



**Department of the Treasury**

**Internal Revenue Service**

P.O. Box 2508

Cincinnati, OH 45201

Release Number: **201718039**

Release Date: 5/5/2017

UIL Code: 501.03-30

Date: February 6, 2017

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

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,

Jeffrey I. Cooper  
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:** December 9, 2016

**Employer ID number:**

**Contact person/ID number:**

**Contact telephone number:**

**Contact fax number:**

**Legend:**

B=  
C=  
D=  
E=  
R =  
T =  
V =

**UIL:**

501.03-30  
501.32-01  
501.33-00  
509.02-02

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**

- 1) Do you meet the operational test under Treasury Regulation § 1.501(c)(3)-1(c)(1)? No, for the reasons stated below.
- 2) Have your net earnings inured in whole or in part to the benefit of private shareholders or individuals as stated in Treas. Reg. § 1.501(c)(3)-1(c)(2)? Yes, for the reasons stated below.
- 3) Do you meet the requirements to be a supporting organization under section 509(a)(3)(A) of the Code and Treas. Reg. § 1.509(a)-4(b)? No, for the reasons stated below.

**Facts**

You were formed as an unincorporated association on date R in the state of T.

According to your Articles of Association, your purpose is to generate and oversee funds for increasing student achievement, student engagement and development, which align with the mission of V. Your secondary function is to advise the school administration in areas of policy or other administrative affairs. You state you are charitable, religious/educational, and may make distributions under 501(c)(3) of the Code, and desire to carry on any other purposes or acts permitted by the laws of T.

Your Articles and Bylaws state that no part of your net earnings shall inure to the benefit of, or be distributable to, your members, officers, or other private persons, except that you shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of your stated purposes.

V is a for-profit Sub-Chapter S Corporation owned by individual B.

B is your president; C is your vice president and E is your secretary.

Your Board of Directors is composed of individuals B, C, D, and E, as well as two additional members appointed by the parents of V. Individuals C and D are parents of a former student of V. E is a non-voting member of the board and is employed as the principal of V.

The responsibility of the Board shall include, but not be limited to, fundraising, establishing funding priorities, approving general budgets, advising school policy and advising school personnel matters.

Revenue will come from fundraisers, grants, and individual donors. Your Board will oversee all revenues and expenses.

V will be the only recipient of funds. Your treasurer will keep receipts, documentation, and books for all grants, loans, or distributions to them. You will require quarterly reports on the use of funds.

You requested to be recognized as a supporting organization to V. To date, all of your expenditures have been for supplies, equipment, and other items for the exclusive use of children attending V. You have also purchased equipment required by the state for increased licensing requirements of V.

## Law

Section 501(c)(3) of the Code provides for the recognition of exemption of organizations that are organized and operated exclusively for religious, charitable, or other purposes as specified in the statute. No part of the net earnings may inure to the benefit of any private shareholder or individual.

Section 509(a)(3)(A) of the Code describes an organization which is organized and at all times thereafter is operated exclusively for the benefit of one or more specified organizations described in sections 509(a)(1) or 509(a)(2).

Treas. Reg. § 1.501(a)-1(c) provides that the terms "private shareholder or individual" in Section 501 of the Code refer to persons having a personal and private interest in the activities of the organization.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order 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. § 1.501(c)(3)-1(c)(1) states 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.

Treas. Reg. § 1.501(c)(3)-1(c)(2) stipulates 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.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized and operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. The organization must establish that it is not organized or operated to benefit private interests such as designated individuals or the persons who created it.

Treas. Reg. § 1.509(a)-4(b) states in order to qualify as a supporting organization under section 509(a)(3)(A) of the Code, an organization must be both organized and operated exclusively “for the benefit of, to perform the functions of, or to carry out the purposes of” one or more specified publicly supported organizations. If an organization fails to meet either the organizational test or the operational test, it cannot qualify as a supporting organization.

Revenue Ruling 76-206, 1976-1 C.B. 154, held that a nonprofit organization formed to promote the retention of music programs of a local for-profit radio station by seeking program sponsors, urging the public to patronize the sponsors, and soliciting subscriptions to the station's program guide, all of which activities tended to increase the station's revenues, did not qualify for exemption under section 501(c)(3) of the Code. The organization's board of directors represented the community at large and did not include any representatives of the for-profit radio station. It was held that the activities resembled a public relations campaign designed to enable the for-profit radio station to continue broadcasting classical music. The organization's efforts enabled the radio station to increase its total revenues. The increase in listening audience that may occur as a result of the organization's activities would enhance the value and salability of the station's airtime. A similar enhancement was derived through the sale of the station's program directories. Thus, the organization's activities would benefit the for-profit radio station in more than an incidental way.

In *Better Business Bureau of Washington, DC, Inc. v. United States*, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. The petitioner's activities were largely animated by non-exempt purposes directed fundamentally to ends other than that of education.

In *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), several for-profit organizations exerted significant indirect control over *est of Hawaii*, a nonprofit entity, through contractual arrangements. The question for the court was not whether the payments made to the for-profits were excessive, but whether they benefited substantially from the operation of the nonprofit. The Tax Court concluded that the for-profits were able to use the nonprofit as an “instrument” to further their for-profit purposes. Neither the fact that the for-profits lacked

structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in section 501(c)(3) of the Code.

