the following reason(s):

You have failed to establish that your operations will further any substantial charitable purpose. You have also failed to establish that you will not benefit private interests in other than an incidental manner.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file federal income tax returns on the form indicated above. Based on the financial information you furnished, it appears that returns should be filed for the tax years indicated above. You should file these returns with your key District Director for exempt organization matters within 30 days from the date of this letter, unless a request for an extension of time is granted. Returns for later tax years should be filed with the appropriate service center as indicated in the instructions for those returns.

If you decide to contest this ruling under the declaratory judgment provisions of section 7428 of the Code, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date that this ruling was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Processing of income tax returns and assessment of any taxes due will not be delayed because a declaratory judgment suit has been filed under section 7428.

[redacted]

In accordance with section 6104(c) of the Code, the appropriate State officials will be notified of this action.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown above.

Sincerely,

(signed) [redacted]

[redacted]
Director, Exempt Organizations
Division

cc: DD, Western (Los Angeles, CA)
Attention: EO Group

cc: [redacted] State Officials

cc: [redacted]

CP:E:EO:T:3
[redacted]
8/28/96

CP:E:EO:R
[redacted]
8-30-96

[redacted]

[redacted]

CP:E:EO:T:3

EIN: [redacted]

Dear Applicant:

We have considered your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code.

The information submitted indicates that were incorporated under the nonprofit laws of [redacted] on [redacted]. Your stated purposes are as follows:

> The corporation is organized and operated for charitable and educational purposes and for the prevention of cruelty to adults, children, or animals.

You state that your activities will include utilizing funds solicited from and contributed by the general public, including businesses in [redacted], to make contributions to other worthy charitable organizations, such as youth activity organizations. You state that you will also assist in funding [redacted] community projects, including renovation, construction, and purchase of a facility to care for and provide activities for youth with working parents while the parents are at work.

You state that your initial fundraising program will be conducted under a contract with [redacted] (hereafter [redacted]). On [redacted] you entered into a contract with [redacted]. Under the contract [redacted] has the exclusive right to solicit contributions on your behalf using your organization's name. The contract provides that [redacted] will solicit contributions from the general public through a marketing program based upon telephone and personal contacts with individuals and businesses.

The terms of the contract provides that [redacted] will be entitled to compensation for its marketing and solicitation efforts in the amount of seventy percent (70%) of the gross contributions and donations received. The contract requires you to compensate [redacted] for its services weekly.

Your financial statements indicate that your telephone solicitation income for the 4 months ending [redacted] was $[redacted]. Total payments to [redacted] for the four month period was $[redacted]. Your total income to-date is $[redacted]. Your total payments to [redacted] is $[redacted]. You financial statements indicate that you have made no distributions to educational and/or charitable organizations recognized exempt under section 501(c)(3) of the Code.

Your president and founder is [redacted]. The president of [redacted] is [redacted], who is also the father of [redacted].

Section 501(c)(3) of the Internal Revenue Code provides for the exemption of organizations that are organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any shareholder or individuals.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that in order for an organization to be exempt as an organization described in section 501(c)(3), it 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 or operational test, it is not exempt.

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

Section 1.501(a)-1(c) of the Income Tax Regulations defines "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization will not be considered as operating exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

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 one or 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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of section 1.501(c)(3)-1(d)(1) 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 interest.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" as used in section 501(c)(3) of the Code includes relief of the poor and distressed or of the underprivileged.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Rev. Rul. 67-5, 1967-1 C.B. 123, concerned a foundation controlled by its creator's family and operated to enable the creator and his family to engage in financial activities which are beneficial to them, but detrimental to the foundation. The Service concluded that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. The ruling reasoned as follows:

> The use of the foundation as a vehicle for activities advantageous to its creator and his family and as a source of funds to finance such activities, the resulting investments by the foundation in assets that fail to produce income for a charitable program commensurate in scope with its financial resources, the continued failure of its trustees to protect the value of these investments, and their failure to make them income-producing, all establish

> that the foundation is operated for a non-exempt purpose, substantial in nature. That purpose is to serve the private financial interests of its creator and his family. . . . Furthermore, the foundation fails to serve a public, rather than a private, interest and therefore is not operated exclusively for charitable purposes.

Thus, the foundation was not entitled to exemption under section 501(c)(3) of the Code.

In International Postgraduate Medical Foundation, T.C. Memo 1989-36, the court held that the Service had properly revoked the 501(c)(3) status of an organization that did not operate exclusively for exempt purposes. The court based its conclusion, in part, on the fact that a related for-profit corporation had benefitted substantially from the manner in which the activities of the exempt organization were conducted. In these circumstances, the court said, an organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code, even though it furthers other exempt purposes.

