



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201247016**
Release Date: 11/23/2012
Date: August 28, 2012

UIL: 501.03-00

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.

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.

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,

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: June 13, 2012

Contact Person:

Identification Number:

Uniform Issue List: 501.03-00

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

Date 1:

Date 2:

State:

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 were incorporated on Date 1 under State non-profit corporation law. You filed Form 1023 (Application For Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code) on Date 2.

Your Certificate of Incorporation (hereinafter "Certificate") states that you are formed exclusively for scientific, educational, and charitable purposes within the meaning of I.R.C. § 501(c)(3). Your specific purpose is to "conduct activities to advance communication network infrastructure and technologies that enable the interchange of communication and information among regional users . . . by developing, operating and maintaining a sustainable wholesale open access communications and information network."

Your primary activity will be the creation of an 800 mile hi-speed fiber optic broadband telecommunications network that will provide a backbone to support the proposed expansion of various high-speed telecommunications services in a rural area in State. Currently, this rural area is serviced by standard telephone, cellular, and internet technologies. You intend to be the "carrier's carrier" by providing wholesale hi-speed broadband connection paths to commercial telecommunication companies, who will then provide retail hi-speed broadband communication services to individual subscribers. In other words, you will provide the "backbone" through which commercial providers will offer their services to the public. The network will be open to all commercial providers or others requiring hi-speed broadband.

You will not provide services directly to the public. Instead, you intend to lease your hi-speed broadband pathways to commercial telecommunication companies who will then offer their services to the public. Currently, you have not entered into agreements with any commercial providers because the network has not been constructed. You will operate using a "wholesale" model. The fees charged to commercial telecommunication companies for using your hi-speed broadband network will be based on cost of constructing and operating it. However, you will not require these commercial telecommunication companies to reduce prices in order to ensure that this cost saving is passed on to the public. Instead, you believe consumers will recognize a cost savings from these commercial telecommunication companies solely through increased competition between commercial providers.

You will own any hi-speed broadband networks built. However, you will hire contractors to operate and maintain your hi-speed broadband networks. These contractors have not yet been chosen.

You are conducting two auxiliary activities. The first is a wireless pilot project, which is now complete. This project was funded by a governmental agency with the intent to create a small wireless network to determine whether wireless broadband was suitable to meet rural population needs and to provide information on how wireless services fits into an open access network. The second is a wireless clearinghouse project, which is ongoing. This project locates, lists, and categorizes locations within State that would support cellular sites or wireless broadband transmitters. Normally these activities would be conducted by cellular providers looking to expand service to a community. However, this project is intended to improve this process.

Once the network is established, your future activities would include managing and expanding the hi-speed broadband network. No specific timeline exists for network construction; development depends on funding availability.

LAW

I.R.C. § 501(c)(3) exempts from taxation any corporation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

I.R.C. § 513(a) provides that an the term "unrelated trade or business" means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under I.R.C. § 501.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in I.R.C. § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in I.R.C. § 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.

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(i) provides that an organization may be exempt as an organization described in I.R.C. § 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals.

Treas. Reg. § 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. Thus, to meet this requirement, the organization must 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.

Treas. Reg. § 1.501(c)(3)-1(d)(2) explains that the term “charitable” is used in I.R.C. § 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in I.R.C. § 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of “charity” as developed by judicial decisions. Such term includes: relief of the poor and distressed or of the underprivileged; advancement of education or science; lessening the burdens of Government; and promoting social welfare by organizations designed to accomplish any one of the above purposes.

Treas. Reg. § 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of I.R.C. § 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization’s exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

Rev. Rul. 69-528, 1969-2 C.B. 127, determined that providing investment services on a regular basis for a fee is a trade or business ordinarily carried out for profit, even if that service were regularly provided to exempt organizations. Therefore, any I.R.C. § 501(c)(3) organization providing such services would be carrying on an unrelated trade or business.

Rev. Rul. 72-124, 1972-1 C.B. 145, held that the aged are a charitable class and that an organization that operates to address the needs of the aged by providing for the “primary needs” of such individuals for housing, health care, and financial security in conformity with the criteria specified in this ruling was held to be exempt under I.R.C. § 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245, determined that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify

under I.R.C. § 501(c)(3). According to the Service, providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that services are provided at cost and solely for exempt organizations is not sufficient to qualify the activity as charitable within the meaning of I.R.C. § 501(c)(3). Therefore, the Service held that the organization's activities were not charitable.

