



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201310046**
Release Date: 3/8/2013

Date: 12/13/2012

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.32-00; 501.32-01; 501.33-00; 501.36-00

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz
Director, Exempt Organizations
Rulings and Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: 10/16/2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = Name of Director
C = Name of Director
D = Name of Director
E = Name of Director
F = Name of Organization
G = Name of Organization
N = Name of manufacturer
O = State
P = Date

UIL:

501.32-00
501-32-01
501.33-00
501.36-00

Dear

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

This letter supersedes our letter dated April 19, 2012 and considers your protest.

Issues

- Do your activities of purchasing and selling coffee and hot chocolate constitute a commercial activity and therefore cause you to fail the operational test for exemption under section 501(c)(3) of the Code? Yes for the reasons stated below.

Letter 4036 (CG) (11-2005)
Catalog Number 47630W

- Are you structured in such a way that part of your earnings may inure to the benefit of insiders? Yes for the reasons stated below.
- Does the lack of a proper dissolution clause cause you to fail the organizational test under section 501(c)(3) of the Code? Yes for the reasons stated below.

Facts

You were incorporated in the State of O on P for any legal purpose. You amended your purpose to include the required section 501(c)(3) language. Your dissolution clause was amended to indicate that your assets upon dissolution will be distributed equally among F and G, two named charities.

Your board currently consists of four members. B is married to C and D to E. B and D are principals in a corporation and have a business relationship.

There is a relationship between you and the recipient organizations in that your employees, officers and directors are volunteers in the F & G movement. In fact your directors are active members of an F unit. Units of F and G will be the sole recipients of funds from you.

Your activities are aimed primarily at helping units defray their direct costs . Your also aim to augment operating funds and to provide scholarships.

Your activity consists of purchasing custom pre-packaged coffee and hot chocolate from N an unrelated for-profit company. You will then market these through the units of F and G and their charting organizations. F and G units then sell the items to the public either by delivery to pre-order customers or by conducting other means of sale to raise funds. Units will purchase coffee and hot chocolate at the lowest cost that you can provide. Your methods are designed to maximize profit to the F and G units and units will benefit from your small overhead as a non-profit. Your goal is to produce a return on investment of % and the sales will generate funds equal to or greater than costs. The Units will receive a portion of the sales price of the products sold with a goal of at least % of the sales price. You will use approximately % of the sales price to maintain your program depending on sales volume and donations received. Sales of coffee will generate approximately to % of your gross receipts and sales of hot chocolate will generate the rest.

Two of your directors B and D will be paid a salary to manage and market the program to F and G Units. Compensation paid will be based on the time and effort spent to manage the charity and will increase each year based on the increase in sales. The two directors will spend % of their time on the activity at start up and over time perhaps % of their time. Units in all states will eventually participate with the possible exception of states imposing internet sales tax. Units will purchase coffee and hot chocolate from you. Products will be shipped to the units to a business or residential address. The shipping costs are added and typically average % of the order price.

The public can purchase coffee and hot chocolate directly from your website at the fundraising price. Product is paid for on the website and shipped directly to the customer. The portion of the sales price that constitutes the fundraising proceeds will be credited to the Unit as selected by the customer. You will then contribute a portion of the sales price to the Units and/or their charting organizations responsible for the sale. Units will complete a Unit Participation Application and abide by your Program Participation Agreement.

You will accept returns in case of product defect and you stipulate that no sales of your products should be made at less than public price. Your products are available for retail distribution only through F and G and through your website to the general public.

You will also raise funds for yourself by product sales and other direct contributions. The general public that purchase from the website can select to donate the fundraising portion of the sale as a direct donation to you. Funds raised by you in this manner is used to offset your expenses such as compensation, costs of shipping and product production, marketing, advertising and other costs of doing business.

