



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

Date: July 9, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.36-01

Number: **201540016**  
Release Date: 10/2/2015

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  
WASHINGTON, D.C. 20224**

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

**Date:**

May 13, 2015

**Employer ID number:**

**Contact person/ID number:**

**Contact telephone number:**

**Contact fax number:**

**LEGEND:**

B = Name  
C = Name  
D = Organization  
F = State  
G = Organization  
H = Date  
J = Suite Name  
K = Suite Name  
L = Organization  
Q = Website  
g = Percent  
h = Percent  
j = Percent  
k dollars = Number  
m dollars = Number  
n dollars = Number  
p dollars = Number  
q dollars = Number  
r dollars = Number  
s dollars = Number  
t dollars = Number  
u dollars = Number  
v dollars = Number  
w dollars = Number  
x dollars = Number  
y dollars = Number  
z dollars = Number

**UIL:**

501.36-01

**Letter 4036 (Rev. 7-2014)**

Catalog Number 47630W

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 meet the operational test for exemption under section 501(c)(3) of the Internal Revenue Code? No, for the reasons stated below.

### **Facts**

You were incorporated on H in the state of F. The third article in your initial Articles of Incorporation states you were formed to offer services/products related to the care of pets. You later amended your Articles of Incorporation to state that you were formed for charitable, religious, educational, and scientific purposes.

You are a successor to a for-profit entity, D. B and C, husband and wife, were each 50% shareholders in D. C is now your President and you will compensate both B and C. Your remaining board members are either related to B and C or employed by companies owned by B and C. No assets or liabilities were transferred to you from the for-profit. However, you lease property that was previously used by D. The property is leased at approximately market rental rate from L, a single-member LLC owned by C.

C signed a Waiver of Salary Agreement stating that she waives the right to receive a salary of k dollars per year. However, per the agreement, if C should for any reason leave her capacity as your President and director she will be paid the full amount of her annual salary for the full 5 years of her original term of office.

The predecessor for-profit organization, D, was engaged in the boarding and veterinary care of dogs and cats. All activities of the predecessor organization have been transferred to you. You became a nonprofit organization so that you can accept tax-deductible contributions which will give you the opportunity to provide education, promote animal population control, and lessen animal cruelty. You plan to provide public awareness on the need for spaying and neutering animals, free or reduced boarding and veterinary care for stray and rescued animals, and financial support for other like-minded organizations. Your activities will be advertised through your website, social media, radio and newspaper advertising, and personal contacts with other organizations and customers. Your activities will mainly be funded through net receipts from boarding, grooming, and veterinary care of dogs and cats.

Your website, Q, provides the following information about the services that you offer:

- **Boarding and Daycare:** Your facility includes background music, television, central heat and air conditioning, video surveillance, and proper staff to guest ratio. You also have J penthouse suites (large suites with plenty of sunlight, heated floors, and a TV and DVD player) for dogs and K suites for cats.
- **Grooming services** that include cuts, nail trim, ear cleaning, and bathing.
- **Fitness and Spa treatments** for pets that include a heated spa, treadmill, and other fitness equipment for aerobic conditioning as well as strength and balance/coordination training. Pet massage is also offered for relaxation.
- **Training:** Puppy and adult classes are offered.
- **Veterinary Hospital:** Your veterinary services are currently unavailable but you will restart the following services as soon as you can: complete range of medical/surgical care, dentistry, spay and neuter, vaccinations, wellness programs, and diet and nutrition. Your veterinary hospital has a fully stocked pharmacy, recovery and hospitalization rooms, computerized lab equipment and a digital x-ray.
- **Party Hall:** Individuals can host their pet's special occasion at your party hall. You will arrange for a cake and decorate the hall.

