



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: **201017067**  
Release date: 4/30/10  
Date: 2/2/2010  
UIL Code: 501.03-22  
501.03-27, 501.33-00, 501.33-01

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 as an organization described in Internal Revenue Code section 501(c)(3). 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. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

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.

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.

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,

Rob 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: 12/16/2009

Contact Person:

Identification Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

B = a state  
C = a date  
D = a local college alumni organization  
E = a university  
F = a national fraternity  
G = a national educational foundation  
N = a dollar amount  
O = a dollar amount

**UIL:**

501.03-22  
501.03-27  
501.33.00  
501.33-01

Dear

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

**Issue:**

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons described below.

**Facts:**

You were incorporated in the state of B on date C. You are affiliated with D, a local college fraternity alumni association that is exempt under section 501(c)(7) of the Code. Your trustees are members of D.

D recently used its housing corporation to construct a new facility for a local chapter of college fraternity F with which you are affiliated. The local chapter of F has approximately 31 members.

Your Articles of Incorporation state that you were organized exclusively for charitable, religious and/or educational purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code or the corresponding section of any future federal tax code and for the following more particular and included purposes:

- (a) To provide tuition and room/board scholarships to students at university E.
- (b) To have and exercise all rights and powers conferred on nonprofit corporations under the laws of state B, or which may hereafter be conferred; provided, however, that this corporation shall not, except to an insubstantial degree, engage in any activities or exercise any powers that are not in furtherance of the primary purposes of this corporation as set out in (a) above.

Your specific purpose per your application for exemption, is to provide scholarship assistance in the form of tuition and room and board scholarships to the members of the local chapter of the college fraternity F who demonstrate either financial need, academic excellence, or both.

You estimated that out of the approximately 31 members of the local chapter of the college fraternity F, you will award scholarships to about 10 to 14 local fraternity members in a typical year. You projected that that the amount of each of your scholarships will be between \$N and \$O.

Your application further stated that you will review scholarship applications submitted by the local fraternity members, and will select recipients for the scholarships using the criteria of demonstrated financial need and demonstrated commitment to excellence in pursuit of an academic course of study. Your application also said that this activity will be conducted by your trustees, and will take all of your time and financial resources. You asserted that this activity is educational within the meaning of section 501(c)(3) in that it enables students to advance their formal education at university E.

Your application indicated that you were formed as an alternative to the individual college fraternity chapter scholarship account overseen by G, the national college fraternity scholarship foundation. According to your application, G's scholarship procedures reduce the effectiveness of donations to G from the local college fraternity alumni association D. You asserted that because the members of D (acting through

you) are willing to devote their time in evaluating local students and awarding local scholarships, you are, or will be able to provide more scholarships to local fraternity members than could be offered through G, the national college fraternity

scholarship foundation.

You stated that your fundraising will be limited to direct personal appeals and mailed, e-mailed, and telephonic appeals to individuals, businesses, and organizations.

In response to the questions on Schedule H of the Form 1023, Application for Recognition of Exemption, you stated that the purpose of your scholarships is to allow those students at university E who are members of the local chapter college fraternity F to pursue excellence in education without the encumbrance of excessive student debt, or the need to postpone education in order to raise funds necessary to pay tuition and other expenses.

You said that your program will also be publicized through word of mouth at events sponsored by the local chapter of the college fraternity F, and will also be published in fraternity newsletters, if space is available.

Per your application for exemption, all members of the local chapter of the college fraternity F shall be eligible to submit an application for scholarship consideration and the selection criteria you will use to determine eligibility for the program are as follows:

1. An applicant must be a member of the local chapter of college fraternity F.
2. An applicant's financial status will be considered as follows:
  - (a.) Applicant's personally available financial resources
  - (b.) Applicant's annual income
  - (c.) The annual income of applicant's parent or guardian (unless applicant is independent of said parents or guardians)
3. An applicant's academic record will be considered (College transcripts will be the primary consideration, if an applicant has completed college coursework. If an applicant has completed no, or very little college coursework, then the applicant's high school transcript shall be considered.).

The number of scholarships you will make annually will be based on your available resources from year to year. Your objective will be to provide larger scholarships to local fraternity members with greater demonstrated financial need that perform at an above-average level scholastically. The amount of grants will be determined relative to the financial need and scholastic performance of the applicant pool in each year.

Per your application for exemption, in order to maintain eligibility and to receive additional scholarship awards, a student must remain a member of the local chapter of

the college fraternity F, must maintain enrollment at university E, and must make adequate progress toward a degree.

Your local fraternity member scholarship recipients will be required to submit transcripts to you for each semester in which scholarship funds have been granted. Your trustees will review the academic progress of each award recipient. Funds may be paid to the scholarship recipient, upon the recipient's producing evidence of enrollment for the semester for which the scholarship award applies. However, funds may also be paid directly to university E on the recipient's behalf. Should a recipient withdraw from enrollment at university E or otherwise resign or become terminated from the local chapter of the college fraternity F, you reserve the right to seek reimbursement of the scholarship award, through court initiated action, if necessary.

