

INTERNAL REVENUE SERVICE
DISTRICT DIRECTOR
P.O. BOX 2508
CINCINNATI, OH 45201

DEPARTMENT OF THE TREASURY

Person to Contact:

Contact Telephone Number:

Reply to:

Date:

CERTIFIED MAIL:

Dear Applicant:

We have considered the information submitted in support of your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code and have determined that you do not qualify under this section. The reasons for this conclusion and the facts on which it is based are explained below.

The evidence submitted indicates that you were incorporated [REDACTED] for the purpose of "Engaging in any lawful activity for which corporations may be formed under [REDACTED] These Articles of Incorporation, as presently written, do not provide for the distribution of assets to qualified 501(c)(3) organizations in the event the corporation dissolves.

You state in your application that on [REDACTED] was entered into between [REDACTED], "to encourage the materialization of trade and cultural exchange between the two cities." As a result of this agreement, [REDACTED] was established. In your application, you state that the primary activities of your organization include the following:

1. Provide funding for small health and educational projects in [REDACTED]. This activity expects to promote funding for children of [REDACTED] to improve their health and educational standards.
2. Provide funding for a tutorial program for [REDACTED]. This project will attempt to improve the literary and overall learning skills of [REDACTED]. Semi-annual fairs and other projects will be conducted by volunteers from the community to raise funds from this project.

Code	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Surname	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Date	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

3. Provide hospitality for [redacted] when they are on official business in [redacted]. The organization will endeavor to maintain and improve the political, economic and social ties between the people of [redacted]. The overall objective of this activity is to improve economic and cultural ties between [redacted] officials visiting [redacted] for business purposes.
4. Promote Tourism. Through Tourism, [redacted] will endeavor to maintain and improve the political, economic and cultural ties between [redacted]. Activities will be conducted by volunteers and [redacted] will also request assistance from the [redacted].
5. Promote [redacted]. You state in your application that "The promotion of [redacted] products between [redacted] will result in closer commercial ties and will permit the organization to work with the business community toward charitable endeavors."

You indicate that all of the activities described above will consume at least [redacted] % of the time and effort of [redacted]. You also state in your application that you expect to "operate a [redacted]." The purpose of [redacted], as described in your application, "is to have a visual representative of [redacted]." You further state that the "shop will be manned by volunteers or part-time workers on a daily basis and that the shop will charge market prices for [redacted]." You estimate that approximately [redacted] % of [redacted] time will be devoted to operating the gift shop.

On page 2 of your [redacted] you state that [redacted] is a start-up business specializing in selling the finest quality [redacted] objects of art, textiles, gift liqueurs and music to [redacted] tourists and the local population." In addition to the gift shop, you indicate that [redacted] expects to "build a network system which will help to foster a number of fruitful activities in the community including [redacted] and providing for the accessibility to new markets." You also provide in your application that [redacted] will be open six days a week from Monday to Saturday. Each object will consist of a set price, which range from [redacted] dollars to [redacted] dollars.

You further indicate in your application that [redacted] in local newspapers, radio and tourist information brochures and participate in different cultural exhibits and festivals to help [redacted] expose their wares to the public." You also indicate in your application that "It should be clearly understood that this venture will be for non-profit and the proceeds from this operation will be used primarily to help establish an office which will formally represent [redacted]."

Income for your organization is projected as follows:

	1996-1997	1997-1998	1998-1999
Gross Sales	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
Cost of Goods Sold	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

Expenses have been shown for the following:

Sales	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
Rent-Booth	[REDACTED]	[REDACTED]	[REDACTED]
Stamps & Supplies	[REDACTED]	[REDACTED]	[REDACTED]
Utilities	[REDACTED]	[REDACTED]	[REDACTED]
Insurance	[REDACTED]	[REDACTED]	[REDACTED]
Payroll Taxes	[REDACTED]	[REDACTED]	\$ [REDACTED]
Net Income Before Taxes	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax for organizations organized and operated exclusively for charitable, religious, educational and other stated purposes, no part of the net earnings of which 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 qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under this section.

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations specifies that an organization is organized for one or more exempt purposes if its Articles of Incorporation limit the purposes of the organization to exempt purposes.

Section 1.501(c)(3)-1(b)(iv) of the Income Tax Regulations state that an organization is not organized exclusively for one or more exempt purposes if, by the terms of its articles, its purposes are broader than the purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations provide that an organization is not organized "exclusively" for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose if, upon dissolution, such assets would, by reason of a provision in the organization's articles of incorporation or by operation of law, be distributed for one or more exempt purposes or to the Federal government, or to a state or local government for a public purpose.

Section 1.501(c)(3)-1(d)(1) of the Income Tax Regulations states that an organization is not organized or operated for any purpose under section 501(c)(3) unless it serves a public rather than a private interest. Thus, to meet the requirements of this subparagraph, an organization must demonstrate that it is not organized and operated exclusively for the benefit of private interests such as designed individuals, the creator or his family, shareholders of the organization or persons controlled directly or indirectly by such private interests.

