



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

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

**Release Number: 200737044
Release Date: 9/14/07
Date: June 18, 2007
UIL Code: 501.03-05**

**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 under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(3).

We made this determination for the following reason(s):

You have not established that you are operated exclusively for exempt purposes described in section 501(c)(3) of the Code. You are not operated for an exempt purpose listed in section 1.501(c)(3)-1(d)(1)(i) of the Income Tax Regulations. You have not established that your operations relieve the poor or distressed or of the underprivileged or otherwise serve a charitable purpose as defined in section 1.501(c)(3)-1(d)(2). Even if your operations further an exempt purpose, you do not operate exclusively for such purpose because you do not serve a public interest. You do not serve a public interest because you operate for the benefit of private interests within the meaning of section 1.501(c)(3)-(d)(1)(ii). Since you are operated for the benefit of private interests, including the private interests of your founder, your net earnings inure to the benefit of private shareholders or individuals within the meaning of section 1.501(c)(3)-1(c)(2).

Because 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. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, 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 we mailed this letter to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

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.

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,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

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: November 30, 2005

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

L =

M =

Date 1 =

Date 2 =

a =

Dear :

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

Facts

On Date 1, you were incorporated as an a nonprofit public benefit corporation under the laws of the State of a. On Date 2, you filed Form 1023, the application for recognition of exemption under section 501(c)(3) of the Code.

Your Articles of Incorporation state that you are organized exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. Your Articles provide that you will have between one and five directors. Your Board of Directors consists of two individuals, L and M, who are father and son, respectively. Your officers consist of L, who serves as President, and M, who serves as Secretary/Treasurer.

Your Bylaws state that your purpose is:

To provide fertility services at no cost to married and single women who desire to have children and have chosen to become pregnant by artificial insemination.

You provide, at no charge, frozen donated sperm to selected women to use in becoming pregnant. You receive donations of sperm, which you store in a sperm bank. The sperm bank

provides you with storage, shipping and freezing of the donated sperm. You have a long-term sperm storage agreement with this sperm bank.

You do not pay your sperm donors. Currently, only three men have donated sperm. Of the total number of vials of frozen sperm currently available, one donor has donated five percent, the second donor has donated seven percent and the third donor has donated 88 percent.

Your website includes an extensive biography of the third donor, but has virtually no biographical information on the first and second donors. Based on the information you submitted and the information included on your website, we believe that the third donor is M.

Your website describes the services that you provide and solicits applications from women seeking to become recipients of donated sperm. The website contains an application form that interested women may submit on a confidential basis. The application contains twelve questions, one of which is: "Which sperm donor do you want to use?" The other questions include the applicant's views on a child's upbringing and environment; the family environment in which the applicant intends to raise the child; whether the applicant has previously tried any sort of fertility treatment; the applicant's age, ethnic background and education; where the applicant lives; reasons the applicant wants to have a child by artificial insemination; reasons the applicant chose the particular sperm donor; achievements of which the applicant is especially proud; information about the applicant's blood family; and anything else that the applicant wishes to say.

When you receive an application from a prospective recipient, an officer of your organization or a volunteer codes the applicant's answers into a computer readable form, and runs the answers through a computer program, which assigns a number score to the applicant. If the score exceeds a certain threshold, the applicant is accepted, otherwise, the applicant is rejected. The threshold score is adjusted so that the number of recipients you accept matches the number of sperm vials that you have available for the donor chosen by the applicant.

An officer of your organization may overrule the decision based on the threshold score. When this has occurred, the officer concluded that the applicant had more merit than judged by the computer program threshold score. Thus, the applicant was accepted even though the applicant's score did not exceed the threshold score for acceptance.

Once a recipient is selected and has successfully completed medical testing, you arrange for the sperm bank to transfer the appropriate vials of frozen sperm to the recipient.

You state that you are not required to be licensed by any governmental entity. You state that your contracted sperm bank has satisfied all regulatory requirements regarding medical matters.

Your funding comes from cash and marketable securities donated by M. You do not intend to conduct any active fundraising program or conduct any fundraising activities.

Law

An organization described in section 501(c)(3) of the Code must be organized and operated exclusively for one or more exempt 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(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

Rev. Rul. 66-323, 1966-2 C.B. 216, concluded that an organization that collected and distributed human blood and blood products for the benefit of the public and conducted related research qualified for exemption under section 501(c)(3) of the Code because it served a public purpose.

In this revenue ruling, the organization's board of trustees was comprised predominantly of public members who were not otherwise associated with the organization.

The organization obtained blood from professional and volunteer donors and supplied blood and blood products to hospitals, including local and Federal government institutions, doctors, clinics and commercial laboratories. Within the limits of its ability, it supplied blood free for indigent and charity patients. The organization served as a free repository of blood for a local research foundation in a volunteer program jointly maintained by it and the foundation. It also provided blood to other institutions for research purposes. In addition, the organization: (a) collaborated with an exempt organization in a free program of blood typing of volunteer donors; (b) opened several blood-drawing stations in the area which it serves; (c) pioneered the development of a program to help meet the need for fresh blood in connection with open heart surgery; (d) allocated funds to a blood coagulations research program conducted jointly with an exempt research center; and (e) provided gratuitous services of an educational nature to the community.

