



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201232034**
Release Date: 8/10/2012

Date: May 16, 2012

UIL: 501.03-00; 501.03-20

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.

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,

Lois G. 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 30, 2012

UIL: 501.03-00
501.03-20

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

State =
Seminar =
Date1 =
Date2 =
Date3 =
Price1 =
Price2 =
Salary =
Year =

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.

FACTS:

You are a non-profit corporation incorporated in State. You submitted an application for recognition of tax exempt status under section 501(c)(3) of the Internal Revenue Code ("Code") and requested public charity status as a church under § 170(b)(1)(A)(i) of the Code.

According to your Bylaws, you intend to provide "Christian spiritual leadership and pastoral care to individuals and fellowships in the international community of believers that visit [your] ministry website." In furtherance of these purposes, you provide "free spiritual services through the website including, but not limited to sermon preparation, outlines, and spiritual illustrations; Bible study, prayer group, and leadership training materials; membership, statement of faith, and other church-building materials; articles and fictional reading materials; etc." In your narrative statement, you describe yourself as an "online ministry." According to you, "[t]hree groups of people have been identified as using [your] spiritual services." These groups are "[i]ndividuals

who need access to a spiritual community for their own purposes, [i]nternational individuals who need more spiritual sources in English than their local community provides, [and] [l]eaders of international Christian groups who lack trained Christian leadership that need materials found on this website to help them to provide spiritually for their group.”

In the Form 1023, you state that you would receive funds through the sale of goods or services. In your Date1 letter you state that your founder previously performed seminars entitled “Seminar.” Your website provides an overview of the seminar. According to your Date2 letter the seminar focuses on self love and serves mostly as a self-help course for leading a happier life. The seminar is not specifically religious, but draws from religion and religious concepts. You intend to provide these seminars at a rate of Price1 per person. Additionally, you state in your Date1 letter that you anticipate selling future books by your founder at approximately Price2 a book, plus shipping and taxes. Currently, your founder is not selling any books nor is she currently offering the seminar. You state in your Date2 letter that the last time your founder offered the seminar was in Year. You clarify in your Date3 letter that the writing and sale of books and the preparing and conducting of the seminar may take up to fifty percent of your time. The same letter also states that any such book or seminar would be substantially similar to the representative samples provided in articles on your website. According to your Date3 letter, the copyright of any books you sell or promote would remain with the author and you would get ten percent of the proceeds with the remainder going to the author.

You completed Schedule A to the Form 1023. In your attachment to Schedule A, you provide a statement of faith and a code of doctrine and discipline. In your attachment to Schedule A, you state that your “form of worship evident in the materials that appear on the website, published by [you are] Christian protestant and evangelical.”

You explain that you do not have a regularly scheduled religious service. Rather, your activities are conducted over the internet. You state that you are a “virtual church” with materials “available at all times.” You do not have an established place of worship, rather, all activities are conducted through your website. You do not conduct baptisms, weddings, funerals, or religious instruction of the young.

You have an invitation to membership. However, you “urge all members of [your] ministry and all visitors to [your] website to become active members in a local church in [their] areas that teaches from the Bible.” You state that “anyone can become a member of this ministry while keeping their membership and staying active in their local church.”

The Certificate of Formation that you filed with your state declares that you are organized for any or all lawful purposes. The Certificate does not contain a dissolution clause or a prohibition against inurement, but in your Date1 letter you committed to making the necessary changes.

Your Board of Directors consists of three related individuals. Your chairman of the board is also your founder and minister. One board member is the brother of the founder, while the other is the daughter of the founder. You expect that the board of directors will grow and change as the “website ministry becomes better known.” The Chairman of the Board will be compensated at a rate comparable to executives in organizations of similar size or fifty percent of gross revenue, whichever is less. The Chairman is currently not compensated, however, due to lack of any funds, and the starting salary of the Chairman is currently projected at Salary. The other two board members are uncompensated. You state that you have no connection with organizations

related to your officers or directors.

LAW:

Section 501(c)(3) of the Code provides that organizations may be exempted from tax if they are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and "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") provides that in order to be exempt under 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 that section.

