



Department of the Treasury

Internal Revenue Service

P.O. Box 2508

Cincinnati, OH 45201

Release Number: 201525012

Release Date: 6/19/2015

UIL Code: 501.03-30

501.32-01

501.36-00

Date: March 25, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) 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 the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Director, Exempt Organizations

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date: December 16, 2014

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

C = Law

B = Law

S = Number

T = Number

v = Dollar Range

W = Date

X = State

y = Dollar Amount

z = Dollar Amount

UIL:

501.03-30

501.32-01

501.36-00

Dear _____ :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons described below.

Facts

You formed as a business corporation on W in the state of X. Your Articles of Incorporation state that you are authorized to issue ownership shares, and your Bylaws outline how those shares are to be issued.

You are one hundred percent minority owned and operated. The four members of your board of directors are all related through family.

You were formed to relieve the poor, disadvantaged, distressed, underprivileged, and in particular ex-felons in seeking gainful employment. Your goal is to convert ex-felons into productive citizens. Your primary activity to accomplish this goal is to provide ex-felons training on how to operate and maintain various types of construction equipment. You were established to take advantage of the enormous growth in the highway building and highway maintenance industry through the state and federal highway budget program. After the ex-felons receive training, they can be employed and become beneficial citizens in the community. This will help them successfully integrate back into society to benefit the community as a whole.

You plan to be involved in all aspects of highway construction and maintenance, concrete and asphalt application, and in debris removal. You will primarily do this by contracting with state and federal governments in the construction, enhancement, and maintenance of highway infrastructure. Because you are minority owned and operated and will be large enough to handle the size of the jobs, you will be in a better position to bid on large projects. You plan to comply with Federal Laws C and B, which set aside funds for state and federal projects. You state there are large amounts of government funds set aside for minority owned businesses, which will give you a stronger opportunity to negotiate contracts in the governmental sector and provide personal service at a competitive rate, creating a dedicated customer base. You also plan to establish joint ventures with larger and more established companies to bid on future projects.

According to the business plan included with your application, you will handle the hauling of sand and gravel, asphalt, and debris for the state and private sector. You state you have no competition in bidding for jobs with more than S dump trucks with the advantage of C. You will have at least T dump trucks with at least that many employees to operate them. You will have several acres of land and a warehouse to house equipment and a classroom. You will also target other markets that will include private businesses looking to upgrade their grounds, such as business parks and office parks. You will advertise your services to the private sector through advertisements in the trucking and hauling section of local papers and various business directories.

The ex-felons will complete their initial training with you. You will provide classroom training on how to operate and repair dump trucks, dump trailers, earth movers, dozers, track hoes, mixing machines, etc. Supervised instruction and training will continue on the job during your various work projects. These trainees will remain with you as full-time employees once their initial training is complete. You will compensate employees at three times the minimum wage and provide an employee benefit package with medical, dental, vision, disability, life, and cancer insurance, a section 125 plan, sick leave, vacation pay, 401(k) matching, income tax planning and income tax preparation. You will also provide financial planning and estate planning. You will require ex-felons to contribute a small percentage of earnings to a charitable organization and participate in charitable mentoring.

You also plan to create subsidiary businesses in the future. The first subsidiary would be related to purchasing and rehabilitating run down and dilapidated homes. These homes will then be made available to lower middle class and upper lower class individuals for purchase. All of the work related to this activity will be done by ex-felons, but supervised by your board of directors. A second subsidiary would involve a temporary shelter divided into two units; one unit for battered women and another for at-risk teens. You are not currently operating any subsidiary businesses.

You plan to receive income from grants and services rendered to the public and private sector, expecting to receive grants of \$y and expecting to receive \$z in income in the next three years. For example, you state the average rate of revenue for debris removal service is approximately between \$v an hour depending on the project. Expenses expected to be incurred include those related to the acquisition of land and equipment, and

normal expenses related to the maintenance of equipment and facilities. Expenses also include compensation to your employees and each member of your board of directors. You also plan to maintain a reserve sinking fund designed to withstand hard financial times.

Law

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable and educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax 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(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:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

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

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 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, 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, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Revenue Ruling 67-150 1, 1967-1 CB 133, describes on organization whose only activity is to rehabilitate ex-convicts and parolees in order to make them self-supporting and useful citizens. This was conducted through discussion groups, forums, and various different programs to assist them as well as educate the general public on various issues. The income of the organization was derived from contributions and all funds were expended for the programs of the organization. This organization was found to be exempt under section 501(c)(3).

Revenue Ruling 73-127, 1973-1 CB 221, states that a nonprofit organization that operated a cut-price retail grocery outlet and allocates a small portion of its earnings to provide on-the-job training to hard core unemployed does not qualify for exemption under section 501(c)(3). The store operated in a similar manner to profit-making businesses in the area, and its gross earnings are used to principally pay salaries and other

customary operating expenses incurred in the operation of a grocery store and to expand the operations of the store. It was concluded that the operation of the store and operation of the training program were two distinct purposes sought to be accomplished by the organization through its use of resources. Since the commercial operation of a grocery store is not a recognized exempt purpose and this activity was substantial and conducted on a scale larger than reasonably necessary to conduct the training program, the organization was found not to be exempt.

