



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

Contact Number:

Legend:

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Employer Identification Number:

Dear

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue 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.

Facts

You were incorporated on a under the laws of the State of L as a nonprofit corporation. According to your application for exemption and your Internet web site, you operate as a facilitator to contributors who want to donate tangible personal property, such as boats, to a charity that the donors designate. You have no written agreements with any charities, and you have no on-going listing agreements with any boat brokers. You have not accepted any donations of boats that are subject to a lien.

When a donor wants to donate a boat to a charity, you agree that you will donate the net proceeds from the sale of the boat to the charity the donor designates. The donor transfers to you both possession of the boat and legal title. At that time, you

assume all the risk of loss associated with the boat and you pay for the applicable insurance. When you take possession of the boat, you arrange for its moorage. You also determine whether any services, repairs or upgrades need to be made to the boat in order to make it more readily marketable. If needed, you arrange with independent contractors to perform this work. You also enter into a "Listing Agreement" with an independent boat broker for the sale of the boat. When a broker sells a boat, you pay the broker a commission, usually 10 percent, from the proceeds of sale. You also pay the various expenses you incurred in connection with the boat, such as for repairs, upgrades and moorage. From the net proceeds that remain, you pay to the charity the donor had designated 50 percent of the net proceeds and you retain the other 50 percent.

You also acquire boats from donors in "bargain purchase" transactions. Under this arrangement, when the donor contributes a boat, you pay the donor a portion of the value of the donated boat. When a broker sells a boat, you pay the broker a commission and you pay the various expenses you incurred in connection with the boat. From the amount remaining, you retain the amount you paid the donor. In determining the amount that you pay to the charity, you reduce the amount of the net sales proceeds by the amount you paid the donor and by the commission and expenses and you pay the charity 50 percent of the amount remaining.

The following example illustrates a bargain purchase transaction that you engage in: A donor owning a boat having a fair market value of \$100,000 transfers the boat to you in a bargain purchase transaction in which you pay the donor \$60,000 and designates a charity which the donor wants to benefit. You incur \$12,000 of expenses for repair, upgrading and moorage of the boat. A broker sells the boat on your behalf for \$100,000 and you pay the broker a 10 percent commission (\$10,000). After payment of the commission, you receive \$90,000, from which you pay the \$12,000 of expenses, leaving \$78,000. Since you paid the donor \$60,000, you retain this amount, leaving \$18,000. You then pay 50 percent of this amount, or \$9,000, to the charity the donor had designated and you retain the other 50 percent, also \$9,000.

Law

An organization described in section 501(c)(3) of the Code, must, among other requirements, be organized and operated exclusively for certain purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states:

In order to be exempt as an organization described in section 501(c)(3), 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.

Section 1.501(c)(3)-1(c)(1) of the regulations states:

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(d)(1) of the regulations states:

(i) An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

....

(b) Charitable,

....

(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph 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 interests.

Section 1.501(c)(3)-1(e)(1) of the regulations states:

An organization may meet the requirements of section 501(c)(3) 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. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

In Rev. Rul. 64-182, 1964-1 C.B. 186, an organization derived its income principally from the rental of space in a large commercial office building. The organization's charitable purposes are carried out by making contributions and grants to other charitable organizations. In this revenue ruling, the IRS concluded that this organization met the primary purpose test of section 1.501(c)(3)-1(e)(1) of the regulations because it carried on a charitable program that was commensurate in scope with its financial resources.

In Rev. Rul. 85-184, 1985-2 C.B. 84, a public utility entered into an agreement with a charitable organization under which the charity designated the utility as its authorized agent to collect contributions to the program on the charity's behalf. When the utility's customers pay their bills, they are given the opportunity of paying an additional amount designated as contributions to the charity's financial assistance program for the elderly and handicapped. The utility collects these contributions, segregates them from its own funds, does not exercise any dominion or control over the contributions, and transfers them to the charity weekly.