Although your selection committee currently consists solely of your trustees, who are members of the local college fraternity alumni association D, you plan, as you begin to raise funds and develop the ability to make more scholarship awards, to appeal to D to supply additional persons to serve on your selection committee.

Currently, you have no plan to make scholarship awards to relatives of members of your trustees, your selection committee, officers, directors, or other related parties. However, in the future, if a relative of such a person is a student at university E, and a member of the local chapter of the college fraternity F, you will consider such scholarship applicant along with other scholarship applicants. In such an event, the related individual who is on your selection committee will be required to abstain from all proceedings related to scholarship awards during any period when the relative is under consideration for an award.

In the additional information you submitted about your application for exemption, you stated that your financial resources will probably limit the number of scholarships that you can make in a typical each academic year. Therefore, you will create a hierarchy of deserving local fraternity members based on their financial need and academic excellence. Accordingly, you will award scholarships first to those local fraternity members with more acute financial need and to those local fraternity members with more outstanding academic performance.

You stated that financial need means that the local fraternity member's current financial resources, as measured by a formula you created, are insufficient to currently pay the costs of the local fraternity member's education. Your formula takes into account the cost of tuition and fees as established by university E in the applicable academic year for two sixteen credit hour semesters, plus the cost of room and board for on-campus dormitory living and a campus dining hall meal plan, plus an allowance for books and materials to arrive at the total cost of education for an academic year. Each local fraternity member who applies will be required to report his own and his parents' or

guardians' annual income, along with the amount of any other scholarships, grants, or tuition reductions received by the local fraternity member for that academic year. You will use these factors to arrive at the total amount of resources available to each local fraternity member who applies for one of your scholarships. You will treat the extent to which the total current cost of education

exceeds the local fraternity member's current resources as the dollar amount of the financial need for that local fraternity member for an academic year.

You stated that academic excellence will be measured by an examination of cumulative grade point averages for the local fraternity members who have completed at least twelve credit hours of college coursework and by high school grade point averages for those students who have not. You will rank the local fraternity members from highest to lowest by such grade point averages.

You will give priority in awarding scholarships to the local fraternity members in the following order:

- Fraternity members with comparatively greater demonstrated financial need who have maintained a grade point average of 2.8 or above.
- Fraternity members with comparatively moderate demonstrated financial need who have maintained a grade point average of 3.5 or above.
- Fraternity members with comparatively greater or moderate financial need who have maintained a grade point average of 2.0 or above.
- Fraternity members with less financial need or lower grade point averages.

Although you estimated that in a typical year you will most likely only be able to award scholarships to 10 to 14 of the approximately 31 members of the local college fraternity F, if you are very successful in fundraising and if all of the local fraternity members meet your minimum requirements and submit applications, it would be possible under your scholarship procedures for every local fraternity member to receive one of your scholarships in a particular year.

You stated that you further intend to award principally academic scholarships, and to make disbursement of such funds directly to the university. Therefore, the only monitoring you will conduct will be to have each local fraternity member / recipient provide you with evidence that he completed at least twelve credit hours of study during the course of the semester for which the scholarship was granted.

If you instead pay funds directly to a particular local fraternity member, he will be required to provide you with the evidence of completion of academic study, as described above, and he will further be required to provide evidence of payment of room and board expenses in at least the amount of the scholarship award.

You will work with the administration of the university to ensure that the local fraternity member / recipients are not permitted to withdraw from coursework in order to receive a refund of all or part of your scholarship funds. If you discover that your scholarship funds have been misused under your procedures or have been used for a non-exempt purpose, you will issue a demand letter to the local fraternity member / recipient calling for a reimbursement of the award paid. If the fraternity member / recipient fails to respond to the demand, you will seek legal counsel to obtain repayment of the funds.

**Law:**

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (the regulations) states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization: (a) Limit the purposes of such organization to one or more exempt purposes; and (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of 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 that 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)(ii) of the regulations states that an organization is not organized or 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 creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Rev. Rul. 56-403, 1956-2 CB 307, stated that the awarding of scholarships by a foundation solely to undergraduate members of a designated fraternity did not, by itself,



preclude exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 as an educational organization.

Rev. Rul. 57-449, 1957-2 C.B. 622, stated that where a decedent bequeathed the residue of his estate in trust, the income and principal of which was to be used to pay a certain amount of money to all individuals who were enrolled as students in a particular school as of a particular date, the value of the trust was not deductible from the

decedent's gross estate as a bequest for educational purposes under section 2055 of the Internal Revenue Code of 1954.

