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September 9, 2009

Internal Revenue Service EO Classification  
ATTN: Exempt Organization Officer  
Mail Code 4910DAL  
1100 Commerce Street  
Dallas, TX 75242-1198

**RE: Sustainable Forestry Initiative, Inc. (SFI)  
EIN #80-0030060**

Dear Exempt Organization Officer:

Pursuant to Internal Revenue Service (IRS) Complaint Referral Form 13909 (also attached), the Washington Forest Law Center (WFLC) submits this complaint on behalf of **Forest Ethics**, a nonprofit conservation organization.

We write to report to the Internal Revenue Service a non-profit “forest certification” organization that is currently exempt under section 501(a) and 501(c)(3) of the Internal Revenue Code of 1986 (“Code”). We believe this organization, **Sustainable Forestry Initiative, Inc. (SFI)** (EIN #80-0030060), may be organized and operated for private benefit rather than public charitable benefit and interests. Further, although SFI holds itself out as a publicly-supported charitable organization under IRC section 509(a)(2), SFI may be unable to demonstrate “substantial public support” and furthermore may have failed to exclude from its calculation of “public support” the funding provided by persons who are deemed to be “disqualified persons.”

Although it is approved as a 501(c)(3) tax-exempt organization, SFI is organized, governed, and operated more like an industry trade association that promotes its private “certification” label than a separate charitable organization dedicated to setting high standards for forest products. First, SFI’s purposes—certification of private forests for a limited number of large industrial timber and paper companies—do not lessen the burden of government because the government is not in the business of providing “certification” of forestry practices.

Second, SFI substantially serves the private interest of non-exempt SFI-certified timber and paper companies. SFI became exempt under IRC 501(c)(3), but SFI was incorporated by individuals affiliated with timber and paper companies and SFI’s by-laws assign timber and paper companies one-third of its director positions. SFI is, by its own admission, virtually completely funded by the timber and paper companies whose lands and operations SFI

certifies. SFI's environmental standards are substantially developed by persons with close ties to the forest companies subject to SFI's certification standards. During the past several years SFI has continued to maintain close administrative ties to the American Forest and Paper Association, a 501(c)(6) trade association which created SFI in 1994. SFI also serves private interests because its forestry "standards" are vague, ambiguous, and grant wide discretion to the companies whose products are certified by SFI. These standards thus appear to provide too much latitude for forest landowners to serve their private interest in profitable forestry, rather than in the charitable endeavor of protecting the environment. In practice, SFI certification standards provide in many geographic areas of the U.S. little or no more added environmental protection than state and federal laws governing for-profit forestry.

Finally, we have a good faith basis to believe that SFI, a 509(a)(2) organization, may run afoul of the IRC requirement that a 509(a)(1) public charity must receive at least one-third of its financial support from "public sources" and that this one-third cannot be donated by "disqualified persons." By its own admission, virtually all of SFI's financial support (which was approximately \$5 million in 2007) comes from the companies whose forests or products are certified by SFI. SFI refused to provide us with a breakdown of its contributors so we are unable to make a "disqualified person" analysis but it appears that SFI may be violating the IRC's "disqualified" person rules as a result of its prosperous fundraising and relatively small universe of corporate donors.

SFI's 501(c)(3) and 509(a)(2) status permits it to claim the mantle and tax benefits of a nonprofit public charity, thereby seeking to gain environmental and social credibility, and allowing its supporters to deduct their contributions. SFI's 501(c)(3) status not only impacts taxpayers but works to the disadvantage of forest certification organizations that serve a public charitable purpose but must compete with SFI.

We request the IRS to investigate and, if appropriate, determine that SFI is not properly organized and operated as a tax-exempt charitable organization under Code sections 501(c)(3) and 509(a)(2).

## **II. Factual Background on SFI**

### **A. Forest Certification, In General**

The "green building" market, which represented just 2 percent of the construction market in 2005, could grow to as much as a quarter of all commercial and institutional building starts and 20 percent of the value of residential starts by 2013. By 2013, the green building sector may grow to a \$93 to \$140 billion market. Because the "green building" market in part relies on "certified" forest products and lumber, "forest certification" has become a major factor in the green building economy. Certified fiber is also rapidly gaining market share in the U.S.'s \$150 billion paper and print industry. Approximately 225 million acres of private and state forests are today "certified" by some type of certification entity in the United States.

"Certification" of forests and forest products (generally lumber and pulp for paper) theoretically means that these products were grown and harvested in a sustainable and environmentally-protective manner according to high environmental and social standards.

Oftentimes, certifying entities represent that certification provides environmental and social protection beyond that ordinarily required by federal, state, or local laws and regulations. The certified practices may be those of timber companies, governments, family forest owners, communities, indigenous groups or conservation organizations. Certification allows those environmentally beneficial forest management practices to be recognized and valued in the marketplace.

To encourage the use of certified forest products and to distinguish them from non-certified products in a busy commercial marketplace, certified products usually bear the label of the entity that has certified them. Chain of custody procedures ensure that certified products are tracked from forest to consumer and that material from non-certified controversial sources does not get mixed in with certified products.

A metrically-based, rigorous forest certification process that has appropriate separation between the certifier and the certified can provide direct public charitable environmental benefits. “Certified” products also provide forest landowners with definite economic benefits because the green building market can be developed to pay a premium for a certified product, the extra cost bearing a direct correlation to the environmentally and socially beneficial manner in which the product was produced.

## **B. SFI History and Governance Structure**

The SFI forest certification program was founded in October 1994 by the American Forest and Paper Association (AFPA), a Washington, D.C.-based timber industry trade association organized under Code § 501(c)(6) (Business League). For its first six years (until 2000), the activities now carried out by SFI were an AFPA program, not a separate legal entity.

In September 2000, AFPA spun off its SFI program to a new entity called “Sustainable Forestry Board, Inc.” (SFB).<sup>1</sup> SFB was incorporated in Washington, D.C. as a non-membership, nonprofit corporation on January 22, 2002.<sup>2</sup> [Note: SFB changed its name to the “Sustainable Forestry Initiative, Inc. (SFI) in November of 2006. We refer to the SFB and SFI interchangeably].

SFI—then SFB—was incorporated by William Banzhaf, Rick Holley, and Thomas E. Arend, Jr. and had an initial board of 13 directors.<sup>3</sup> Two of these three incorporators had close ties to the timber industry: Banzhaf was a former CEO of the Society of American Foresters and former president of George Banzhaf & Company—one of the nation’s oldest forest products consulting firms.<sup>4</sup> Holley is and remains the CEO of Plum Creek Timber Co—one of the

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<sup>1</sup> See

[http://www.afandpa.org/Content/NavigationMenu/Environment\\_and\\_Recycling/SFI/SFI.htm](http://www.afandpa.org/Content/NavigationMenu/Environment_and_Recycling/SFI/SFI.htm) (last visited May 28, 2009).

<sup>2</sup> Attachment 1.

<sup>3</sup> Attachment 2.

