



DLA Piper LLP (US)
The Marbury Building
6225 Smith Avenue
Baltimore, Maryland 21209-3600
www.dlapiper.com

Lee A. Sheller
lee.sheller@dlapiper.com
T 410.580.4260
F 410.580.3260

April 24, 2014

VIA E-MAIL (STEPHANIE.N.ROBBINS@IRS.GOV)

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:3)
Stephanie Robbins (534-25)
1111 Constitution Avenue, N.W.
Washington, DC 20224

**Re: Protest of Denial of Section 501(c)(6) Status of OpenStack Foundation (E.I.N. 46-0618689)
1214 W. 6th Street, Suite 211, Austin, Texas 78703;
Daytime Phone Number: 512-827-8633; Daytime Phone of Power of Attorney: 410-580-4260**

Dear Ms. Robbins:

The purpose of this letter is to protest the denial of Section 501(c)(6) status to OpenStack Foundation (the "Foundation") pursuant to your letter dated March 12, 2014, a copy of which is attached hereto (the "Denial Letter").

By my letter dated April 8, 2014, we requested an extension to respond until April 25, 2014, and you granted that request by e-mail dated April 9, 2014.

The Denial Letter concludes that the Foundation does not meet the following requirements of an organization described in Section 501(c)(6):

- a) Its purpose must not be to engage in a regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining.
- b) Its activities must be directed at the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.
- c) Its primary activity cannot be performing particular services for members.
- d) It must be primarily engaged in activities or functions constituting the basis for its exemption.

I will address each of the foregoing requirements in the remainder of this letter.



Internal Revenue Service
April 24, 2014
Page Two

Engaging in a Regular Business of a Kind Ordinarily Carried on for Profit

In order to determine whether the Foundation is disqualified from Section 501(c)(6) status because it is "engaged in a regular business of a kind ordinarily carried on for profit" it is necessary to analyze the business activities that a for-profit business would undertake and compare them to the activities of the Foundation. After such an analysis, it is clear that the Foundation is not engaged in a regular business of a kind ordinarily carried on for profit.

You cite Revenue Ruling 81-174, 1981-1 C.B. 335, for the proposition that "the business' nature determines whether it is ordinarily carried on for profit."

Revenue Ruling 81-174 described the organization under consideration as follows:

The organization is formed for the purpose of, and has as its sole activity, the provision of medical malpractice insurance. Although its rates are not designed for profit, the organization charges fees, issues policies, and performs administrative services typical of insurance companies' normal operation. It is the nature of this activity that determines whether it is a business ordinarily carried on for profit. Since the provision of medical malpractice insurance is a business of a kind ordinarily carried on for profit, the organization is not operated as a business league within the requirements of section 1.501(c)(6)-1 of the regulations.

Revenue Ruling 81-174 distinguished itself from Revenue Ruling 71-155, 1971-1 C.B. 152, in which the IRS determined that the organization was described in Section 501(c)(6). Revenue Ruling 81-174 described the distinction as follows:

In Rev. Rul. 71-155, a state-mandated association composed of all insurance companies writing a specified type of insurance in a given state was formed for the purpose of making insurance available to all persons in high-risk categories. The organization operated by accepting applications, and then assigning them to a member company, which performed the actual insurance functions. Unlike the organization in this case, the organization described in Rev. Rul. 71-155 did not assume the risk on the policy, and therefore was not itself engaged in the insurance business.



Internal Revenue Service
April 24, 2014
Page Three

You have asserted that the Foundation has competitors as evidence that the Foundation is engaged in a regular business of a kind ordinarily carried for profit. However, as Revenue Ruling 81-174 points out, it is necessary to compare what, in fact, the Foundation does with what potentially competing profit-oriented businesses do in order to determine whether the Foundation is engaged in a regular business of a kind ordinarily carried on for profit.

The Foundation coordinates the development of software useful for the cloud computing and technology industry by providing a framework for the development of the software by individual members who are not employees of the Foundation. The software is developed by thousands of individual members of the Foundation around the world who collaborate via on-line tools and periodic events organized by the Foundation. As of April 23, 2014, the Foundation supports 265 projects of which ten are integrated projects that an organization can use all or part of to build public or private cloud capabilities and 255 are various projects that are generally useful for developing, testing, automating and contributing to distributed computing systems (a current list can be seen online at: <https://review.openstack.org/#/admin/projects/>).