Rev. Rul. 66-103, 1966-1 C.B. 143, held that an organization whose primary activity was to provide awards and grants, including scholarship and fellowship grants, to needy individuals who would otherwise not be able to pursue their studies for lack of funds and with no monetary benefits to the donor organization, qualified for exemption under section 501(c)(3) of the Code. The organization was primarily engaged in the charitable activity of relieving poverty.

Rev. Rul. 67-367, 1967-2 CB 188, stated that a nonprofit organization whose sole activity was the operation of a scholarship plan for making payments to pre-selected, specifically named individuals did not qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Rev. Rul. 69-257, 1969-1 C.B. 151, held that an organization providing scholarships to recipients selected from a broad class of applicants on the basis of scholastic standing, qualified for exemption under section 501(c)(3) of the Code because it was engaged in the charitable activity of advancing education.

In the United States Tax Court decision of *Alumnae Chapter Beta of Clovia, Petitioner v. Commissioner of Internal Revenue, Respondent*, Docket No. 1484-81X, which was filed May 26, 1983, the Court upheld the denial of exemption under section 501(c)(3) to an organization that provided subsidized housing for members of the Beta of Clovia organization who were students and members of the active chapter of Beta of Clovia and provided a chapter house for the Clovia organization. Although some housing was also provided for University of Minnesota students who were not members of Beta of Clovia, the record showed that precedence was given to members of the active chapter. The court concluded that the organization's benefits were overly directed toward a narrowly designated group, leading to the conclusion that the "operated exclusively" test of section 501(c)(3) was not met.

In the United States Tax Court decision of *Local Union 712, I.B.E.W. Scholarship Trust Fund v. C.I.R.*, T.C. Memo. 1983-76, the Tax Court upheld the Service's position that the organization was not operated exclusively for exempt purposes under section 501(c)(3) of the Code, since it was serving the private interests of its members.

The organization was created pursuant to a collective bargaining agreement between the union and the association which was established for the purpose of awarding scholarships to the children of union employees. Since 1972, all applicants were eligible for the scholarship under the terms of the trust agreement and all such applicants were awarded scholarships. From 1967 through 1971, all applicants were eligible but not all were awarded scholarships. The ratio of scholarships awarded to the number of applicants for 1967, 1968, 1969, 1970 and 1971 were 2:5, 2:8, 2:3, 3:5 and 2:5.

In its memo, the court stated that to qualify for exemption under section 501(c)(3), an organization must benefit a sufficiently broad class to confer a public benefit. The benefits in that case were available only to the children of the employees covered by the

collective bargaining agreement. The court decided that the class was too restricted to confer the public benefit contemplated by section 501(c)(3).

#### **Application of the Law to the Facts:**

In determining whether you meet the requirements of section 501(c)(3) of the Code, we considered whether you further exclusively charitable and educational purposes for the benefit of the general public, or whether you benefit to a substantial degree the private interests of a narrow group of individuals and organization D, which is exempt under section 501(c)(7) rather than 501(c)(3).

You are distinguishable from the organization described in Rev. Rul. 56-403, 1956-2 CB 307. That revenue ruling stipulated that scholarships were open to members of all chapters of a designated fraternity who were in their senior year at any college or university and were based on scholarship, character, and service to the institution. By having the awards open to students at a national level, the benefit to a specific local chapter or individual in control of such a program was sufficiently minimized. Your organization differs from this because your scholarships are available only to members of a single local college fraternity chapter, and based on the information provided, almost half of the members of that local chapter will usually receive an award.

You are similar to the situation described in Rev. Rul. 57-449, 1957-2 C.B. 622. In that ruling, the value of the decedent's residual trust was not deductible to his estate since the trust was not considered to be established for educational purposes for the benefit of a charitable class. Similarly, an organization (trust or otherwise), set up to benefit an entire group of individuals who can be individually identified at a certain point in time by some common factor would not qualify for exemption as an organization under Internal Revenue Code Section 501(c)(3), contributions to which are deductible under section 2055 of the Internal Revenue Code of 1954.

You will rank the applications from the local fraternity members based on the information contained in the applications and you will make awards, starting at the top of the ranking list and proceeding as far down the list as your resources will permit,

possibly including those local fraternity members who meet your lowest standards. The purpose of the ranking is to prioritize distributions when your resources are scarce. The more abundant your resources, the more likely that a higher percentage of all of the members of the local chapter of the college fraternity F will receive an award. Although you estimated that in a typical year almost half of the local fraternity members would benefit, they might in some years all benefit if your fundraising was very successful and if the local fraternity members all submitted applications and all met your minimum standards, namely that the local fraternity member's financial need would be moderate or less than moderate and that the local fraternity member's grade point average would be at least 2.0.

