

NO PROTEST RECEIVED. CASE CLOSED BY REVIEWER [REDACTED]
Internal Revenue Service
District Director

Department of the Treasury
P.O. Box 2508
Cincinnati, OH 45201

Person to Contact:

Telephone Number
[REDACTED]

Refer Reply to:
EP/EO

Employer Identification Number:
[REDACTED]

Date: MAY 20 1997

[REDACTED]
[REDACTED]
[REDACTED]

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure 1.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for your corporation to file an annual income tax return on Form 1120. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the Office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

[REDACTED]

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b) (2) of the Internal Revenue code provides in part that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely yours,

C. Ashley Bullard

C. Ashley Bullard
District Director

[REDACTED]

Enclosures 3

ENCLOSURE ONE

page 1

The information you submitted indicates that [REDACTED] was formed on [REDACTED] in [REDACTED]. You filed Form 1023, Application for Recognition of Exemption under section 501(c)(3) of the Internal Revenue Code of 1986 on December 24, 1996.

Article II of your organizing document, your Articles of Incorporation, states that the purposes for which the corporation was organized are:

"Responding to human crises and problems by helping people increase their capacity to manage and cope with life challenges including but not limited to supplying (sic) people with household goods and clothing. Accepting donations of and selling household goods, clothing, accessories etc. Donating net proceeds to other non-profit organizations with similar purposes."

The corporation is organized on a directorship basis and has no membership. Your board had four members:

[REDACTED], President
[REDACTED], Vice President
[REDACTED], Sec. Treasurer
[REDACTED], Member

[REDACTED] and [REDACTED] are husband and wife. [REDACTED] and [REDACTED] are sisters. None of the board members receives compensation for board duties. None of the board members is a board member of an established section 501(c)(3) entity or represents such an entity on your board.

At the request of the Service you expanded the board to include three new members and passed a resolution limiting board compensation. The three new board members had previously worked as volunteers at the store.

Your application states that the corporation will accept donations of household goods. Most of the goods received will be resold. Some will be given to those who have an immediate need for such items. Your policy in this regard is that, upon referral from a social service agency, you will allow individuals to have as many household items as they need, and as many as three items of each type of clothing (pants, shirts etc.) they require.

You state that your beginning inventory and store fixtures are obtained by [REDACTED] in a sealed bid auction for the assets of a former thrift shop operation. The funds for this purchase, and additional start-up funds, were provided to [REDACTED]

ENCLOSURE ONE

page 2

[REDACTED] by her father [REDACTED] as a gift.

On [REDACTED] transferred inventory and fixtures valued at \$ [REDACTED], plus an additional \$ [REDACTED] in start up funds, to the corporation in exchange for a promissory note for \$ [REDACTED].

The terms of the promissory note call for the corporation to make monthly payments of a least \$ [REDACTED] per month and for interest to accrue at the rate of [REDACTED] percent per annum. If the corporation misses three consecutive monthly payments the note becomes due in full upon the written demand of [REDACTED].

On [REDACTED] lent an additional \$ [REDACTED] to the corporation in exchange for a promissory note requiring monthly payments of \$ [REDACTED]. This note charged interest at [REDACTED] percent per annum and also became due in full if the corporation missed [REDACTED] consecutive payments. The proceeds of this note were used to rent a dumpster to remove water damaged inventory, to purchase inventory and to purchase supplies.

Board members [REDACTED] are also co-managers of the thrift store, which is open 49 hours per week. They are the only people who staff the store on a regular basis although volunteers provide some assistance. You intended that both be compensated for this work at the rate of \$ [REDACTED] per week for [REDACTED], and \$115 per week for [REDACTED]. The salary for [REDACTED] was later reduced due to higher than expected start-up costs for the store. [REDACTED] has also deferred some of the salary payments due her.

You state that for the year ended [REDACTED], the sale of donated items accounted for [REDACTED] percent of all income. The remaining income was derived from the sale of purchased inventory.

Your primary expenses for this period were those typical of a retail operation; store rent, store supplies, utilities, insurance, and payroll expenses.

Section 501(c)(3) of the Internal Revenue Code of 1986 recognizes corporations organized and operated for charitable purposes as exempt from income tax.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations defines "charitable" to include the relief of the poor and distressed or of the underprivileged.

Section 1.501(c)(3)-1 of the Regulations defines the organizational and operational tests for exemption from income tax. Section

1.501(c)(3)-1(a)(1) states, "In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one of the purposes specified in the 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(c)(1) states, "An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."

Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated for exempt purposes unless it serves a public rather than private interest. This section also states:

"...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."

The term "private shareholder or individuals" is defined in section 1.501(a)-1(c) as "persons having a personal and private interest in the activities of the organization."

In general the presence of a single non-exempt purpose, if substantial in nature, will preclude tax-exempt status regardless of the number or importance of truly exempt purposes. Better Business Bureau v. U.S., 326 U.S. 279, 283 (1945). A non-exempt activity will not result in denial of exemption where it is only incidental and less than substantial in nature, Seasongood v. Commissioner, 227 F.2d 907, 910 (6th Cir. 1955). A slight and comparatively unimportant deviation from the approved rule is not fatal. The IRS position on this subject is that all the resources of the organization, other than an insubstantial part, must be applied in pursuit of the exempt purpose. This position is clarified in Revenue Ruling 77-366, 1977-2 C.B. 192.

