



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200520032**

Release Date: 5/20/2005

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No Third Party Contact

Date: 12/16/04

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

*** =

State =

A =

Y =

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.

You were incorporated on *** under the State Nonprofit Corporation Act. Your charter states that you were formed for the following purposes:

- (a) to promote, encourage , and help assure the availability of quality health care financing to the low-income citizens of developing countries at an appropriate cost and in accordance with professionally recognized standards;
- (b) to study and promote improved methods and means of health care financing and the improvement and protection of the public health;
- (c) to study, implement, and assist in the development, administration and delivery of health care financing , acting in conjunction with national, state, and local governments and their agencies, nongovernmental organizations (NGOs), professional societies or associations, patients, hospitals, nursing homes, other health

care facilities and delivery systems, the insurance industry, health care service corporations, representatives of management and labor, and any other interested persons and organizations; and

(d) promote the public welfare through the development and improvement of health care delivery and financing systems.

You will engage primarily in providing technical assistance to financial institutions and insurance companies in creating and implementing A products and other products designed for the poor in developing countries. You define A as the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. A products include insurance on health and dental care, life, and accidental death and are provided by insurance companies that are usually for-profit and regulated.

You refer to assisted financial institutions as Y institutions. Y institutions provide loans and credit to low-income persons and businesses. Y institutions extend small amount of loans that are in the average of \$100 for a term of four months up to one year. Borrowers can renew loans only upon full payment of outstanding loans.

You will identify and select a Y institution and an insurance company for appropriate partnership and assisting them in their relationship in their development of products and services. You indicate that the specific activities you will provide to Y institutions and insurance companies include the following:

- Research banking legislations to ensure legality of products and distribution channels
- Research to determine market and supply demands
- Developing product prototypes responding to market needs
- Review insurance legislation to ensure legality of products and their delivery
- Process development between Y institutions and insurance companies
- Product pilot test and development
- Assistance in the planning and implementation of a rollout plan after the product passes the pilot test
- Customer satisfaction studies
- Product review

You indicate that A is different from traditional insurance in various aspects. A is sold through Y institutions as compared to traditional insurance that is sold by insurance agents or branches. A coverage is often restricted to generic drugs to keep the premiums lower. A premiums are calculated using adjusted national treatment statistics as compared to traditional insurance premiums that are calculated using national treatment statistics.

You charge a fee in providing assistance to Y institutions and insurance companies. You indicate that your fees vary depending on the activity, the costs of personnel you send, and the assisted clients. Your activities are provided by your subcontracted professionals and by your president/director. Your fee to clients includes their daily rates plus 10 percent for your other

expenses. These professionals charge a daily rate ranging from \$450 to \$900 per day. Your president/director's daily rate fee is \$600 per day.

Section 501(c)(3) of the Code provides exemption for organizations that are organized and operated exclusively for educational, charitable, or other exempt purposes.

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

Section 1.501(c)(3)-1(d)(ii) of the regulations 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. Thus, to meet the requirements 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 creators, 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 provides that 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. An organization, which is organized and operated for the primary purpose of carrying on an unrelated trade or business, is not exempt under section 501(c)(3).

Rev. Rul. 68-117, 1968-1 C.B. 251, held that a nonprofit domestic organization formed and operated to help poor rural inhabitants of developing countries was furthering charitable and educational purposes and exempt under section 501(c)(3) of the Code. The organization conducted a guided self-help program for social and economic development that included furnishing expert guidance to subsistence-level farmer groups on modern agricultural methods, livestock and poultry care, and up-to-date marketing practices in an effort to raise their standard of living; providing assistance in arranging credit for farmers on reasonable terms with a realistic repayment schedule; establishing a program to purchase on credit U. S. surplus agricultural commodities under long term supply contracts pursuant to the Agricultural Trade Development and Assistance Act of 1954; training farm women in home economics, cooking, nutrition, food preserving, and infant care; conducting demonstrations on how to upgrade dilapidated housing at a cost that the farmers can afford; and conducting public health training programs with emphasis on preventative measures.

In carrying out its program, the organization works in cooperation with governments of the developing countries and with U. S. governmental agencies whose programs relate to economic development in the countries. The organization does not charge for any of its services but rely for financial support from contributions.

Rev. Rul. 68-165, 1968-1 C.B. 253, held that a domestic nonprofit corporation that provided free technical and material assistance for self-help projects designed to improve the living conditions of underprivileged people in foreign countries was engaged in charitable activities and exempt under section 501(c)(3) of the Code. The organization's activities included furnishing tools, educational materials, and other supplies, providing agricultural assistance, and giving advice and training necessary to administer health and welfare programs.

Rev. Rul. 54-305, 1954-2 C.B. 127, describes an organization whose primary purpose is the operation and maintenance of a purchasing agency for the benefit of its otherwise unrelated members who are exempt as charitable organizations. The ruling held that the organization does not qualify for exemption under the predecessor to section 501(c)(3) of the Code because its activities consisted primarily of the purchase of supplies and the performance of other related services, which are considered ordinary trade or business.

