

IRS Letter Rulings and TAMs (1998-2010), UIL No. 0501.03-00 Exception from tax on corporations, certain trusts, etc. (Exempt v. not exempt); Religious, charitable, etc., institutions and community chest. IRS Letter Ruling 200945069 (Aug. 13, 2009), Internal Revenue Service, (Aug. 13, 2009)

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LTR 200945069, August 13, 2009

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[\[Code Sec. 501\]](#)

Exception from tax on corporations, certain trusts, etc. (Exempt v. not exempt); Religious, charitable, etc., institutions and community chest.

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, Robert Choi, Director, Exempt Organizations, Rulings & Agreements.

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. We have separately considered whether you qualify as a supporting organization under section 509(a)(3). Based on the information submitted, we have concluded that you do not qualify as a supporting organization under section 509(a)(3). Even if you qualified for exemption under section 501 (c)(3), we have concluded that you would be a private foundation. The basis for our conclusion is set forth below.

FACTS:

The First Amendment and Restatement of your trust document states that you are formed exclusively for charitable, religious, educational and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Code.

Section 1.03 of your amended trust document provides that the trust shall continue forever unless and until the trustees shall decide to terminate the trust, which decision may be made by the trustees at any time. Upon termination, the net assets shall be paid out for one or more qualified purposes, or one or more supported organizations, or any combination thereof.

Section 3.02(a) of your amended trust agreement provides that each year the trustees shall distribute 30 percent of the net income of the trust, but in no case less than one percent of the gross assets of the trust to A and the balance, if any, for the general charitable purposes of B. B is a donor advised fund with A.

Section 3.02(b) provides that in addition to the distribution above, trustees shall distribute a total of 85% of the net income of this trust less the amount above to one or more of the organizations listed on Schedule A, in the amounts and proportions directed by the majority vote of the trustees.

Section 3.02(c) provides that the trustees shall make such discretionary distributions or expenditures of the income (in excess of 85% of the net income) and the principal of the trust to, or in support of any charitable functions of one or more of the organizations listed on Schedule A.

Section 4.03 of the amended trust document provides that the trustees shall be divided into two classes: the "Family Trustees," who as a group shall have five votes; and the "Independent Trustees," who as a group shall have six votes.

Section 4.05 of your amended trust document provides that each Independent Trustee must be appointed by A. Upon the death, inability to serve, or resignation of any Independent Trustee, A shall have the right to appoint a successor. The number of votes of each Independent Trustee shall be equal to the result obtained by dividing six by the total number of Independent Trustees appointed as Trustees.

C, D, E, and F are your Family Trustees. A appointed G and H, a director of A, to your board of trustees.

In a letter dated August 15, 2005, you list in question #1 how you will be responsive to the needs of A. You also list how you will maintain a significant involvement in the operation of A, your primary charity. You state that the trustees of A will meet annually to:

- Exercise responsibility for your operational decisions.
- Review your business plan and budget.
- Monitor your compliance with A's decisions at the same board meeting.
- Manage or develop financial plans for you that you have drafted.
- Approve, develop or revise your budget that you have drafted. A will not direct the transfer of funds from one organization to another. However, such a transaction would be subject to review by A.
- Review and approve any amendments or restatements of your trust agreement or bylaws. A does not ratify the appointment of any Family Trustees nor does it have the unilateral authority to remove a Family Trustee for cause. A will ratify the election of all of your officers and has the power to remove any or all elected officers.

Further, A will meet annually to:

- approve your financial transactions, to review and approve your accounting functions and accounting staff or contract accounting organization.
- Review and evaluate the conveyance, transfer, lease or sale of your assets.
- Review and approve all borrowings and guarantees and other forms of indebtedness incurred by you.
- Review and approve your dissolution plan.
- Review investment of your assets and replace investment advisers who do not perform to A's standards.
- Review your charitable contributions to ensure that they meet the needs of A and are consistent with A's policies.

In question #2 you state that A could unilaterally terminate the relationship with you. However, you did not address whether you could unilaterally terminate the relationship with A.

You state that the board of A will not direct the transfer of funds from one organization listed on Schedule A to another. You will direct the transfer of funds to different public charities, but your selections will be subject to annual review, correction, ratification, or mediation by A.