Organizations that are organized and operated on a non-profit basis do not automatically qualify for exemption under section 501(c)(3). The fact that an organization does not make a profit is not the determining factor. See United States v. La Societe Francaise de Bien. Mut. 152, F2d 243 (9th Cir. 1945), cert denied 327 793 (1946); Hassett v. Associated Hospital Service Corporation, 125 F 2d 611 (1st Cir. 1942, cert. denied 316 U.S. 672 (1942); Baltimore Health and Welfare Fund v. Commissioner, 69 T.C. 554 (1978); and B.S.W. Group Inc. v. Commissioner, 70 USTC, 352 (1978).

In Better Business Bureau v. United States, 326, U.S. 270-283, the court held that the existence of a single non-exempt purposes, if substantial in nature, will destroy exemption under section 501(c)(3). In order to qualify for exemption under this section, the applicant organization has the burden of proof to show that (1) it is organized and operated exclusively for a purpose or purposes described in section 501(c)(3), (2) that no part of its net earnings inures to the benefit of any private shareholder or individual, and (3) that no substantial part of its activities consist of the dissemination of propaganda or otherwise attempting to influence legislation or engaging in political activity. See Kenner v. Commissioner, 318 F. 2d, 632, (7th Cir. 1963).

In Calvin K. and Mary I. of Oakknoll, Petitioners v. Commissioner of Internal Revenue Service, Respondent, 69 USTC, 770, the requirements of the "organizational test" of section 501(c)(3) are discussed. The court states that "an organization is not organized exclusively for one or more exempt purposes unless upon dissolution, its assets are dedicated to an exempt purpose." Without an irrevocable commitment to distribute their assets to qualified 501(c)(3) entities in their creating document, an organization fails the organizational test of section 501(c)(3).

In B.S.W. Group, 70T.C. at 359, the court states that although an organization is not disqualified from tax exempt status solely because its primary activity constitutes a business, when it conducts a business with an apparently commercial character as its primary activity, "that fact weighs heavily against exemption."

In International Postgraduate Medical Foundation v. Commissioner, 56 TCM 1140, the court considered the exempt status of an organization whose activities were co-mingled with a for-profit business. The court stated that "when a for-profit corporation benefits substantially from the manner in which the activities of a related non-profit exempt organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes."

In Living Faith v. Commissioner, 91-1, USTC (7th Cir. 1991) the court discusses the commerciality doctrine as it relates to organizations described in section 501(c)(3). The court reviewed certain factors that are used to determine if an organization is operated exclusively for charitable and educational rather than commercial purposes. These factors are that:

1. The organization sells goods and services to the general public;
2. The organization is in direct competition with other entities providing the same services;
3. The prices set by the organization are based on formulas within the industry rather than "below cost";
4. The organization uses promotional materials to enhance sales;
5. The organization advertises its services to the general public;
6. The organization does not utilize volunteers but pays salaries to officials and others;
7. The organization maintains the same hours of operation which are similar to other commercial enterprises in the area;
8. The organization's annual financial statements show a gross profit at the end of its fiscal year;

The court further indicated in this case that because the primary activity of the organization in Living Faith was to operate restaurants and food stores, its operations were as "presumptively commercial" as the sale of prescription drugs to the general public and holders of special VIP cards, Federation Pharmacy Servs. Inc. v. Commissioner, 80-2, USTC, 9553, 625 F. 2d 804,808 (8th Cir. 1980) or the sale of consulting services, see B.S.W., 80-2, USTC, at 358, "or the sale of any other product." Federation Pharmacy, 80-2, USTC 9553, 615 F. 2d at 808.

In Ralph H. Eaton Foundation v. Commissioner, 55-1 USTC, 248, the court determined that an organization that engaged in commercial sales activities and donated its profits to charitable organizations was not exempt under section 501(c)(3). The court held that "while the second purpose of the organization was charitable, the first purpose clearly was not." Since the organization did not meet the organized and operated exclusively for charitable purposes requirement, it did not qualify for exemption under section 501(c)(3).

In Randall Foundation v. Riddell, F. 2d 803, (6th Cir. 1957), an organization was established to operate as a nonprofit charitable foundation. Income to the organization came primarily from the sale of shares of stock donated by the foundation's creator. The court held that this organization was primarily engaged in operating a commercial investment business and also stated that "a corporation which in its inception engages in trade, business or speculative and has a vague charitable design, does not come within the terms of the statute."

With regard to the organizational test under section 501(c)(3), your Articles of Incorporation state that "This corporation is formed for the purpose of engaging in any lawful activity for which corporations may be formed under [redacted]" and that "This corporation is a non-profit corporation." These Articles of Incorporation do not limit the purposes of your corporation to exclusively religious, charitable, educational or other purposes described in section 501(c)(3). Although you are formed for non-profit purposes and to "engage in any lawful activity for which corporations may be formed under [redacted]" these purposes are broader than those permitted by section 501(c)(3). In addition, your Articles of Incorporation contains no provision for the distribution of your assets in the event the corporation dissolves. As the court held in Calvin K. of Oakknoll, "an organization is not organized exclusively for one or more exempt purposes unless, upon dissolution, its assets are dedicated to an exempt purpose." Therefore, for the reasons stated, your organization does not meet the organizational test of section 501(c)(3).