You are distinguishable from the organization described in Rev. Rul. 66-103, 1966-1 C.B. 143. That ruling held that an organization whose primary activity was to provide awards and grants, including scholarship and fellowship grants, to needy individuals who would otherwise not be able to pursue their studies for lack of funds and with no monetary benefits to the donor organization, qualified for exemption under section 501(c)(3) of the Code. That organization was primarily engaged in the charitable activity of relieving poverty. However, you will solicit support from members of your related alumni association, whose housing corporation has a vested interest in scholarships for room and board expenses. Therefore, you will to a significant degree serve the private interests of D, a related organization which is exempt as a social club under section 501(c)(7) rather than as an exclusively charitable or educational organization under section 501(c)(3).

You are similar to the organization described in Rev. Rul. 67-367, 1967-2 CB 188. As noted previously, the fact that the beneficiaries can be specifically identified by name to a significant degree denotes an unacceptably high level of preselection, which indicates that you will substantially promote private interests in a manner inconsistent with section 501(c)(3) which requires that organizations be operated for public rather private purposes.

You are distinguishable from the organization described in Rev. Rul. 69-257, 1969-1 C.B. 151. That ruling held that an organization that provided scholarships to recipients selected from a broad class of applicants on the basis of scholastic standing, qualified for exemption under section 501(c)(3) of the Code because it was engaged in the charitable activity of advancing education. In contrast, your class of applicants is very limited (membership in the local chapter of the college fraternity F) and the main factor that will restrict or expand the percentage of local fraternity members receiving your scholarships will be your fundraising ability.

You are similar to the organization described in *Alumnae Chapter Beta of Clovia* in that limiting the eligibility to receive a benefit (scholarship) to such a narrowly designated group, leads to the same conclusion, namely that you cannot meet the "operated

exclusively” test of section 501(c)(3).

You are similar to the organization described in *Local Union 712, I.B.E.W. Scholarship Trust Fund*. In its initial period, that organization did not award scholarships to all of its applicants, but awarded scholarships to a significant portion of its applicant pool (from 25-60%). Once its resources were established, that organization awarded scholarships to all eligible applicants. You have stated that the number of scholarships to be granted by your organization annually will be based on your available resources from year to year. Your objective will be to provide larger scholarships to local fraternity members with greater demonstrated financial need who perform at an above-average level scholastically. The amount of your grants will be determined relative to the financial need and scholastic performance of the applicant pool in each year. The criteria for

making your grants indicate that when you are very successful at fundraising, you may be able to provide scholarships to all local fraternity members who apply.

**Applicant’s Position:**

You asserted that you are a purely philanthropic organization created to provide funding for education to students. You believe that the size and identity of the pool of scholarship applicants are irrelevant.

**Service Response to Applicant’s Position and Conclusion:**

The term “philanthropy” does not appear in section 501(c)(3), although we agree that some elements of your scholarship procedures serve educational and charitable purposes. However, our analysis of the above described facts, the relevant law, and the additional information you submitted about your position on the issue indicates to us that the size and identity of your pool of scholarship applicants are relevant factors to consider in determining whether your scholarship procedures will exclusively serve charitable and educational purposes for the benefit of the general public and thereby qualify for exemption under section 501(c)(3) or whether your scholarship procedures will benefit private interests to a substantial degree and therefore fail to meet the requirements for exemption under section 501(c)(3).

Under your scholarship procedures, students at university E will be able to substantially improve the likelihood that they can attain scholarships for tuition and room and board simply by joining the local chapter of the college fraternity F. If you did qualify for exemption under section 501(c)(3), donors to you would be able to take income tax deductions on their Forms 1040 under section 170. The members of the local college fraternity alumni association D, to which you are related, would know in advance that their donations to you would assist only those applicants from a small pre-identified pool, namely the members of the local chapter of the college fraternity F.

Additionally some or all of the room and board portion of the local fraternity members' scholarships will be paid to or for the benefit of your related local college fraternity alumni organization D, which is a social rather than charitable organization and which is exempt under section 501(c)(7) rather than 501(c)(3).

Based on this final analysis, we concluded that your scholarship procedures will benefit private interests to a substantial degree and that you therefore do not qualify for exemption under section 501(c)(3).

### **Appeal Rights and Procedures:**

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.

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 protest, signed by one of your officers under the penalties of perjury, within 30 days from the date of this letter. We will consider your protest and decide if the information affects our determination. If your protest does not provide a basis to reconsider the determination at our level, we will forward your case to the independent IRS Appeals Office. You can find more information about the role of the Appeals Office in the enclosed Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in 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](http://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 appeal 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 decide to protest, please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

If you mail a protest to us, please mark it to the attention of the IRS contact person listed on page one of this letter.

You may also fax a protest to us using the fax number shown on page one of this letter. If you fax a protest, please call the IRS contact person listed on page one of this letter to confirm that he 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