

# "I Know It When I See It."

01.30.15 | Linda J. Rosenthal, JD



*I can't define it, "but I know it when I see it."*

Back in [Another Way to Sink the Ship: Too Much Lobbying](#), we mentioned that determining "how much is too much" is a tough call. "Is 'lobbying,'" we asked, "something like 'obscenity'? A term that Supreme Court justices can't define but they know it when they see it?"

Could that apply as well to the Private Benefit Rule? It's fair to speculate that more than one person over the years has muttered quiet obscenities trying to understand and apply this key prohibition implicit in section 501(c)(3) of the Internal Revenue Code.

### **"There and Back Again"**

In "[How to Torpedo Your Tax Exemption: The Fifth Way](#)," we told you that the Private Benefit Rule and the No Inurement Rule are tough concepts to conquer, and that readers of this blog should expect to see these topics popping up repeatedly.

So here we are again – fairly quickly after posting "[Inurement and Private Benefit Are Often Confused](#)."

To recap the [basic rule](#): An organization cannot be exempt from tax under section 501(c)(3) of the Internal Revenue Code unless it is organized and operated exclusively for charitable purposes.

But "[exclusively](#)" really means "[primarily](#)" and what you can't do is benefit private persons to more than an "insubstantial" degree.

### *A Rare Display of Humor*

In a moment of levity, even the [IRS has acknowledged](#) that some private benefit may lurk within the loftiest of "exempt" (public or charitable) operations and activities:

”

---

*An apocryphal domestic relations case has a judge inquiring of the elderly plaintiff about why, after some fifty years of marriage, she was now seeking a divorce. ‘Well, your honor,’ she replied, ‘enough is enough!’*

*In the charitable area, some private benefit may be unavoidable. The trick is to know when enough is enough.*

#### ***Some Private Benefit?***

But, later, in a more serious moment, the IRS again tries to explain this elusive test:

”

---

Genuine public benefit often provides an incidental benefit to private individuals. But if private interests are served, *other than incidentally*, exemption is precluded. GCM 37789 helps define incidental by explaining that private benefit must be both qualitatively and quantitatively incidental. (emph. in orig.)

What is “qualitatively incidental” public benefit? It “means that the private benefit is a mere byproduct of the public benefit.”

What is “quantitatively incidental” public benefit? It is private benefit that is “insubstantial in amount.”

So – if a marvelous organization is doing wonderful things for the human race, it may still qualify for (or be able to retain its existing) tax-exempt status so long as any “incidental” private benefit along the way is not just “insubstantial in amount” but also can fairly be described as a “mere byproduct” of its “exempt” (public, charitable) purposes.

#### ***Qualitatively Incidental***

To illustrate the term “qualitatively incidentally,” the IRS cites two of its revenue rulings.

##### ***The Case of the Lake Lane***

In Revenue Ruling 70-186, a hypothetical organization was formed to “preserve and enhance” as a “public recreational facility” a sizeable lake that borders on several communities. It has “public facilities” including beaches and launching ramps that are used extensively. The organization’s activity is treating the lake water. Money comes from the affected municipalities as well as contributions from lake-front owners and members of the general public.

This an example of qualitatively incidental benefit. The “benefits from the organization’s activities flow principally to the general public through well maintained and improved public recreational facilities.” Lake-front property is certainly enhanced by what the organization provides, but this

private benefit does “not lessen the public benefits . . . through well maintained and improved public recreational facilities. . . In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.”

*The Case of the Block Benefit*

Compare the Lake Lane facts with a hypothetical organization described in Revenue Ruling 75-286. It was formed by residents and businesses on a certain city block “to preserve and beautify the block, to improve all public facilities within the block, and to prevent physical deterioration of the block.”

What does it do? The group pays the city government to plant trees and encourages residents to plant shrubbery, and organizes litter-control activities – all in the public areas within the block.

But membership is limited to residents and business owners on the block. Money comes from voluntary member contributions and block parties. This organization operated to serve “private interests by enhancing members’ property rights.” Although a better-looking block certainly enhances the community at large, this organization’s restricted focus and membership trumped any public benefit. Its private benefit was *not* “qualitatively incidental”; it was not a “mere byproduct of the public benefit.”

***Quantitatively Incidental***

If any private benefit that flows from an organization’s activity is “qualitatively incidentally,” it must pass a second hurdle. The private benefit must be small compared to the public benefit of that *specific activity*. The size of the private benefit is not compared to all of the organization’s activities.

The more exactly you can quantify the private benefit, the more likely it is to be non-incidental. You should also consider the number of entities benefiting. That is, if all of an organization’s business dealings are with a single entity (or group of related entities), or promoter or developer, private benefit is more like to be present. Further, private benefit is more likely to be substantial if the group receiving the benefit is small.

***Conclusion***

There are many more hypothetical examples from the IRS as well as actual cases that have worked their way through the tax agency and on to the courts.

It’s hard for most folks to know it when they see it. Stay tuned.