The coffee and hot chocolate will also be sold by you directly to the various units. The units will then sell the products to the public. The Units order from your website. Products are shipped directly to the units who will make deliveries to pre-order customers or conduct other means of sale. The public can reorder using your website. The fundraising portion of website sales accumulate in money accounts until requested by the Unit. Point accounts are maintained for individuals. Year to date and Lifetime total points are maintained for each individual as a convenience to the Unit. You later indicated that the point system has been eliminated. Since coffee is an expensive commodity and its prices can vary, you try to maximize the amount that goes back to the Unit from the sale of coffee.

You contracted with a commercial manufacturer to purchase pre-packaged coffee and hot chocolate products. The manufacturer is unrelated to you except in a business supplier relationship. You raise your funds by product sales and other direct contributions and a portion of products sales price will be contributed to the units responsible for the sale. You further state that coffee currently sells at a price close to market price and supports at least a % return to the units. You also state that hot chocolate will sell for a price that will provide the units an approximate return of %. You will use approximately % of the price of coffee to maintain your program and reduce the percentage if you are able to increase the sales volume. The hot chocolate would be passed through at your cost.

Your Program Participation Agreement include provisions that F and G units may be extended credit after the initial order, and F and G units should not sell coffee and hot chocolate at less than the public price specified on your website. You further state that a 1 month lead time will be needed for large orders.

You gross receipts are expected to be over \$ for your first fiscal year and over \$ and \$ for the next two fiscal years from sales of coffee and hot chocolate. B and D will be paid for their services of marketing and managing the program. The amounts of compensation paid to B and D increases each year. You seek to provide a return of at least % to the F and G units after covering all expenses.

Your other expenses include marketing, travel, advertising, delivery vehicle and other costs of doing business such as office supplies, website and other operational expenses such as telephone etc.

In the future you plan to provide scholarships to college bound individuals for tuition, books etc. You clarified that you do not plan to run your own scholarship program but will give all funds to another organization that operates an existing scholarship program.

Law

Section 501(c)(3) of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, provided no part of the net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of section 501(c)(3) if it operates a trade or business that is in furtherance of its exempt purposes but not if it is operated for the primary purpose of carrying on an unrelated trade of business as defined in section 513 of the Code.

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

Section 1.502-1(a) of the Regulations provides that in the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the ground that all profits of such organization are payable to one or more organizations exempt from taxation under section 501.

Revenue Ruling 54-305, 1954-2 C.B. 127, describes an organization whose primary purpose is the operation and maintenance of a purchasing agency for the benefit of its otherwise unrelated members that are exempt as charitable organizations. The organization in this revenue ruling did not qualify under the predecessor to section 501(c)(3) of the Code because its activities consisted primarily of the purchase of supplies and the performance of other related services, which are ordinarily considered an ordinary trade or business.

Revenue Ruling 57-52 1957-1 C.B. 196, states that a corporation organized for the purpose of promoting and conducting home shows, the net earnings of which inures to the benefit of a county recreational board in the form of rent for the use of its premises, is not exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code of 1954.

Revenue Ruling 72-369, 1972-2 C.B. 245, states that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Revenue Ruling 73-164 1973-1 C.B. 223 states that a church-controlled commercial printing corporation whose business earnings are paid periodically to the church, but which has no other significant charitable activity, is a feeder organization as described in section 502 of the Code and does not qualify for exemption under section 501(c)(3).

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In Old Dominion Box Co. v. United States, 477 F.2d 344 (4th Cir. 1973) cert. Denied 413 U.S. 910 (1973) the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

In B.S.W. Group, Inc v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial business. The Tax Court stated:

We must agree with the Commissioner that petitioner's activities constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organization for profit.

In Easter House v. U.S., 12 Cl. Ct. 476 (1987), aff'd in an unpub. opinion, 846 F.2d 78 (Fed. Cir. 1988), cert. den., 488 U.S. 907 (1988), the organization in exchange for a fee, provided adoption services to parents seeking to adopt a child, including services to pregnant women who intended to place their newborns for adoption. These fees were the organization's sole source of income. The Claims Court concluded that the organization's business purpose of operating an adoption service, not the advancement of educational and charitable activities, was its primary goal. It competed with other commercial organizations providing similar services. Thus, "[p]laintiff's competition provides its activities with a commercial hue." 12 Cl. Ct. at 486. Accordingly, the organization did not qualify for exemption under section 501(c)(3) of the Code.