The issue in this revenue ruling was whether the customers who contribute to this program are allowed a charitable contribution deduction under section 170(a) of the Code. The Service concluded that since the utility was acting as the charity's collection agent in receiving certain funds over which the utility exercised no dominion or control and which the utility earmarked for use by the charity, a customer who makes such contribution is entitled to a charitable contribution deduction under section 170(a) in the year the utility pays the funds to the charity.

In Rev. Rul. 2002-67, 2002-2 C.B. 873, O, a charitable organization, entered into a written agreement with X, a for-profit entity licensed to sell cars in the same state where they are both located. The agreement provides that X, acting as O's authorized agent, will administer a fund-raising program for O in exchange for a fee. X's activities under the agreement are subject to O's review and approval. The agreement provides that X will act on O's behalf to:

- (1) Solicit donation of used cars;
- (2) Accept, process and sell the cars;
- (3) Transfer the proceeds of the sales to the charity, less X's fee; and
- (4) Provide each donor with substantiation of that donor's contribution, including the acknowledgement that contains the required information.

B transferred a used car to X as O's authorized agent.

In this revenue ruling, the IRS concluded that because the charity and X have established a valid agency relationship under the laws of the state, X has the authority to act on the charity's behalf according to the terms of their agency agreement. Thus, for purposes of section 170 of the Code, B's transfer of the car to X as the charity's authorized agent is treated as a transfer to the charity. This revenue ruling states that the determination of whether an agency relationship exists is based upon the requirements of state law, and that not all contractual relationships will result in an agency relationship under state law.

In State Police Association of Massachusetts v. Commissioner, 125 F.3d 1 (1st Cir. 1997), a state police association that is tax-exempt under section 501(c)(5) of the Code, published a yearbook and derived income from advertisements placed in the yearbook. The association contracted with an outside for-profit company to publish the yearbook and recruit telemarketers to solicit advertisements. The telemarketers worked out of field offices selected by the outside firm with the association's approval and solicited local and national businesses within geographic areas demarcated by the association. They used a canned solicitation format approved by the association, which identified themselves as calling on behalf of the association. Troopers monitored all solicitations. The association retained the right to inspect the field offices from which the solicitations took place. Payments for ads sold were made to the association and paid set percentages of the gross receipts to the telemarketers and to the outside firm.

The principal issue in this case was whether the advertising revenues were subject to the tax on unrelated business income. One of the subordinate issues was whether the outside firm was an agent of the association, in which event their advertising activities would be attributed to the association, or simply an independent contractor. In concluding that the outside firm was the association's agent, the court of appeals stated:

In the first place, an independent contractor can be an agent if, and to the extent that, the contractor acts for the benefit of another and under its control in a particular transaction. See Restatement (Second) of Agency §§ 2, 14N (1957). In the second place, the label which contracting parties place on their relationship is not decisive of their status vis-a-vis third parties. [Citations omitted.]

125 F.3d at 7.

In analyzing the relationship between the association and the outside firm, the court stated:

. . . [N]o single factor is dispositive. [Citations omitted.] Rather, the nature of the relationship between the Association and the outside firms depends on a myriad of factors, including control over the manner and means of performing the work, the skill required, and the method of payment, the duration of the

relationship, and similar factors. [Citations omitted.] The relevant factors here, taken as a whole, solidly support the Tax Court's determination that the outside firms acted as the Association's agents.

Ibid.

In Rev. Rul. 72-369, 1972-2 C.B. 245, an organization was formed to provide managerial and consulting services for section 501(c)(3) organizations to improve the administration of their charitable programs. The organization enters into agreements with unrelated section 501(c)(3) organizations to furnish managerial and consulting services on a cost basis.

This revenue ruling stated that:

An 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 a 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 intent element necessary to establish this activity as charitable.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. The Tax Court stated:

We must agree with the Commissioner that petitioner's activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit

70 T.C. at 358.

In Easter House v. U.S., 12 Cl. Ct. 476 (1987), aff'd in an unpub. opinion, 846 F.2d 78 (Fed. Cir. 1988), cert. den., 488 U.S. 907 (1988), the organization, in exchange for a fee, provided adoption services to parents seeking to adopt a child, including services to pregnant women who intended to place their newborns for adoption. These

fees were the organization's sole source of income. The Claims Court concluded that the organization's business purpose of operating an adoption service, not the advancement of educational and charitable activities, was its primary goal. It competed with other commercial organizations providing similar services. Thus, "[p]laintiff's competition provides its activities with a commercial hue." 12 Cl. Ct. at 486. Accordingly, the organization did not qualify for exemption under section 501(c)(3) of the Code.

