



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200935044**
Release Date: 8/28/2009

Date: May 26, 2009

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:
1120

Tax Years:
All

UIL: 501.04-00

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(4). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. We also attempted to contact the person holding your power of attorney. Because we did not receive a reply or a protest within the requisite 30 days, the proposed adverse determination is now final.

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.

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, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

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



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: March 25, 2009

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

You or X =
Research Institute =
\$a =

Dear :

We have 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 have concluded that you do not qualify for exemption under section 501(c)(4). The basis for our conclusion is set forth below.

You were formed by several members of a state legislature who share ideological, philosophical, and political principles. Your articles state that your purpose is: "to benefit the educational and economic welfare of [the residents of your state] through its work with people of common interest and its promotion of various policies and programs."

Membership in your organization is limited to members of your state legislature. Membership expires every two years, with the end of the legislative session. According to your by-laws, upon a unanimous vote, your Board of Directors will extend membership invitations to state legislators in November of each even-numbered year. The Directors may terminate membership at any time, after a unanimous vote. The Directors will adopt rules for scoring the floor votes of the legislators during each regular and special session. This score may be used to extend an invitation to join or to terminate membership.

Your initial board of directors selects subsequent directors and your three officers. Neither your articles of incorporation, nor your by-laws prevent directors or officers from receiving legislative assistance from you.

In your application, you explained that you will engage in four activities: developing a legislative agenda, drafting and filing legislation, working to pass the agenda through public relations activities such as media relations, and educating the general public through marketing and advertising. You initially said that:

Marketing and advertising of the...legislative agenda to the public will account for the greatest expenditures of organizational resources. [Our] advertising and marketing will center on [our] website, where all organizational publications will appear free of charge.

In response to a development letter asking you to describe any changes in your plans for the future, you stated that you no longer have a website, and have no plans to establish one in the immediate future. You did not expand upon that answer or explain whether you would conduct marketing or advertising in some other medium.

Your application stated that you will "also expend a significant amount of resources on direct lobbying and other methods of influencing legislation," explaining that it would be strictly issue-oriented and would not constitute intervention in electoral partisan politics. You will not advocate the election or defeat of any candidate for government office, nor permit your name or resources to be used for such campaign purposes. Each member will be required to sign a declaration stating that he recognizes that the organization and its publications and activities are not to be used for election-related purposes. You will monitor use of your publications and activities and notify any person who uses them for campaign purposes to desist immediately. Any member who does so a second time, will have his membership revoked. In addition, if any member uses the internal scoring system for electoral purposes, or makes public any information based upon it, he will immediately be removed from membership.

Smaller in resource utilization, but important, will be development of a legislative agenda. Apparently, committees of members will make recommendations for two agenda items in each of five subject areas for approval by the board.

You explained that your board will direct staff in "compiling academic reports, journals, statistics, and other research to aid in drafting model legislation to be filed...by a member of the organization." You will provide the members with background required to become an expert in key issues. Your staff will coordinate conference calls and meetings between members and interested parties, conduct research, write persuasive policy papers, solicit grants and contributions, and plan marketing campaigns that target legislators or the general public.

Your remaining resources will be devoted to organizational activities such as fund-raising and administration.

In answer to a question on the application about your relationships with other organization, you asserted that you will not be connected to any other organization. However, two of your founders and directors also serve as directors of the Research Institute. The two organizations also plan to share staff, although you represent that their duties will be "performed and compensated separately." You also plan to share office space and equipment, at least initially, with the Research Institute. You represent that the Research Institute will not subsidize your activities in any way, and that finances, expenditures, revenue streams, and activities of the two organizations will remain separate.

You will charge members annual dues of \$a, but expect that most of your revenues will be contributions from individuals and corporations. According to your initial financial statement, contributions will total ten times your expected dues. Your revised profit and loss statement, submitted with a subsequent communication, states that you received all of your income to date

from "corporate contributions" during the first year of operations. The same document indicates that "outside contract services" account for most of your expenditures to date.

