



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201330037**
Release Date: 7/26/2013

Date: April 30, 2013

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.03-00; 501.03-30; 501.32-00; 501.36-01

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.

Since 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.

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, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

Letter 4038(CG) (11-2005)
Catalog Number 47632S

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: March 8, 2013

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = individual
C = individual
D = individual
M = state
x = date
y = date

UIL:

501.03-00
501.03-30
501.32-00
501.36-01

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.

Issues

1. Do you fail to pass the operational test, therefore disqualifying you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.
2. Have you failed to establish that your funds will not inure to the benefit of your founders, causing you to be disqualified from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.
3. Does your sale of motorcycle parts and accessories at market rates further a substantial, non-exempt commercial purpose under Section 501(c)(3) of the Code? Yes, for the reasons described below.

Letter 4036(CG) (11-2011)
Catalog Number 47630W

Facts

You were initially formed by Articles of Association on date x, but incorporated approximately four months later in M on date y. You were formed by B, C and D. B and C are husband and wife and D is their daughter.

Your Articles of Association named you as the first partner, with B as the second, and outlined an agreement with B, stating that the partners agree to "...engage in the business of raising money through motorcycle rides to assist in the funding of treatment homes for adult and juvenile delinquents in their rehabilitation." The Articles further state the partnership will continue for a period of 20 years after which it may continue for a period of on-going years or for such time as the partners may see fit.

The Articles of Association also state that each of the partners are 'contributing their skill and labor to the association and it is understood that each partner will be paid wages or a salary for such labor that the partner may perform'. The members of the association shall constitute the committee which shall fix the wages or salaries to be paid.

The Articles of Association further state that B shall be the managing partner and as such will have the full authority to manage, conduct, operate and arrange all the business affairs. B can hire and fire other employees needed to carry on the business, determine wages and make contracts with employees, enter into other contracts and do anything that is ordinarily done as the manager of a business.

Section 6 of your Articles of Association is titled "Division of Profits." It states the following:

At the end of each year or at such time as the committee of the whole may decide, the profits of the association shall be distributed in the following proportions: describe. It is agreed however the expenses of the business shall be borne equally and all operating expenses shall be deducted before profit is determined.

Section 8 of your Articles of Association states that if you dissolve during your 20 year projected lifespan, the assets will be sold and any profits will be distributed to the facility/facilities normally receiving funding from this business.

Your Articles of Incorporation state you are organized exclusively for 501(c)(3) purposes, and named B, C and D as trustees.

In your application for exemption you referred to your Articles of Association in explaining past, present and future activities rather than providing a description. You did indicate motorcycle rides would be generating funds for donation to sober homes and to

institutions rehabilitating juveniles.

During correspondence you submitted a revised Form 1023 which described your main activity as raising money from the sale of motorcycle parts and accessories. Merchandise for sale is obtained through a shipping contract with a third party supplier. When someone orders from your site, you then log in to the supplier's site as a contracted dealer and order the product which is then shipped to the customer. Prices on your website for merchandise are suggested retail prices. You remain a contracted dealer with the supplier as long as you sell at least \$ worth of merchandise annually. Profits from this activity will fund a rehabilitation facility for boys and girls. Along with the merchandise sales you also conduct an annual poker run open to the public for a registration/participation fee. Funds left after expenses are to be donated to a local homeless shelter.

The lead page of your website states you are a motorcycle parts and apparel store, and includes the following:

Your site also contains a link to your annual poker run and details on the event.

Your website is available to anyone interested in purchasing parts and accessories. You also submitted a voluminous catalog of all the parts and accessories available on your website.

Your website states,

You submitted actual and estimated expenses. In your first year you indicated operating losses of over \$. Further, you showed no profit in your annual poker run and no funds contributed to charity. In years two and three you show a profit, however, your expense projections did not include compensation amounts or the cost of goods purchased from the supplier.

Your application for exemption indicates that compensation amounts of B, C and D depend on your income. You said when gross sales reach a specific amount, the board member that is working 40 hours a week on the website will receive compensation of % of the month's gross sales per month. When your sales increase to another specific amount, the board member that is working in customer service, organizing the poker runs and marketing the website will receive a wage of % of the month's gross sales per month. Your secretary will be paid minimum wage for time spent at board meetings or other business ventures. A board meeting will be held to determine the amounts and who will receive what wages. Salary amounts were decided by your board members. The person not receiving the income will vote with the other non receiving member and determine the salary and who receives it. You indicated no limit to the compensation any individual could receive.

You said % of C's time is spent on the website. Over a year span you estimate that % of B's time is spent proofing and marketing the website.