Rev. Rul. 79-19, 1979-1 C.B. 195, held the physically handicapped are distressed persons within the meaning of I.R.C. § 501(c)(3) and therefore a charitable class.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of private benefit, if substantial in nature, will destroy an organization's tax-exempt status regardless of the organization's other charitable purposes or activities.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352, 352-55, 360 (1978), the Tax Court determined that an organization formed to provide consulting services on the topic of rural-related policy and program development to tax-exempt organizations at, or close to cost, did not qualify for exemption under I.R.C. § 501(c)(3) as an educational, scientific, or charitable organization. In examining the organization's activities, the court noted that an organization may operate a trade or business and still qualify under I.R.C. § 501(c)(3). "Rather, the critical inquiry is whether [the organization's] primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for [the organization]." This determination "is a question of fact to be resolved on the basis of all the evidence presented by the administrative record." Factors to be considered include "the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits." Furthermore, "[c]ompetition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes." Applying this analysis, the court determined that the organization's services obviated the need for non-profits to employ full-time staff for that function, that the organization's fee was based on the cost of providing services rather than the tax-exempt organization's ability to pay, that the organization realized profit, that the organization's financing was not typical of § 501(c)(3) organizations, and that, in practice, the organization did not limit its services to § 501(c)(3) organizations. Therefore, the court concluded that the organization did not qualify for tax-exempt status under I.R.C. § 501(c)(3) because it served a substantial commercial purpose.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court determined that the American Campaign Academy, a training program for political campaign professionals, operated for the private benefit of the Republican party because its curriculum was tailored to Republican interests, its graduates worked for Republican candidates and incumbents, and it was financed by Republican sources. The Tax Court defined private benefit as "nonincidental benefits conferred on disinterested persons that serve private interests." Private benefits included "advantage; profit; fruit; privilege; gain; [or] interest."

RATIONALE

An organization seeking tax-exempt status under I.R.C. § 501(c)(3) must be organized and operated exclusively for educational, scientific, charitable, or other exempt purposes with no

part of its net earnings inuring to the benefit of any private shareholder or individual. See also Treas. Reg. § 1.501(c)(3)-1(a)(1). You state that you are seeking tax-exempt status under I.R.C. § 501(c)(3) as a charitable organization that advances education and science by providing a hi-speed broadband telecommunications network to a rural area. Based on a review of your activities, you are not described in I.R.C. § 501(c)(3) as explained below.

1. Exempt Purposes

An organization satisfies the operational test if it is operated exclusively for one or more exempt purpose. Treas. Reg. § 1.501(c)(3)-1(d)(1). An organization is “operated exclusively” for one or more exempt purpose only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in I.R.C. § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1). The presence of a single, substantial non-exempt purpose will destroy the exemption regardless of the number or importance of any truly exempt purposes. Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945). You fail the operational test because you are not operated exclusively for one or more exempt purpose.

The term “charitable” is used in I.R.C. § 501(c)(3) in its generally accepted legal sense and is not to be construed as limited by the separate enumeration in that section. See Treas. Reg. § 1.501(c)(3)-1(d)(2). The term “charitable” includes the following: relief of the poor and distressed or of the underprivileged; advancement of education or science; lessening the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above. Id. Additionally, a purported charitable activity must benefit a sufficiently large and indefinite class. The Service has recognized charitable classes to include the poor, distressed and underprivileged,¹ the aged,² and the sick or handicapped.³

You intend to provide a hi-speed fiber optic broadband “backbone” for commercial telecommunications companies. You state that access to the hi-speed broadband network will be provided to these commercial telecommunications companies at cost. However, merely providing services at cost is not charitable. See Rev. Rul. 72-369, 1972-2 C.B. 245. Although the public is the intended recipient of the ultimate benefit of your hi-speed broadband network, you provide your services to commercial telecommunications companies and not to the public. However, even if your services were provided directly to the public, providing hi-speed broadband service is not an inherently charitable activity. Therefore, the hi-speed broadband network you provide is neither charitable nor is the class of persons serviced—commercial telecommunications companies—a charitable class. Indirect public benefit is not sufficient to render your activities charitable. Thus, you have not shown that you are operated exclusively for one or more exempt purpose.

2. Private Benefit

You serve substantial private interests in violation of I.R.C. § 501(c)(3). An organization is not organized or operated exclusively for one or more exempt purpose unless it serves a public rather than private interest. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests

¹ Treas. Reg. § 1.501(c)(3)-1(d)(2).

