



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201219028**
Release Date: 5/11/2012
Date: February 14, 2012
UIL Code: 501.03-05
501.32-00
501.33-00

Contact Person:
Identification Number:
Contact Number:
Employer Identification Number:
Form Required To Be Filed:
Tax Years:

Dear

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, 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, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

Letter 4038(CG) (11-2005)
Catalog Number 47632S

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: December 22, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B = individual
C = individual
D = individual
F = business
H = business
J = business
M = date
O = date
P = state
R = state
s = dollar amount
t = dollar amount
u = dollar amount

UIL Nos:

501.03.05
501.32.00
501.33.00

Dear

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code ("Code") as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

Issues

Are you formed to obtain grants primarily benefitting B through F? Yes, for the reasons given below.

Are private interests being served prohibiting you from qualifying for exemption under section 501(c)(3) of the Code? Yes, based on the reasons stated below.

Facts

Individuals B, C, and D are listed as your governing members. B owns and operates F as a sole proprietor. F is a for profit jewelry business run from B's home. C and D were selected as board members by B as being "friends who live nearby".

B hired H, a professional fundraising company based in R, to seek private grants for F. B signed a contract with H on date M to provide the following services:

1. Foundation Research
2. Grant Application Preparation and Packaging
3. Grant Proposal Writing
4. Consultation to direct the client toward the best avenue to reach grant funding goals

Although you have three board members B was the only individual to sign this contract.

As part of the grant writing process, H promised to aid F in securing approximately \$ _____ in grant funding. The fee charged for this was s dollars. The contract also states if a minimum of \$ _____ is not raised, approximately t dollars of the fee will be waived. None of the grant requests sent out by H were ever provided to you or B.

B was contacted by a representative of J, a for profit company based in R, and told a foundation was willing to provide a grant of approximately \$ _____ to F on the condition that B had a tax-exempt corporation through which to give approximately 5% of grant proceeds to local charities. Therefore, upon receipt of the grant, around \$10,000 (or 5%) would be wired to your bank account to be donated back to the community. B signed a contract with J to provide the following services for a fee of u dollars:

1. Home State Non-Profit Corporation
2. Non-Profit Corporate Kit
3. IRS Form 1023

Again, although you have three board members B was the only individual to sign this contract.

The representative of J told B that receiving the grant money for F hinged upon receiving tax-exemption, as it was a stipulation of the donor and was the only way to receive grant funding. Also, until tax-exemption was received, no names of those providing the grant

funding would be released. B was also told that after tax-exemption was received, B would be able to work directly with the donor foundation and would no longer need the services of J.

A business plan for the grant proposal was provided on F's letterhead. This proposal showed that the grant funding would be used for supplies, outside labor, photography, marketing consulting, advertising, IT consulting, tools, trade show fees and expenses, travel, and website development consistent with the needs of a jewelry business. The grant proposal contained more than \$ in expenses directly related to F. You also stated that B is struggling to operate F and would love to do more advertising and hire employees. Receiving grant funding would allow these goals to be accomplished.

Per J's contracted services, you were incorporated on date O in state P. Your Articles of Incorporation state your specific purpose is to provide distribution of funds to local schools to assist with book and equipment purchases and to help with benefits for schools. You will also provide donations to the local humane society.

Your activities are essentially the same as the above listed purposes. You plan to make donations to support local schools and animal services.

Although you did not submit actual budgets, you indicated your intentions were to split the 5% received from the potential grant funds between two entities. This would entail an approximate donation of \$ to two designated charities. The remainder of the grant funds would be used for F. You further documented your intentions by stating you needed to set up a 501(c)(3) due to the potential donors stipulation. The only reason for donating to your local community through the 501(c)(3) was to fulfill the potential donors stipulation. The 501(c)(3) was the only way you would receive funds for your business.

You indicated since you filed Form 1023, both H and J seem to have closed down. You did not have the information about the potential donor and you do not expect to receive the initial grant described above. You explained that you simply wanted to receive grant money for your jewelry business, F, and you were happy to donate a portion of it back into the community. You also explained that you plan to apply for more grants in the future:

"I do expect to apply again! It was very encouraging that I got at least one donor to commit! With the rising costs of my materials, I am struggling to keep my business going. I would love to do more advertising, and I'd love to be able to hire some help. A grant would be such a blessing!"