<sup>4</sup> See Speaker Biography: William H. Banzhaf, Ecosystem Management Initiative, *available at* <http://www.snre.umich.edu/ecomgt/events/bios/banzhaf.htm> (last visited July 9, 2009).

nation's largest wood product manufacturers and real estate investment trusts (REIT).<sup>5</sup> SFB's Application for Recognition of Exemption (Form 1023) explicitly concedes that "SFB was initially developed by the AFPA" and that the SFB "may use facilities, such as office space donated by the AFPA."<sup>6</sup> Of the SFB's initial thirteen person board, eight were affiliated with timber or paper companies or private forestry interests.<sup>7</sup>

Soon after it incorporated in Washington, D.C., SFB applied for federal tax-exemption on or about May 10, 2002. According to its Application for Recognition of Exemption (IRC Form 1023), SFB/SFI's charitable purpose is to "further the purposes of sustainable forestry and environmental conservation" and "helping to ensure the environmental and economic sustainability of the nation's forest[s]." SFB's Form 1023 claims that its actions serve public rather than private interests:

The SFB's activities will be directed by an independent Board of Directors, comprising a diverse group of stakeholders representing a cross-section of interests, which Board will include significant nonprofit and public sector representation. Commercial and private interests will be represented on the Board but these interests will not exercise majority control over the SFB.<sup>8</sup>

The IRS approved SFI's application for recognition of exemption as an organization described in Section 501(c)(3) on September 13, 2002.<sup>9</sup>

Although SFB became an independent Washington, D.C. nonprofit corporation and obtained 501(c)(3) status in 2002, SFB has maintained a close financial relationship to the AFPA. For example, just after its not-for-profit incorporation, on February 18, 2002, AFPA and SFB executed a "Reimbursement Agreement" allowing AFPA to perform certain administrative tasks for SFB.<sup>10</sup> The Agreement was signed on behalf of SFB by Rick Holley, the CEO of Plum Creek Timber Co. and the then chairman of SFB.

Another example of the SFB's close ties to the AFPA is reflected in SFI's 2007 Form 990 tax return. On line 52, pg. 7 of its 2007 tax return, SFI states that it has a "contracted services" relationship with AFPA.<sup>11</sup> SFI's 2006 Form 990 tax return also states that SFI's books are "in care of" AFPA (line 91a)<sup>12</sup> and that SFI reimburses AFPA for "salary, payroll taxes, and

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<sup>5</sup> Plum Creek owns more than 7 million acres of land in major timber producing regions of the United States. See About Plum Creek, Plum Creek Timber Co. *available at* <http://www.plumcreek.com/AboutPlumCreek/tabid/54/Default.aspx> (last visited July 14, 2009).

<sup>6</sup> Attachment 3 (Ex. D to IRS Application 1023).

<sup>7</sup> See Attachment 2 (Banzhaf, Bedell, Burris, Cashwell, Dillon, Holley, McDougall, Moseley)

<sup>8</sup> Attachment 4 (SFB IRS Form 1023, Ex. B, at 3).

<sup>9</sup> Attachment 5 (Determination Letter).

<sup>10</sup> Attachment 6 ("Reimbursement Agreement" dated February 18, 2002).

<sup>11</sup> Attachment 7.

<sup>12</sup> Attachment 8.

benefit expenses of its employees.”<sup>13</sup> SFI’s 2006 Form 990, Schedule A (line 52) also states that SFI has an “historic and continuing relationship” with AFPA.<sup>14</sup>

In November of 2006, SFB filed with the Washington D.C. Dept. of Consumer and Regulatory Affairs to change its name to Sustainable Forestry Initiative, Inc. (SFI, Inc.). This change was approved and became effective on November 3, 2006.<sup>15</sup>

SFI asserted in its Form 1023 (Attachment 2, Exhibit B) and its promotional materials that it is governed by a multi-stakeholder board and that persons affiliated with the timber industry are in the “minority.” But SFI’s board of directors has always included many individuals with direct ties to private timber and paper companies on whom, by its own admission, SFI depends virtually exclusively for funding.

For example, SFI’s initial board of directors in 2002 consisted of 13 individuals. Of these 13, 9 were affiliated with major industrial timber companies or forestry consultant organizations<sup>16</sup> and SFI’s president was Rick Holley, the CEO of Plum Creek Timber Co. In 2004, SFI’s board expanded to 15; 7 of these 15 board members were affiliated with major timber or paper companies, including its vice-chair John A. Luke, the chairman and CEO of MeadWestvaco<sup>17</sup> but all of the new board members were selected and approved by the then existing board members. In 2005, SFI’s 15 member board included 7 members affiliated with industry, including its co-chair Colin Moseley.<sup>18</sup> In 2006, SFI’s 15 member board changed in composition but included 7 industry members, including its co-chair John A. Luke of MeadWestvaco.<sup>19</sup> In 2007, SFI’s 15 board members remained the same, including its co-chair John A. Luke. While SFI’s board appears to be non-industry-controlled from a numerical standpoint, SFI’s admission that “virtually all” of its donated funds come from SFI-certified timber and paper companies creates the appearance that SFI’s industry directors may bear disproportionate influence over the rigor of SFI’s standards and its strategic direction. This appearance is reinforced by the fact that, throughout its existence, a major timber or paper industry executive has **always** been chair or vice-chair of SFI.<sup>20</sup>

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<sup>13</sup> Attachment 9.

<sup>14</sup> See Attachment 9.

<sup>15</sup> Attachment 10.

<sup>16</sup> Specifically, William Banzhaf (Society of American Foresters, Banzhaf Consulting); Allen Bedell (Circle B Logging, Arkansas); “Skeet” Burris (Cypress Bay Plantation); John Cashwell (Pacific Lumber); John Dillion (International Paper); Rick Holley (Plum Creek Timber Co.); Duane McDougall (Willamette Industries); Colin Moseley (Simpson Timber Co.).

<sup>17</sup> Specifically, John Luke, Jr. (MeadWestvaco); “Skeet” Burris; John H. Cashwell (Seven Islands Land Co.); John Faraci (International Paper); Colin Moseley; Steven R. Rogel (Weyerhaeuser Co.); Joe Young (Low Country Forest Products).

<sup>18</sup> Specifically, Moseley, Luke, Burris, Faraci, Rogel, and Young.

<sup>19</sup> Specifically, Luke, Young, Faraci, Patrick Moore (Smurfit-Stone Container Corp., Mary Motlow (Cumberland Springs Land. Co.), Marvin Brown (Oregon Dept. of Forestry), and Rogel.

<sup>20</sup> Banzhaf; Holley (2002); Luke (Vice-chair, 2003); Luke (Vice-chair, 2004, 2005, 2006, 2007); Holley (2008, 2009).

SFI's board includes individuals who are not directly employed by timber or paper companies and SFI asserts that the presence of these individuals reflects that it is not dominated by industry. But our research reflects that many of these individuals have a financial relationship with SFI-certified timber and paper companies, a relationship we ask the IRS to consider in its assessment of whether SFI serves a public or a private interest.