Section 1.501(c)(3)-1(c)(1) 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. 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) provides 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. To meet the requirement of this subsection, the burden of proof is on the organization to show 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)(1)(iii), *Example 2*, denies exemption to an art museum whose principal activity is exhibiting art created by a group of unknown but promising local artists, including organizing tours of the exhibited art. All of the art exhibited is offered for sale at prices set by the artist. The museum sales the art under consignment whereby the artists keep ninety percent of the proceeds providing ten percent to the museum to cover costs. None of the artists exhibited were on or related to the board of trustees that determined who was shown. The organization is denied exemption since a substantial purpose of the museum is to advance the private interests of the artists shown.

Section 1.501(c)(3)-1(d)(1)(iii), *Example 3* denies exemption due to substantial private benefit to an organization that is operated primarily to educate others using a program developed by its founder. The organization pays a for profit organization owned by the found for the rights to use the program. The program was previously used to educate others on a for profit basis under the for profit organization.

Rev. Rul. 56-262, 1956-1 C.B. 131, provides that an organization qualifies as a church only if its principal purpose or function is that of a church. An organization, whose activities include the conducting of religious services and/or the ministrations to the sick or mentally retarded, may have characteristics of a church and a hospital, and an educational institution, but where the principal purpose or function of such an organization is not that of a church or association of churches, or an educational organization, or a hospital, it will not qualify under any of the classes of organizations set forth in section 170(b)(1)(A)(i), (ii) or (iii).

Rev. Rul. 61-170, 1961-2 C.B. 112, provides that an organization is operated for a private rather than public benefit, in part, because the organization had no public participation in management. This ruling is distinguished from Rev. Rul. 55-656, 1955-1 C.B. 262.

Church by Mail v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), *aff'g* 48 T.C.M. (CCH) 471 (1984), the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated: "The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church." In this case, the executives of the Church were also the executives and owners of a for profit publishing company that exclusively published and sold items from the Church. The publishing company and the executives made profits from selling the works of the Church. The publishing company was deemed to receive a substantial benefit from the efforts of the Church since all of its profits derived from selling products of the Church.

In American Guidance Foundation, Inc. v. United States, 490 F. Supp. 304 (D.D.C. 1980) *aff'd* in an unpublished opinion (D.C. Cir. 1981), the court upheld the IRS's determination that a nonprofit corporation failed to qualify as a "church" for purposes of exemption under section 501(c)(3). "Faced with the difficult task of determining whether or not religious organizations are in fact churches," the court explained, "the IRS has developed fourteen criteria which it applies on an ad hoc basis to individual organizations." That is, in applying the analysis to determine whether a religious organization may properly be characterized as a church, the Service considers whether the organization has the following characteristics:

- (1) a distinct legal existence
- (2) a recognized creed and form of worship
- (3) a definite and distinct ecclesiastical government
- (4) a formal code of doctrine and discipline
- (5) a distinct religious history
- (6) a membership not associated with any other church or denomination
- (7) an organization of ordained ministers
- (8) ordained ministers selected after completing prescribed studies
- (9) a literature of its own
- (10) established places of worship
- (11) regular congregations
- (12) regular religious services
- (13) schools for the religious instruction of the young
- (14) schools for the preparation of its ministers

The court added that no single factor is controlling in making this determination, although some are "relatively minor" in importance while others are of "central importance," including the existence of an established congregation served by an organized ministry, the religious education of the young, the dissemination of a doctrinal code, and the provision of regular religious services. At a minimum, the court concluded, a church includes a body of believers or communicants that assembles regularly in order to worship.

In Foundation of Human Understanding v. U.S., 88 Fed. Cl. 203 (Fed. Cl. 2009), *aff'd* 614 F.3d

1383 (Fed. Cir. 2010), the court stated that the "associational test" is a threshold standard that a religious organization must satisfy in order to obtain church status. The court went on to determine

The extent to which Foundation brings people together to worship is incidental to its main function which consists of a dissemination of its religious message through radio and internet broadcasts, coupled with written publications. When bringing people together for worship is only an incidental part of the activities of a religious organization, those limited activities are insufficient to label the entire organization a church.