In Airlie Foundation v. I.R.S., 283 F Supp. 2d 58 (D.D.C. 2003), the District Court found that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions at its facilities. The organization's patrons were not limited to tax-exempt entities, but included patrons of a private and corporate nature. The organization paid significant advertising and promotional expenses and derived substantial income from the weddings and special events held at its conference center. The court determined that the organization's activities competed with a commercial nature and purpose. The court concluded that although the organization carried out a number of charitable and educational activities, these were incidental to its primary purpose of operating a for-profit conference center.

In University Hill Foundation, etc., 446 F.2d 701, the court of appeals reversed the tax court decision and held the organization was not exempt. The court opined that any exempt organization possesses the inherent competitive advantage of being able to trade on its exemption. The only reason for articulating separate remedial provisions dealing with feeder organizations on the one hand, and unrelated business income on the other, is the possibility of two types of charity-oriented exempt organizations. By definition a feeder organization does not participate directly in any exempt activity; if it is exempt, the exemption is earned derivatively, by virtue of the feeder organization's financial support for the exempt activities of a school, or church, or charity. Once it is determined that the primary purpose of the feeder organization is to make money as an independent enterprise rather than to funnel money, more or less passively, to the charity, no difficulty arises in divesting the feeder organization of its exemption. The remedy cannot be so direct if an incontestably exempt organization, such as a university, is engaged in business enterprises on the side to support its exempt activities. The exemption of a university cannot be as blithely removed as it can in the case of a feeder organization, for a university is by definition exempt. Thus the remedy is different: The tainted income is determined to be taxable though the university as a whole remains exempt.

Application of Law

You are not described in section 501(c)(3) of the Code and Section 1.501(c)(3)-1(a)(1) because you fail both the organizational and operational test of section 501(c)(3). You fail the

organizational test because your Articles of Incorporation do not contain the requisite dissolution clause. Section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations. The dissolution clause in your Articles of Incorporation does not dedicate your assets upon dissolution to a charitable purpose in the event the named organizations are unwilling to accept the assets or are no longer described in IRC 501(c)(3) or are no longer in existence.

You fail the operational test for exemption under 501(c)(3) because you are operated in a commercial manner. You purchase coffee and hot chocolate products and resell the products to F and G units. You contract with for-profit manufacturers to purchase the products and then resell the products to the F and G units and the general public. Your price to F and G covers your costs. Your price to the general public covers your costs as well as a contribution to F and G units. You are marketing the products through advertising and marketing efforts of the board members. You are in competition with other for-profit establishments. These facts demonstrate a commercial and substantially non-exempt purpose inconsistent with section 501(c)(3) of the Code and Section 1.501(c)(3)-1(c)(1) of the Regulations.

You are not as described in section 1.501(c)(3)-1(d)(1)(ii) of the regulations because insiders stand to benefit through the control of you and your operations.

Because your primary purpose is to carry on a trade or business you are not as described in Section 1.501(c)(3)-1(e) of the regulations. Your primary purpose is purchasing products and reselling the products to the F and G units and to the general public.

Even though F and G units may profit from the sale of products they purchase from you or from your sales to the general public exemption is not allowed because your operation is that of a trade or business. Section 502 of the code and Section 1.502-1(a) of the Regulations.

You are similar to the organization in revenue ruling 54-305 because like it you are involved in a business activity, specifically purchasing and selling products.

You are similar to the organization in revenue ruling 57-52 because even though F and G units profit from your product sales your operation is commercial and therefore not exempt.

You are similar to the organization in revenue ruling 72-369 because even though your activities are directed to exempt F & G units, this is not sufficient to characterize your purchasing and selling operations as charitable within the meaning of section 501(c)(3) of the Code.