In Airlie Foundation v. I.R.S., 283 F. Supp. 2d 58 (D. D.C. 2003), the District Court found that that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions on its facilities. The organization's patrons were not limited to tax-exempt entities, but included patrons of a private and corporate nature. The organization paid significant advertising and promotional expenses and derived substantial income from weddings and special events held at its conference center. The court determined that the organization's activities competed with a number of commercial, as well as non-commercial entities, which strongly evidenced a commercial nature and purpose. The court concluded that although the organization carried out a number of charitable and educational activities, these were incidental to its primary activity of operating a for-profit conference center. The court stated:

While plaintiff's organizational purpose is exempt and the foundation operates, in important respects, in an exempt fashion, there is a distinctive "commercial hue" to the way Airlie carries out its business.

283 F. Supp. 2d at 65.

RATIONALE

When an individual wants to donate a boat to a specific charity, you and the individual verbally agree that the individual will transfer to you possession of the boat and legal title. You agree that you will assume full responsibility for the boat, and will arrange for making the appropriate services, repairs or upgrades that need to be made to make the boat more readily marketable. You also agree that you will arrange for the boat to be sold and that after the sale, you will donate to the designated charity on behalf of the donor, after payment of the applicable expenses, 50 percent of the net proceeds of sale, and that you will retain the other 50 percent.

In some cases, you enter into the same arrangement with a donor but with a "bargain purchase" element. Under this arrangement, when the donor transfers the boat to you, you pay the donor a portion of the value of the boat. When the boat is sold, you retain the amount you paid to the donor and then donate to the designated charity on behalf the donor, after subtracting this amount plus applicable expenses, 50 percent of the net proceeds. You retain the remaining 50 percent.

As a result of this arrangement with a donor, you are performing services for and on behalf of the donor that facilitate the donor's contribution of a boat to the charity designated by the donor. Thus, you are serving as an agent of the donor. See Rev. Rul. 85-184, supra; Rev. Rul. 2002-67, supra; and State Police Association of Massachusetts v. Commissioner, supra.

By you serving as an agent of each donor, you are performing commercial services for these individuals in a manner that is similar to the organization in Rev. Rul. 72-369, supra. Arranging for donors for the charitable contribution of their boats, by taking possession and title to the boats; by arranging with third parties for their moorage, for necessary repairs and upgrades, and for sales by brokers; and by paying the net sales proceeds to the charity designated by the donor, all constitute common commercial activities, rather than activities that further a charitable purpose. See B.S.W. Inc. v. Commissioner, supra; Easter House v. U.S., supra; and Airlie Foundation v. I.R.S., supra. The fact that your activities consist exclusively of performing services for individuals who wish to donate boats to section 501(c)(3) organizations does not render your activities as charitable. Rev. Rul. 72-369, supra.

In addition, since all of your activities constitute the operation of a commercial activity, you are organized and operated for the primary purpose of carrying on an unrelated trade or business. As a result, under section 1.501(c)(3)-1(e)(1) of the regulations, you do not meet the requirements of section 501(c)(3) of the Code. Unlike the organization described in Rev. Rul. 64-182, supra, you do not carry on a charitable program that is commensurate in scope with your financial resources.

Therefore, you do not operate exclusively for charitable purposes, as required in section 501(c)(3) of the Code and the regulations thereunder.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

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

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your 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 officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available 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 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 a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, and do not intend to protest our denial of exempt status, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If you also disagree with our proposed deletions, you should send your comments on the deletions with your protest statement, and not to the address shown in Notice 437.

Internal Revenue Service
SE:T:EO:RA:TPU
PE: 3G1
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437