² Rev. Rul. 72-124, 1972-1 C.B. 145.

³ Rev. Rul. 79-19, 1979-1 C.B. 195.

such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. An organization's activities may benefit the private interests of disinterested persons as well. American Campaign Academy v. Commissioner, 92 T.C. 1053, 1069 (1989). "Prohibited private benefits may include an 'advantage; profit; fruit; privilege; gain; [or] interest.'" Id. at 1065-66 (1989) (citing Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982)). Applicant must show that no more than an insubstantial part of its activities benefit private interests or any other nonexempt purpose. Id. at 1066.

Your hi-speed broadband telecommunications network provides substantial private benefit to commercial providers. First, your construction of this hi-speed broadband network obviates the need for commercial providers to construct such hi-speed broadband networks themselves, which creates a significant cost savings to commercial telecommunications companies. For example, your wireless clearinghouse project reduces the cost of entry for commercial telecommunication companies by identifying locations that would support cellular sites or wireless broadband transmitters. Second, you will operate at cost but will not have any agreements requiring commercial providers to pass the cost savings you create on to the public. Although you argue that your activities create competition among telecommunication companies, which you expect to force prices down for the public, you do not provide any evidence that consumers will recognize any cost savings by the services you provide to commercial telecommunication companies. Finally, you provide no services directly to the public; all of your services are provided directly to commercial telecommunication companies. Although the public will derive some benefit from the increase in coverage and availability of commercial telecommunication companies, the primary benefit is to the commercial telecommunication companies who receive access to a population that is otherwise unavailable without a considerable capital outlay.

3. Substantial Commercial Purpose

You are operated for substantial commercial purpose because your primary activity, the operation of the hi-speed broadband network, is generally considered a trade or business ordinarily carried on for profit. An organization may meet the requirements of I.R.C. § 501(c)(3) although it operates a trade or business as a substantial part of its activities if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized and operated for the primary purpose of carrying on an unrelated trade or business. Treas. Reg. § 1.501(c)(3)-1(e)(1). An "unrelated trade or business" is any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under I.R.C. § 501(a). I.R.C. § 513(a).

In determining the existence, or nonexistence, of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. Treas. Reg. § 1.501(c)(3)-1(e)(1). "[T]he critical inquiry is whether petitioner's primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for [the organization]." B.S.W. Group, Inc. v. Comm'r., 70 T.C. 352, 357 (1978). Factors to be considered include "the particular manner in which an organization's activities are conducted, the commercial hue of those

activities, and the existence and amount of annual or accumulated profits.” Id. “Competition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes.” Id. at 358.

For example, Rev. Rul. 69-528, 1969-1 C.B. 279, involved an organization that regularly carried on an investment service business. The organization was formed to provide investment services on a fee basis exclusively to exempt organizations. The Service determined that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit. Therefore, the organization did not qualify under I.R.C. § 501(c)(3) because it regularly carried on the business of providing investment services, which would be an unrelated trade or business if carried on by any tax-exempt organizations on whose behalf it operated. Furthermore, Rev. Rul. 72-369, 1972-2 C.B. 245, determined that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. Providing services at cost and solely to exempt organizations is not sufficient to make the activity charitable. Finally, in B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court determined that an organization formed for the purpose of providing consulting services “primarily in the area of rural-related policy and program development” did not qualify under I.R.C. § 501(c)(3) because providing consulting services is a business “ordinarily carried on by commercial ventures organized for profit.”

Like the organizations in Rev. Rul. 69-528, Rev. Rul. 72-369, and B.S.W. Group, access to your hi-speed broadband network is provided for a fee. Such services are usually provided by commercial telecommunication companies organized for profit. These factors indicate that operation of the hi-speed broadband network is a trade or business ordinarily carried on for-profit serving a substantial non-exempt commercial purpose. Thus, your primary purpose is the carrying on of an unrelated trade or business because operation of the hi-speed broadband network, as previously discussed, serves no exempt purpose.

CONCLUSION

Based on the above, we have made a determination that you fail to meet the requirements necessary to be recognized as a tax-exempt organization under § 501(c)(3) because you are not organized and operated exclusively for one or more exempt purpose. 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.

This declaration must be signed by an elected officer, a member of the board of directors, or a trustee rather than an attorney or accountant.

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:T3)

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,

Director, Exempt Organizations