One example is Larry Selzer, CEO of the Conservation Fund. The Conservation Fund's 2008 annual report lists numerous SFI-certified companies as donors, including Weyerhaeuser (\$10-49,999 level), AFPA (\$1000-4999 level), and Georgia-Pacific, International Paper (\$10,000-49,999 level).<sup>21</sup> Similarly, John Faraci, CEO of International Paper (also an SFI board member) and John A. Luke, CEO of MeadWestvaco (also an SFI board member) are members of the Conservation Fund's Corporate Council, as is W. Henson Moore, retired CEO of the AFPA.<sup>22</sup> Another example is Tom Franklin, who joined SFI's board in 2008. Mr. Franklin is senior vice president of the Theodore Roosevelt Conservation Partnership, which listed the Plum Creek Timber Co. Foundation as a major contributor in its 2005 and 2007 annual reports.<sup>23</sup>

While we do **not**, in any way, impugn the integrity of these individuals or question their commitment to conservation causes, we do point out that these individuals have financial ties to SFI-certified timber companies. We believe the IRS may want to consider such ties, in the particular circumstances of this situation, in conducting its private interest versus public interest analysis.

### **C. The SFI Certification Process**

We briefly describe the SFI certification process.

SFI's application for exemption under Code § 501(c)(3) states that its forest certification program qualifies for exemption because its purposes are "sustainable forestry and environmental conservation through maintenance, enhancement, verification, and promulgation of the SFI." The SFI program focuses on forest products and practices. Its two main activities are setting certification standards (for forest, chain-of-custody, paper, printer and fiber sourcing), and promoting and marketing its "certified" label to prospective wood and paper purchasers.

Forest landowners who wish for their lands to be SFI "certified" must have their land assessed. SFI maintains a list of SFI "lead verifiers" who conduct these assessments. Under the SFI process, auditors are chosen and paid by the companies seeking SFI certification and are themselves from for-profit entities. Together, the landowner and the auditor develop a site-specific landowner plan, called the "Program Participant's SFI Program" ("Plan"). If the auditor determines that the landowner's Plan conforms to SFI standards, the auditor issues a "Certificate of Conformance" and an "Audit Report" that is only shared with the landowner.

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<sup>21</sup> Attachment 11.

<sup>22</sup> Attachment 12.

<sup>23</sup> Attachment 13.

Most SFI-certified landowners are then required to have their lands audited periodically to evidence compliance with the Plan.

The SFI program authorizes a participant to use the SFI's label and logo on the participant's forest or products as part of an overarching SFI marketing campaign entitled "Good for You – Good for our Forests." SFI advertises that its brand is "a proven benefit of certification that you can see on the ground – and on your bottom line" and acts as a program participant's "gateway to certified forest products and suppliers that will help simplify your purchasing decisions, demonstrate your corporate social responsibility, and meet the needs of your organization and its customers."<sup>24</sup> SFI also provides an online database of forest products, sorted by provider.

SFI has been conducting a multi-million dollar advertising campaign promoting its SFI labels and brand. According to SFI's 2007 amended Form 990 tax return, Schedule A, Part II-A, the most recent tax return we could obtain, this advertising included \$1,838,711 paid in 2007 to the national advertising firm Porter Novelli.<sup>25</sup>

A sample of SFI's ads, which appear in national and local publications and on roadside billboards around the country are attached to this complaint.<sup>26</sup> These advertisements demonstrate the vigor with which SFI promotes its label in the marketplace on behalf of the companies certified by SFI.

#### **D. SFI Governance Structure and Program Participants**

##### **1. SFI Governance Structure, In General**

SFI's bylaws were very recently revised, on June 5, 2009.<sup>27</sup> According to these new bylaws, SFI is governed by 18 board members divided among three "sectors": Economic, Environmental, and Social. All "Economic Directors" must be associated with companies whose forests and operations are certified by SFI.<sup>28</sup> SFI's directors serve three-year terms, are identified by a Nominations Committee, and are selected by the full board of directors.<sup>29</sup> SFI's bylaws permit board members to serve two consecutive three-year terms but allows exceptions when approved by "unanimous consent" of the board. Since its inception, SFI's board has been—and still is—self-recruiting and selecting.

SFI was incorporated as a non-membership organization.<sup>30</sup> When its bylaws changed, this basic organizational format was not altered, although SFI's website has a "members only" password-protected link. SFI has no mechanism for organizations or individuals to join, vote, or elect the board of directors. In addition, although SFI maintains an "External Review Panel," that panel is also self-selecting and perpetuating. The IRS may wish to assess these

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<sup>24</sup> See <http://www.sfiprogram.org/find/index.php>.

<sup>25</sup> Attachment 14 (Part II-A).

<sup>26</sup> Attachment 15.

<sup>27</sup> Attachment 16.

<sup>28</sup> See Attachment 16 (Art. II, 1.1).

<sup>29</sup> Art. IV, 2.

<sup>30</sup> Article II of the SFI bylaws states that "[t]he Corporation shall not have members."

and other aspects of SFI's structure, in the context of SFI's specific history and activities, in making its determination of whether SFI serves public or private purposes.

## **2. SFI Program Participants**

SFI does not have members and its bylaws do not permit it to have members. Rather than members, SFI has "program participants," who purportedly include: "companies, universities, conservation groups, government agencies, timber investment management organizations and real estate investment trusts (REITs)."<sup>31</sup>

We have determined, however, that over two-thirds of SFI's "program participants" are private companies who have completed the SFI certification process and whose forests are certified by SFI. These include privately owned timber investment management organizations and real estate investment trusts. Additionally, over half of these are AFPA member organizations. By contrast, fewer than 15% of the program participants are universities, conservation groups, and government agencies. Many of this latter group are Canadian entities.<sup>32</sup>

## **3. SFI Donor Information**

SFI informed us that the "vast majority" of its "financial support is provided by SFI Program Participants who use our forest management and fiber sourcing standards."<sup>33</sup>

## **4. SFI Environmental Standard Development Process**

SFI's environmental standards are reviewed every five years by what SFI calls its "Standards Review Task Group."<sup>34</sup> According to SFI's website, this task force is currently composed of six individuals.<sup>35</sup> Of these six individuals, three are affiliated with SFI-certified companies, including its chairperson, Joe Lawson of Mead WestVaco, one of the largest packaging companies in the world.<sup>36</sup> After the Standards Review Task Group develops recommended changes, the proposed standards go to a "Standards Review and Writing Team." According

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<sup>31</sup> See [http://www.sfiprogram.org/files/pdf/SFI\\_Licensing\\_Application.pdf](http://www.sfiprogram.org/files/pdf/SFI_Licensing_Application.pdf).

<sup>32</sup> Analysis performed by *comparing* AFPA Membership List *available at* <http://www.afandpa.org/memberdirectory.aspx> (last visited July 13, 2009); *with* the SFI 2005-2009 Certified Companies *available at* [http://www.sfiprogram.org/files/pdf/SFI\\_Certification\\_List\\_Website.pdf](http://www.sfiprogram.org/files/pdf/SFI_Certification_List_Website.pdf) (last updated June 30, 2008); *and* SFI's Search Certified Product list *available at* <http://www.certifiedwoodsearch.org/sfiprogram/searchproducts.aspx> (Search for all) (last visited July 13, 2009); also note that AFPA Associate Member PricewaterhouseCoopers audited 15% of SFI's forest programs.