Although the organization charged those who were able to pay for its services, its charges for blood and blood products were generally less than the prevailing rates charged by commercial blood distributors. Furthermore, it was committed by its charter to use all funds received for its services in excess of operating costs for the accomplishment of its declared charitable purposes, including expansion of its services as required by the community need. It was also committed to furnish services to any person notwithstanding his or her inability to pay. Additionally, the organization's trustees were required to review periodically the schedule of charges to insure that they were not higher than was reasonably necessary to enable it to perform its community function.

In carrying out its purposes, the organization had a volunteer blood replacement program which enabled recipients of blood to extinguish, in whole or in part, the charges they would otherwise have to pay. With some of the institutions it served, replacement of blood was accepted on a two-for-one basis with no service charge.

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 this subparagraph unless it serves a public rather than a private interest. An organization that serves a private interest other than incidentally, is not entitled to exemption under section 501(c)(3). Thus, although an organization's operations may be deemed to be beneficial to the public, if it also serves private interests other than incidentally it is not entitled to exemption. The word "incidental" has both qualitative and quantitative connotations.

For a benefit to be qualitatively incidental, it must be a necessary concomitant of the activity which benefits the public at large. That is, the benefit to the public cannot be achieved without necessarily benefiting certain private individuals. For example, in Rev. Rul. 70-186, 1970-1 C.B. 128, an organization was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. Although the organization clearly benefited the public at large, there necessarily was also

significant benefit to the private individuals who owned lake front property. In this ruling, the IRS determined that the private benefit was incidental in a qualitative sense, stating:

The benefits to be derived from the organization's activities flow principally to the general public through the maintenance and improvement of public recreational facilities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

There is also a quantitative connotation to the term "incidental." For example, in Rev. Rul. 76-152, 1976-1 C.B. 151, a group of art patrons formed an organization to promote community understanding of modern art trends. The organization selected modern art works of local artists for exhibit as its gallery, which was open to the public, and for possible sale. If an art work was sold, the gallery retained a commission of ten percent and paid the remainder to the artist. In this ruling, the IRS concluded that since ninety percent of all sales proceeds are turned over to the individual artists, such direct benefits are substantial and the organization's provision of these benefits is not merely incidental to its other purposes and activities.

In Rev. Rul. 60-143, 1960-1 C.B. 192, the social and recreational activities carried on by an alumni association of a university were merely incidental to the association's basic purpose of advancing the interests of the university and thus, did not preclude the association from being described in section 501(c)(3) of the Code. This revenue ruling noted that "an activity which is in fact incidental, secondary or subservient to an organization's exempt purpose or purposes and which, when weighed against the whole of the activities of the organization, is less than a substantial part of the total, will not ordinarily operate to deny exemption."

In Rev. Rul. 75-196, 1975-1 C.B. 155, held that an organization operating a law library whose rules limited access and use to members, or their designees, of a local bar association qualified for exemption as an organization described in section 501(c)(3) of the Code. Although the attorneys who used the library might derive personal benefit in the practice of their profession, the benefit was incidental to the library's exempt purpose and a logical by-product of an educational process.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court held that an organization that as its primary activity operated a school to train individuals for careers as political campaign professionals was not operated exclusively for exempt purposes as described in section 501(c)(3) of the Code because the school's activities conferred impermissible private benefit. The court defined "private benefit" as "nonincidental benefits conferred on disinterested persons that serve private interests."

In Callaway Family Association v. Commissioner, 71 T.C. 340 (1978), an organization was formed to study and research the genealogy of the Callaway family, to issue related publications, and to provide instruction and education in the methodology of historical, biographical, and genealogical research. In this case, the Tax Court concluded that:

Petitioner's activities, when aggregated, demonstrate that primarily private interests are being served. Any educational benefit to the public created by petitioner's activities is incidental to this private purpose.

71 T.C. at 344.

In Benjamin Price Genealogical Association, 79-1 USTC (CCH) ¶ 9361 (D. D.C. 1979), the U.S. District Court held that an organization formed to disseminate information on, and to preserve documents relating to, the genealogy of Benjamin Price did not qualify for exemption under section 501(c)(3) of the Code because it was created and operated primarily for the benefit of the private interests of its members rather than exclusively for educational purposes.

In Manning Association v. Commissioner, 93 T.C. 596 (1989), an organization was formed to acquire and preserve the ancient Manning homestead and other historic relics and records of the descendants of William Manning and to encourage communication among his descendants. The Tax Court concluded that although the organization did serve some educational purposes, it did not operate exclusively for educational purposes because its nonexempt activities, furthering the private interests of the Manning family, were substantial.

