Mission Impact Department **Council Operations**

M E M O

To: Mark Moshier
From: Russ McNamer
Re: Private Benefit Doctrine
Date: May 25, 2010

Question

Is the creation of individual youth accounts within the unit, where a portion of the money that an individual Scout raises during a fundraising event is reserved for his use alone, an incidental private benefit as allowed under 501(c)(3)tax-exempt status?

Brief Answer

The creation of individual youth accounts within the unit, where a portion of the money that an individual Scout raises during a fundraising event is reserved for his use alone is not an incidental private benefit. The BSA has not met its burden of proof to establish that it is not organized or operated under 501(c)(3) tax-exempt status for the benefit of private interests related to individual youth accounts.

Background

On March 7, 2002, a letter was received by the National Office from Richard R. Shelly, related to the use of a "reserve scout account program" within his Cub Scout Pack. Enclosed was a letter from the IRS in response to a letter he sent.

The IRS responded: "The distribution method that you are proposing – the creation of a reserve fund within the Pack where a portion of the money that an individual Scout raises during a fundraising event is reserved for his use alone is a troublesome one. Earmarked accounts may not be compatible with continued tax exemption. Such a decision cannot be made without considering all of the facts and circumstances. Accordingly, we are not ruling definitively at this time." (Undated letter from Gerald V. Sack, manager, Exempt Organizations, Technical Group 4)

Facts

The Boy Scouts of America and local councils are recognized as tax-exempt under an IRS group exemption ruling dated November 24, 1965. Units are considered tax-exempt as an integral part of local councils. The tax-exempt status of the Boy Scouts of America National Council, and through our group exemption for local councils, is based on being organized and operated exclusively for charitable purposes as stated in the governing documents.

Bylaws Article I, Section 2:

"The purpose of the Corporation is as set forth in the original certificate of incorporation under the laws of the District of Columbia, dated February 8, 1910, and restated by the Congress of the United States of America on June 15, 1916, as follows: 'That the purpose of this corporation shall be to promote, through organization and cooperation with other agencies, the ability of boys to do things for themselves and others, to train them in Scoutcraft, and teach them patriotism, courage, self-reliance, and kindred virtues, using the methods which are now in common use by Boy Scouts.' In achieving this purpose, emphasis shall be placed upon its educational program and the oaths, promises, and codes of the Scouting program for character development, citizenship training, and mental and physical fitness."

Bylaws, Article XI, Section 1, Clause 2:

"Contributions shall be solicited in the name of the Boy Scouts of America only through or by the authority of the Corporation, and shall be limited to the National Council or chartered local councils, in accordance with these Bylaws and Rules and Regulations of the Corporation. Youth members shall not be permitted to serve as solicitors of money for chartered organization units, for the local council, or in support of personal or unit participation in local, national, or international events. Youth members, however, are permitted to secure sponsors for council or district activities approved by the executive board. These approved activities may result in financial support for the local council in accordance with the Bylaws and Rules and Regulations of the Corporation."

Rules and Regulations, Article XI, Section 1, Clause 1, (b) Purpose:

"All money raised by or received for the benefit of a unit or local council shall be deemed to be received or acquired solely for the benefit of Scouting as interpreted and promoted by the Boy Scouts of America."

Rules and Regulations, Article XI, Section 1, Clause 1, (c) Local Council Control:

"Subject to the general rules and regulations adopted by the National Council or Executive Board, local councils shall control the raising and expenditure of all funds for local Scouting work in their jurisdiction."

Discussion of the Law

"IRC 501(c)(3) provides exemption from federal income tax for organizations that are 'organized and operated exclusively' for religious, educational, or charitable purposes. The exemption is further conditioned on the organization being one 'no part of the net income of which inures to the benefit of any private shareholder of individual.'"

"The word 'private' has been held to mean the antonym of 'public' – used to distinguish a private individual from the general public – and is intended to limit the scope of those persons who personally profit from an organization to the intended beneficiaries of the allowable activities." (Overview of Inurement/Private Benefit Issues in IRC 501(c)(3), 1990 IRS EO CPE Text)

"The regulations cited above contrast private, non-exempt purposes with public exempt purposes. Note that it is the organization's true purpose, not the stated purpose or the organizational language, that we must consider. A benefit that is necessary part of the exempt purpose of the organization does not serve private interests. On the other hand, anything flowing from an organization's activities other than public, charitable benefits may be serving private interests and therefore a nonexempt purpose." (Private Benefit Under 501(c)(3), 2001 IRS EO CPE Text)

Private Benefit

"The amount of private benefit that will be permitted depends on the magnitude of the private benefit in relation to the public benefit derived from the organization's activities and whether the private benefit is necessary in order to effectuate the organization's exempt purpose."

"The private benefit standards do not derive from that portion of the statute which prohibits inurement of net earnings. They are based on that portion of IRC 501(c)(3) that requires an organization to be 'operated exclusively' for exempt purposes. However, 'operated exclusively' has two meanings. Both meanings are contained in Regs 1.501(c)(3)-(1)(c)(1) :

(c) Operational Test
(1) Primary Activities. 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). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."