You also state that A will meet annually to exercise responsibility over you. You will present your business plan and budget to A for its approval.

Your by laws provide that your board of trustees is divided into two classes: The "Family Trustees, who have a total of five votes and the "Independent Trustees", who have a total of six votes. C, the donor, may appoint a family trustee. A does not ratify the appointment of any family trustees. Nor can it unilaterally remove a family trustee for cause. C may also appoint an independent trustee if the number of trustees becomes less than three.

Further, trustees are appointed for life. However, any non-family trustee may be removed from office with or without cause by an affirmative two-thirds vote. Elections, resolutions and other matters requiring a vote of the trustees shall be decided by a majority vote.

C, a disqualified person under section 4946, appointed three family members to your board. Because of their relationship to C, the three trustees appointed by C are also disqualified persons.

A, the primary charity, appointed two persons as independent trustees. Section 4.06 of your bylaws provides that an attorney, accountant or similar professional who renders professional advice to a settler or to the trust may be an independent person or trustee. At least one of the persons appointed to your board by A is also on A's board of directors.

Section 6.01 of your amended trust agreement provides that your trust agreement may be amended at any time by a written instrument upon the unanimous vote of the trustees.

501(c)(3) Law

Section 501(a) of the Code provides, in part, that organizations described in section 501(c) are exempt from federal income tax. Section 501(c)(3) of the Code describes, in part, an organization that is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or 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 provides that in order for an organization to be exempt under section 501(c)(3) of the Code it must be both organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or 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 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)(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 such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized exclusively for any of the purposes specified in section 501(c)(3) unless it serves public rather than private interests. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled director or indirectly, by such private interests.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of statutorily exempt purposes. Thus, the operational test standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations that further nonprofit goals outside the scope of section 501(c)(3).

In Lapham Foundation, Inc. v. Commissioner, 389 F.3d 606, aff'g T.C. Memo. 2002-293, the Sixth Circuit affirmed the Tax Court holding that the foundation failed to meet the test to qualify for supporting organization status. In Lapham, the foundation's contributions to the supported organization were to be used for making grants to support charitable activities in southeastern Michigan, in general, and in Northville, Michigan, in particular. The Appeal Court mentioned that AEF, the beneficiary of the supporting organization in that case, did not have to follow the advice of the supporting organization. Thus, the distributions made by the supporting organization could not be said to be earmarked for a program or activity when AEF was not required to make distributions for purposes of such activity.

ANALYSIS AND CONCLUSION:

I. Exemption under section 501(c)(3) of the code.

The facts submitted with the request indicate that the foundation is not engaged in any activities whatsoever, of a charitable nature or otherwise, other than donor recommendations made by some disqualified person trustees to A, a community foundation, as to which funds to distribute from the account held in your name. This is insufficient to constitute a charitable activity.

The First Amendment and Restatement of the your Family Foundation Trust Agreement names A as a supported organization on Schedule A and further, paragraph 3.02(a) defines the annual support distributed by you to A. Further, paragraph 4.05 of such document describes how A will "control" you by appointing independent trustees who in the aggregate will have over 50 percent of the vote (six out of eleven votes).

The importance of A is apparent throughout your submission. For example, the answer to question 1 of the letter dated August 15, 2005, lists all the actions A will take or is authorized to take with respect to you. See also the answer to question 2 of that same letter, which states that A could unilaterally terminate its relationship with you.

Various information submitted in the file identifies A as a community foundation. The brochure under tab 8 of the letter of August 15, 2005, describes A as follows:

A is classified as a public charity under the Internal Revenue Code of 1986 as described in sections 501(c)(3), and 509(a)(1) and 170(b)(1)(A)(vi). It is structured to operate as a national community foundation that may provide support for any qualified charitable cause. A offers a variety of charitable services including education on "planned giving" and the development of component foundations commonly known as donor advised funds.

Paragraph 3.02(a) of the amended trust document, described above, allows trustees to make discretionary distributions to charitable organizations and suggests that the applicant has a component foundation with A. The board minutes provided by A also support this proposition. All the suggestions for distributions of funds were made by the donor and the donor's family members with a directive to H, the trustee appointed by A, to disperse the funds to the charities.