The technical committee and program leads of the Foundation determine what additions to the integrated software projects should be developed based on what would be most helpful to the vast majority of software users (whether or not they are members of the Foundation). The Foundation supports the development of the integrated software projects and the other projects through the collaboration tools, community management activities, organizing the twice-yearly design summits and periodic technical meetings, as well as marketing and education activities to bring new developers to the project who will further contribute to the code base and to educate the market about the benefits of cloud computing and OpenStack software.

The Foundation does not engage in a business of a kind ordinarily carried on for profit. For profit businesses in the cloud computing space typically develop software for the specific needs of their customers and provide these development services along with maintenance and other services needed by their customers. The Foundation does not provide services and virtually all of the OpenStack software is developed by individual members of the Foundation who are not employees of the Foundation.

The Foundation can be readily distinguished from for-profit business in the cloud computing space just as the state-mandated association described in Rev. Rul. 71-155 can be distinguished from the organization in Rev. Rul. 81-174. The organization in Rev. Rul. 71-155 took some preliminary steps which ultimately could lead to providing insurance to the public. However, the organization could not actually write the insurance and assume the risks which were the true indicia of the for-profit business in question. Similarly, the Foundation encourages the development of cloud-related software, but does not go past this preliminary step. The Foundation does not utilize the software to address the specific computing needs of customers as for-profit businesses in the computing space must do.



Internal Revenue Service
April 24, 2014
Page Four

You cite MIB, Inc. v. Commissioner, 80 T.C. 438 (1983), rev.'d on other grounds, 734 F.2d 71 (1st Cir. 1984), for the proposition that in determining whether an organization is engaged in a business of a kind ordinarily carried on for profit the focus is on "the existence of competing profit-oriented businesses." In citing MIB, Inc., you also state: "Factors indicating the existence of competing profit-oriented businesses include whether there was reasonably foreseeable competition, whether a for-profit business would or could perform a similar function if the organization ceased operations, and the existence of actual competition."

The organization seeking Section 501(c)(6) status in MIB, Inc. was a nonprofit corporation whose primary activity was the operation of a system for the exchange of confidential underwriting information among its member life insurance companies which consisted of virtually all such companies in the United States. While making such information available to its members, the organization provided to its members additional information which would allow them to detect and deter fraud and misstatements in life insurance applications.

The Tax Court in MIB, Inc. ultimately determined that the organization was not engaged in a business of a kind ordinarily carried on for profit. The Tax Court noted that there was no actual competition to the activities of the organization. The Tax Court went on to state the following principle:

We agree that reasonably foreseeable competition from existing businesses should be considered. But we do not believe a finding that an organization is conducting the type of business ordinarily conducted for profit should be based upon mere speculation that someone might possibly try to undertake the activity for profit if the organization ceased to do so. The type of activity involved in the *Jockey Club* case – the publishing of primarily statistical information for the sale to the public – is the type of activity many existing publishers were readily equipped to handle. Here by contrast, petitioner did not sell its reports to non-members; it simply provided a cooperative service for its own members. We have no basis for concluding that a for-profit business would or could perform a function similar to petitioner's information exchange if petitioner ceased its operations.

By applying the principles set forth by the Tax Court in MIB, Inc., it is clear that no for-profit business would carry out the activities of the Foundation. The Foundation merely provides a framework in which its members develop OpenStack software which is made available without charge to the members and to the public in general. No for-profit organization would undertake those activities.



Internal Revenue Service
April 24, 2014
Page Five

You cite Bluetooth SIG, Inc. v. United States, 611 F.3d 617 (9th Cir. 2010) for the proposition that allowing the OpenStack Software to be used by the public for free does not support the argument that the Foundation is not engaged in a business of a kind ordinarily carried on for profit. You noted that the Ninth Circuit Court of Appeals in Bluetooth SIG, Inc. recognized that licensing intellectual property for a low price is a business tactic to prevent competitors from forming rival technology standards.

In order to understand the significance of that conclusion by the Ninth Circuit, it is important to note that Bluetooth SIG earned significant net income from its members separate and apart from membership dues. Although Bluetooth SIG did not charge its members a royalty for using its software, it did charge its members a \$10,000 listing fee for each product which Bluetooth SIG approved to use the software¹.

Even without charging a fee to use the software, in 2001 Bluetooth SIG earned \$1,800,000 (34% of its total revenue) from listing fees and in 2002 Bluetooth SIG earned \$2,700,000 (40% of its total revenue) from listing fees.