The Preamble to proposed regulations under section 501(c)(3) of the Code states: "The examples illustrate that prohibited private benefits may involve non-economic benefits as well as economic benefits." 70 F.R. 53599 (September 9, 2005). Section 1.501(c)(3)-1(d)(1)(iii) of the proposed regulations, Example 1, describes an educational organization whose purpose is to study history and immigration. The focus of its historical studies is the genealogy of one family. It solicits members only from the members of that family. Its research is directed toward publishing a history of that family. A major objective of its research is to identify and locate living descendants to enable them to become better acquainted with each other. This example concludes that the organization's activities primarily serve the private interests of members of a single family rather than a public interest. Therefore, the organization is operated for the benefit of private interests in violation of the restriction on private benefit in section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd in unpublished opinion 647 F.2d 170 (9th Cir. 1981), several for-profit est organizations exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the non-profit 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.

RATIONALE

Serving a Public Interest

Under section 1.501(c)(3)-1 of the regulations, in order for an organization to qualify for exemption under section 501(c)(3) of the Code, it must be organized and operated exclusively for one or more exempt purposes, such as a charitable purpose. Section 1.501(c)(3)-1(a) of the regulations provides that if an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for an exempt purpose unless it serves a public rather than a private interest.

Rev. Rul. 66-323, supra, concluded that an organization that collected and distributed human blood and blood products for the benefit of the public and conducted related research qualified for exemption under section 501(c)(3) of the Code because it served a public purpose. Except for the fact that you provide donated sperm to recipients at no charge, your activities are substantially different from the organization described in this revenue ruling.

In this revenue ruling, the organization's board of trustees was comprised predominantly of public members who were not otherwise associated with the organization. However, your Board of Directors consists of only two individuals, L and M, who are father and son, respectively. In addition, your officers consist of only L, who serves as President, and M, who serves as Secretary/Treasurer. It is a significant that M is your founder, your sole financial donor, and your principal sperm donor.

In this revenue ruling, the organization obtained blood from professional and volunteer donors. However, although your donors are volunteers, there are only three donors, of whom one, M, has donated 88 percent of the total number of vials donated. As noted, M is your founder, your sole financial donor, your principal sperm donor, one of two related trustees and one of two related officers.

In this revenue ruling, the organization supplied blood to a wide variety of recipients, including hospitals, local and Federal government institutions, doctors, clinics and commercial laboratories. Also, within the limits of the organization's ability, it supplied blood free for indigent and charity patients. It served as a free repository of blood for a local research foundation in a joint volunteer program. It also gave blood to other institutions for research purposes. Furthermore, it provided a variety of services relating to the provision of blood in medically-necessary situations and engaged in providing related educational services.

Although you screen applicants and quantitatively evaluate their answers to your questionnaire to determine their suitability to receive sperm donations, you have not demonstrated that the standards you use for evaluating applicants or selecting recipients have any medical, psychological or social underpinnings. Furthermore, one of your officers, who may himself be the donor of the sperm to be given to the recipient, may subjectively overrule the initial screening decision.

Therefore, you do not serve a public purpose as required by section 1.501(c)(3)-1(d)(1)(ii) of the regulations and in the same manner as the organization described in Rev. Rul. 66-323, supra.

Private Benefit

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for an exempt purpose unless it serves a public rather than a private interest. Thus, the organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals or the organization's creator or the creator's family. An organization that serves a private interest other than incidentally, is not entitled to exemption under section 501(c)(3). Thus, although an organization's operations may be deemed to be beneficial to the public, if it also serves private interests other than incidentally it is not entitled to exemption. See American Campaign Academy v. Commissioner, supra.

The word "incidental" has both qualitative and quantitative connotations. See, e.g., Rev. Rul. 70-186, supra; Rev. Rul. 76-152, supra; Rev. Rul. 60-143, supra; and Rev. Rul. 75-196, supra.

In addition, an impermissible private benefit is not limited to economic benefits, but may also consist of non-economic or intangible benefits. See American Campaign Academy v. Commissioner, supra; Callaway Family Association v. Commissioner, supra; Benjamin Price Genealogical Association, supra; and Manning Association v. Commissioner, supra. See also, Preamble to proposed regulations under section 501(c)(3) of the Code, at 70 F.R. 53599 (September 9, 2005); and section 1.501(c)(3)-1(d)(1)(iii) of the proposed regulations, Example 1.

The non-profit organization in est of Hawaii, supra, was controlled by several for-profit organizations through contractual arrangements. Similarly, you are controlled by one individual, M, who is your founder, your sole financial donor, your principal sperm donor, one of two related trustees, and one of two related officers. Thus, taking into account your structure, governance and operations, your activities result in the provision of more than an incidental level of private benefit to M and his family. Therefore, you violate the prohibition in section 1.501(c)(3)-1(d)(1)(ii) of the regulations against impermissible private benefit.

Therefore, you are not organized and operated exclusively for charitable purposes, as required in section 501(c)(3) of the Code and the regulations thereunder. Consequently, you do not qualify for exemption under section 501(c)(3) of the Code.

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 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.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see 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 protest 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 this address:

Internal Revenue Service

SE:T:EO:RA:T:1
1111 Constitution Ave, N.W.
Washington, D.C. 20224

You may also 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.

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