The answer to question 6 of the August 15 letter regarding your revenue and expenses is referenced in the answer to attachment 1. Attachment 1 is a statement of activity for the years 2002, 2003, 2003, 2004, and 2005 on the letterhead of A, with A's address, phone number and other information on the printed letterhead. The statements for those years are addressed to you and C, the primary donor. All activity is recorded on these statements.

The actual revenue and expenses of this account appear to all flow through a bank account. The statements on this account are found under tab 5 of the letter of August 15, 2005. The bank statements are addressed to you, C and H as trustees, at the address listed for A.

Tab 4 contains the signature card for the bank account listed above. The account is listed in your name with H as trustee. On the signature card, the address listed is for A. Although your employer identification number (EIN) is listed on the signature card, the only person having signature authority on the card is H, who is on

the governing board of A. The bank statements beginning in 2002 and through April 30, 2005, are sent to the address listed for A. Also contained with the bank statements under tab 5 is a statement of hold on a large check in the account number listed for this account and addressed to A.

In summary, the information submitted is that only H had signature authority over the account and the bank statements were sent to the address for A. The Notice of Hold statement is addressed to A. This information suggests that the bank account was being operated by and for A. However, your name and EIN are listed on the account signature card. It could also reasonably be argued that the bank statements were sent to H in his capacity as your Trustee

Regardless whether one would treat the bank account as an agency of A or as an account for you, the fact remains that the bank account is used for transactions and very little in the way of funds remain in that account on a continuing basis. Most of the assets are held by A.

A's account statements in your name indicate that since the end of 2003, the account has held in excess of \$X (Tab 11). The great part of such funds are in commercial investment accounts. One commercial investment account contains the name of A and its address on the envelope. Following the initial page, the top of the investment report shows the brokerage number and your name. At the end of the statement, there is an item listed as "Additional Information About Your Investment Report" showing that the account on this investment report is registered to you under the address used for C. A letter of February 16, 2005, on A's letterhead and written by H as director/trustee to a second commercial investment company, requested an account performance report for your account and one other account.

Tab 11 also contained the brokerage account statements of a third investment business. The envelope for the statement was mailed to H, trustee, A, and to you with the address for A.

What the investment statements show is that the assets are held by A for the community trust component fund in your name. The legal overlay for all donor advised funds and component parts of community foundations is that the donor advised fund or community foundation is legal owner of the assets in its advised or component funds. These types of charities contain legal statements in the donor documents that the donor advised fund or community foundation exercises ownership, dominion, control and/or ownership over all funds in the accounts.

Since, in this case, A already has received all the assets, there is no activity function or purpose for any purported supporting organization. To the extent that your trustees, including the disqualified person trustees, have an advisory right to make suggestions or recommendations as to the destination of charitable distributions, the opinion in *Lapham Foundation, Inc. v. Commissioner*, 389 F2d 606 (6th Cir. 2004) is on point. The Appeal Court mentioned that AEF, the beneficiary of the supporting organization in that case, did not have to follow the advice of the supporting organization. Thus, the distributions made by the supporting organization could not be said to be earmarked for a program or activity when AEF was not required to make distributions for purposes of such activity.

Thus, for purposes of section 501(c)(3) of the Code, you have no activity, assets, or program. You are either a nonentity or an organization without meaning and purpose. The point here is that you are not funded, you do not invest your assets, nor do your trustees meet to consider distributions to the supported organization(s). It is as if the donor distributed the charitable donations straight to A and bypassed your organization, or, at best, used your organization as a mere conduit to transfer money from the donors to A. Therefore, we conclude that you are not operated exclusively for purposes described in section 501 (c)(3) of the Code.

Section 509(a)(3)

LAW:

Section 509(a)(3)(A), in effect, describes as a public charity, an organization which is organized and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph (1) and (2).

Section 509(a)(3) of the Code provides that the term "private foundation" does not include an organization which

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2).

(B) is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2), and

(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in section 509(a)(1) or (2).

Section 509(a)(3)(B) of the Code provides that, in order to qualify under section 509(a)(3), an organization must be "operated, supervised, or controlled by," "supervised or controlled in connection with," or "operated in connection with" one or more publicly supported organizations.

Section 1.509(a)-4(d)(1) of the regulations provides that in order to meet the requirements of section 509(a)(3)(A), an organization must be organized and operated exclusively to support or benefit one or more "specified" publicly supported organizations. The manner in which the publicly supported organizations must be "specified" in the articles for purposes of section 509(a)(3)(A) will depend upon whether the supporting organization is "operated, supervised, or controlled by" or "supervised or controlled in connection with" such organizations or whether it is "operated in connection with" such organizations.

Section 1.509(a)-4(g)(1) of the Income Tax Regulations provides that an "operated, supervised, or controlled by" relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations. Each of the items "operated by" "supervised by," and "controlled by," as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any one of these terms is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization.

ANALYSIS AND CONCLUSION:

II. Failure to Qualify as a Type I Supporting Organization

You state that you meet the requirements for section 509(a)(3) as an organization that is "operated, supervised, or controlled by" A, an organization that is described in section 509(a)(1) or (2).

Our records indicate that A is a private foundation. Since your articles of incorporation do not identify a support a publicly supported organization and you are not engaged in activities that support or benefit a publicly supported organization, you do not satisfy the organizational and operational tests under section 509(a)(3).

Furthermore, you have failed to establish that you meet the relationship test of section 509(a)(3)(B) of the Code because your bylaws permit you to give the majority of your assets to A, a donor advised fund. Although your trustees may make recommendations to A regarding the distributions, A is not required to follow their advice. Since you do not engage in any programs and activities, you are not "operated, supervised, or controlled by" A.

CONTROL TEST:

Disqualified persons (DPs) within the meaning of section 4946 of the Code may exercise control over your organization.

Section 509(a)(3)(C), in effect, provides that public charity status under section 509(a)(3) is precluded for an organization that is controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) and (2).

Section 1.509(a)-4(j)(1) of the regulations provides:

That if a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a foundation manager of the

supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly supported organization, then for purposes of this paragraph, such person will be regarded as a disqualified person rather than as a representative of the publicly supported organization.

An organization will be considered "controlled," for purposes of section 509(a)(3), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of a substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization.

Thus, if the governing body of a foundation is composed of five trustees, none of whom has veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered controlled, directly or indirectly, by one or more disqualified persons by reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting right with respect to stocks in which members of the governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

Rev. Rul. 80-207, 1980-2 C.B. 193, held that for purposes of classification as a supporting organization under section 509(a)(3) of the Code, an employee of a corporation owned (over 35 percent) by a substantial contributor, a disqualified person, will be considered under the indirect control of a disqualified person for purposes of the control test.

Rev. Rul. 80-207 provides the following analysis:

Because one of the organization's directors is a disqualified person and neither the disqualified person nor any other director has a veto power over the organization's actions, the organization is not directly controlled by a disqualified person under section 1.509(a)-4(j) of the regulations. However, in determining whether an organization is indirectly controlled by one or more disqualified persons, one circumstance to be considered is whether a disqualified person is in a position to influence the decisions of members of the organization's governing body who are not themselves disqualified persons.

ANALYSIS AND CONCLUSION:

Your amended trust agreement permits you to distribute 30% of your net income, but in no case less than 1% of the gross assets of your trust to A, a private foundation, and the balance, if any, for the charitable purposes of B, a donor advised fund. This provision allows C, your donor to use your assets to make recommendations to A. You provided minutes that show that all the suggestions for distributions of funds were made by C and her family members with a directive to H, the trustee appointed by A, to disperse the funds to the charities. Since the donor and her family members direct the distribution of your funds, instead of the public charity, you do not satisfy the control test under section 509(a)(3) of the Code.

You also fail the control test because your bylaws give family members appointed to the board five of 11 votes, but requires a two-thirds vote before they or any other trustees can be removed. Since independent trustees control only 6/11 (55%) of the votes, they have less than the required two-thirds. Therefore, we conclude that you do not qualify as a supporting organization under section 509(a)(3).

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:

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, Robert Choi, Director, Exempt Organizations, Rulings & Agreements.