Rev. Rul. 69-528, 1969-2 C.B. 127, describes an organization formed to provide investment services on a fee basis only to organizations exempt under section 501(c)(3) of the Code. The organization invested funds received from participating tax-exempt organizations, was free from the control of the participants and had absolute and uncontrolled discretion over investment policies. The ruling held that the organization's activities of providing investment services on a regular basis is a trade or business ordinarily carried on for profit and precluded the organization from qualifying for exemption under section 501(c)(3).

Rev. Rul. 72-369, 1972-2 C. B. 245, describes an organization formed to provide managerial and consulting services for nonprofit organizations exempt under section 501(c)(3) of the Code. The organization enters into agreements with unrelated organizations to furnish managerial and consulting services at cost. The services consist of writing job descriptions and training manuals, recruiting personnel, constructing organizational charts, and advising organizations on specific methods of operation all designed for the individual needs of each client organization. The ruling states that 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 are provided at cost and solely for exempt organizations is not sufficient to characterize the activity as charitable within the meaning of section 501(c)(3). The ruling held that the organization does not qualify for exemption under section 501(c)(3).

Rev. Rul. 73-127, 1973-1 C.B. 221, described an organization that operated a retail grocery store to residents of a poverty area. The store operated in a manner similar to profit-making business in the area but sold groceries at prices substantially lower than those of competing grocery stores. The store provided free delivery service to residents who needed it and it participated in the Federal food stamp program. Also, the organization provided job training for unemployed residents. The organization's store earnings were used principally for salaries and customary operating expenses of the grocery store. The organization allocated 4% of its earnings for use in a continuous training program for the hardcore unemployed. The organization provided training in the various jobs in a retail food store and provided trainees with a small salary during the training period at its store. The trainees are expected to seek employment elsewhere in the retail food industry.

The ruling held that the organization did not qualify for exemption under section 501(c)(3) of the Code. While the organization's purpose of providing job training for the unemployed is charitable and educational under section 501(c)(3), the organization's purpose of operating a low-cost grocery store is not a recognized charitable purpose. The grocery store operation is an independent objective of the organization notwithstanding its use in part for the training program. Also, the grocery store operation was conducted on a scale larger than was reasonably necessary for the organization's job training program, and was not intended to, or in fact served solely as a vehicle for carrying out the training program.

In *B.S.W. Group v. Commissioner*, 70 T.C. 352 (1978), the Court considered the petition for exemption under section 501(c)(3) of the Code of an organization which was formed for the purpose of providing consulting services primarily in the area of rural-related policy and program development. The organization's goals are to help entities deal with problems they face regarding the external environments within which they operate, changing priorities, and implementing realistic internal planning and management policies. Another important goal of the organization is to improve clients' understanding of governmental policy processes and methods of becoming more effective in their work through public and private funding. In ruling that the organization did not qualify for exemption under section 501(c)(3), the Court indicates that the organization's activities constitute the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures for profit. Further, competition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes.

In *Airlie Foundation v. IRS*, 2003 U.S. Dist. LEXIS 16647 (D.D.C., Sept. 24, 2003), the plaintiff was formed for educational purposes and its primary activity is the operation of a conference center. On average, it hosted 600 groups per year of which an average of 20% of its conference events were for government clients, 50% for nonprofit and/or educational clients, and 30%-40% for other uses that include private events and commercial clients pursuing their private interests. The court held that the plaintiff operated its conference center as a commercial business and was not entitled to recognition of exemption under section 501(c)(3) of the Code. The court stated -- "While plaintiff was organized for an exempt purpose, the Court cannot find, under the totality of the circumstances, that it is operated similarly."

Our analysis indicates that you are primarily engaged in assisting insurance companies and financial institutions in developing and marketing insurance and loan products to be made available to citizens of, and businesses operating in developing countries. Essentially, your activity is acting as a broker between the providers (Y company and the insurance company) and the consumers. You will receive income for providing services to assisted entities and you use your income primarily to pay for fees and other expenses in providing your service. This service for fee activity is indicative of an ordinary trade or business activity similarly found in Rev. Ruls. 54-305, 69-528, 72-369, as well as in *B.S.W. Group*, and *Airlie Foundation*, *supra*. While we recognize that your activity would provide benefits to low-income consumers, we found that a significant part of your activities is promoting the business of assisted insurance companies and financial institutions. Further, the Y company and the insurance company expect to generate profit from the service they provide.

By engaging primarily in a trade or business ordinarily carried on for profit not in furtherance of an exempt purpose you are not operated exclusively for one or more exempt purposes under section 501(c)(3) of the Code. See sections 1.501(c)(3)-1(c)(1) and 1.501(c)(3)-1(e)(1) of the regulations.

You are distinguishable from the organizations described in Rev. Ruls. 68-117 and 68-165, whose activities for the underprivileged and poor people in foreign countries were found to be charitable within section 501(c)(3) of the Code. Whereas those organizations directly provided free services to program beneficiaries, you are providing services to program providers and for a fee basis. Further, while we recognize that your activities may indirectly provide certain benefits to needy people and could further an exempt purpose, a greater part of your activities is not in furtherance of an exempt purpose. See Rev. Rul. 73-127.

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, 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 it is convenient, you may fax your reply using the fax number shown in the heading of this letter.

Internal Revenue Service
TE/GE, SE:T:EO:RA:T:3

1111 Constitution Ave, N.W., PE
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.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437