



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201303017**
Release Date: 1/18/2013
Date: October 26, 2012

UIL: 501.00-00; 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.

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,

Holly O. Paz
Director, Exempt Organizations
Rulings and 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: September 6, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

D = Name of Farm
E = Director of Operations
J = Name of Foreign Organization
N = Country
Y = Date
X = State

UIL:

501.00-00
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

- 1) Do your activities cause you to fail the operational test, disqualifying you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.
- 2) Do your activities primarily serve to the private benefit of your Director of Operations, E, precluding you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.
- 3) Do the payments made for the expenses of the farm owned by your Director of Operations, E, and his wife constitute prohibited private inurement of income under

Letter 4036 (CG) (11-2011)
Catalog Number 47630W

section 501(c)(3) of the Code, therefore precluding you from exemption? Yes, for the reasons described below.

- 4) Does your method of writing large checks payable to cash demonstrate your lack of control and discretion over your funds, therefore precluding you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.
- 5) Does your lack of adequate and detailed responses to our inquiries cause you to fail the operational test, precluding you from qualifying for exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

Facts

You were formed as a corporation in the state of X on date Y. Your Articles of Incorporation, in part, state you are formed to provide youth empowerment and community education programs.

You filed Form 1023 requesting exemption under Section 501(c)(3) of the Code. You were formed after your board members went to the foreign country N and saw firsthand the need for peace in the region. You visited organization J located in the foreign country N, and selected your name based on J's name. You selected the name because you "...liked the name of the group...". You were inspired by what J had done and you wanted to help in a similar way. You did not choose your name to fund only J, but to give that same kind of inclusiveness and togetherness that the name implies. J is not an exempt organization.

Your Director of Operations is E. Per your website, E is a farmer whose large farm, called D, is ringed by religious settlements. E's family has been offered money for the land but will not sell due to their commitment to peace and coexistence. E's family has established J to provide arts, drama and education to the children in the villages and refugee camps of the region. Your website states that you are working on several critical projects on E's land located in foreign country N. The projects you have supported include a new generator, solar power, a cistern, a women's education center and the planting of olive trees. You also indicate E has made trips to various locations around the world to set up "Friends of" organizations to support his farm.

Regarding the farm you said, "The profits go towards their operational expenses, but more importantly to their efforts for peace and co-existence in the region." The farm is unable to legally build permanent infrastructure. In addition, the farm is not connected to the power grid or to public water. Further, foreign country N is building a concrete barrier and the land will soon be cut off from the rest of the area. N's government is attempting to seize the land owned by E. N's government can seize uncultivated land, which is why there has been an effort to cultivate the farm.

One of your newsletters states, "Every dime you donate goes to support..." foreign organization J. Your website indicates you had a "...one-time-only drive..." to help E's family purchase farm equipment. You distributed funds to E's family, but later said this "...statement was poorly worded." You meant to say the funds went to J. You further asserted E and his wife manage the finances of J and are the signatures for the checking account for J. You said "...all financial

dealings...” regarding J are done through E and his wife.

You provided a list of distributions made in your first year of operations. Ten out of the eleven distributions you made were to J. You asserted you will fund organizations other than J, but you simply have not named another recipient yet. Later you said J will be your “...primary recipient.”

Your website is soliciting funds for specific requests made by E for the farm. The requests for funds are to cover kitchen needs, a wine press, cafeteria improvements, for the maintenance workshop, a first aid station, water pumps, and a part-time cook and dishwasher. Further your website says that E’s family has incurred large legal bills to fight the battle still going on in the courts today. Specifically:

If they could build on their own property; if they could get access to clean water and electricity; if they could get their produce to market; if they had clear access to their own road leading to the farm; if they weren’t being harassed by the military and settlers; if they could do lots of other things we all take for granted every day in this country – they wouldn’t need this financial support.

You agreed that money donated to J for capital improvements cannot be exempt from income tax. You claimed no capital improvements were made to E’s farm after a specific date and agreed to exemption effective that date. However, a year later you are still soliciting and expending funds for capital improvements for J. You also submitted board meeting minutes after this specific date stating that E is planning new infrastructure for the land including an increase in the irrigation piping installation, installation of a waste water recycling system and installation of a wind turbine.

You submitted copies of your bank statements. The statements included numerous payments made to your directors. There were many checks written for thousands of dollars to “cash.” There were also thousands of dollars worth of transfers between your bank account into the bank account of your directors. There were also thousands of dollars worth of checks written to “cash” with a memo line including that E would be taking the money to J. Another of the checks indicated on the memo line that it was for an iPhone for E and another check indicating it was for E’s phone use. Additionally, there were several checks written to your directors for airfare. No documentation was provided to substantiate these expenses.

In all, you were sent 11 requests for additional information. Of those 11 requests, your case was administratively suspended for failure to respond timely to our requests 6 times.