Revenue Ruling 73-128, 1973-1 CB 222, describes an organization that was formed to provide educational and vocational training and guidance to non-skilled persons who are unable to find employment or cannot advance from poorly paid employment due to inadequate education. The organization's job training program centered on the manufacture and sale of a line of toy products. Those hired as trainees are not hired as permanent employees and the organization tries to place them in permanent positions in the community as soon as they are adequately trained. Most of the merchandise is sold through normal channels, although, some are donated to other community organizations. Any additional income received is used to finance the organization's other community service activities. The question in this case was whether there is a clear and causal relationship between the manufacturing activity and the training of individuals for the purpose of improving their capabilities, and whether the scale of the endeavor suggests that it is being conducted on a scale larger than reasonably necessary to accomplish the organization's charitable purpose. The organization in question was granted exemption under section 501(c)(3) as it was found that the manufacturing activities were an integral part of the training process and there was no evidence to suggest that it is being conducted on a scale larger than reasonably necessary.

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

In Living Faith Inc. v Comm'r, 60 T.C.M., 710, 713(1990), aff'd 950 F.2d 365 (& Cir. 1991), the court wrote 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 on to find commerciality and thus offered the best contemporary explanation of the commerciality doctrine.

In Arlie Foundation, Inc. v. U.S., 283F. Supp. 2d 58 (D. D.C., 2003), the organization operated a conference facility made available primarily to exempt organizations and governmental units. It was found that even though the organization argued that serving non-profit and governmental clients is indicative of an exempt purpose, the organization was found not to be exempt under section 501(c)(3). This was because it was found to be operating in a manner not significantly distinguishable from a commercial endeavor, and thus furthering a substantial non-exempt purpose. The court also found that the organization's patrons were not limited to exempt entities, or a charitable class.

Application of law

Section 501(c)(3) of the Code sets forth two main tests to qualify for exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). You are formed with the state as a for-profit, stock corporation. The provisions of your Articles of Incorporation do not limit your purposes to exclusively 501(c)(3) purposes, nor do they require you to distribute your assets for exclusively

501(c)(3) purposes upon dissolution. As a result, you have not satisfied the organizational test required by Sections 1.501(c)(3)-1(b)(1)(i) and 1.501(c)(3)-1(b)(4) of the Regulations.

You are operating for substantial commercial purposes, which furthers private, rather than public, purposes. Therefore, you are not operated for exclusively charitable and educational purposes under Section 1.501(c)(3)-1(c)(1) of the Regulations. Some of your proposed activities do further educational purposes, such as providing training and employment to ex-convicts. However, a substantial portion of your time is dedicated to the commercial purpose of securing contracts and performing services for a fee similar to an ordinary business. Despite any charitable or educational purposes you may achieve, your operations do not further exclusively 501(c)(3) purposes.

Your Articles of Incorporation and Bylaws authorize you to issue capital stock and to make distributions to stockholders. The holding of stock by any private individual that entitles that individual to any part of your assets or income constitutes inurement prohibited under Section 501(c)(3) of the Code. As a result your net earnings are set to inure to private individuals, which precludes exemption under Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations. Because your organizing documents are structured in this manner, you do not meet the organizational and operational tests of Section 1.501(c)(3)-1(a)(1) of the Regulations.

You are not like the organizations described in Revenue Rulings 67-150 and 73-128. The ex-felons that you train will be permanent employees, and you will provide them a competitive compensation and benefit package. This demonstrates that they will be long-term employees to further your commercial operations. Your planned expenses are to further the operation of your business, such as land and equipment acquisition and maintenance and compensation. While you may provide some charitable and educational assistance as outlined in Revenue Ruling 67-150, the scale of your commercial endeavor is larger than reasonably necessary to accomplish any charitable purpose, demonstrating you are operating for substantial commercial purposes.

You are operating similarly to the organization described in Revenue Ruling 73-127. You provide job training to individuals who are chronically unemployed. However, you plan for these individuals to be permanent employees when training is complete. You are organized as a for-profit organization and operate in a fashion similar to for-profit businesses. You will compete in bidding processes with other for-profit businesses. Since your commercial operations are a substantial non-exempt purpose, you are not organized and operated exclusively for charitable purposes.

As with the case of the Better Business Bureau of Washington D.C., operating a business to assist in the normal construction and maintenance of highways as well as providing services in debris removal and concrete and asphalt application is a substantial non-exempt purpose. As this case outlines, any evidence of a substantial non-exempt purpose precludes exemption under section 501(c)(3) of the Code.

Similar to the Arlie Foundation and Living Faith, you have not sufficiently represented that you are significantly distinguishable from a commercial endeavor. You are formed as a for-profit corporation. To provide services to state and federal governments, you plan to bid for contracts in competition with for-profit enterprises. You plan to earn market rate for services you provide. Your expenses primarily relate to maintaining and operating facilities and equipment, compensation, and benefits. You will advertise in ordinary business publications and maintain a reserve of funds for hard economic times. Thus, even though you may provide some education and training to employees, you are also serving a substantial non-exempt purpose of operating a business.

Conclusion

Based on the information provided, you do not qualify for exemption because you are not organized or operated for exclusively 501(c)(3) purposes. While you may provide some training to individuals representing a charitable class, a substantial part of your activities are commercial in nature. Your operations also inure to the benefit your shareholders since you are for-profit, stock corporation. Therefore, you do not qualify for exemption under 501(c)(3) of the Code.

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

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

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Director, Exempt Organizations

Enclosure:
Publication 892