Recently we requested an update on your activities since you submitted the application, any changes in your plans for the future, revisions of financial expectations, copies of solicitation materials, and copies of public relations or public education materials. You submitted only a summary of financial information for the past three years, the requested copies of your Articles of Incorporation and By-Laws, and a statement that:

According to guidance of legal counsel, all necessary documents were filed with the Internal Revenue Service in order to apply for recognition of non-profit status for X. Out of abundance of caution and given the length of time since the application was filed, X's directors decided not to proceed with developing promotional materials, engage in activities, or continue fundraising until which time the Internal Revenue Service has recognized the legal tax-exempt status of the organization.

LAW

Section 162(e) of the Internal Revenue Code (the "Code") denies deduction from income tax of expenses for lobbying (among other activities), specified as influencing legislation.

Section 162(e)(4) of the Code defines the term "influencing legislation" as an attempt to influence legislation through communication with any member or employee of a legislative body.

Section 501(c)(4) of the Code states that an organization will be recognized as exempt from federal income tax under that subsection if it is a civic league or organization not organized for profit but operated exclusively for the promotion of social welfare, and no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Section 4911 of the Code defines lobbying expenditures as those made for the purpose of influencing legislation through an attempt to affect the opinions of the general public or through communication with any member or employee of a legislative body who may participate in the formulation of the legislation.

Section 1.501(c)(4)-1 of the Income Tax Regulations (the "regulations") states that an organization may be exempt as an organization described in section 501(c)(4) if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community, bringing about civic betterments and social improvements.

Section 1.501(a)-1(c) of the regulations defines the words "private shareholder or individual" as used in section 501 as persons having a personal and private interest in the activities of the organization.

Section 56.4911-2(b) of the Public Charities Regulations ("regulations") defines direct lobbying communications as attempts to influence legislation through communication with a legislator when the communication refers to specific legislation and reflects a view on such legislation.

Section 56.4911-2(b)(4) Example (6) of the regulations explains that if a legislator is a member of an organization, and receives a monthly newsletter in her capacity as a subscriber rather than as a legislator, that an editorial in the newsletter reflecting a view on pending bills will not be considered direct lobbying communication.

Rev. Rul. 79-316, 1979-2 C.B. 228 found that an organization qualified for exempt status under section 501(c)(4) because it cleaned up liquid spills in a city port area that were caused by members and non-members for the same fee, and by preventing and cleaning up liquid spills that endanger marine life and shorefront property was primarily engaged in activities designed to benefit all the inhabitants of the community.

Rev. Proc. 2009-9, 2009-2 I.R.B. 256 in Section 4.01, provides that the Internal Revenue Service will recognize the tax-exempt status of an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from Federal income tax is claimed. Section 4.03 provides that exempt status may be recognized in advance of the organization's operations if its proposed operations are described in sufficient detail to permit a conclusion that it will clearly meet the particular requirements for exemption pursuant to the section of the Internal Revenue Code under which exemption is claimed. Section 4.03(2) states that the organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

In Commissioner v. Lake Forest, 305 F.2d 814 (4th Cir. 1962), the court concluded that the cooperative housing organization did not have exclusively social welfare purposes, but rather substantial and material advantages for the members.

In Monterey Public Parking Corporation v. United States, 481 F.2d 175, 177 (9th Cir.), the court affirmed the lower court ruling that an organization constructed and operated a parking garage for the public benefit. Its organizers benefited also, but in a manner 'indistinguishable from that which inured to the community as a whole.'

In Contracting Plumbers Cooperative Restoration Corporation v. United States, 488 F.2d 684 (2d Cir. 1973), cert. denied 419 U.S. 827 (1974), the court held that the cooperative organized by plumbers to repair cuts made in city streets by its members was not entitled to exemption as a civic league because it was organized by members who had substantial business interests in it, and each member enjoyed economic benefits precisely to the extent that he used and paid for the repair service.

In Church of Eternal Life & Liberty v. Commissioner, 86 T.C. 916, the court deduced from the exclusive control of the founder and major contributor over the assets and funds of the organization, together with a finding that the compensation to him was excessive, that the earnings inured to his private benefit.

RATIONALE

An organization may be recognized as exempt from federal income taxes under section 501(c)(4) of the Internal Revenue Code (the Code) if it is operated for the promotion of social welfare, or to bring about civic betterments and social improvements. The organization must have as its primary objective benefits to the community as a whole, not benefits restricted to its membership.