<sup>33</sup> Attachment 17.

<sup>34</sup> Attachment 18 (reprinted from [www.sfiprogram.org/standard-development-process.php](http://www.sfiprogram.org/standard-development-process.php)).

<sup>35</sup> Attachment 19.

<sup>36</sup> Joe Lawson (Mead WestVaco); Bob Emory (Weyerhaeuser); Mike Branch (Smurfit-Stone).



to SFI's website, this team consists of six individuals.<sup>37</sup> Of these six, **five** are employed by SFI-certified timber or paper companies.<sup>38</sup>

In sum, the vast majority of the people who recruit, develop, and write the SFI environmental standards are employed by SFI-certified companies.

### **III. SFI was Not Organized and is Not Operated Exclusively for Tax-Exempt Purposes**

In order to be exempt under Code § 501(a) as an organization described in Code §501(c)(3), an organization must be both **organized and operated** exclusively for “religious, charitable, scientific... literary or educational purposes.”<sup>39</sup> However, as explained below, there is substantial evidence that SFI is not organized and operated for such tax-exempt purposes.

#### **A. SFI was Not Organized for Tax-Exempt Purposes.**

##### **1. SFI's purposes do not lessen the burden of government.**

A commercial organization can defeat the general presumption of non-charitable purpose by demonstrating that it lessens the burdens of government. *Indiana Crop Improvement Association, Inc. v. Comm'r of Internal Revenue*, 76 T.C. 394, 396, 398 (1981). The burdens of government are lessened only if two criteria are satisfied. *Quality Auditing Co.*, 114 T.C. at 507. First, the activities engaged in by the organization must be those which a governmental unit considers to be its burden. *Id.* In other words, it must be shown that a governmental unit accepts as its responsibility the activities conducted by the organization and recognizes the organization as acting on the government's behalf. *Id.* Second, the organization's performance of the activities must actually lessen the burdens of Government. *Id.* However, “the mere fact that such activities might improve the general economic well-being of the Nation or a State or reduce any adverse impact from the failure of Government to carry out such activities is not enough.” *Id.*

In *Indiana Crop Improvement Association*, an organization which certified seeds was found to be serving a public interest, but only because the organization was charged by the State and Federal seed regulatory agency with this task, and there was no evidence of promoting the economic interests of commercial seed producers and commercial farmers. See *Indiana Crop Improvement Association, Inc. v. Commissioner of Internal Revenue*, 76 T.C. 394, 396, 398 (1981).

Even governmental agency-expressed concerns and requests fall short of recognition that an organization is acting in the government's stead. For example, despite being approached by “a number of governmental agencies and private industrial owners and developers... [to] develop a certification program for structural steel fabricators” and despite working in collaboration with technical experts and agencies, the steel fabrication certification

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<sup>37</sup> Attachment 20.

<sup>38</sup> Joe Lawson (Mead WestVaco), Bob Emory (Weyerhaeuser), Mike Branch (Smurfit-Stone), Brian Kernohan (Forest Capital Partners), Chris Davidson (International Paper).

<sup>39</sup> Treas. Regs 1.501(c)(3)-1(a)(1).

organization under question in *Quality Auditing* was held not to be a 501(c)(3) organization. There is no statutory recognition of steel auditing as a government responsibility, nor was there evidence the government would otherwise have developed a similar program. See *Quality Auditing*, 114 T.C. at 500, 508.

*Quality Auditing* made the additional point that when private entities join public entities in requesting a certification program, the purpose of lessening the burden on the government is no longer exclusive. See *Id.* at 508-09.

Notwithstanding any alleged public demand for forest certification, SFI does not lessen the burdens of government without a statutory or administrative recognition that forest certification is a governmental responsibility. SFI does not replace government regulation of forestry. Nor has SFI articulated any facts in its documents, bylaws, website or other materials that indicate that is the case. SFI also does not lessen the burden on government because its forest certification system protects the environment to such an extent that the need for government regulation is reduced. See Section 2 (below).

**2. SFI's certification standards are too vague and ambiguous to serve a public charitable purpose. They provide discretion to forest landowners to manage their forests to advance their private economic interests, and offer little or no marginal environmental protection beyond that required by state and federal laws and regulations governing forestry.**

The gravamen of this section is this: SFI's environmental "standards" do not contribute to or result in any public charitable purpose.

SFI's Application for Recognition of Exemption (IRS Form 1023, Exhibit B) filed on May 13, 2002<sup>40</sup> claims that SFI (then SFB) "promotes conservation and responsible management of the environment, through sustainable forestry practices." Its Form 1023 implies that SFI promotes a charitable purpose by promoting forestry that is more environmentally protective or sustainable than that required by applicable state and federal laws. We do not believe SFI's standards advance this charitable purpose.

SFI maintains a set of forestry "standards" (called "Principles, Objectives, and Indicators") with which SFI-certified forests must comply. A copy of SFI's 2005-2009 standards is attached.<sup>41</sup>

The key to understanding why SFI's standards are vague and ambiguous is that SFI does not promulgate or specify specific *prescriptive* forest certification requirements. Instead, SFI promulgates a set of general "objectives," "performance measures," and "indicators." These commitments are not numeric, measurable, or quantifiable. They provide forest managers with considerable flexibility to achieve economic targets.

For example, SFI claims that its standards include "measures to protect water quality, biodiversity, wildlife habitat, species at risk and forests with exceptional conservation value."

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<sup>40</sup> See Attachment 4.

<sup>41</sup> See Attachment 18.

SFI also claims that its standards “ensure long-term forest productivity and conservation of forest resources,” that they “protect” forest and soil productivity and water quality, and that they “promote” habitat diversity and conservation of forest plants and animals.

But SFI’s standards on their face are riddled with and heavily diluted by un-measurable or unverifiable terms, weak or vague verbs, and qualifiers (e.g., “where practical”) that permit a much greater degree of flexibility and discretion in their interpretation and implementation by forest managers, certifiers and auditors. The bottom line is that SFI’s standards are so vague, ambiguous, weak, and qualified that they allow the private interest in conducting profitable forestry to trump the charitable purpose of environmentally and socially protective forestry.