You are similar to the organization in revenue ruling 73-164 because you too pay earnings periodically to exempt organizations but have no other significant charitable activity.

You are similar to organization in the Better Business Bureau because you operate for the substantial non-exempt purpose of purchasing and selling products.

You are similar to Old Dominion Box because private parties B, C, D and E stand to benefit from your operations through their close control of you as well as compensation they receive from your proceeds. In addition the for-profit manufacturer whose products you purchase and sell also stands to benefit from your operations.

You are similar to BSW Group and Arlie Foundation because you too are operating in a commercial manner. Your products are priced to make a profit. You operate with paid staff and you market and advertise your product. You compete with commercial for-profit companies.

Like Easter House , supra, the fees you will charge to your clients will not be set at substantially below your costs. Further you will rely significantly on paid employees including paying salaries to your own officers and your marketing campaign is designed to expand your clientele.

Like University Hill Foundation you do not participate in any exempt activity and your claim for exemption is simply derived from the fact that you feed profits from your business to specified exempt organizations.

Applicants Position

You indicate that your articles of incorporation currently contain language regarding asset disposition upon dissolution and that upon your dissolution assets shall be distributed equally among F and G which are 501(c)(3) organizations.

You also indicate that the public buys products at the fundraising price. The fundraising portion would be returned to the designated F and G units and councils as if they had sold it directly, or the scholarship fund, or direct donation fund as selected by the buyer. You state that this is different from a commercial online for-profit store.

Services response to applicants position

The language as it exists in your articles of incorporation is insufficient to meet the organizational test for exemption under section 501(c)(3) of the code. As explained above it does not dedicate your assets upon dissolution to a charitable purpose in the event the named organizations are unwilling to accept the assets or are no longer described in IRC 501(c)(3) or are no longer in existence

The prices of products you sell are set at market price and then marked up so as to receive at least a % margin. You will use % of the proceeds to maintain your program. Your product is sold to the general public on your website. You are not different from a for-profit commercial business simply because F and G units would have received the same portion had they sold the products directly.

Applicant's Protest

You state that you do not agree with the statement of facts regarding your goal. You state your goal is to teach youth in responsible citizenship, character development and self-reliance through participation in a wide range of outdoor activities, educational and career-oriented programs in partnership with community organizations.

You further state that too much focus was placed on the coffee sales as a commercial business and selling to the general public. You stated "This is not our primary focus. This sales activity for the boys and girls was developed to remove economic barriers to participation and create workforce development skills..."

You indicated again that your articles of incorporation currently contain language regarding asset disposition upon dissolution and that upon your dissolution assets shall be distributed equally among F and G which are 501(c)(3) organizations.

Service Response to Applicant's Protest

You have not provided any additional documentation on how you will teach the youth responsible citizenship, character development or self-reliance through activities conducted by you. Your only activity as described in your application is to purchase and sell coffee and hot chocolate to the general public and pass on the net proceeds to F and G.

Therefore you fail the operational test under section 501(c)(3) because you are operated in a commercial manner.

The language as it exists in your articles of incorporation is insufficient to meet the organizational test for exemption under section 501(c)(3) of the code. As explained above it does not dedicate your assets upon dissolution to a charitable purpose in the event the named organizations are unwilling to accept the assets or are no longer described in IRC 501(c)(3) or are no longer in existence.

Conclusion

You do not meet the requirements under section 501(c)(3) for the following reasons any one of which standing alone is sufficient cause for denial.

- The facts and applicable law, as stated above, show you fail the operational test because the manner in which you purchase, sell and market products is commercial.
- The facts and applicable law, as stated above, show insiders B,C,D and E stand to benefit from your operations through their control of you as well as compensation.
- The facts and applicable law, as stated above, show you fail the organizational test because your articles of incorporation do not contain an adequate dissolution provision.

Accordingly, we conclude you do not qualify for exemption as an organization described in section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to

our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Deliver to:

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly G Paz
Director, Exempt Organizations
Rulings and Agreements

Enclosure, Publication 892