In *International Postgraduate Medical Foundation v. Commissioner*, T.C. Memo, 1989-36 (1989), the court considered whether a nonprofit corporation that conducted continuing medical education tours qualified for exemption under section 501(c)(3) of the Code. 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) of the Code, even if it furthers other exempt purposes.

In *Salvation Navy v. Commissioner*, T.C. Memo. 2002-275, the court found that the organization failed to meet the operational test under Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) because it could not prove that it was not organized to serve the private interests of its founder. The organization conceded that it and the individual in question were one in the same. The court found that the affairs of the organization and the individual in question were irretrievably intertwined, and that the benefits the individual sought to obtain via a determination letter would have inured to the individual himself.

### **Application of Law**

Section 501(c)(3) of the Code sets forth two requirements for an organization to be recognized as exempt. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). (See Treas. Reg. § 1.501(c)(3)-1(a)(1)). According to your organizing document, in addition to being a charitable, religious and educational organization, you will also carry on any other purposes or acts permitted by the laws of T. In addition, your organizing document limited your activities to those of a corporation exempt under section 501(c)(3) of the Code or an organization to which contributions are deductible under section 170(c)(2) of the Code. Because you do not meet the operational test, you do not qualify for exemption under section 501(c)(3) of the Code.

The facts indicate that V will benefit directly from your operations. You will direct funds to V, a for-profit Sub S Corporation owned by your president, B. Your funds will be used to offset operating costs and to purchase equipment and supplies that V would otherwise be responsible for these costs. Accordingly, your board members, a majority of whom are related, benefit from the funds you direct to V's operations. Since your earnings inure to the benefit of private individuals, you do not meet the requirements of Treas. Reg. § 1.501(c)(3)-1(c)(2). Your board members are private shareholders or individuals as described in Treas. Reg. § 1.501(a)-1(c) because they have a personal and private interest in your activities.

Treas. Reg. § 1.501(c)(3)-1(c)(1) states an organization will not be exempt if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. You are paying expenses for which V would otherwise be liable. V is a related for-profit school owned by B, your president. As a result, your operations are providing a substantial private benefit to V and B, a substantial non-exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized and operated exclusively for exempt purposes unless it serves a public rather than a private interest. You were formed to subsidize the

operations of V. Thus, because of V's relationship with you, it receives the benefit of receiving equipment and supplies free of charge that it would otherwise have to purchase.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) also provides that the organization must establish that it is not organized or operated to benefit private interests such as designated individuals or the persons who created it. By purchasing equipment and supplies that will be used exclusively at V, you are benefitting the private interests of B, your president who founded and owns V as an S Corporation.

You do not meet the provisions of section 509(a)(3)(A) of the Code and Treas. Reg. § 1.509-4(b) because you are organized and operated exclusively for the benefit of V, a for-profit S Corporation founded by your president, B. Generally, in order to be a supporting organization under section 509(a)(3) of the Code, you must have been organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified publicly supported organizations (i.e., an organization exempt under 501(c)(3) and publicly supported under either section 509(a)(1) or section 509(a)(2)).

You are similar to the organization described in Rev. Rul. 76-206 in that the organization's activities in the ruling helped a for-profit radio station increase its total revenues. Likewise, you are helping a for-profit school increase its total revenues by subsidizing operating costs it would otherwise incur. The fact that the organization in the ruling had a board of directors from the community at large who did not include any representatives of the for-profit radio station did not strengthen their claim to exemption.

As held in *Better Business Bureau of Washington, DC, Inc.*, a single non-exempt purpose, if substantial, will preclude tax exemption under section 501(c)(3) of the Code. Your activities result in substantial private benefit to V, and your earnings inure to the benefit of your president, B, the owner and founder of V. Like the organization described in this case, an organization with the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of other exempt purposes.

You are similar to the organizations in *est of Hawaii*, and *International Postgraduate Medical Foundation*, given that V's for-profit activities benefit from your operations. You were formed as a supporting organization to, and intended your funds to be distributed to V in the form of purchasing equipment and supplies for the school. You are serving as an "instrument" to further the purposes of V. Because your related for-profit organization, V, benefits substantially from the manner in which you operate, you are not operated exclusively for exempt purposes.

You are comparable to the organization described in *Salvation Navy* because you could not prove that you were not organized and operated to serve the private interests of your president, B.

## **Conclusion**

You are not operated exclusively for exempt purposes as set forth in section 501(c)(3). Your net earnings inure to the benefit of your president, a private individual. In addition, it is clear that your operations result in substantial private benefit to V.

As a result, we conclude that you are not operated exclusively for public rather than private purposes. We conclude based on the stated facts that you do not qualify for tax exemption because more than an insubstantial part of your activities is not in furtherance of exempt purposes. Therefore, you do not qualify for exemption under section 501(c)(3).

Because we have determined you are not exempt under section 501(c)(3) of the Code, you do not meet the requirements of a supporting organization under section 509(a)(3)(A).

### **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](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure:  
Publication 892