With regard to the operational test required to be exempt under this section, the applicant organization must demonstrate that:

1. It is operated exclusively for charitable and other stated purposes;
2. That no part of the net earnings of the organization inures to the benefit of any private shareholder or individual, officer, trustee, director or any other private person;
3. That the organization serves exclusively public rather than private interests;
4. That the organization is not operated for a substantial non-exempt purpose.

The first requirement of the operational test states that an organization must demonstrate that it is operated exclusively for charitable, educational, religious and other stated purposes. You state in your application's [redacted] that "it should be clearly understood that this venture will be for non-profit and the proceeds from this operation will be used primarily to help establish an office which will formally represent [redacted] Your proposed activities state that some of your projects will include providing funding for small health and educational activities in [redacted] and funding for a tutorial program for [redacted]. These activities are both charitable and educational. However, your proposed financial statements show no funds budgeted to pay for these programs. Your intent to use the proceeds from any fund raising to establish an office which will formally represent [redacted] is not a charitable or educational activity and is prima facie evidence that you are not operated exclusively for any purpose described in section 501(c)(3). Therefore, we have determined that you do not meet the operated exclusively requirement of the operational test.

The second requirement of the operational test states that "no part of the net earnings of the corporation inure to the benefit of any private individual." Your major source of financial support is expected to come from revenue received from goods and services sold in [redacted]. Two of your board members are responsible for running the daily operations of this business operation and will receive compensation and benefits as a result of their being associated with [redacted]. This arrangement causes your organization to fail the second part of the operational test since the net earnings of the corporation inure to the benefit of private individuals who are "insiders" and board members of the corporation.

The third requirement of the operational test states that an organization exempt under section 501(c)(3) must be operated for exclusively public rather than private interests. You indicate in your application that the majority of your time and activities will be devoted to promoting tourism, promoting [REDACTED] between [REDACTED]

Since these activities primarily promote commercial purposes of local businesses, these activities fail the operated exclusively for public purposes requirement since the major beneficiaries of these activities are [REDACTED] rather than the entire community at large.

The last requirement of the operational test is that an organization cannot be operated for a substantial non-exempt purpose. Evidence submitted with your application indicates that your primary purpose will be to [REDACTED] This activity is expected to be your main source of financial support since you expect to generate most of your revenue from "gross sales" of Haitian items displayed in the shop. You have provided the following information regarding your "gift shop" operations:

1. [REDACTED] will be open six days a week from Monday to Saturday;
2. That you will charge "market prices" for [REDACTED] souvenirs or gifts. Each object will have a set price which ranges from [REDACTED] dollars to \$ [REDACTED]
3. That the [REDACTED] is a start-up business specializing in selling the finest quality [REDACTED] objects of art, textiles, gift liqueurs and music to [REDACTED] tourists and the local population;
4. That you expect to advertise in local newspapers, radio, and local tourist information brochures and also participate in cultural exhibits and festivals to help [REDACTED] expose their wares to the public.

The information submitted with your application clearly indicates that [REDACTED] proposes to be run as a commercial business. You indicate that [REDACTED] will specialize in selling [REDACTED] goods at market prices, that you expect to advertise in local newspapers and other media, that the profits from the gift shop will be used primarily to establish an office which will formally represent [REDACTED]. By operating in this manner, your activities are like the organization discussed in Living Faith, where the court determined that since the primary activity was to operate restaurants and food stores, these activities were "presumptively commercial" and served a substantial non-exempt purpose which precludes exemption under section 501(c)(3).

In Randall Foundation v. Riddell, stated that "a corporation which in its inception engages in trade, business or speculation and has a vague charitable design does not come within the terms of the statute." Also, the court held in B.S.W. Group, when an organization conducts a business with an apparently commercial character as its primary activity, "that fact weighs heavily against exemption." In addition, although you state that you expect to fund children's health programs and tutorial programs, your proposed expenses are those normally associated with operating a commercial trade or business and there is no indication that you expect to spend any of your funds to pay for these charitable activities. Therefore, for the reasons stated, we have determined that you are also operated for a substantial non-exempt commercial purpose which precludes exemption under section 501(c)(3).

Since you have not met your burden of proof to show that you meet the organizational and operational tests under this section, we have concluded that you are not entitled to exemption under section 501(c)(3). You are required to file federal income tax returns on Form 1120.

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Contributions to your organization are not deductible by donors under sections 170, 2106, 2055 and 2522 of the Code.

In accordance with the provisions of section 6104(c) of the Code, a copy of this letter will be sent to the appropriate state officials.

If you do not agree with this determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892.

Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or if you request at any mutually convenient district office. If you will be represented by someone who is not one of your principal officers, that person will need to file a power of attorney or tax information authorization with us.

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination on this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust administrative remedies. Section 7428(b)(2) of the Code provide, 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."

Appeals submitted which do not contain all of the information required by Publication 892 will be returned for completion.

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

Sincerely yours,


District Director

Enclosure: Publication 892

cc: 