In this case, the organization had the substantial non-exempt purpose of benefitting a for-profit travel agency controlled by parties related to the organization. The organization had been formed and was controlled by an individual who had previously operated all tour operations through a for-profit entity. The travel agency received substantial fees from customers attending tours promoted by the organization, under a non-competitive arrangement.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), aff'g T.C.M. 84-349, the court upheld denial of 501(c)(3) status to an organization because it was operated for the non-exempt purpose of providing a market for the services of a for-profit fund-raising firm owned by parties related to the organization. Key facts considered by the court included that employees of the for-profit firm devoted two-thirds of their time to the organization's business that the majority of the organization's income went to payments to the for-profit firm; and that the controlling parties profited from the relationship.

est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), held that an organization that was essentially controlled by a separate for-profit commercial entity was operated for a substantial non-exempt purpose where it promoted a certain body of knowledge, which was owned by that commercial entity. Whether the agreements between the parties reflected arm's length negotiation was irrelevant to the analysis. The court noted that the commercial entity was trading on the organization's tax-exempt status.

In Senior Citizens of Missouri, Inc. v. Commissioner, T.C. Memo 1988-493, the court denied 501(c)(3) status to an organization because it paid unexplained advances to its solicitors representing 33.2% of its gross revenues. The court found this to be clearly substantial. Thus, it failed the operational test of section 501(c)(3) of the Code.

In Better Business Bureau v. United States, 326 U.S. 279, 283 (1945) the U.S. Supreme Court stated in a case involving a claim for exemption on exclusively educational grounds:

> In order to fall within the claimed exemption an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single noneducational purpose, if substantial in nature, will destroy an organization's exemption regardless of the number or importance of truly educational purposes.

In People of God Community v. Commissioner, 75 T.C. 127 (1980), the organization paid its minister, also a director who controls the organization, with a compensation based on a percentage of the organization's gross receipts. The Court found that with such compensation arrangement, a portion of the organization's earnings is being passed to the minister, and paying over a portion of gross earning to those vested with control of an organization constitutes private inurement. Accordingly, the Court held that the organization is not exempt under section 501(c)(3) of the Code.

You are not organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. The operation of your telemarketing fundraising program under the circumstances described constitutes a substantial nonexempt purpose and activity within the meaning of section 1.501(c)(3)-1(c)(1) of the regulations which serves the private business interests of [redacted] rather than public interests pursuant to section 1.501(c)(3)-1(d)(1)(ii).

Your financial statements indicate that you have made no distributions to charity since your formation. Thus, it appears that you have conducted only insignificant activities aimed at accomplishing your charitable purposes, compared to the substantial business and other financial benefits provided to [redacted]. In addition, inconsistent with the terms of your contract with [redacted] you have made payments constituting approximately 77% of your gross receipts derived from fundraising through telemarketing. Under the circumstances your earnings inure to the benefit of [redacted] through [redacted], which is entitled to a substantial portion of your gross receipts pursuant to section 1.501(c)(3)-1(c)(2) of the regulations. People of God Community v. Commissioner, supra; International Postgraduate Medical Foundation, supra; Church by Mail, Inc. v. Commissioner, supra; est of Hawaii v. Commissioner, supra; and Senior Citizens of Missouri, Inc. v. Commissioner, supra. Therefore, the operation of your fundraising program is not devoted to exclusively educational or charitable purposes within the meaning of section 501(c)(3) and Better Business Bureau v. United States.

Accordingly, we conclude that you do not qualify for exemption under section 501(c)(3) of the Code.

You are required to file federal income tax returns. Contributions to you are not deductible under section 170 of the Code.

You have a right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power attorney and otherwise qualify under our Conference and Practice Procedures.

If you do not protest this proposed ruling in a timely manner, it will considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that, "A declaratory judgement or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the United States Court of Federal Claims, 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".

If we do not hear from you within 30 days, this ruling will become final and copies of it will be forwarded to your key District Director. Thereafter, any questions about your federal income tax returns or the filing of tax returns should be addressed to that office.

When submitting additional letters with respect to this case to the Internal Revenue Service, you will expedite their receipt by placing the following symbols on the envelope:

Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224
CP:E:EO:T:3,
Attention: Ed Brown, Room 6137.

Sincerely,

[redacted]

[redacted]
Chief, Exempt Organizations
Technical Branch 3

cc: DD, Los Angeles
Attention: EO Group

cc: [redacted]

cc: State Officials
[redacted]

CP:E:EO:T:3

CP:E:EO:T:3
[redacted]
7/24/95

[redacted]
7/24/95