



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201224036**
Release Date: 6/15/2012

Date: March 19, 2012

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.00-00; 501.03-00; 501.03-05

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)(). 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.

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.

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,

Lois G. Lerner
Director, Exempt Organizations

Enclosure

Notice 437

Redacted Proposed Adverse Determination Letter

Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: December 5, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

State =

Date =

Dear :

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

FACTS

You are a State nonprofit public benefit corporation formed on Date. Your Articles of Incorporation provide that you are "organized for charitable, religious, educational and scientific purposes within the meaning of § 501(c)(3)," and specifically, to dispense cannabis (also known as marijuana) intended to be used for medicinal purposes. Your articles state that you are organized for public purposes.

Your bylaws require the issuance of certificates of capital stock, and provide that the certificates represent the interests of the shareholders. The bylaws further state that shareholders may be entitled to receive dividend payments. Your shareholders elect your board of directors annually.

In your Form 1023 Application, you state that your formation followed the passage of State legislation that allows for the cultivation and use of cannabis by seriously ill individuals upon a physician's recommendation. You explain that under State Attorney General guidelines issued for this legislation, you are required to operate in the business form known as a "public benefit corporation."

You further describe yourself as a "clinic devoted to the care and nurturing of persons in medical distress for various reasons." You state that you are dedicated to educating eligible individuals about their rights when using cannabis as a medical therapy, and to provide them safe, legal access to cannabis.

You indicate that only your members may purchase or receive a donation of cannabis because the only recognized entities under the State Attorney General Guidelines are cooperatives and collectives that allow members and caregivers to associate. You do not charge a membership fee. To become a member, a person must be at least 18 years old, have a written referral from a qualified doctor, and provide a picture identification card. You keep copies of the doctor's referral and the member's identification for your records, noting the expiration date of the referral. After determining the member's eligibility, you review your policies and procedures with the member.

You represent that you run your clinic in a manner similar to a doctor's office. Members must make an appointment to receive services and obtain the cannabis. You treat members in a private area and allow only the member and caregiver into the dispensary during the consultation. The consultation determines which variety and form of cannabis is appropriate for each member. You distribute the cannabis only in amounts permitted by State law.

In addition, you provide information to members regarding how to ingest and use topicals; which varieties are more effective; recipes that include cannabis; and instructions to grow your own cannabis. You provide grading services for homegrown cannabis. You also discuss with your members current legislation and laws regarding the legal use of cannabis in State, and provide information and literature on a variety of subjects related to alternative medicine and different treatment options.

You charge your members a "suggested donation price" per visit to cover the farmer's costs of growing and providing the cannabis. Members may make the donation in cash or homegrown cannabis in exchange for using the dispensary and obtaining information and periodicals related to alternative medicine. You state that you will provide cannabis free of charge to members in need of financial aid. You sell to your members cannabis provided by your members to raise funds for this purpose. Your staff determines financial hardship. Besides the ingestible form, you also sell cannabis raw and in other forms.

As indicated on your Form 1023 Application, your primary source of funds will be member donations and some public donations. You plan to conduct quarterly cannabis raffles. In addition to selling cannabis, you will sell items such as t-shirts, organic pipes, topicals, butter and edibles, and pharmacy front-counter items, such as lighters.

APPLICABLE LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable 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 § 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. 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)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes and do not expressly empower it to engage, otherwise than as

an insubstantial part, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iv) of the regulations provides that in no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which it is created are broader than the purposes specified in § 501(c)(3). The fact that the actual operations of such organization have been exclusively in furtherance of one or more exempt purposes shall not be sufficient to permit the organization to meet the organizational test.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3) of the Code. An organization will not be operated exclusively for exempt purposes if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" refer to persons that have a personal or private interest in the activities of the organization. See § 1.501(a)-1(c).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, the organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals or shareholders of the organization.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in § 501(c)(3) of the Code in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See *Restatement (Second) of Trusts*, §§ 368, 372 (1959); 4A Scott and Fratcher, *The Law of Trusts*, §§ 368, 372 (4th ed. 1989). However, a trust is invalid if its purpose is illegal. *Restatement (Second) of Trusts*, § 377 (1959).

Section 1.501(c)(3)-1(d)(3)(i) of the regulations provides, in part, that the term "educational" as used in § 501(c)(3) of the Code relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

21 U.S.C. § 802(16) defines marijuana as "all parts of the plant *Cannabis sativa* L. whether growing or not; the seeds thereof; the resin extracted from any part of such plant; and every compound, manufacture, salt, derivative, mixture, or preparation of such plant, its seeds or resin."

21 U.S.C. § 812(c), Sch. I(c)(10) lists marijuana as a hallucinogenic substance and includes it on schedule I of the Schedules of Controlled Substances. A schedule I substance is a substance that (1) has a high potential for abuse; (2) has no currently accepted medical use in treatment in the United States; and (3) there is a lack of accepted safety for use of the drug under medical supervision.