Chapman v. Commissioner, 48 T.C. 358 (1967), held that an organization of dentist missionaries formed to spread the Gospel and improve dental care in foreign countries was a not a church, where the organization was not affiliated with any church, drew its members from various Christian denominations, and did not attempt to promote membership in any particular Christian denomination. A concurring opinion notes that the organization failed to bring people together as the principal means of accomplishing its religious purpose.

est. of Hawaii v. Commissioner, 71 T.C. 1067 (1979), the Tax Court held that compensation need not be unreasonable or exceed fair market value to be private benefit, stating "[n]or can we agree with petitioner that the critical inquiry is whether the payments made to International were reasonable or excessive. Regardless of whether the payments made by petitioner to International were excessive, International and EST, Inc., benefited substantially from the operation of petitioner."

In Bubbling Well Church of Universal Love v. Commissioner, 74 T.C. 531, 534 (1980) *aff'd*, 670 F.2d 104 (9th Cir. 1980), the Tax Court explained that an organization that is closely-controlled by related individuals must clearly demonstrate that private interests will not be served and that net earnings will not inure to the benefit of insiders. Given the control over the petitioner organization by related individuals, the court could not conclude "from the information in the administrative record that part of the net earnings did not inure to the benefit of the [controlling] family or, stated another way, that petitioner was not operated for the [family's] private benefit." In reaching this conclusion, the court noted that the situation:

. . . calls for open and candid disclosure of all facts bearing upon petitioner's organization, operations, and finances so that the Court, should it uphold the claimed exemption, can be assured that it is not sanctioning an abuse of the revenue laws. If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that petitioner fails to meet the requirements of section 501(c)(3).

74 T.C. at 535.

In The Church of Eternal Life and Liberty, Inc. v. Commissioner, 86 T.C. 916 (1986), an organization with only two members that pursued a policy discouraging membership was held to not be a church since it failed to serve any associational role for purposes of worship.

First Church of In Theo v. Commissioner, 56 T.C.M. (CCH) 1045 (1989), held that an organization was not a church where its principal activity was publishing religious literature and it had no plans for membership, although it conducted some religious services. The

organization did not have a formal creed, other than the Bible and a belief that God dwells in all people, no sacerdotal functions, no membership unassociated with other churches, no regular congregations or services, no established place of worship, no organized ministry for ministering to the congregation and no youth instruction. It was uncontested, however, that petitioner was an exempt religious organization.

ANALYSIS:

Organizations may be exempted from tax if they are organized and operated exclusively for religious, among other, purposes. Section 501(c)(3). An organization is considered organized for exempt purposes if its articles of incorporation limit its purposes to one or more exempt purposes and dedicates the assets to an exempt purpose upon the dissolution of the organization. Sections 1.501(c)(3)-1(b)(1), (b)(4). In this case, you have not included either statement in your Certificate, therefore you are not currently organized for an exempt purpose. However, you have committed to adding the necessary language.

More importantly, you have not demonstrated that you are exclusively operated for an exempt purpose. See section 1.501(c)(3)-1(c)(1). While some of your activities are educational and religious, you also have a significant non-exempt purpose of promoting the works of your founder. You anticipate conducting seminars previously offered by your founder and selling books that may be created by your founder. Your founder previously sold her seminar and books for profit through her personal website.

The regulations clearly regard transfers of for-profit activity to an exempt organization as indicative of private benefit. The regulations contain two examples of organizations denied exempt status because the organizations provided similar support for a founder's private activity. Section 1.501(c)(3)-1(d)(1)(iii), *Examples 2 and 3*. You have said that up to 50 % of your president's time, which you expect to compensate, could be spent on writing books and seminar materials. You have represented that you will not acquire copyrights to the books or seminars that you plan to market and produce. Rather, your founder or other authors will retain the rights to books and materials that you will promote and sell on your website. You anticipate that they will direct ten percent of the proceeds to you. Thus, you will pay to produce and promote material from which your founder and other authors will primarily benefit. A similar retention of copyrights by artists when an organization sold their work is described as private benefit in another example in the regulations. Section 1.501(c)(3)-1(d)(1)(iii), *Example 2*.