You submitted minutes from your board meetings. During one of the meetings B, C and D discussed renting B and C's house "...until a brick and mortar [sic] store is established." You later submitted a rental agreement for that property between you and C, signed by B and C. You will pay % of their utilities and \$ a month for rent once the website is generating money.

Law

Section 501(c)(3) of the Code describes corporations organized and operated exclusively for charitable 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 regulations states 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(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 which accomplish one or more of such exempt purposes specified

in section 501(c)(3) of the Code. 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(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals as defined in Section 1.501(a)-1(c).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an exempt organization must serve a public rather than a private interest. The organization must demonstrate that it is not organized or operated to benefit 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." Thus, if an organization is operated to benefit private interests rather than for public purposes, or is operated so that there is prohibited inurement of earnings to the benefit of private shareholders or individuals, it may not retain its exempt status.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3), even though its net profits do not inure to the benefit of individual members of the organization.

Rev. Rul. 72-369, 1972-3 C.B. 245, held an organization formed to provide management and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code because it is a trade or business ordinarily carried on for profit.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

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 businesses. 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 organized 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. 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 Living Faith Inc. v. Commissioner, 60 T.C.M., 710, 713 (1990), aff'd 950 F. 2d 365 (Cir. 1991) the court said that the activities were conducted as a business and the organization was in direct competition with other restaurants and health food stores; thus it did not qualify for exemption under Section 501(c)(3). The appellate court stated the factors that the court relied upon to find commerciality and thus offered the best contemporary explanation of the commerciality doctrine. These factors include:

1. The organization sold goods and services to the public.
2. The organization was in direct competition with for profit businesses.
3. The prices set by the organization were based upon pricing formulas common in retail food businesses.
4. The organization utilized promotional material and "Commercial catch phrases" to enhance sales.
5. The organization advertised its services and food.
6. The organization did not receive any charitable contributions.

Application of Law

You are not described in Section 501(c)(3) because you are not operated exclusively for charitable purposes. You have also failed to establish your earnings will not inure to your founders. Selling motorcycle parts and accessories via your web site at retail prices is not an exclusive charitable activity. You are controlled by three related individuals, B, C and D, who will benefit from compensation and lease agreements related to sales of products. As you are not described in section 1.501(c)(3)-1(a)(1) of the regulations and because more than an insubstantial part of your activities involve these product sales you fail the operational test and do not meet the requirements of section 1.501(c)(3)-1(c)(1) of the regulations.

You are not described in Section 1.501(c)(3)-1(c)(2) of the regulations as you have failed to establish your earnings will not inure to insiders. You have agreements that were not negotiated arms-length to compensate insiders in relation to a percentage of

your gross sales and through other transactions and three related individuals are controlling your operations.

You are not described in Section 1.501(c)(3)-1(d)(1)(ii) as you have failed to demonstrate you serve public, rather than private, purposes. B, and B's family, has full authority to manage, conduct, operate and arrange all of your business affairs; and all stand to benefit from your operations. .

You are not described in Section 1.501(c)(3)-1(e) of the regulations as your primary purpose of operating a website which sells motorcycle parts to the public in a commercial manner does not exclusively further charitable purposes. This activity constitutes a trade or business of a commercial, rather than charitable, nature.

You are similar to the organization described in Rev. Rul. 72-369 because you are operating a business ordinarily carried on for-profit in operating a website for the sale of motorcycle parts and accessories.

You are similar to the organization in Better Business Bureau as you have a substantial non-exempt purpose of maintaining a website for the retail sale of merchandise.

You are similar to the organization in Living Faith as you exhibit certain factors evident of non-exempt commercial operations. You sell goods to the public as a substantial part of your activities. You are in direct competition with other retailers, for profit included, who sell the same products. Your prices are set common to other retail operations and you intend on advertising your site to increase sales. Finally, you are supported substantially through sales rather than charitable contributions. These factors demonstrate a commercial rather than charitable purpose.

You are similar to the organization in B. S. W. Group as the activity of selling parts and accessories in the manner described is characteristic of a regular trade or business for-profit. Your activities are consistent with the conduct of a business ordinarily carried on by commercial ventures. You are similar to the organization in Easter House because your primary activity is the sale of merchandise on your website. You will compete with other commercial enterprises providing similar services and selling similar parts.

Conclusion

You fail to meet the operational test as you are not operated for a charitable purpose. You have failed to establish earnings will not inure to insiders or that you are not operating for private purposes. Your activity of selling parts and accessories is indicative of a non-exempt commercial operation. Accordingly, we conclude you do not qualify for exemption as an organization described in section 501(c)(3) 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. 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:

Internal Revenue Service
EO Determinations Quality Assurance

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance

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 O. Paz
Director, Exempt Organizations
Rulings and Agreements

Enclosure: Publication 892