21 U.S.C. § 841(a), known as The Controlled Substances Act, states that it is illegal for anyone to knowingly or intentionally manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense a controlled substance.

United States v. Oakland Cannabis Buyers' Cooperative, 532 U.S. 483, 490 (2001), reiterates that there is only one exception from the Act for cannabis: Government-approved research projects. "It is clear from the text of the Act that Congress has made a determination that marijuana has no medical benefits worthy of an exception." *Id.* at 493.

In *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

In *Ould v. Washington Hospital for Foundlings*, 95 U.S. 303, 311 (1877), the Court noted that "[a] charitable use, where neither law nor public policy forbids, may be applied to almost any thing that tends to promote the well-doing and well-being of social man."

In *Mysteryboy Inc. v. Commissioner*, T.C. Memo 2010-13 (2010), the Tax Court held that the organization failed the operational test partly because the organization proposed to promote illegal activities.

In *Bob Jones University v. United States*, 461 U.S. 574 (1983), the Supreme Court held that racially discriminatory education is contrary to public policy and the University therefore could not be viewed as providing public benefit within the charitable concept.

In *Harding Hospital, Inc. v. United States*, 505 F.2d 1068, 1071 (6th Cir. 1974), the court held that an organization has the burden of proving that it satisfies the requirements of the particular exemption statute. The court noted that whether an organization has satisfied the operational test is a question of fact.

In *Federation Pharmacy Services, Inc. v. Commissioner*, 72 T.C. 687 (1979), *aff'd*, 625 F.2d 804 (8th Cir. 1980), the Tax Court held that while selling prescription pharmaceuticals to elderly persons at a discount promotes health, this does not entitle it to an automatic tax exemption under § 501(c)(3) of the Code.

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352, 358 (1978), the court held that a consulting organization whose sole service was to find individual researchers for their clients, only some of which were exempt, did not qualify for exemption under section 501(c)(3) of the Code. The court found that B.S.W. Group's primary "activity constitutes the conduct of a consulting business [that] is ordinarily carried on by commercial ventures organized for profit."

Rev. Rul. 61-170, 1961-2 C.B. 112, holds that a nurses' association, which maintains an employment register primarily for the employment of its members, is not entitled to exemption under § 501(c)(3). The organization is primarily engaged in the performance of personal services by operating an employment service principally for the benefit of its members. Public participation in the management and support of the organization is negligible. It draws its support primarily from members, and a board of trustees composed of professional nurses controls the organization without public participation of any kind. Therefore, the organization is not free from substantial private benefit considerations in the operation of the nurses' register.

Rev. Rul. 69-175, 1969-1 C.B. 149, holds that a nonprofit organization formed by parents of pupils attending a private school that provides school bus transportation for its members' children serves a private rather than a public interest. The organization's income approximately equals the expenses involved in its operations.

Rev. Rul. 73-349, 1873-2 C.B. 179, holds that an organization formed to purchase groceries for its membership at the lowest possible prices on a cooperative basis is not exempt as a social welfare organization described in § 501(c)(4) of the Code. The organization was a private cooperative enterprise for the economic benefit or convenience of its members. Any benefit to the community was incidental to the benefit received by the members.

Rev. Rul. 75-384, 1975-2 C.B. 204, holds that a nonprofit organization, whose purpose was to promote world peace, disarmament, and nonviolent direct action, did not qualify for exemption under §§ 501(c)(3) or (c)(4). The organization's primary activity was to sponsor antiwar protest demonstrations in which demonstrators were urged to violate local ordinances and commit acts of civil disobedience. Citing the law of trusts, the ruling stated that all charitable organizations are subject to the requirement that their purposes cannot be illegal or contrary to public policy.

ANALYSIS

Based on the information you provided in your application and supporting documentation, we conclude that you are not organized and operated exclusively for exempt purposes under § 501(c)(3) of the Code. An organization can be recognized as exempt under § 501(c)(3) only if it shows that it is both organized and operated exclusively for charitable, educational, or other exempt purposes. If an organization fails to meet either the organizational test or the operational test, it is not exempt. Treas. Reg. § 1.501(c)(3)-1(a)(1).

You do not satisfy the operational test of § 1.501(c)(3)-1(c) of the regulations. Whether an organization operates exclusively in furtherance of an exempt purpose is a question of fact. An organization seeking tax-exempt status under § 501(c)(3) carries the burden of proving that it satisfies the requirements of the statute. See *Harding Hospital*, 505 F.2d at 1071. Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. at 283, the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

The common law of trusts specifies that a charitable trust cannot be created for an illegal purpose. See *Restatement (Second) of Trusts*, § 377. Similarly, the Supreme Court noted in *Ould v. Washington Hospital for Foundlings*, 95 U.S. at 311, that "[a] charitable use, where neither law nor public policy forbids, may be applied to almost any thing that tends to promote the well-doing and well-being of social man." Like a trust, a § 501(c)(3) organization cannot be created for a purpose that is illegal. See Rev. Rul. 75-384, *supra*; *Mysteryboy Inc. v. Comm'r*, T.C. Memo 2010-13 (2010) (organization that encouraged sexual activity with minors with the goal to repeal child pornography and rape laws was not exempt from federal income taxation; activities of the organization violated public policy as reflected in Federal and state laws).