We need not determine whether the proceeds from books and seminar sales are reasonable or above fair market value. "The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially." Church by Mail, 765 F.2d at 1392. Compensation need not be unreasonable or exceed fair market value to be private benefit. est. of Hawaii, 71 T.C. 1067. Benefits directed to those who control an organization deserve special scrutiny. You will be the primary advertiser and purveyor of your founder's books and seminars, thus as in Church by Mail and est. of Hawaii you are creating substantially all of the market for the founder's products. Both cases deemed this benefit to be substantial for the private interests involved.

While an organization may have an insubstantial non-exempt purpose, a substantial non-exempt purpose will prevent recognition for exemption regardless of the other exempt purposes.

Section 1.501(c)(3)-1(c)(1). Furthermore, section 1.501(c)(3)-1(d)(1)(ii) provides 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. You anticipate that creating and promoting your founder's book and seminar activities may take up to fifty percent of your staff time, which is certainly a substantial part of your activities. Therefore, we cannot find that you are organized exclusively for an exempt purpose.

A community based board of people with no financial interests in the entity can help prevent it from operating for private rather than public benefit. See e.g. Rev. Rul. 61-170, supra; see also Bubbling Well Church, 74 T.C. at 535. However, your board of directors is small and closely related by family ties as your founder, her brother, and her daughter are the sole directors. While this factor alone is not enough to deny exemption (Bubbling Well Church, 74 T.C. at 535), combined with the private benefit demonstrated above, it creates greater cause to believe that you are operated for private, rather than public, interests.

Church Status

You have also requested public charity status as a church under section 170(b)(1)(A)(i), but even if exemption were recognized you would not qualify as a church. Religious purposes alone are not enough to establish an organization as a church. Church of Eternal Life, 86 T.C. at 924. In determining whether a taxpayer qualifies as a church, the IRS applies a fourteen part test, which was upheld in American Guidance Foundation, 490 F. Supp. 304. The characteristics reviewed in making the determination of whether a religious organization is a church are:

- (1) a distinct legal existence
- (2) a recognized creed and form of worship
- (3) a definite and distinct ecclesiastical government
- (4) a formal code of doctrine and discipline
- (5) a distinct religious history
- (6) a membership not associated with any other church or denomination
- (7) an organization of ordained ministers
- (8) ordained ministers selected after completing prescribed studies
- (9) a literature of its own
- (10) established places of worship
- (11) regular congregations
- (12) regular religious services
- (13) schools for the religious instruction of the young
- (14) schools for the preparation of its ministers

In reviewing these characteristics, no single factor is controlling although some are "relatively minor" in importance while others are of "central importance." Id. at 306. "A church's principal means of accomplishing its religious purposes must be to assemble regularly a group of individuals related by common worship and faith." Church of Eternal Life, 86 T.C. at 924. "At a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship." American Guidance Foundation, 490 F. Supp. at 306; see also Church of Eternal Life, 86 T.C. at 924; Chapman, 48 T.C. at 367 (Tannenwald, J., concurring).

You lack the most important, associational characteristics of a church, as well as most of the other factors deemed important to church identity. A website on the internet does not qualify as a place of worship, nor do individuals accessing that website constitute a congregation assembled to worship. Foundation of Human Understanding, 614 F.3d at 1391. Additionally, you do not ordain ministers, do not have regular congregations or services, do not have schools for religious instruction, and do not perform any sacraments such as weddings, baptisms, or funerals. Also, you encourage members to maintain membership in other churches and be baptized by other ministers. Therefore, although your purposes and activities would be religious, we cannot recognize you as a church for the purposes of public charity status.

CONCLUSION:

You do not qualify as a church or as an exempt organization. Your Certificate of Formation does not currently meet the organizational test. You also do not meet the operational test because your sale of books and seminars created by and profiting your founder combined with your small, related board lead to the conclusion that you are operated for private rather than public benefit.

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
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,

Lois G. Lerner
Director, Exempt Organizations