If this factor is taken into account it is clear that Bluetooth SIG had created a pricing model which allowed it to earn significant profits from fees for services.

In contrast, the Foundation is dependent on membership dues, discretionary contributions from corporate and event sponsors and charges from membership events in order to cover its expenses. The Foundation also does not own any patents and does not hold any copyrights for the vast majority of the software which is distributed and developed through the Foundation's processes.

In summary, your position that the Foundation is engaged in a business of a kind ordinarily carried on for profit is unsupported by the authorities you cite. In fact, the authorities which you cite require that the opposite conclusion be reached.

Improvement of Business Conditions of One or More Lines of Business

It is not always easy to identify the relevant "line of business", the business conditions of which must be improved, in order to qualify for Section 501(c)(6) status.

One articulation of the meaning of "line of business" which you refer to in the Denial Letter is that a line of business is an "entire industry", rather than a single brand in an industry. The Denial Letter also cites National Muffler Dealers Association, Inc. v. United States, 440 U.S. 472 (1979) for such proposition. However, the industry vs. brand distinction is not always relevant.

¹ Certain other members were only charged \$5,000 per product, but paid annual dues of either \$7,500 or \$35,000 depending on the size of the manufacturer.



Internal Revenue Service
April 24, 2014
Page Six

Treasury Regulation §1.501(c)(6)-1 sets forth the requirements of a Section 501(c)(6) organization. It does not require that the organization represent an entire industry. The Treasury Regulation states in pertinent part as follows:

It is an organization of the same general class as a chamber of commerce or a board of trade.

A chamber of commerce or board of trade would typically represent a multitude of different industries located in a particular geographic location.

Rev. Rul. 74-147, 1974-1 C.B. 136, which you cited in the Denial Letter, describes an organization which qualifies for Section 501(c)(6) status although its activities did not improve business conditions of any particular industry. It represented diversified businesses that own, rent or lease digital computers produced by various manufacturers. What the businesses had in common was their need to most efficiently utilize digital computers.

The IRS also issued Rev. Rul. 83-164, 1983-2 C.B. 95, in which the IRS determined that an organization did not qualify for Section 501(c)(6) status because the organization, although representing many diverse businesses which used digital computers, only directed its activities to users of a particular brand of computers. The organization provided a competitive advantage to the manufacturer and users of that particular brand of computer.

The Denial Letter posits that individuals and entities that create and use cloud computing software is a line of business, but OpenStack software is a brand within such line of business and, therefore, Section 501(c)(6) status should be denied pursuant to Rev. Rul. 83-164, rather than granted pursuant to Rev. Rul. 74-147.

The Foundation exists to ensure that the future of cloud computing is open and accessible to everyone, by helping the industry work together to produce an open and modular software framework designed to plug in to all third party technologies, whether open or proprietary, to the exclusion of no individual or company.

It is critical to understand that OpenStack software is a framework for integrating industry technologies, rather than a stand alone product or brand which competes with third party technologies. There is an industry-wide benefit as a result of the existence of OpenStack software.

We all now take the world wide web for granted and understand that it is not a single brand of computing software. However, when it was first being developed it started out as a single project to build an open HTTP server. One might have erroneously categorized it as a brand of software competing with



Internal Revenue Service
April 24, 2014
Page Seven

other software because certain standards were developed so that it could grow and become more functional. Similarly, cloud computing software is not a brand of software, nor is the software for which the Foundation promotes development. Of the 265 projects currently supported by the Foundation, 255 provide general support for cloud computing that makes working in a distributed cloud environment easier and more accessible. These general support projects include a generic way to do automated testing, a distributed code review system and a distributed testing mechanism. The remaining 10 projects do not compete with other software, but provide open source software that can be used with other types of software by organizations, members and non-members of the Foundation, that are building public or private cloud capabilities.

As you may be aware, it has recently become public that there is a so-called Heartbleed security vulnerability in much of the software used on the world wide web. One of the Foundation's areas of focus is on security and development of critical projects in the cloud computing space which further points out how the Foundation is focused on cloud computing in general for the benefit of all businesses which use cloud computing.

You noted in the Denial Letter that there are certain businesses which have developed their own software such as Microsoft Azure, Amazon Web Services and Google Cloud Services. The Denial Letter also refers to the fact that Apache, a nonprofit, has developed software called CloudStack.