Law

Section 501(c)(3) of the Code describes corporations organized and operated exclusively for charitable purposes no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the regulations provides that the terms "private shareholder or individual" in Section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a)(1) of 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(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 which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. 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(c)(2) of the regulations 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 as defined in Section 1.501(a)-1(c).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an exempt organization must serve a public rather than a private interest. The organization must demonstrate that it is not organized or operated to benefit 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." Thus, if an organization is operated to benefit private interests rather than for public purposes, or is operated so that there is prohibited inurement of earnings to the benefit of private shareholders or individuals, it may not retain its exempt status.

Rev. Rul. 63-252, 1963-2 C.B. 101, states that contributions to certain domestic charitable organizations are deductible if it can be shown that the gift is, in fact, to or for the use of the domestic organization, and that the domestic organization is not serving as an agent for, or channel for, a foreign charitable organization. In reaching this conclusion, the revenue ruling states that it seems clear that the requirements of section 170(c)(2)(A) of the Code would be nullified if contributions inevitably committed to go to a foreign organization were held to be deductible solely because, in the course of transmittal to the foreign organization, they came to rest momentarily in a qualifying domestic organization. In such cases, the domestic organization is only nominally the donee; the real donee is the ultimate foreign recipient.

Rev. Rul. 66-79, 1966-1 C.B. 48, amplifies Rev. Rul. 63-252 to provide that contributions to a domestic charity that are solicited for a specific project of a foreign charitable organization are deductible under section 170 of the Code if the domestic charity has reviewed and approved the project as being in furtherance of its own exempt purposes and has control and discretion as to the use of the contributions. This conclusion is reached because the contributions received by the domestic charity are regarded as for the use of the domestic organization and not the foreign organization receiving the grant from the domestic organization.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature,

will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In Texas Trade School v. Commissioner, 30 T.C. 642, (1958), aff'd 272 F. 2d 168 (5th Cir. 1959), the officers of the school leased property owned by them to the school and caused the school to erect improvements hereon which benefited them individually. The officers shared in the schools net earnings as the result of the payment to them of excessive and unreasonable rent for the physical plant leased by the school and as a result of the construction by the petitioner of buildings which became part of their real estate.

The Court of Appeals in Parker v. Commissioner, 365 F.2d 792. 799 (8th Cir. 1963) affirmed,, the findings of Tax Court that foundation was pursuing a substantially nonexempt purpose in the publication and commercial exploitation of the writings of the founder, director and prime functionary of foundation. The founder had control of the foundation's day to day activities, complete control of its finances and the founders personal funds were to a degree commingled with the funds of the foundation, and that the evidence clearly supported the finding that the foundation was pursuing a substantial non-exempt purpose.

In Western Catholic Church v. Commissioner, 73 T.C. 196 (1979), the Tax Court held that although separate requirements, the "private inurement" test and the "operated exclusively for exempt purposes" test often overlap substantially. The petitioner's only activities were some individual counseling and distribution of a few grants to needy individuals. The petitioner's failure to keep adequate records and its manner of operation made it impossible to trace the money completely, but the court found it clear that money passed back and forth between petitioner and its director and his for-profit businesses. The Court Held that petitioner had not shown it was operated exclusively for exempt purposes or the no part of its earnings inured to the benefit of its officer.

In Unitary Mission Church v. Commissioner, 74 T.C. 507 (1980), it was held that the prohibition against inurement or private benefit is absolute, the amount or extent not being determinative. Petitioner's financial decisions are controlled by one of petitioner's ministers, and his wife. The minister received widely fluctuating "parsonage allowances" over a 3-year period as compensation for leading services and for being available for pastoral counseling. There is no evidence in the administrative record of any differing duties that he performed over these years. There is also insufficient evidence in the record regarding some of the travel expenses paid to the minister and his wife and regarding two loans made to the minister's secular employer. Parsonage allowances of fluctuating amounts were also paid in some years to petitioner's other two ministers; yet, there is no evidence in the record about any services they performed for petitioner. The Tax Court concluded that petitioner is not entitled to exemption because a part of its net earnings inures to the benefit of private shareholders or individuals.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the Sixth Circuit court found that although the organization did serve religious and charitable purposes, it existed to serve the private benefit of its founders, and thus failed the operational test of section 501(c)(3). Control over financial affairs by the founder created an opportunity for abuse and thus the need to be open and candid, which the applicant failed to do.

In National Association of American Churches v. Commissioner, 82 T.C. 18 (1984), the Tax Court denied a petition for declaratory judgment that the organization qualified for exempt status as a church. In addition to evidence of a pattern of tax-avoidance in its operations, the court noted that the organization had failed to respond completely and candidly to IRS during administrative processing of its application for exemption. An organization may not declare what information or questions are relevant in a determination process. It cited a number of declaratory relief actions that upheld adverse rulings by the Service because of the failure of the applicants to provide full and complete information on which the Service could make an informed decision.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 166 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in a substantial private benefit to its founders.