Revenue Ruling 71-581, 1971-2 CB 236 described a corporation created to run a thrift shop. The corporation was created by a group of non-profit organizations described in section 501(c)(3) of the Code. All profits from the shop were payable to these organizations. Substantially all of the goods offered for sale had been donated to the organization and more than half the work in the store was performed by uncompensated volunteers. Paid employees were reasonably compensated. The organization was incorporated separately

from the controlling organizations to insulate the assets of the exempt organizations from any liability that might arise from the operation of the thrift shop, and to provide a separate governing body to coordinate volunteers.

In granting exemption to this organization the Service noted that the separate corporation was merely a device by which the charitable entities accomplished an activity they could have conducted on their own, that is, accepting donations of goods and converting those donations to cash for charitable uses through the use of volunteer labor.

You are unlike this organization in that you are not performing a function for an established charitable entity or entities. You are not controlled, either through your organizing document or through your directors, for the benefit of any particular section 501(c)(3) entity. The decision as to which charitable organizations benefit from your thrift store is a matter determined by your independent board of directors.

You are also unlike this organization in that most of the work in the store is performed by compensated individuals or individuals who would be compensated if business conditions permitted.

Revenue Ruling 80-106, 1980-1 CB 113 describes another thrift shop. All the thrift shop's profits were required by its governing documents to be distributed to specified section 501(c)(3) organizations. Substantially all of the work at the shop was performed by volunteers.

In this case the thrift shop sold items that were donated and items on consignment. The consignment items were obtained at arm's length under the following terms:

- a) The retail price was agreed upon with the consignor.
- b) If the item was not sold within a specified time, it would become a donation if not picked up.
- c) If the consigned item sold within the specified time, the shop would pay the consignor a fixed percentage of the sale.

In granting exemption to this organization exemption the Service noted that section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business shall not be exempt from taxation under section 501 on the grounds that all of its profits are payable to one or more organizations exempt from taxation under section 501. However, section 502(b)(2) provides that the term "trade or business" shall not include any trade or business in which substantially all the work is performed

[REDACTED]

without compensation.

In this case the Service reasoned that because substantially all of the work was performed by volunteers, the organization itself was not carrying on a "trade or business" for the benefit of the beneficiary organizations. Because the payments to the consignor were based on a reasonable percentage of the sales price, the method of acquiring the inventory (consignment) did not constitute private benefit to the consignors.

You are unlike this organization in that the only regular staffing of the store is provided by [REDACTED] and [REDACTED] and you are not controlled by or operated by a recognized charitable entity.

Revenue Ruling 64-108, 1964-1 CB 186 describes a corporation that derived its income from the rental of office space. The charitable purpose of the corporation was to further the operations of other charitable entities through contributions and grants made from the rental income. The board had complete autonomy in selecting the recipients of these contributions and grants. While this revenue ruling dealt specifically with rental income the same principal would apply to A+ Thrift. In granting this organization exemption the Service determined that its primary purpose was charitable because it was carrying out a charitable program commensurate in scope with its financial resources.

It is our position that the organization and operation of [REDACTED] is so significantly unlike that of the thrift shops described in either Revenue Ruling 71-581 or Revenue Ruling 80-106 as to put it outside the bounds of those rulings. We hold that you are more like the organization described Revenue Ruling 64-108.

For this reason your exemption under section 501(c)(3) must be determined based on whether you are carrying out a charitable purpose commensurate with your resources.

You state that you intend to donate approximately 1% of your net profit to recognized section 501(c)(3) entities and that any remaining balance will be used for store improvements. However, in terms of your gross receipts, your donations are less substantial.

For your first months of operation in [REDACTED] you calculated your gross receipts to be \$[REDACTED], your contributions to recognized charitable entities totaled \$[REDACTED].

Your projected budgets for [REDACTED] indicate that you will make donations to recognized charitable organizations totaling \$[REDACTED] in [REDACTED]. This figure represents only [REDACTED] percent of your estimated gross receipts

Department of the Treasury Internal Revenue Service
Consent to Proposed Adverse Action
(All references are to the Internal Revenue Code)

Case Number [REDACTED]	Date of Latest Determination Letter
Employer Identification Number [REDACTED]	Date of Proposed Adverse Action Letter MAY 20 1997
Name and Address of Organization [REDACTED]	

I consent to the proposed adverse action relative to the above organization as shown by the box(es) checked below. I understand that if Section 7428, Declaratory Judgments Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

- Denial of exemption
- Revocation of exemption, effective
- Modification of exempt status from section 501(c)() to 501(c)(), effective
- Classification as a private foundation (section 509(a)), effective
- Classification as a non-operating foundation (section 4942(j)(3)), effective
- Classification as an organization described in section 509(a)(), effective
- Classification as an organization described in section 170(b)(1)(A)(), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgment under section 7428.

(Signature instructions are on the back of this form.)

Name of Organization	
Signature and Title	Date
Signature and Title	Date