The Denial Letter acknowledges that the Foundation is similar to the organization in Rev. Rul. 74-147 because the Foundation serves many types of businesses that use the cloud, but the Denial Letter concludes that

rather than addressing Computing (i.e. cloud computing) problems generally, you produce the Software (i.e. OpenStack Software) to address specific Computing problems and promote the Software to the exclusion of other Computing software. Accordingly, like the organization in Rev. Rul. 83-164, you direct your activities to improving the business conditions in only the segments of various lines of business that have adopted the Software. Additionally, your activities provide a competitive advantage to Software adopters because they are saved the expense of developing software similar to the Software. [parentheticals added for clarification]

The foregoing conclusion in the Denial Letter is incorrect.

The components of the framework built by the Foundation are all open and freely available to be leveraged by any company which wishes to improve its cloud computing service. Even a single line of code (of the over one million lines of code in the OpenStack software) could be taken by any company (at no cost) and used to improve the competitiveness of the company's product or service. This open model



Internal Revenue Service
April 24, 2014
Page Eight

is the opposite of exclusionary and thus produces benefits to an entire industry by sharing innovations freely as they are produced.

Apache CloudStack, for example, integrates with components of OpenStack to enable object storage, a form of storing information critical to that software platform's place in the market.

Microsoft is making money today supporting several large customers who are using OpenStack with their cloud technology called "Hyper-V". This is made possible because of the open and modular nature of the OpenStack framework to support third party technologies, such as compute virtualization.

Amazon Web Services benefits from the existence of the OpenStack software, because the OpenStack framework can be configured to support the Amazon API, allowing users to connect with, and pay for, services Amazon provides.

Google's Compute Engine service, similarly, is a technology which can interoperate with OpenStack due to support for the Google API within the OpenStack framework. This benefits Google's business.

In the Denial Letter while discussing the "line of business" requirement you stated the following: "Benefiting non-members and members alike is the key to this requirement. Bluetooth SIG, 611 F.3d 617."

Due to the fact that the OpenStack software is open source, members and non-members alike can, and do, utilize the OpenStack software in order to provide solutions to cloud computing problems.

The Denial Letter also asserts that the Foundation is similar to Bluetooth SIG which the 9th Circuit determined did not benefit a line of business because Bluetooth SIG did not benefit all or nearly all of the members of both the wireless communications and consumer electronics industries. The activities of Bluetooth SIG were exclusionary. Only those persons who were members of Bluetooth SIG could utilize its proprietary software and could have their products listed as approved Bluetooth products by paying Bluetooth SIG a listing fee.

The Foundation, on the other hand, does not exclude anyone from membership in the Foundation. Individual employees of Microsoft, Amazon and Google are members of the Foundation. Any user or developer of cloud computing software can benefit from the development of the OpenStack software. While the members of Bluetooth SIG benefited by excluding certain competitors from membership in Bluetooth SIG, thereby obtaining a competitive advantage by having their products, rather than the competitors' products listed as approved Bluetooth products, the Foundation's open membership



Internal Revenue Service
April 24, 2014
Page Nine

policy does not benefit its members in comparison to other users and developers of cloud computing software who are not members.

The Denial Letter recognizes the similarities of the Foundation to the organization in Rev. Rul. 69-632, 1969-2 C.B. 120, but attempts to distinguish the Foundation from the organization in the revenue ruling by equating the OpenStack software to a particular competing product within the cloud computing space. The Denial Letter analogizes the OpenStack software to a particular brand of muffler or cola. However, the OpenStack software is not in competition with other software. It is open source software which can be utilized in conjunction with other software to benefit any business seeking a computing solution for an application using cloud computing.

For the foregoing reasons the Foundation satisfies the requirement that its activities be directed at the improvement of business conditions of one or more lines of business.

Performance of Particular Services for Members

The distinction between the benefits which a Section 501(c)(6) organization can confer upon its members without affecting its tax exempt status and those services which are considered "particular services" is not always an easy distinction to make.

As the Tax Court observed, "it can hardly be supposed that individuals would often join organizations without the expectation of receiving some personal benefits therefrom."²

Furthermore, the IRS has ruled that advertising that promotes the business interests of a particular industry was a permissible activity of a business league even though the individual members derive some benefits from the advertising campaign.³

In making the determination as to which activities promote the common business interests and which activities are treated as particular services, several courts have cited the factors set forth in Carolinas Farm & Power Equipment Dealers Association v. United States, 699 F.2d 167, 171 (4th Cir. 1983). The Fourth Circuit stated that the following characteristics reflect the provision of particular services: (a) charging proportionate fees; (b) limiting participation to members; and (c) providing the same type of services commonly available from for-profit entities.