For example:

- SFI Indicators measure only whether some form of “system... program... plan [or] documentation” is present, rather than whether a specific, verifiable condition or result is being achieved *in the forest*. And rather than require forest managers to actually *do* something specific, the SFI standard often simply requires them to “address... support... promote... encourage... [or] contribute to” something. If the language of the standard itself fails to explicitly require tangible and measurable results *in the forest*, then specific forest management outcomes cannot be assured.
- With respect to biodiversity protection, the SFI standard requires only that certified landowners “manage” wildlife habitats and “contribute to” or “promote” (rather than “protect” or “maintain”) the conservation of biodiversity, and most of the associated indicators require only programs, plans, methodologies, or information collection rather than measurable results in the forest. Apart from requirements for “measures” and “plans” to protect riparian zones, water bodies, and undefined “special sites,” the SFI standard does not actually require the establishment or set-aside of protected areas. Nor does it preclude management activities that put specified high conservation values or features at risk, or require the protection of such values or features throughout certified forest units.
- SFI interprets the meaning of some of its standards quite loosely, with numerous opportunities for a landowner to adopt alternative approaches. For example, a key SFI “interpretations” document contains the following qualification regarding the conservation of critically imperiled or imperiled species and communities:

“In the rare case where the protection of an individual species or community carries exceptionally high costs or disproportionate impact and where the [certified landowner] is unable to implement any of the conservation strategies in a reasonable period of time (perhaps 3-5 years), and where laws or regulations do not apply, the [landowner] is free to implement other management or operational alternatives.”<sup>42</sup>

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<sup>42</sup> Attachment 21 (pg. 5, last paragraph).

- The vast majority of SFI performance measures (PMs) and indicators require only the development of a “plan” or “policy” without specific environmental, social, or economic outcomes to make Program Participants accountable for their practices.
- SFI’s standards<sup>43</sup> are vague and place discretion for adherence in SFI-certified forest managers. For example,
  - Principle 7: “Protection of Special Sites and Biological Diversity: To manage forests and lands of special significance (biologically, geologically, historically or culturally important) **in a manner that takes into account** their unique qualities and to **promote** a diversity of wildlife habitats, forest types, and ecological or natural community types.”
  - Performance Measure (PM) 2.1, Indicator (Ind.) 5: “Artificial reforestation programs that **consider** potential ecological impacts of a different species or species mix from that which was harvested.”
  - PM 3.2, Ind. 1: “Program **addressing** management and protection of streams, lakes, and other water bodies and riparian zones.”
  - PM 4.1, Ind. 6: “Support of and participation in plans or programs for the conservation of old-growth forests in the **region** of ownership.”
  - PM 5.3, Ind. 3: “Trees in clearcut harvest areas are at least 3 years old or 5 feet high at the desired level of stocking before adjacent areas are clearcut, **or as appropriate to address operational and economic considerations**, alternative methods to reach the performance measure are utilized by the Program Participant.”
  - “Although conformance with laws is the intent, **certification bodies are directed to look for a spirit and general record of compliance rather than isolated or unusual instances of deviation.**”
  - “Program participants shall ensure that long-term harvest levels are **sustainable** and **consistent with appropriate** growth and yield models and plans.”
  - PM 2.2: “Program Participants shall **minimize** chemical use required to **achieve Management objectives...**”
  - PM 2.3: “Program Participants shall **implement management practices to protect** and maintain forest and soil productivity.”
  - PM 2.3: “Use of erosion control measures to **minimize** the loss of soil and site productivity.”

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<sup>43</sup> See Attachment 18.

**B. SFI Is Not Operated Exclusively For Charitable Purposes.**

We believe that SFI is not operated exclusively for charitable purposes but, instead, serves to benefit the private interests of the limited class of SFI “program participants”—the timber and paper companies who fund SFI and benefit financially as the direct result of having obtained SFI certification.

The federal laws governing tax-exempt organizations have developed a “substantial private benefit” test to examine the public versus private benefit derived from a charitable organization’s operations. See Treas. Regs 1.501(c)(3)-1(a)(1). An organization exempt under Code § 501(c)(3) must function *exclusively* for “religious, charitable, scientific... literary or educational purposes.” Treas. Regs 1.501(c)(3)-1(a)(1).

The private benefit test defines the meaning of “exclusively.” While an exclusive purpose does not mean “solely” or “absolutely without exception,” *the presence of a single non-exempt benefit or interest, if substantial in nature, precludes exempt status, regardless of the number or importance of truly exempt purposes. Quality Auditing Co., Inc. v. Comm’r of Internal Revenue*, 114 T.C. 498, 504 (2000) (emphasis added). The burden of proving no substantial private benefit or interest rests on the taxpayer seeking tax exempt status. See *Quality Auditing*, 114 T.C. at 506.

Whether an entity has engaged in substantial private benefit is a question of fact based on all relevant facts and circumstances. *World Family Corp. v. Comm’r of Internal Revenue*, 81 T.C. 958, 967 (1983). This question is resolved by looking at the actual as well as the stated purposes of an organization and the activities it engages in to accomplish those purposes. *Christian Manner International, Inc. v. Comm’r of Internal Revenue*, 71 T.C. 661 (1979).

**1. SFI’s operations substantially benefit a limited class of SFI-certified timber and paper companies.**

A private benefit occurs when private persons, groups or entities receive some degree of advantage, profit, gain or interest. *Retired Teachers Legal Def. Fund, Inc. v. Comm’r of Internal Revenue*, 78 T.C. 280, 286 (1982). If one or more activities benefit a class of private interests, the organization is precluded from qualifying under section 501(c)(3), regardless of coexisting exempt purposes or incidental public benefit. *Retired Teachers Legal Def. Fund*, 78 T.C. at 289 (citing to Supreme Court’s decision in *Better Bus. Bureau v. United States*, 326 U.S. 279, 283 (1945)).

The courts consider a number of factors to assess the private or public nature of an organization’s operations including the type of activity, the nature, size or makeup (selectiveness) of the class or classes that benefit from one or more of the organization’s activities, and the purpose or motive of the organization in providing the private benefit. See *American. Campaign Acad. v. Comm’r of Internal Revenue*, 92 T. C. 1053., 1076 (1989); *Ginsberg v. Comm’r of Internal Revenue*, 46 T.C. 47 (1966); *Retired Teachers Legal Def. Fund*, 78 T.C. at 289.

The Tax Court has found private benefit where the class that benefits from the organization's work is **too selective**. For example, in *Columbia Park*, developers of a massive real estate development in Maryland formed a 501(c)(3) organization to take title to a 1,400 acre park and recreational area within the boundaries of the 14,000 acre development. See *Columbia Park & Recreation Ass'n, Inc. v. c.*, 88 T.C. 1, 2-3 (1987). The organization's activities included maintaining parks, lakes, preschool education, and other services for a community developed by the private developer. *Id.* The general public was permitted to use only some, but not all, of the recreational facilities and was required to pay higher rates to use them. In disallowing the organization's exempt status, the Tax Court determined that the facilities and services offered to the general public constituted only a small percentage of the organization's total assets and a rather limited percentage of the organization's budget. *Id.* 88 T.C. at 5-6, 7-8, 19-20.

In *Ginsburg*, the tax court affirmed the IRS's revocation of an organization's exempt status, in part because the activities **benefited too small a class of interests**. *Ginsberg*, 46 T.C. at 52-55 (1966). The organization's activities included the dredging and maintenance of three waterways that were bounded by the properties of twenty private landowners. *Id.*, at 49-50. Those neighboring private landowners were both the organization's members and its main contributors. *Id.* at 49, 54-55. The size of the beneficial class, the *Ginsburg* court held, was too small.