Your primary activity, the distribution of cannabis, is illegal. Federal law does not recognize any health benefits of cannabis and classifies it as a controlled substance. 21 U.S.C. § 812. Federal law prohibits the manufacture, distribution, possession, or dispensing of a controlled substance. 21 U.S.C. § 841(a). Congress has "made a determination that marijuana has no

medical benefits worthy of an exception" to the general rule that the manufacture and distribution of cannabis is illegal. *Oakland Cannabis Buyers' Coop.*, 532 U.S. at 493.

Current federal law prohibits the use of cannabis except in limited circumstances; those limited circumstances do not include the use of cannabis for medicinal purposes. *See Id.* The fact that State legalized distribution of cannabis to a limited extent is not determinative because under federal law, distribution of cannabis is illegal. Because you advocate and engage in activities that contravene federal law, you serve a substantial nonexempt purpose.

You also operate for private purposes rather than the public interest. An organization that operates primarily for the benefit of its members serves the interests of a select group of individuals rather than the community's or the public's interest. A business or other activity that assists the community incidentally and only provides benefits to a limited number of members of the community more than incidentally is not charitable. *See e.g.*, Rev. Rul. 61-170, *supra*, Rev. Rul. 69-175, *supra*, and Rev. Rul. 73-349, *supra*.

Your Form 1023 Application and supporting material indicate that you are a cooperative organization and only distribute cannabis to your members. In State, a cooperative must conduct itself primarily for the mutual benefit of its members as patrons of the organization. The organization uses its earnings for the general welfare of its members or it equitably distributes its earnings or services to its members.

You state that you sell or give cannabis to members based on their financial need. The Tax Court in *Federation Pharmacy Services, Inc. v. Comm'r*, 72 T.C. at 692, stated that selling health items at a discount "is not, of itself, a charitable deed. Many profitmaking organizations sell at a discount. Nor does the fact that [Federation Pharmacy] seeks to sell its drugs at cost alter the result; so does an old-fashioned cooperative, yet it is not entitled to classification as charitable." *Id.* (citations excluded). As a cooperative, your activities benefit private interests more than incidentally, which precludes exemption under § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

To satisfy the organizational test, an organization's Articles of Incorporation must limit its purposes to those listed in § 501(c)(3). Additionally, the Articles must not expressly empower the organization to engage, more than insubstantially, in activities that are not in furtherance of those exempt purposes.

You do not satisfy the organizational test described in Treas. Reg. § 1.501(c)(3)-1(b)(1). Your specific purpose is to dispense medicinal cannabis. Distributing cannabis does not further any exempt purpose. Your Articles of Incorporation therefore do not limit your purposes to one or more exempt purposes under § 501(c)(3). Instead, your Articles empower you to engage, other than as an insubstantial part of your activities, in activities not themselves in furtherance of an exempt purpose.

You also fail the organizational test because your bylaws allow for the issuance of capital stock to shareholders who vote on the members of the board of directors. The bylaws state that shareholders may be entitled to receive dividend payments. Thus, your bylaws allow your net earnings to inure to the benefit of private shareholders or individuals, contrary to Treas. Reg. § 1.501(c)(3)-1(c)(2).

CONCLUSION

Based on the facts and information submitted, you are not organized and operated exclusively for exempt purposes. Your primary purpose of distributing cannabis not only violates federal law, but also furthers a substantial nonexempt purpose. You also operate for private purposes rather than the public interest. An organization that operates primarily for the benefit of its members serves the interests of a select group of individuals rather than the community's or the public's interest. A business or other activity that assists the community incidentally and only provides benefits to a limited number of members of the community more than incidentally is not charitable. In addition, your bylaws state that shareholders may be entitled to receive dividend payments. Thus, your bylaws allow your net earnings to inure to the benefit of private shareholders or individuals. Therefore, you are not described in § 501(c)(3) of the Code.

Accordingly, you do not qualify for exemption as an organization described in § 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under § 170 of the Code.

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.

Your protest statement should be accompanied by the following declaration:

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.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see 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 protest as a failure to exhaust available administrative remedies. Code § 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 this address:

Internal Revenue Service
SE:T:EO:RA:T:4
1111 Constitution Ave, N.W.
Washington, DC 20224

You may also 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,

Lois G. Lerner
Director, Exempt Organizations