² National Leather & Shoe Finders Association v. Commissioner, 9 T.C. 121, 126 (1947), acq. 1947-2 C.B. 3.

³ Rev. Rul. 55-444, 1955-2 C.B. 258.



Internal Revenue Service
April 24, 2014
Page Ten

As you noted in the Denial Letter, the First Circuit in MIB, Inc. stated that "a major factor in determining whether services are "particular" is whether they are supported by fees and assessments in "approximate proportion for the benefits received.""

The Foundation does not charge fees in proportion to services rendered, limit benefits to members or provide the same type of services commonly available from for-profit entities.

The Denial Letter cites Rev. Rul. 68-264, 1968-1 C.B. 264 for the proposition that particular services include "an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses." That definition is certainly not a bright line test for identifying particular services. For example, the IRS routinely grants Section 501(c)(6) status to organizations, the sole purpose of which is to lobby on behalf of the members of an industry, and such lobbying is a convenience or economy to the members of the organization in the operation of their own businesses.

The Denial Letter states that the Foundation develops software which its members would have to develop themselves and, therefore, the activities of the Foundation produce a clear convenience and economy for the members, relieving them of a burden that they would otherwise incur. The Denial Letter concludes that such activities constitute the performance of a particular service for individual persons.

Rev. Rul. 69-632, refutes that conclusion.

The organization in Rev. Rul. 69-632 was composed of members of a particular industry and was formed to develop new and improved uses for existing products of the industry. The association contracted with various research organizations, institutes and universities for specific research projects selected by a committee of technical experts chosen from the association's membership. The results of these projects was published and made available to the interested public. The revenue ruling states as follows: "The association's members select research projects in order to increase their sales by creating new uses and markets for their projects." Even though the organization in Rev. Rul. 69-632 produced results which could contribute directly to the profitability of its members and the results are a clear convenience and economy for the members which the members would have to develop themselves if it were not developed by the organization, the IRS determined that the organization was described in Section 501(c)(6).

If the organization described in Rev. Rul. 69-632 qualifies for Section 501(c)(6) status, then the Foundation should clearly qualify for Section 501(c)(6) status.

The Foundation merely provides a structure for the construction of its software which may be helpful for all those involved in utilizing cloud computing, members and non-members alike. The software



Internal Revenue Service
April 24, 2014
Page Eleven

is not created to help any particular member in their business of cloud software development or the use of cloud software, nor are members charged for work done on particular aspects of the OpenStack software.

As such, the Foundation's activities do not include the performance of particular services for individual persons.

Primarily Engaged in Activities and Functions Constituting the Basis for its Exemption

The Denial Letter lists the eight characteristics of a Section 501(c)(6) organization as set forth in Treasury Regulation §1.501(c)(6)-1. The Denial Letter does not dispute the fact that the Foundation satisfies the following four characteristics of a Section 501(c)(6) organization:

1. It must be an association of persons having some common business interest, and its purpose must be to promote this common business interest.
2. It must not be organized for profit.
3. It must be a membership organization and have a meaningful extent of membership support.
4. No part of its net earnings may inure to the benefit of any private shareholder or individual.

The Denial Letter asserts that the Foundation does not satisfy the other requirements of a Section 501(c)(6) organization. This letter refutes that assertion.

As discussed above, the Foundation's activities are directed at the improvement of business conditions of one or more lines of business, the Foundation is not engaged in a regular business of a kind ordinarily carried on for profit and the Foundation's primary activity is not performing particular services for individual persons.

As a result, the Foundation satisfies this final requirement set forth in the Denial Letter.

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Internal Revenue Service
April 24, 2014
Page Twelve

If, after considering this protest, you are not in a position to issue a determination letter that the Foundation is described in Section 501(c)(6), the Foundation requests a conference to discuss the protest with you.

Very truly yours,

DLA Piper LLP (US)

A handwritten signature in cursive script that reads 'Lee A. Sheller'.

Lee A. Sheller

Enclosure



Internal Revenue Service
April 24, 2014
Page Thirteen

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents and to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct and complete.

OPENSTACK FOUNDATION

By:

Name: Jonathan Bryce

Title: Executive Director

A handwritten signature in black ink, appearing to read 'Jon Bryce', written over a horizontal line.

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