Application of Law

You are not organized and operated exclusively for charitable purposes under Section 501(c)(3) of the Code as your net earnings inure to the benefit of E. The provision of inurement can be direct or indirect. E is a private individual, as he is your Director of Operations, within the meaning of section 1.501(a)-1(c) of the regulations and your net earnings inure to his benefit. An organization will be denied exemption if any of its net earnings inure to the benefit of private individuals per section 1.501(c)(3)-1(c)(2) of the regulations. Even a small amount of inurement will prevent exemption to be granted.

Pursuant to section 1.501(c)(3)-1(a)(1) of the regulations, if an organization fails to meet either the organizational test or the operational test, it is not exempt. You are soliciting funds for and supporting a farm owned by E. The private interests of E and his family are being served. E has control over your operations and has a personal interest in your activities. As a result, you do not meet the requirements of the regulations..

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized exclusively for any of the purposes specified in section 501(c)(3) of the Code unless it serves public, rather than private interests. Your activities serve the private interests of E; therefore, you do not meet this requirement of the regulations..

As in Western Catholic Church v. Commissioner, supra, although separate requirements, the "private inurement" test and the "operated exclusively for exempt purposes" test often overlap substantially. In your case, the payments made to operate and improve E's farm constitutes private inurement, therefore precluding you from being operated exclusively for exempt purposes.

You are similar to Texas Trade School because you too will make improvements to property owned by individuals. In your case, you will fund improvements to property owned by E, causing your earnings to inure to the benefit of E and his family and therefore precluding you from exemption.

Section 501(c)(3)-1(d)(1)(ii) of the regulations further clarifies that it is necessary for an 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 such private interest. You were set up to benefit E and his family through the funding of J. As stated in Better Business Bureau of Washington, D.C., Inc. v. United States, supra, the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. E continues to own the farm that you are funding, creating private inurement, which destroys your claim for exemption. A number of courts have held that unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control can constitute inurement. Further, you are funding a privately owned farm through your contributions to J, furthering a non-exempt purpose. See Parker v. Commissioner, supra.

E, who is also your Director of Operations, and his wife hold signatory authority of your J's checking account. You make most of your donations to J. E and his wife have control over the funds you donate to J. Much like Basic Bible Church v. Commissioner, supra, even if you do serve some level of charitable purpose, you have existed to serve the private benefit of your director, and thus failed the operational test of section 501(c)(3). Control over financial affairs by E and his wife have created an opportunity for inurement.

In Unitary Mission Church v. Commissioner, supra, it was held that the prohibition against inurement or private benefit is absolute, the amount or extent not being determinative. E continues to own the farm you are supporting through J, and your funds are being used to pay for the related expenses. You are not entitled to exemption because your net earnings inure to the benefit of E. KJ's Fund Raisers v. Commissioner, supra.

An applicant for exempt status must provide sufficient information for the Service to make an informed decision, as indicated in National Association of American Churches, supra. In the course of the processing of your application for exemption you failed to respond timely to our request for additional information six times. The responses you did provide caused us to ask the same questions multiple times and we often received minimal details regarding your operations. When we did receive information, it led us to the conclusion that you are not operating exclusively for exempt purposes, causing you to fail the operational test under section 501(c)(3) of the Code.

Like the organizations in Rev Rul 63-252 and 66-79 you collect donations in support of J. These donations come to rest temporarily with you and are then forwarded on to J. You do not review and approve the project and you also do not have any control or discretion as to the use of these contributions some of which are indicated to be used "where most needed".

Applicant's Position

You will have specific requests for funding and you require reporting of the use of funds. If you find your funds are not being used as they should be you will discontinue distribution of funds. You will support only educational and humanitarian programs and you understand that you

cannot provide charitable distributions for infrastructure improvements to the farm.

Service Response to Applicant's Position

Despite your claim that you will have specific requests for funding, require reporting of the use of funds and discontinue distribution if you find funds are not being used as they should be, you have not provided any substantiation to support this claim. The facts clearly show that you were formed to distribute funds to J and to benefit E. Your website continues to solicit donations for E's farm. The facts do not show support of only educational and humanitarian programs.

Conclusion

Based on the above facts and law, we conclude:

You fail the operational test because you are not operated exclusively for section 501(c)(3) purposes. Specifically you are operated to protect the farm/land owned by E and his family.

By providing funds which are used to support a privately-owned farm in country N, you are operating for the private benefit of E.

You made payments for the expenses of the farm and for the personal expenses of E who is your Director thereby allowing your funds to inure to the benefit of E. Your income and activities relating to protecting the land owned by E and his family result in Inurement to E and his family.

By transferring funds directly to E's account, making payments in cash and to E personally, and providing no substantiation of the use of such funds and cash payments you also do not maintain control and discretion over your funds.

You frequently failed to submit a timely response to our inquiries and the responses often lacked sufficient detail. Therefore, you fail the operational test, disqualifying you from exemption under Section 501(c)(3) of the Code.

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, 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,

Holly O. Paz
Director, Exempt Organizations
Rulings & Agreements

Enclosure, Publication 892