Law

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable, scientific, or educational

purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax 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). 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(c)(2) of the Income Tax Regulations provides 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.

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 exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subsection, 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.

In Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that, in order to fail within the claimed exemption, an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), cert. denied, 497 U.S. 1005 (1990), the court held that when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the organization is not operated exclusively for exempt purposes within the meaning of Section 501(c)(3), even if it furthers other exempt purposes.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under section 501(c)(3) of the Code of a nonprofit corporation that conducted continuing medical education tours. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded that when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes.

In KJ's Fund Raisers, Inc. v. Commissioner, 74 T.C.M. 669 (1997), the court held that a nonprofit organization, which sold lottery tickets on the premises of a for-profit business had a substantial non-exempt purpose to enhance the profits of the for-profit business. The owners of the for-profit business formed the nonprofit organization purportedly to raise funds for distribution to charitable causes. The nonprofit's lottery tickets were sold during the regular business hours by the owners and employees of the for-profit business. The owners of the for-profit initially controlled the board and later indicated that it would vest control in unrelated parties. The nonprofit opined that the organization "would fold without the original founders of the organization as officers." In finding that the nonprofit had a substantial nonexempt purpose, the court reasoned that the owners of the for-profit were in a position to control the nonprofit. Additionally, the court found that the publicity received by the for-profit was a significant benefit.

Application of Law

Based on our analysis you do not satisfy the operational requirements of the Code and Regulations to be recognized as exempt under section 501(c)(3) of the Code. Your operations will result in impermissible private benefit to insiders. Moreover, you have not shown that you are formed exclusively for an exempt purpose under section 501(c)(3) of the Code. The facts show you were formed to receive a grant to further F's business operations. This results in impermissible private benefit to B through F, which precludes you from exemption under section 501(c)(3).

You do not meet the operational test under Section 1.501(c)(3)-1(c)(1) of the regulations and are not "operated exclusively for one or more exempt purposes", as set forth in section 1.501(c)(3)-1(c)(2) of the regulations, because your net earnings inure in whole or in part to the benefit of F and F's owner, B. You were created to secure grants for F. F will receive 95% of these grant funds. As a result, B is receiving a substantial benefit in the form of funds flowing to F. You were formed not for 501(c)(3) purposes, but instead as a requirement for F to receive grant funding. This leads to inurement of earnings accruing to B through F, which precludes exemption under 501(c)(3).

You are not operating exclusively for exempt purposes per Section 1.501(c)(3)-1(d)(1)(ii) of the regulations as you serve private rather than public interests. F would not qualify to receive a grant to support its operations without your approval as a 501(c)(3). While you do plan to provide grants to charitable organizations, it is clear your primary purpose is to help F qualify for grant funding, as F is retaining 95% of any funds received. Thus, F and F's owner, B, benefit substantially from your creation. By conducting activities that serve private interests, you are not operated for an exclusively exempt purpose.

You are like the organization in Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), in that you are not "operated exclusively" for exempt purposes. As described above, you substantially further the private interests of your board member, B, and B's jewelry business, F. Of all funding you receive only 5% will be used

towards charitable purposes; the remainder will go to F. Like the organization in the court case, this single nonexempt purpose destroys your claim for exemption under section 501(c)(3) of the Code.

You are similar to the corporation described in International Postgraduate Medical Foundation v. Commissioner and Church by Mail, Inc. v. Commissioner, supra, because F and, by extension, B, benefit substantially from your formation. You stated funds would not be released to F without your approval of your 1023 application, which demonstrates you were created as a 501(c)(3) entity with the intention to help F receive grant funding. In fact, you state you were formed simply to receive grant funding for your for-profit jewelry business.

Your purposes are consistent with the organization described in KJ's Fund Raisers, Inc. B, who has control over your operations as a director and your founder, will also simultaneously be managing F. You were formed by B to facilitate the flow of funding to F. The decision by B to create you to secure grant funding for F shows that the private interests of B are being served.

Conclusion

You do not meet the operational requirements to be recognized under section 501(c)(3) of the Code. Your primary purpose is to secure grants used to further the private interests of B and through F. This constitutes a substantial non exempt activity and provides private benefit and inurement to B. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the 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 all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Publication 892