



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Number: **201130010**  
Release Date: 7/29/2011

Date: May 4, 2011

UIL: 501.32-00; 501.33-00

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.

Since 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.

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.

Letter 4038 (CG) (11-2005)  
Catalog Number 47632S

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,

Lois Lerner  
Director, Exempt Organizations

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: March 3, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

B = individual  
C = individual  
D = individual  
F = business  
G = state  
H = business  
K = individual  
L = business  
M = street  
N = award  
X = date  
y = dollar amount

**UIL:**

501.32-00  
501.33-00

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.

**Issues**

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

**Facts**

You were incorporated on date X, pursuant to the nonprofit corporation statutes in the state of G. Your Articles show you were formed to provide education and training in the performing arts and create performance opportunities. To do so you will teach master classes, give seminars, and conduct workshops for students. You will also solicit and provide scholarship funds for students and present performances.

Letter 4036 (CG) (11-2005)  
Catalog Number 47630W

Your governing body originally consisted of B and C who are related to each other by marriage. You were asked to expand your board to ensure public interests, and did so, adding four unrelated individuals. One of the additional board members, K, is an employee of L, of which B and C have ownership interests.

In your initial application you stated that your activities would include education, training, and opportunities in the performing arts to create performing options and opportunities for those who participate. This would include classes, workshops and training as well as seminars. You later removed these as activities and indicated your sole activity going forward will be providing grants to individuals wishing to pursue opportunities in the performing arts.

Grants, or scholarships, will be awarded to allow students to further their education and training in the arts. Funds could be used for summer programs at colleges or camps or be used by those studying arts related programs at universities. 35 to 40 percent of grants awarded are estimated to be used for programs at F.

F is a for profit dance company owned and operated by B and C which has been offering performance and training opportunities nearly identical to your initially planned activities for more than 5 years. F employs D as a coach for participants. You referred to F as "your organization", but indicated no intention of taking over F's activities. F remains a viable entity. C also owns and operates H, a similar for profit dance company.

Your grants would be publicized online, at dance competitions, to former students of F and at schools emphasizing the performing arts. Any student with the desire to further their training is eligible for grants. Financial need is not necessarily a factor in choosing recipients but instead selection will be based on training, previous performances, competitions, years of study, age and recommendations of faculty. An interview and audition are also part of the application and selection process.

Auditions will be conducted by D. Flyers for your scholarship promote D as an M music director and N winner offering classes on how to succeed as a young performer. Online materials for F show D also conducts auditions and interviews for students looking to get accepted into the F programs.

Grants will be awarded by a selection committee. Your selection committee consists of B, C and D. You stated the committee will consist of at least five members but later confirmed its only members are these three individuals.

#### **Law**

Section 501(a) of the Internal Revenue Code provides for the exemption from federal income tax for organizations described in Section 501(c)(3). Such organizations are recognized as exempt if they are organized and operated exclusively for religious, charitable, and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations ("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 exempt 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(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it. It is the burden is on the organization to establish that it is not organized and 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 private interests. The organization's activities must be broad enough in scope to confer a public benefit versus serving to benefit only a few.

Revenue Ruling 61-170, 1961-2 CB 112 provides that operating under the control of one person or a small, related group suggests that an organization operates primarily for non-exempt private purposes, rather than exclusively for public purposes.

Salvation Navy v. Commissioner, T.C.M. 2002-275 (2002), the court found that one of the reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that its net earnings would not inure to the benefit of a private individual, its founder.

Ohio Disability Association, An Ohio Non-Profit Corporation v. Commissioner, T.C.M. 2009-261 (2009), the court found that the information provided did not demonstrate that there is oversight to prevent the organization from being operated to benefit the founder and sole director. The information provided does not permit the court to conclude that the petitioner will operate exclusively for exempt purposes and that no part of the net earnings will inure to the benefit of a private shareholder or individual.