"The Code speaks of purposes while the operational test focuses on activities. But purposes may be inferred from activities."

"The courts recognize that a single activity can serve both an exempt and a nonexempt purpose. In such cases the problem is determining the organization's primary purpose. The outcome depends on the weight assigned to various indicators of exempt versus nonexempt purpose."

"Application of the primary purpose standard involves a weighing of facts and circumstances which vary greatly from case to case. This gives the Service and the courts considerable discretion in rationalizing a decision in a particular case. It also limits the

precedential value of a case or revenue ruling because it is almost always possible to factually distinguish a case from those that came before the courts or the Service."

Incidental Private Benefit

"In G.C.M. 38459, Chief Counsel had observed that 'an organization which serves a private interest other than incidentally is not entitled to exemption as an organization described in section 501(C)(3). Thus, although an organization's operations serve a public interest, exemption will be denied if private interests are also served.'"

"In our opinion, the word 'incidental' in this context has both qualitative and quantitative connotations. We think it is qualitative in the sense that to be 'incidental', the private benefit must be a necessary concomitant of the activity which benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefitting certain private individuals."

"There is also a quantitative connotation to the term 'incidental' in this context."

"In our consideration of the proposed revenue ruling in G.C.M. 35701 … we stated that:

'If the purposes or operations of an organization are such that private individuals who are not members of a charitable class receive other than an insubstantial or indirect economic benefit therefrom, such activities are deemed repugnant to the idea of an exclusively public charitable purpose. ..This result is the same, moreover, even if the purposes and activities of the organization would be charitable were it not for the element of private benefit.'"

"It thus appears that any private benefit arising from an organization's activities must be 'incidental' in both a qualitative and quantitative sense if that organization is to be entitled to exemption under section 501(c)(3). That is, an activity may provide an indirect benefit to private interests, and thus be 'incidental' from a qualitative standpoint, but if it provides a substantial benefit to private interests, albeit indirectly, it will negate charitability and exemption under 501(c)(3)."

"While the prohibition against inurement operates only against insiders, the prohibition against serving private interests operates against all parties who receive a benefit not accorded to the public as a whole." (1990 IRS EO CPE Text)

The Burden of Proof

"Regs. 1.501(c)(3)-1(d)(1)(ii) states the burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests. This requirement applies equally to inurement and private benefit issues. While it is difficult to prove a negative, the organization is certainly in a better position than the service to know the detailed facts surrounding its formation and operation"

"Failure to provide relevant information is a sufficient basis for both the Service and the courts to refuse to recognize the organization as exempt. This reduces the possibility that an organization may take refuge in a gray theoretical area or retreat into claims of ignorance about its own operations. Simply put, the organization must establish the factual basis for its exemption."

"Since inurement and private benefit issues are highly fact dependent, the courts do not look with favor on an organization's failure to provide relevant facts and they are not hesitant to find that an organization has failed to carry its burden." (1990 IRS EO CPE Text)

Applying the Law to the Facts

"The discretion inherent in finding and weighing facts can produce results which are difficult to rationalize." (1990 IRS EO CPE Text)

"At first glance, it appears from the above discussion that straightforward rules or principles can be applied to private benefit issues. American Campaign Academy defines private benefit as 'non-incidental benefits conferred on disinterested persons that serve private interests.' Court cases, revenue rulings, and GCMs further define non-incidental, benefits, disinterested persons, and private interests. We understand that private benefit must be both qualitatively and quantitatively incidental. We think we can distinguish between substantial and insubstantial benefits. We believe we can distinguish interested and disinterested persons. We can identify direct and indirect benefits."

"In reality it is difficult to apply the private benefit analysis."

"Ultimately, we must take the 'facts and circumstances' of each individual case and apply the law discussed above to determine the presence of private benefit. For example, benefits that are nonincidental in one factual situation may be incidental in another given the totality of the circumstances." (2001 IRS EO CPE Text)

"Court decisions, private letter rulings, technical advice memoranda, G.C.M.'s, and articles in professional journals provide a continuing commentary on inurement and private benefit issues. All of these sources stress three major points: (1) an organization is exempt on the basis of its purposes and not its activities; (2) the issue as to what an organization's purposes are is to be resolved in light of the totality of the facts and circumstances in a particular case; and (3) the burden is generally upon the organization claiming exemption to establish that its operations are exclusively in furtherance of exempt purposes and that it does not operate for the benefit of private interests." (1990 IRS EO CPE Text)

Conclusion

The creation of individual youth accounts within the unit is not permitted under the BSA National Bylaws and Rules and Regulations. Where a portion of the money that an individual Scout raises during a fundraising event is reserved for his use alone, it may not be compatible with continued tax exemption of the local council. The creation of individual youth accounts within the unit is not an incidental private benefit to the BSA's primary activities.

Qualitatively, the creation of individual youth accounts within the unit is not a primary activity to accomplish one or more of the exempt purposes of the BSA. It does not benefit the public as a whole. Quantitatively, the benefits from individual accounts are substantial and direct. The BSA has not met its burden of proof to establish that it is not organized or operated for the benefit of private interests related to the creation of individual youth accounts within the unit.