The ratio of charitable beneficiaries to private interests is also an important measure of whether an organization serves a public or private interest. In *Retired Teachers*, the IRS compared the ratio of charitable to non-charitable clients of a legal services organization. The organization's tax exemption was disallowed because two thirds of the clients receiving services fell outside a definition of "poor or distressed." Only one third comprised truly charitable beneficiaries. See *Retired Teachers Legal Def. Fund*, 78 T.C. at 289-90.

In determining the beneficial class, the courts have looked not just to who primarily benefits but also who receives subsequent or secondary benefits. For example, in *American Campaign Academy*, the Tax Court denied exempt status to a school formed to train individuals for careers as political campaign professionals. *Am. Campaign Acad.*, 92 T.C. at 1068-09. While the court found a substantial public benefit to students, the academy also provided subsequent benefits to 98 Republican candidates (including focus of the curriculum on partisan topics that would result in secondary benefit to those candidates). *Id.* at 1074. The court found this indirect but substantial benefit to Republican candidates defeated the exclusive public purpose of the organization. *Id.*

SFI's certification system, as presently composed and operated, benefits private rather than public interests. SFI's standards are so vague and ambiguous that, in practice, they often provide little or no marginal charitable environmental benefit. Yet SFI provides considerable *private* benefit: it provides considerable public relations benefits to a limited universe of SFI-certified companies who seek for their forests products to be "certified" by an independent, tax-exempt organization. As in *Columbia Park* and *American Campaign Academy*, SFI's certification system substantially benefits the timber company "program participants" who developed and primarily fund SFI's activities and environmental standards.

Like the “non-poor” legal clientele in *Retired Teachers*, more than two thirds of SFI’s one-hundred and forty-two forest certifications have been given to for-profit private timber companies. Further, more than half of these certifications are for AFPA corporate member organizations. SFI also has provided fewer than fifteen-percent of its forest certifications to universities, governments, or conservation organizations. This number is fewer than the one-third of the public interest clients served (and determined to be too few) in *Retired Teachers*. See *Retired Teachers Legal Def. Fund*, 78 T.C. at 289-90

**2. SFI was incorporated by its program participants and continues to maintain a close financial and administrative relationship to the AFPA and executives of large timber companies that own millions of acres of SFI-certified forests.**

Who creates or controls a tax-exempt organization also is relevant to determining whether it serves a public or private interest. An organization does not operate exclusively for exempt purposes if it more than incidentally serves a private interest, e.g., the creator or designated individuals. See *Kentucky Bar Foundation v. Comm’r of Internal Revenue*, 78 T.C. 921, 926 (1982). If the organization is organized or *controlled* in a way that is serving the founding private interests or otherwise maintains too close a relationship with private interests, the entity does not serve a public interest. See generally, *Quality Auditing*, 114 T.C. 498; *Am. Campaign Acad.*, 92 T.C. 1053.

When a specific group directs the governing board’s composition or influences the bylaws, it is indicative of too close a relationship. In *American Campaign Academy*, for example, the court found that two of the three initial directors had significant ties to the Republican Party, a group having a significant secondary interest. See *Am. Campaign Acad.*, at 1070. In addition, the school’s bylaws specifically empowered the Republican Party to “have general charge of the affairs, property, and assets of the Corporation.” *Id.*

The continuing participation of a private founding entity or select group is also indicative of a self-serving relationship. In *Quality Auditing*, the 501(c)(3) organization, Quality Auditing Company, was an outgrowth of the American Institute of Steel Construction (AISC), a Section 501(c)(6) business league. AISC was primarily engaged in developing standardized engineering codes and specifications for the construction of steel-framed buildings and bridges. *Quality Auditing*, 114 T.C. at 500-02. AISC developed the “AISC Quality Certification Program” to advise structural steel fabricators regarding compliance with AISC and other industry defined—but, significantly, not government defined—codes. *Id.* Builders seeking certification would pay a fee to AISC, which then contracted with an independent entity to perform the “audit investigation” of the facility. *Id.*

The nonprofit corporation was organized to perform these audits pursuant to the quality certification program administered by AISC. The Tax Court found impermissible private benefit to AISC, because AISC provided the organization’s start-up capital and the content of the audit program carried out by the 501(c)(3) organization. See *Quality Auditing*, 114 T.C. at 501.

Substantial contribution by the organization's participants or customers is also evidence of too close a relationship with private interests. In *Ginsburg* (the group of landowners whose lands surrounded a waterway and who formed an exempt organization to pay for dredging of the waterway), the Tax Court disallowed the organization's exempt status because "it was clear that the association was organized and operated primarily for the benefit of those persons contributing to it." Any other purpose, the court reasoned, was a secondary one. *Ginsberg*, 46 T.C. at 55.

In *Columbia Park*, the recreation areas were funded with "user fees" of landowners within the development. *Columbia Park*, 88 T.C. at 26-27. The Court held that this source of revenue undercut the association's claim that it was a charitable organization. The court held that, "petitioner does not receive voluntary contributions from the public; rather, its source of revenue—96%—is from the members whom it serves." *Id.*

How a nonprofit organization spends its monies is also important to determining private benefit derived from a close relationship with private interests. In *EST*, the nonprofit corporation was not controlled or funded by the same individuals as the for-profit organization; but, it nonetheless substantially benefited the for-profit corporation. It did so by expending its resources to promote the techniques and ideas of the for-profit organization. *EST of Hawaii v. Comm'r of Internal Revenue*, 71 T.C. 1067, 1079-1080 (1979).

Under these precedents, SFI serves a private and not public interest. SFI was originally founded by the AFPA, which presumably exists to serve the private interest of timber and paper companies. SFI's 2002 founders and majority of initial directors were industry, its funders are virtually all industry, its board is heavily populated by timber industry representatives and, by its own admission, SFI has a continuing relationship with AFPA, an industry trade association. *Indeed, SFI's own organizational activities require close relationship with these industry insiders. According to its April 2008 Annual Report and its newly revised bylaws, at least one-third of SFI's governing board must be made up of program participants with economic or industry interests.*

Like the organization in *Quality Auditing*, SFI was actually incorporated by an industry-specific business league (the AFPA). Like *Ginsburg*, the SFI certification program provides substantial (if not exclusive) benefit to its founding "members." Like *American Campaign Academy*, both current and former executives of timber companies whose products are certified by SFI serve on its board of directors.

Under these cases and these facts, we believe that SFI serves a private rather than a public interest.

### **3. SFI operates for commercial, not public, benefit.**

When an organization is created and funded substantially by private companies who stand to benefit from the organization's activities, the activities serve a private and not a public interest. This commercial "hue" of the organization is relevant to its charitable designation, as is competition with commercial enterprises. *See B.S.W. Group, Inc. v. Comm'r of Internal Revenue*, 70 T.C. 352 (1978).



Certification and marketing activities, in particular, presume benefit to a particular industry interest, not the general public. These activities may often constitute an unrelated trade or business which results in unrelated business income tax under Code § 511 and 512. If unrelated trade or business-type activities comprise a substantial part of the organization's operations, the organization is commercial, not charitable in nature. *See, generally, Quality Auditing Co. v. Comm'r of Internal Revenue*, 114 T.C. 498 (2000).

In its decision denying tax-exempt status to the organization in *Quality Auditing*, the Tax Court found a substantial commercial purpose to certification:

[w]e doubt firms would seek and pay to obtain certified status unless they believed the investment would prove lucrative in the future. They likely wish to pursue revenues from a contract requiring certification, or they see the certification process as a vehicle to increased work through an improved control process and reputation for quality.

*Quality Auditing Co.*, 114 T.C. at 510.

In *Federation Pharmacy Services*, the Tax Court held that although the activity of the organization promoted health, which could be a charitable purpose, it was not allowed exempt status because it operated in a commercial manner. *Federation Pharmacy Services, Inc. v. Comm'r of Internal Revenue*, TC Memo 1986-348, 1986 WL 21552 (Tax Court 1986). The opinion notes that the organization relied upon the sale of drugs to the public and competed with commercial pharmacies. *Id.* The slight discount offered, which did not reduce prices below cost, did not amount to a charitable purpose. *Id.*; *see also* Technical Advice Memorandum, TAM 8623006, 1986 WL 369006 (IRS TAM, Feb. 24, 2006) (The element of industry and individual benefit defeats exemption under section 501(c)(3)).

SFI, like *Quality Auditing*, is an industry-funded and substantially industry-dominated and devised certification system. It was initiated by industry and its governance structure is heavily populated by individuals affiliated with the timber industry. SFI's activities have the substantial purpose of placing SFI-certified forest products on a plane with forest products certified under other non-commercial purpose standards that have no direct ties to or exclusive financial dependence on forest landowners.

As in *Federation Pharmacy*, one of the intended effects of the SFI program is to help its participants' products compete in a global forestry marketplace. Its "green" branding makes commercial products more appealing to the purchasers seeking green products. While green branding, like promoting health, may benefit the public by educating and informing consumers, the commercial benefit accruing to industry and commercial interests defeats any charitable effect. Such commercial benefit is incompatible with the exclusive nature of a charity's tax exemption.

Simply put, SFI's evident purpose is to compete in the forest certification business and to maintain a line of certified "green" forest products for the marketing and public relations benefit of the very same timber and paper companies who control the organization. This is private, not public, benefit.

**C. SFI has failed to demonstrate the public support required of a public charity under IRC § 509(a)—the “public support” test.**

For the first years of its existence, SFI reported as a 509(a)(1) organization. On its 2007 income tax return, it changed its reporting status to 509(a)(2). According to its most recent tax returns, SFI is now considering itself a “service provider” public charity under 509(a)(2).

If SFI truly were a section 509(a)(1) “donative” type public charity as reported on prior returns, none of its “exempt function” income could have counted as “public support.”<sup>44</sup> Because most of its support has, indeed, come from exempt function activity,<sup>45</sup> all those years’ prior tax returns are potentially flawed.

While clearly not a 509(a)(1) organization, we do not believe SFI meets the public support requirements of 509(a)(2), either. SFI may not have excluded from its calculation of public support gifts and exempt function activity income from organizational insiders (“disqualified persons” and “substantial contributors”). We believe most, if not all, of SFI’s support is from these organizational insiders.

Form 990 does not require the scheduling of specific donor information (for purposes of donor privacy), but the rules require that those donor support calculations be made. Public charities are excluded from private foundation status on the theory that their exposure to public scrutiny and their dependence upon public support will insulate them from the abuses to which private foundations are subject. *William F. Quarrie, Mable E. Quarrie and Margaret K. Quarrie v. C.I.R.*, 603 F.2d 1274 (7<sup>th</sup> Cir. 1979). Accordingly, a 509(a)(2) organization must maintain scrupulous records of its donors and exempt function income to calculate its true public support.

SFI’s bylaws dated August 26, 2008 provided that SFI “*shall provide to the public all information related to the Corporation’s funding, budget, and expenses.*” Further, SFI’s 2003-2004 Annual Report stated that its “*independently audited financial statement and IRS Form 990 are available upon request.*”

Accordingly, we made a request to SFI for the information necessary to substantiate its claim to public support under 509(a)(2). As we describe in section V, below, none was

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<sup>44</sup> This is the major difference between (a)(1) and (a)(2) organizations. In *Williams Home, Inc. v. U.S.*, 540 F. Supp. 310 (W.D.Va. 1982), the court held that a nursing home was not “publicly supported” because bequests and other lifetime transfers required of incoming residents were admission fees and not gifts, and thus were “exempt function income” that could not be counted as “public support” under the alternative “fact and circumstances” test for 509(a)(1) organizations. In *Home for Aged Men v. U.S.*, 1980 WL 1662 (N.D.W.Va. Sept. 15, 1980), *affirmed* 665 F.2d 1040 (4<sup>th</sup> Cir. 1981), the court held that nursing home incoming residents’ payments were not “membership fees” but rather were fees for services and “exempt function income” which could not be counted as “public support” under 509(a)(1).

<sup>45</sup> In a letter dated April 23, 2009, SFI informed us that “the vast majority of our financial support is provided by SFI Program Participants who use our forest management and fiber sourcing standards.”

forthcoming. Instead, SFI responded to us that the “vast majority” of SFI’s financial support comes from its “program participants who use [SFI’s] forest management and fiber sourcing standards.”

We are not aware of any evidence to show that the public support calculations were ever made despite requesting this and similar information. Had they been carried out, we believe they would expose SFI’s failure to qualify as a public charity.

**1. At least one-third of SFI’s annual financial support must be “public support.”**

The “public support” test is “designed to ensure that an organization which is excluded from private foundation status under section 509(a) is responsive to the general public, rather than to the private interests of a limited number of donors or other persons.” Treas. Reg. § 1.509(a)-3(a)(4).

A “service provider” organization qualifying under section 509(a)(2) must normally receive more than one-third (1/3) of its annual support in the form of “public support,” derived from any combination of gifts, grants, contributions, membership fees, and exempt function activity. Code § 509(a)(2)(A). It must demonstrate sufficient public support for four consecutive years. Treas. Reg. § 1.509(a)-3(c)(1)(i).

**2. Only a limited amount of “exempt function” income from a single source may be counted as “public support.”**

“Exempt function activity” means gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities. Treas. Reg. § 1.509(a)-3(b) (2007). Membership fees that are paid for the purpose of buying goods or services are also considered exempt function activity.

When a person or an entity pays for an exempt service, often only a limited portion of the receipt may be counted as public support. Treas. Reg. § 1.509(a)-3(b) (2007). Under 509(a)(2), gross receipts from exempt activities are public support only to the extent that receipts from a single source not exceed the greater of \$5000 or 1% of the organization’s total support for the year. I.R.C. § 509(a)(2)(A)(ii). Any support from a person or entity in excess of that measure must be excluded from the public support calculation.

SFI’s 2007 Form 990 reports no exempt function activity. It reports \$5.5 million in total support for the year, comprising \$3.2 million in “related or exempt function income” in the form of “membership dues and assessments”; another \$2.1 million in “direct public support”; and \$146,070 in “other revenue.” Again, SFI has neither members, membership dues nor assessments. It does, indeed, have exempt function activities through the operation of its certification system and the promotion of the SFI brand on behalf of SFI participants. The income from these activities should have been reported.

Furthermore, to prove that its exempt function activity fees qualify as public support, SFI should have determined, for every year since its inception in 2002, the number of participants and the fees paid by each participant for SFI's services. Because that calculation is required of a 509(a)(2) organization, those numbers should be readily available.

For example, to calculate the single-source receipts that must be excluded from the public support measure for 2007, SFI would need first to calculate one percent of its total 2007 support. That number is \$55,000 (one percent of \$5.5 million). Accordingly, receipts from any "participant" exceeding \$55,000 should necessarily have been excluded from the public support "pool" for purposes of the public support calculation.<sup>46</sup>

We believe that these calculations may not have been made and, had they been made, the results would show that for each and every year of its existence, SFI's revenue from its exempt function activity was derived from only the few organizations that gain private benefit from its certification program. Its support is not from the general public.

**3. Organizational insiders are "disqualified persons" whose payments must be excluded from the calculation of "public support."**

In addition to exclusion of excess exempt function income from participating organizations, the law determining public support under 509(a)(2) requires the *complete* exclusion from the calculation of public support all payments of any sort (gifts, membership due and fees for services) from organizational insiders. Tax law regards these insiders "disqualified persons."

All funds received from such disqualified persons (not just any amount in excess of some threshold) cannot be counted toward calculation of the 1/3 "public support" for that year. I.R.C. § 509(a)(2)(A)(ii). The Tax Court has had to make these calculations upon request. For example, in *First Church of In Theo v. C.I.R.*, T.C. Memo. 1989-16, 1989 WL 537 (U.S. Tax Ct. 1989), the court held that the organization failed the public support test because "[a]pproximately 84 percent of petitioner's support came from disqualified persons."

"Disqualified persons" include the organization's "substantial contributors" as well as organizational insiders such as directors, officers, and any responsible employee (such as the Executive Director). Attribution rules include family members and controlled entities of disqualified persons, as well. I.R.C. § 4946.

"Substantial contributors" are those who have provided the organization (in the form of donations or fees for exempt function activities) an aggregate amount (that is, the sum of the substantial contributor's payments over all years) of more than \$5,000, where that amount is greater than 2% of the organization's total cumulative support since its inception, determined each year. I.R.C. § 507(d)(2)(A). Once an individual or entity is labeled a "substantial contributor," that status continues indefinitely until such time as that particular individual or entity has made *no* payments for 10 years. I.R.C. § 507(d)(2)(C).

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<sup>46</sup> In earlier years, SFI's annual revenue was much smaller. Accordingly, the threshold of revenue that should have been excluded from the public support calculation would have been one percent of a much smaller number.

SFI charges more than \$5,000 to each participant for certification. Since inception and until recently, its cumulative support has been relatively small. Each participant's fees for services, alone, would easily have exceeded two percent of SFI's total cumulative support, determined each year. Many participating timber companies will certainly have gained "substantial contributor" status very soon in their relationship with SFI.

Once those early participant/funders became substantial contributors, any future fees paid or donations made by the participant should have been excluded from SFI's public support calculation. Because SFI has been in existence for fewer than 10 years, all substantial contributors would still carry that stigma.

By SFI's own admission, its donations and exempt function activity fees are derived from the same industry insiders. SFI has stated that "*the vast majority of our financial support is provided by SFI Program Participants who use our forest management and fiber sourcing standards.*" We believe it highly likely that all or most of those insiders are "substantial contributors" and disqualified persons with respect to SFI. None of their fees or donations should have been included in its 1/3 "public support" calculations.

**V. SFI changed its corporate documents contrary to its stated transparency policy.**

The IRS should assess whether SFI raised the requisite funds from the public for purposes of Code § 509(a)(2). The rules governing the Form 990 filing requirements do not require the scheduling of donor support, but they do require that this analysis be made. To make this assessment, we requested copies of SFI's past income tax returns. Pursuant to SFI's published transparency policy, we also requested the names of and *amounts* donated by its donors to substantiate its claim to public support.

As of August 26, 2008, SFI's bylaws provided that SFI "*shall provide to the public all information related to the Corporation's funding, budget, and expenses.*" Further, SFI's 2003-2004 Annual Report stated that its "*independently audited financial statement and IRS Form 990 are available upon request.*"

We reference these bylaws and annual report in the past tense, because SFI recently amended its bylaws (June 5, 2009). The bylaws were amended immediately after (and, we believe, in direct response to) our request for information. The June 5, 2009 amended bylaws (Attachment 14, at Art. V, § 3) now more narrowly provide that SFI "shall disclose to the public all information that the Internal Revenue Code requires the Corporation to disclose."

In its June 12, 2009 letter responding to our May 6, 2009 inquiry, SFI disclosed this bylaw change and also disclaimed the transparency commitment in its 2003-2004 Annual Report, oddly invoking its corporate name change from SFB to SFI, as if that were a reason to disavow its prior commitments. Note that SFI still uses the same employer ID number that it used when its name was SFB (80-0030060), so it is still the same corporation.

**VI. Conclusion**

This complaint asks the IRS whether for-profit timber and paper companies and a 501 (c)(6) trade association can incorporate, substantially fund, and *de facto* direct and operate a “public charity” to “certify” their commercial products using a certification system that allows private interests to trump public charitable interests.

Based on publically available information, SFI does not operate to serve charitable purposes. SFI’s professed contribution to public “charity” (environmental benefit) is substantially undercut by its vague, ambiguous, and loophole-ridden standards that permit forest managers to elevate private over public interest forestry. That SFI serves private interests is also reflected in the fact that, by its own admission, it receives virtually all of its financial support from the very same timber and paper companies who founded the organization, direct it, and develop its forest certification standards.

SFI also fails the public support test. Although purporting to be a public charity under 509(a)(2), SFI is virtually completely financially supported by the same companies who derive commercial benefit from its certification program. SFI has not disclosed the calculations necessary to exclude disqualified persons and substantial contributors from its calculation of public support. We believe further inquiry will show very little support from non-disqualified persons—if any.

We ask the IRS to investigate SFI and make that further inquiry. We hope you will agree that U.S. taxpayers should not be supporting a so-called “public charity” that serves private interests and whose financial support comes primarily from the very same for-profit companies that benefit from the charity’s services and branding. SFI is not a charity; it is a marketing ploy that benefits private interests.

Sincerely,

  
WASHINGTON FOREST LAW CENTER

Peter Goldman  
Attorney at Law

Enclosures (IRS Form 13909; notebook of Attachments)

cc: ForestEthics  
Ms. Kathy Abusow, CEO of SFI