#### **Application of Law**

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations state that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. An applicant must establish that it is not operated for the benefit of private individuals, such as its creator and family. You are founded to support the functions of F, a for-profit entity owned and operated by C. You are scheduled to provide 35-40% of grants for attendance at F. Your scholarship committee is made up of individuals with direct interest in F. The original scholarship application you provided was titled F auditions. The initial fliers you provided include little if any information about you or your scholarship program but do include information about F as well as F's web site. Although you amended these documents little changed in content outside of the removal of F's name and web site. The scholarship process does not mirror that of what is typically seen for educational or charitable grants – the process seems directed toward those aware of F's programs or those who are currently participating in classes at F or H. The application also seems geared towards those familiar with an audition process used by F that is overseen by D; in that even if an outsider applied they would face a disadvantage for qualification over an applicant already familiar with the process. Although your

initial activities were revised it is still apparent your purpose appears to be supplying interested students with funds to attend classes at F, which is owned by C. B and C are related and are members of your governing body. You have not established that your organization will not be operated for the benefit of B, C, and D. Therefore you have not met your burden of proof that you will be operated for public rather than private purposes. For this reason you are serving private interests and do not meet the qualifications per 1.501(c)(3)-1(d)(1)(ii).

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that if an organization fails to meet either the organizational test or the operational test, it is not exempt. Since you are conducting activities that will substantially benefit founders or insiders of your organization you are not operating exclusively for exempt purposes and do not meet the operational test under 501(c)(3) of the Regulations.

In Revenue Ruling 61-170 the Service determined that control of an organization by a single person, or even a small related group of individuals, suggests that an organization is operated primarily for non-exempt private purposes. Although the board overseeing your organization is diverse and unrelated, since the sole activity you conduct is the provision of grants, the true control of your operations rests in the hands of those deciding who will receive your scholarship awards. Like the organization described in Rev. Rul. 61-170, a small group of related individuals, B, C, and D, have complete control over the selection of scholarship recipients which allows them to avert funds for use by F. Any scholarship recipients who participate in F's program provide a financial benefit to B, C, and D. The benefit in this instance is not insubstantial, and further, because it is a benefit to insiders this constitutes inurement. Because you are operating primarily to benefit F and the private interests of B, C and D you do not qualify for exempt status under 501(c)(3).

In Ohio Disability Association v. Commissioner the court found that the information provided did not demonstrate there was oversight to prevent the organization from being operated to benefit the founder and sole director. In your case, your scholarship committee is comprised of two related individuals and an individual with related interests in F; an entity that is estimated to in the end receive at least 35-40% of the grants you award. Therefore it is possible that the selection committee may show preference either intentionally or unintentionally to applicants who wish to participate in the F program. The individuals with oversight of your organization are in control of funds that will eventually provide them with personal benefit. For this reason you are similar in that there is no outside oversight of the distribution of scholarship funds from inuring to those in control of F.

In Salvation Navy v. Commissioner, the organization could not prove that its net earnings would not inure to the benefit of a private individual, its founder, and did not qualify for exemption from federal income tax. As shown the funds of your organization are scheduled to be used at least in part for programs of F, a for profit entity owned by members of your governing body. Any additional funds awarded for programs at F, which by your admittance is also possible as the 35-40% was only an estimate, would only add to the benefits being derived by B, C and D. Because you have been unable to demonstrate that funds you collect will not directly benefit insiders, like the organization in Salvation Navy, you do not qualify for exemption.

Based on the information submitted, you have failed to establish that no part of your net earnings will inure to private individuals and that you will be operated for a public rather than a private interest. For these reasons you do not meet the basic qualifications for exemption under IRC 501(c)(3).

**Conclusion**

You have not demonstrated that no part of your net profits will not inure to the benefit of private individuals. You have not established that you will be operated for public rather than private purposes. Accordingly, you do not qualify for exemption under section 501(c)(3) of the Code.

**Appeal Rights and Other Procedures**

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. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

*Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:*

*"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."*

*The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.*

*Your appeal will be considered incomplete without this statement.*

*If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.*

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 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 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

You may 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,

Lois Lerner  
Director, Exempt Organizations  
Rulings & Agreements

Enclosure  
Publication 892