Not primarily devoted to social welfare

The information that you have submitted indicates that you will operate primarily for the benefit of your members, rather than to benefit the community as a whole. Courts assessing similar applications have examined the membership structure and types of services that an applicant provides. Classification as a social welfare entity "depends upon the character—as public or private--of the benefits bestowed, of the beneficiary, and of the benefactor." C.I.R.v. Lake Forest, 305 F.2d at 818. We examine these in reverse order.

Your character, as a benefactor, is closely guarded and private. You were founded by three persons now serving as your directors and officers. They have authority to choose subsequent directors and officers, to grant or revoke membership, and to pick the issues that you address. Your members are chosen by the directors, and may only vote on the issues presented to them by the board. The public may not participate in your affairs nor are you accountable to another body. Your founding directors are members of the state legislature whom you intend to assist.

The prospective beneficiaries of your organization are actually your own members: a small group chosen by your directors because their voting records show that they adhere to your ideological and political ideas. The directors may revoke membership at any time, thus exerting control over the members' continued adherence to your political positions. You are not offering support to the legislature in general, but only to those legislators chosen by your directors who continue to vote in the way that you approve. Further, neither your articles of incorporation, nor your by-laws preclude your officer-directors from receiving the same benefits as members.

The benefit that you will give to your members is to augment their work as legislators. You will direct your staff to do research, draft legislation, sponsor meetings with "interested parties" and plan media and marketing campaigns to support their initiatives. This is the work normally conducted by members of a legislator's staff. While some ten percent of your budget will be dues from the members, you will raise ninety percent of the budget from outside individuals and corporations.

The court in Contracting Plumbers Cooperative, concluded that community welfare was not the organization's primary purpose because it provided substantial and different benefits to the community and to its members. 488 F.2d at 687. Many of the factors that the court relied on to make this assessment are present in your situation. Like the Plumbers' Cooperative, your founders had a substantial business interest in your formation. Also, your operation is intended to be of value to your members, by providing them additional resources and assistance in their legislative duties. Like the Plumbers' Cooperative, that only filled the potholes left by its members and not the "equally troublesome potholes" left by others who had to cut into city streets, you will only help your members, not other state legislators. In contrast, the business owners that developed the parking garage in Monterey Public Parking did not give themselves

special privileges, but operated the garage on the same basis for the patrons of all the businesses in the area. 321 F. Supp. at 976.

You stated that you no longer plan a website, on which you had said that you would publish all of your publications, free of charge. The website had been the method of conducting public education. Thus, you apparently no longer intend to provide the benefit of public education.

We conclude that your membership-based structure and the type of services you plan to offer demonstrate that your primary activity is not the promotion of social welfare.

Activity does not constitute exempt lobbying

A social welfare organization may lobby as a primary activity. Although you said that you would expend a significant amount of resources on direct lobbying, you have not shown that your primary activity is lobbying. You are not attempting to influence legislation through communication with legislators. See sections 162 and 4911 of the Code. Your officers and members are themselves legislators, and they choose your issues and draft actual legislation to further their own legislative agendas.

Activity may result in Inurement

No part of the net earnings of an entity that is recognized as exempt under section 501(c)(4) of the Code may inure to the benefit of any private shareholder or individual. Private shareholders and individuals are those who have a personal and private interest in the activities of the organization. Treas. Reg. Section 1.501(a)-1(c). Your officer-directors have private interests in your activities because they are founders, managers, and beneficiaries. They have complete authority over the organization, and can manage its resources for their private benefit. They choose members, issues, and can direct the work of the staff to benefit themselves and others. There are no safeguards in your articles or by-laws to prevent the officer-directors from personally benefiting from your activities. Where an individual or small group has exclusive control over the management of the organization's funds and is the principal recipient of the distributions of the organization, prohibited inurement is strongly suggested. Church of Eternal Life & Liberty, 86 T.C. 916, and cases cited at 927.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

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
TE/GE (SE:T:EO:RA:T:)

1111 Constitution Ave, N.W.
Washington, DC 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.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements