



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

M =
N =
P =
Q =
X =
Y =
Z =

Dear

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. The basis for our conclusion is set forth below.

Facts:

M is organized as a non-profit corporation under state law. According to its articles of incorporation, M is organized for the purpose of "operat[ing] an e-commerce Internet website wherein the vendors agree to donate a percentage of the proceeds from the sales of goods and services to non-profit charities selected by the purchasers of goods and services, and for the transaction of any or all lawful business for which non-profit corporations may be incorporated under the laws of [M's state of incorporation]...."

In its application, M states that its primary activity is the operation of a public access website. M's website acts as a portal to the websites of for-profit online retailers. A visitor to M's website

is told, first, to select a nonprofit organization from a list of M's "nonprofit partners". Next, the visitor is told to choose an on-line "store" from a list of on-line retailers for which M acts as an "affiliate". When the visitor chooses a store, that store's website is framed within M's website. If the visitor purchases items from the store, M earns a commission of a certain percentage of the purchase price from the retailer. The commission is processed through an affiliate management company and sent to M. M then gives the commission to the nonprofit organization that was selected by the website visitor.

M's website homepage states:

You Buy ... They Benefit

Shop online at [M].com and 100% of our commission from your purchase goes directly to the charity of your choice.

The "How Does [M] Work?" page states:

[M].com is partnered with hundreds of online retail stores who provide a commission to [M].com for every purchase that YOU make through our website. We, in turn, redistribute 100% (NO operational cost is taken out) of that commission to the nonprofit organization that YOU choose to support.

Asked to describe its procedures for identifying, and criteria for selecting, "nonprofit partners," M explains in its August 2, 2004, letter:

M identifies and selects NPOs based on need, ratio of operational costs versus "cause funding," standing in the non-profit community ... and their ability to fill [M]'s category needs.

M has entered into agreements (which M terms a "partnership") with various nonprofit organizations which M calls its "nonprofit partners". The "addendum" page of such agreements contains a provision that "[M] pledges to redistribute 100% of the commission earned through a consumer's shopping to the nonprofit organization chosen by the consumer prior to the time of purchase".

In its letter dated January 20, 2004, M states:

The commissions are processed through an affiliate system They [i.e., the affiliates] manage the commissions and then we distribute them to our partner organizations on a quarterly basis. The beneficiary organizations receive a commission check along with a detailed activity report that shows them how much they have earned from each retailer and the visitor traffic report.

M explains the "affiliate system" in more detail in its August 3, 2004, letter:

[M] uses four affiliate management companies. These companies represent about 80% of the online affiliate retail industry....

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An affiliate system operates by paying a publisher ([M]) for actions taken by a consumer as they occur on the Internet, rather than paying up front for advertising space; any type of revenue sharing program where an affiliate receives a commission for generating a lead or sale for an advertiser.

Every [M] Non-Profit Partner's shopping page is tagged with a "sub ID" which is written into the code that makes that page unique. Every time a consumer leaves that page to a retailer's web site the management company that represents the retailer begins to track that consumer. If the consumer purchases an item, the management company documents the sale and commission associated with affiliate/retailer relationship.

The management company aggregates each affiliate's total commissions earned each month from all advertisers that affiliate partners with in the manager's Marketplace, and if this amount exceeds the minimum payout, the management company sends a paycheck (or direct deposit). In our case, [M] then donates 100% of that commission to the designated Non-Profit Partner every quarter if this amount exceeds the minimum payout of \$25. If the amount is less than \$25, the balance rolls over to the next quarter.

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All commissions are received into a [M] account set up just for this process. Every quarter, [M] pulls reports from the management companies and donates 100% of the commission to its designated non-profit partners, unless the amount is less than the minimum payout.

One of the affiliate management companies M contracts with is N. Attached to M's letter of August 3, 2004, is a two-page document, issued by N, and titled "[N], The Simple Facts: Pay-for-Performance Drives Results." Under the heading "What is Pay-for-Performance?" is the following:

Pay-for-performance is a form of online advertising where a marketer pays for results rather than paying to reach a particular audience. A Web site (the "publisher") advertises products or services offered by another Web site (the "advertiser") in exchange for a commission on leads or sales. The publisher displays banners, ads, text links or produces on their Web site and is paid a commission by the advertiser when a visitor takes a specific action, such as filling out a form or making a purchase.

Under the heading "How it Works" is the following:

An advertiser joins the [N] network and places ads, offers, and links in the network, making them available for placement by a publisher. Publishers, looking for links, pay to join the advertiser's pay-for-performance advertising program, and upon acceptance, select and

place the advertiser's offers on their Web site. These offers and links are served and tracked by [N].

When a visitor to a publisher's Web site clicks on one of the advertiser's links, a cookie is set on the visitor's browser that identifies the advertiser, the publisher, and the specific link and payment rates. When the visitor makes an actual purchase online or fills out a form, that transaction is tracked and recorded by [N].

Upon recording the transaction, [N] handles all of the collection and processing required to ensure fair and timely commission payment for the publisher, and all of the administration and verification necessary to ensure qualified sales and leads for the advertiser.

Accompanying M's letter of July 18, 2003, is a six-page document titled "Non Profit Organizations" which M describes as an "informational welcome piece ... which we send out to new organizations." Under "Company Information" is the statement: "[M] is a unique online shopping portal, which aids the partnership between retail America and non-profit organizations through commissions provided by affiliated businesses." Under the heading "Nonprofits" on the "Overview" page, it states:

[M]'s nonprofit partners benefit through an increased source of funding through consumer purchases as well as increased exposure for their organization through information posted on [M]'s web site]. [M] provides the staff, support, and marketing to promote each organization's shopping page. Each nonprofit partner organization has the benefit of promoting advancements and upcoming events within their field on the [M] website.

In response to our request to provide a list of all nonprofit partners and the amount of commissions received by each, M provided, with its letter of August 3, 2004, a list of 48 "nonprofit organizations" and an annual breakdown of the commissions received by M and given over to each nonprofit. The total commissions given over to all 48 nonprofits was \$x. One nonprofit received over \$1,000. Fifteen nonprofits received between \$100 and \$1,000. The remainder received less than \$100, and fourteen of those received less than \$10, in some cases, nothing.

Attached to its letter of August 3, 2004, M provided a summary by year of the sales generated through its website portal for each for-profit retailer, and the commissions received by M for those sales. Total merchant sales through M's website portal amounted to \$z. Total commissions received by M amounted to \$x. Commissions amounted to 4.25 percent of sales.

Aside from the operation of an online shopping portal, M devotes a page of its website to what it calls Q. According to M's application:

The [Q] newsletter highlights the activities of our participating nonprofits and charities. The main purpose of the newsletter is to create awareness for the groups we support and also help generate a buzz about shopping on [M]. The [Q] section of the website will be a page where organizations can post events, fundraisers, news, and volunteer information.

According to its application, M expects to spend 50 percent of its time operating its website. It expects to spend 20 percent of its time on public relations and advertising campaigns. Another twenty percent of M's time is expected to be devoted to fundraising to support M. The fundraising will focus on securing corporate and business sponsorships that will fund M's operations. Finally, 10 percent of M's efforts will be devoted to building the M brand.

According to the application, M's sources of financial support are sponsorships, special fundraising events, and sale of promotional items. In its letter of July 18, 2003, M states:

The income from the e-newsletters will be generated from the sponsorship of banner space. These banners will be available for retailers, corporate sponsors, and individual donors. The enclosed sponsorship contract highlights the banner positions available for the website and the e-newsletter banners will be similarly placed and sized.

M's "sponsorship contract" lists the following types of "Sponsorships":

Homepage Sponsorship Placement (premium)

- Five static banner placements (234x60) at an individual monthly sponsorship fee of \$3000.00 (per placement)
- One, five-placement rotation banner (234x60) at an individual monthly sponsorship fee of \$2,500.00 (per placement)

[Q] Page Sponsorship Placements (premium)

- Five static banner placements (234x60) at an individual monthly sponsorship fee of \$1,500.00 (per placement)

[Q] E-Newsletter Sponsorship Placement

- Two static banner placements (468x60) at an individual monthly sponsorship fee of \$500.00 (per placement)
- Ten static placements (text and misc. sizes) at an individual monthly sponsorship fee of \$100.00 (per placement)

NPO Shopping Community Placements

- Ten static banner placements (234x60) at an individual monthly sponsorship fee of:
 - 1-10 placements = \$80
 - 11-30 placements = \$70.00
 - 31-100 placements = \$60.00

*Placements are established TEN per community.

Non-promotional sponsorships: \$ _____ monthly/quarterly/annually

Corporate sponsorship: \$ _____ monthly/quarterly/annually

The proposed budget submitted as part of M's application estimates tax year 2004 income from sponsorships of more than \$1y.

Attached to M's letter of August 3, 2004, was a printout of M's recent website home page. The webpage lists several "[M] Sponsors" and "[M] Merchants". Among the M Sponsors listed is P. The P banner includes a link to P's website.

M has four directors. One of M's directors is the president and CEO of P. Another of M's directors is a partner and the marketing director of P. In its letter dated August 3, 2004, M states:

[M]'s web designer and independent contractor, P, has accepted work from partner NPO's. Examples include web design, brochure design, and logo design. Fees assessed are at fair market value. M is not compensated for bridging this relationship.

Asked to provide copies of its board of director meetings, M responded in its letter of August 3, 2004, as follows:

[M] is currently operating as a "for profit" corporation without a board of directors. The directors ... will meet only when and if [M] achieves tax-exempt status. If tax-exempt status is not granted, [M]'s "for profit" business plan does not include a board of directors.

Law:

Section 501(a) of the Code exempts from federal income taxation organizations described in section 501(c).

Section 501(c)(3) of the Code describes corporations, trusts, and associations organized and operated exclusively for charitable and other exempt 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) of the Income Tax Regulations provides 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.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization: (a) limit the purposes of such organization to one or more exempt purposes; and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, 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 organizations, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code 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, as defined in section 513. 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.

Rev. Rul. 67-149, 1967-1 C.B. 133, holds that an organization formed for the purpose of providing financial assistance to several different types of organizations which are exempt under section 501(c)(3) of the Code is itself exempt under that section. It carries on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals. The organization does not accumulate its investment income.

In Rev. Rul. 64-182, 1964-1 C.B. 186, a corporation organized exclusively for charitable purposes derives its income principally from the rental of space in a large commercial office building which it owns, maintains and operates. The charitable purposes of the corporation are carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such organizations for charitable purposes. The ruling holds that the corporation is deemed to meet the primary purpose test of section 1.501(c)(3)-1(e)(1) of the regulations, and to be entitled to exemption under section 501(c)(3) of the Code, where it is shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources.

Section 512(a) of the Code provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions which are directly connected with the carrying on of such trade or business, computed with certain modifications.

Section 512(b)(3)(A)(i) of the Code excludes from the definition of unrelated business taxable income all rents from real property.

Section 513 of the Code provides that 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 the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or functions constituting the bases for its exemption under section 501.

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 1.502-1(a) of the regulations provides that, in the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 of the Code on the ground that all of the profits of such organization are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business, and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501.

Rev. Rul. 70-186, 1970-1 C.B. 129, holds that a nonprofit organization formed to preserve and improve a lake used extensively as a public recreational facility qualifies for exemption under section 501(c)(3) of the Code. The organization was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. It is financed by contributions from lake front property owners, from members of the community adjacent to the lake, and from municipalities bordering the lake. The organization's principal activity is to treat the water, to remove algae, and to otherwise improve the condition of the water for recreational purposes. By treating the water, removing algae, and otherwise improving the condition of the water, thereby insuring the continued use of the lake for public recreational purposes, the organization is performing a charitable activity. The benefits to be derived from the organization's activities flow principally to the general public through the maintenance and improvement of public recreational facilities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

Rev. Rul. 76-206, 1976-1 C.B. 514, holds that a nonprofit organization formed to generate community interest in retaining classical music programs by a local for-profit radio station does not qualify for exemption under section 501(c)(3) of the code. The organization promotes classical music by seeking sponsors for classical music programs presented on a commercial station, encouraging existing sponsors to continue such sponsorship, urging listeners to patronize such sponsors, and soliciting listener subscriptions to promote the programs. The ruling reasons that these activities tend to increase the station's revenues and thus benefit the for-profit radio station in more than an incidental way.

Analysis:

On the basis of the information provided by M, we conclude that M is not organized and operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. Rather, we conclude that M is organized and operated for the primary purpose of carrying on an unrelated trade or business within the meaning of section 513 of the Code, and, further, that it is organized and operated for the benefit of private interests.

Organizational Test

To merit exemption under section 501(c)(3) of the Code, an organization must be organized and operated exclusively for one or more exempt purposes within the meaning of section 501(c)(3). See section 1.501(c)(3)-1(a) of the regulations.

The first hurdle, then, an organization faces in establishing its exemption under section 501(c)(3) of the Code is the “organizational test” set out in section 1.501(c)(3)-1(b) of the regulations. Under this test, an organization’s articles of organization must limit the organization’s purposes to one or more exempt purposes specified in section 501(c)(3). In addition, the articles may not authorize the organization to engage in substantial activities that are not in furtherance of an exempt purpose. We find that M’s articles of incorporation fail on both counts.

First, as explained further below, we do not consider M’s stated purpose, i.e., to operate an e-commerce Internet website in the manner described, is an exempt purpose within the meaning of section 501(c)(3) of the Code. Rather, we find such purpose to constitute an unrelated trade or business.

Second, M’s articles expressly permit M to “[transact] any or all lawful business for which non-profit corporations may be incorporated under the laws of [M’s state of incorporation].” Insofar as a nonprofit corporation under state law may engage in activities that are broader than activities in furtherance of exempt purposes within the meaning of section 501(c)(3) of the Code, such provision in M’s articles violates the organizational test requirements under section 1.501(c)(3)-1(b) of the regulations.

Since M is not organized exclusively for exempt purposes as required by section 1.501(c)(3)-1(a) of the regulations, it does not qualify for exemption under section 501(c)(3) of the Code.

Operational Test: Primary Purpose is an Unrelated Trade or Business

Another hurdle to be overcome by an organization seeking exemption under section 501(c)(3) of the Code is the “operational test” set out in section 1.501(c)(3)-1(c) of the regulations. Under this test, an organization must prove that it operates exclusively for one or more exempt purposes within the meaning of section 501(c)(3) by showing that it engages primarily in activities which accomplish one or more of such exempt purposes.

Section 1.501(c)(3)-1(e) of the regulations explains that an organization may operate a trade or business as a substantial part of its activities and still qualify for exemption under section 501(c)(3), so long as the operation of the trade or business is in furtherance of the organization’s exempt purpose and the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

The term “unrelated trade or business”, as it applies to an organization described in section 501(c)(3) of the Code, means any trade or business the conduct of which is not substantially

related (aside from the need of such organization for income or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purposes.

M's primary activity is to operate an Internet portal through which visitors shop for merchandise from online retailers. If an organization exempt under section 501(c)(3) of the Code that otherwise conducts activities in furtherance of an exempt purpose (for example, an organization that accomplishes educational purposes because it operates a school), were to operate an Internet portal through which visitors shop for merchandise and from which such organization received commissions that it applied to its educational programs, such activity would be treated as unrelated trade or business within the meaning of section 513. Such a conclusion is reached because Internet retail shopping is not substantially related to the educational organization's exempt purpose except insofar as it provides the organization with income. The same may be said of any other section 501(c)(3) organization that operates an Internet shopping portal.

Since the operation of an Internet shopping portal is an unrelated trade or business with respect to organizations exempt under section 501(c)(3) of the Code, then M, whose primary purpose is to "operate an e-commerce Internet website," is operated for the primary purpose of carrying on an unrelated trade or business. M estimates that half its resources are spent on operating its website shopping portal, and half its resources are spent on funding its operations and promoting itself. Even M's director admits that M is currently operated as a "for-profit corporation." Since M's primary purpose is the carrying on of an unrelated trade or business, it is not operated exclusively for exempt purposes specified in section 501(c)(3), and does not qualify for exemption under that section.

Rev. Rul. 67-149, *supra*, holds, without discussion, that an organization may qualify for exemption under section 501(c)(3) of the Code if it is formed to provide financial assistance to other organizations, all of which are exempt under section 501(c)(3) of the Code. At first glance, this ruling would appear to encompass the activities of M. On closer look, however, important distinctions emerge.

First, for an organization to come within the ambit of Rev. Rul. 67-149, *supra*, it must provide support solely to organizations that are exempt under section 501(c)(3) of the Code. It is not clear that M provides support solely to section 501(c)(3) organizations. For instance, M's application and supporting materials refer indiscriminately to "charities" and "nonprofit organizations" as though the terms were synonymous. M's informational welcome piece for nonprofit organizations is titled "Non-profit organizations", and states that "[M] is a unique online shopping portal which aids the partnership between retail America and non-profit organizations." The overview section refers to "nonprofit organizations" and "nonprofit partners". The form contract that M uses with its nonprofit partners does not condition the contract on the nonprofit being a section 501(c)(3) organization. When we asked M to describe its criteria for selecting its "nonprofit partners", M makes no mention of section 501(c)(3) status as a requirement. While it may be M's intent to contribute only to section 501(c)(3) organizations, its use of the term "nonprofit" and its seeming lack of procedures to ascertain the exempt status of its nonprofit partners raises the specter that M might provide assistance to organizations other than those that are exempt under section 501(c)(3).

Second, Rev. Rul. 67-149, *supra*, speaks of an organization that “carries on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations [i.e., organizations exempt under section 501(c)(3) of the Code] at periodic intervals.” M’s operations differ in at least two respects.

First, M does more than simply “receive contributions”. M operates a portal website that gives shoppers access to a large number of Internet retailers. M receives commissions based on a percentage of the sales conducted through its website. Such activities constitute a trade or business and not a mere “receiving of contributions.” As explained earlier, an Internet retail shopping portal would be considered unrelated trade or business if conducted by an organization exempt under section 501(c)(3) of the Code. Since M’s purpose, as stated in its articles of incorporation, is “the operation of an e-commerce Internet website”, it follows that M is organized and operated for the primary purpose of conducting unrelated trade or business, an activity not contemplated by Rev. Rul. 67-149, *supra*.

Second, M hopes and expects to earn income to support its operations from fundraising and the sale of advertising. It is uncertain what M will do with the excess if advertising income exceeds expenses. In its December 30, 2003, letter, M mentions that it plans “on creating a foundation to which much of our revenue will go into and then disbursed to programs we support.” Even if M were to carry out such vague plans, that is no guarantee that income would not be accumulated in contradiction to Rev. Rul. 67-149, *supra*.

Rev. Rul. 64-182, *supra*, holds, without discussion, that an organization that derives its income from the rental of commercial office space and that makes contributions to other organizations exempt under section 501(c)(3) of the Code for charitable purposes, may itself qualify for exemption under section 501(c)(3). However, the organization must show that it is carrying on, through contributions and grants, a charitable program commensurate in scope with its financial resources. Upon making such a showing, the organization will be “deemed” to meet the “primary purpose test” of section 1.501(c)(3)-1(e)(1) of the regulations.

Again, M would appear, at first glance, to fit the mold of Rev. Rul. 64-182, *supra*, but a closer look reveals that it does not. The organization described in the ruling receives income in the form of rents from commercial space. Under section 512(b)(3)(A)(i) of the Code, rents from real property are excluded from the definition of unrelated business taxable income. Therefore, the organization is not considered to be conducting unrelated trade or business. M, on the other hand, is organized to operate an e-commerce Internet website. M’s primary activity is to act as a retail affiliate through the operation of an Internet shopping portal. As explained above, the operation of an Internet shopping portal constitutes unrelated trade or business for a section 501(c)(3) organization. Therefore, unlike the organization described in Rev. Rul. 64-182, M derives its income from an unrelated trade or business.

Even if M’s activities were not considered unrelated trade or business, it is not necessarily the case that M’s charitable program would be commensurate in scope with its financial resources. M’s donations to its “nonprofit partners” are limited to the commissions it receives as a retail affiliate. In its letter of August 3, 2004, M reports that it has received \$x in commissions since its inception. On the other hand, M anticipates receiving more than \$1y annually through the sale

of “sponsorships” (advertising). M will use such sponsorship revenue to pay its expenses and to grow its business. Given the discrepancy between the small amounts received as commissions and the large amounts expected from advertising, it is uncertain that M’s “charitable” program would be commensurate in scope with its financial resources.

Even if M were not considered to be organized and operated for the primary purpose of carrying on unrelated trade or business, and even if M were to show that commissions are only given to organizations exempt under section 501(c)(3) of the Code, nevertheless M would still be precluded from exemption under section 501(c)(3) because it operates as a feeder organization within the meaning of section 502. Section 502 provides that an organization operated for the primary purpose of carrying on a trade or business for profit cannot be exempt under section 501 on the ground that all of the profits of such organization are payable to one or more organizations that are exempt under section 501. The term “payable” is interpreted to mean that the organization is obligated to turn over its profits to one or more designated exempt organizations under some legal or equitable obligation.

M is obligated to turn over its commission to the nonprofit organization designated by the person shopping through M’s portal. M’s contracts with its nonprofit partners obligate M to turn over its commission to the nonprofit organization designated by the shopper. On its website, M has offered to turn over its commission to the nonprofit organization chosen by the shopper in exchange for the shopper’s use of M’s portal to access the retailer’s website. The shopper’s use of M’s portal obligates M to turn over its commission to the nonprofit of the shopper’s choice.

Since the shopping portal is M’s only activity, and since the “profits”, i.e., the commissions generated from that activity, cannot be used at M’s discretion but, instead, are payable to specific nonprofits chosen by the shoppers, M falls within the feeder provision of section 502 of the Code. Hence, M is precluded from exemption under section 501(c)(3).

Operational Test: Private Benefit

Under section 1.501(c)(3)-1(d)(1)(ii) of the regulations, an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. Although an organization exempt under section 501(c)(3) of the Code may provide benefits to private individuals, those benefits must be incidental quantitatively and qualitatively to furthering exempt purposes. To be qualitatively incidental, private benefit must be a necessary concomitant of the activity that benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefiting certain private individuals. To be quantitatively incidental, the private benefit must be insubstantial, measured in the context of the overall public benefit conferred by the activity. See Rev. Rul. 70-186, *supra*.

M’s activities provide substantial, not incidental, benefits to private parties. Although M provides benefits to nonprofit organizations by donating its commissions to them, the commissions are insubstantial in comparison with the sales M’s activities generate for M’s for-profit merchant partners. According to M’s documentation, visitors to M’s website have purchased \$z worth of

merchandise from M's merchant partners. In return, M has received commissions from those sales of \$x.

Unlike the situation described in Rev. Rul. 70-186, *supra*, in which an organization preserved a lake for public recreation and, in so doing, incidentally benefited lakefront property owners, in M's case the private benefit is substantial and the public benefit is incidental. The large amount of sales M's operations generate for its merchant partners is not justified by the small amount of commissions received by M and passed on to its nonprofit partners.

Like the organization in Rev. Rul. 76-206, *supra*, that was denied exemption because its activities to promote of classical music resulted in increased revenue for a for-profit radio station, so, too, M promotes "charity" by urging its website visitors to patronize for-profit merchants, thereby increasing such merchants' revenues and benefiting them in more than an incidental way.

In addition, M's operations have led to increased business for P, a for-profit web design company. Two of M's directors are owners of P, and thereby enjoy increased personal benefit based on M's activities. Not only has P been featured on M's website as one of M's "sponsors" with banner space on M's homepage, but M's letter of August 3, 2004, suggests that M has sought out business for P among M's nonprofit partners.

Conclusion:

For the above reasons, we find that M is not organized and operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. Rather, M is organized and operated for the primary purpose of conducting unrelated trade or business. Furthermore, we find that M provides substantial benefits to private for-profit interests in return for a comparatively incidental public benefit.

Accordingly, M does not qualify for exemption as an organization described in section 501(c)(3) of the Code and it must file federal income tax returns.

Contributions to M are not deductible under section 170 of the Code.

M has the right to protest this ruling if it believes it is incorrect. To protest, M should submit a statement of its views to this office, with a full explanation of its reasoning. This statement, signed by one of M's officers, must be submitted within 30 days from the date of this letter. M also has a right to a conference in this office after its statement is submitted. M must request the conference, if it wants one, when it files its protest statement. If M is to be represented by someone who is not one of its officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If M does not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section 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 administrative remedies available to it within the Internal Revenue Service.

If we do not hear from M within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about its federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If M disagrees with our proposed deletions, M should follow the instructions in Notice 437.

If M decides to protest this ruling, M's protest statement should be sent to the address shown below. If it is convenient, M may fax its reply using the fax number shown in the heading of this letter. If the reply is faxed, please contact the person identified in the heading of this letter by telephone to confirm that the fax was received.

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:2)
1111 Constitution Ave, N.W., PE-3G4
Washington, D.C. 20224

If M does not intend to protest this ruling, and if M agrees with our proposed deletions as shown in the letter attached to Notice 437, M does not need to take any further action.

If M has 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
Rulings & Agreements

Enclosure
Notice 437