You charge the following fees for your services:

- **Daycare**
  - u dollars for a full day of daycare (7a.m.-7p.m.) or n dollars per hour per dog
  - x dollars for a 30 day daycare package for the first dog and w dollars for additional dogs
- **Boarding**
  - t dollars – v dollars per night for dog boarding depending on the size of the room and the number of dogs
  - r dollars per night for a cat condo
  - z dollars per month for a monthly boarding package for dogs and y dollars per month for cats
- **Party Room**
  - First 2 hours free

- p dollars per hour after the first 2 hours
- Pool Deck
  - s dollars an hour for up to 3 dogs
- Dog Park
  - m dollars per hour per dog

Fees for the services listed above are based on those of existing boarding facilities in your area. However, your boarding charge for rescue animals is q dollars per day. You plan to board those animals for free once you have hired a veterinarian and can solicit donations. You average around 15-20 animals per day, with 2-3 of those being rescue animals.

All of your employees receive g off of services. Friends and family receive h off of services and employees of G, a for-profit organization owned by B and C, receive j off of services.

## **Law**

Section 501(c)(3) of the Internal Revenue Code provides, in part, for the exemption from federal income tax of organizations organized and operated exclusively for charitable, religious, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501.

Section 1.501(c)(3)–1(a)(1) of the Income Tax Regulations provides that an organization that fails either the organizational test or the operational test is not exempt under section 501(c)(3) of the Code.

Section 1.501(c)(3)–1(c)(1) of the Income Tax Regulations provides that an organization is operated exclusively for exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3). It is not so operated if more than an insubstantial part of its activities do not further those purposes.

Section 1.501(c)(3)–1(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private individuals.

Section 1.501(c)(3)–1(d)(1)(i)(g) of the Income Tax Regulations provides that an organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated

exclusively for the prevention of cruelty to children or animals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations states that to be charitable, an organization must serve a public rather than a private interest. The organization must demonstrate that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly by such private interests. The private benefit restriction is not limited to benefits provided to insiders. Rather, the restriction applies to benefits provided to any individual, whether or not the individual is in a position to control or influence the organization. The private benefit restriction operates against all parties who receive a benefit not accorded the public as a whole.

Section 1.501(c)(3)-1(d)(2) of the Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.513-1(b) of the Income Tax Regulations provides that a trade or business includes any activity which is carried on for the production of income from the performance of services.

Rev. Rul. 73-127, 1973-1 C.B. 221, states a nonprofit organization that operates a cut-price retail grocery outlet and allocates a small portion of its earnings to provide on-the-job training to the unemployed does not qualify for exemption from income tax.

Rev. Rul. 73-587, 1973-2 C.B. 192, states that the income derived by an exempt organization, organized and operated for the prevention of cruelty to animals, from providing pet boarding and grooming service for the general public is income from unrelated trade or business under section 513 of the Code.

In Rev Rul. 74-194, 1974-1 C.B. 129, A nonprofit organization formed to prevent the overbreeding of cats and dogs by providing funds to pet owners who wish to have their pets spayed or neutered but cannot afford the cost of such operations qualifies for exemption under section 501(c)(3) of the Code.

In Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that an organization must be devoted to exempt purposes exclusively. This plainly means 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 Commissioner, 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. These factors include:

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

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In Schoger Foundation v. Commissioner, 76 T.C.380 1981, the court wrote, if an activity serves a substantial nonexempt purpose, however, the organization does not qualify for exemption even if the activity also furthers an exempt purpose.

### **Application of Law**

You were not formed exclusively for charitable or educational purposes under section 501(c)(3) of the Code and you do not meet the operational test under section 1.501(c)(3)-1(a)(1) of the Regulations. You plan to provide public awareness on the need for spaying and neutering animals, free or reduced boarding and veterinary care for stray and rescued animals, and financial support for other like-minded organizations which are all charitable under section 1.501(c)(3)-1(d)(2) of the Regulations. However, these activities make up an insubstantial part of your overall activities. Your primary activities are those which you took over from the predecessor for-profit organization and include providing pet boarding and veterinary services to the public for a fee. You have made no significant changes from the operations of the for-profit entity other than using the proceeds to educate the public on the benefit of neutering and spaying animals and providing reduced cost boarding to rescue animals. Per Section 502(a) of the Code, you are not exempt from taxation because you are operated for the primary purpose of carrying of a trade or business for profit.



By providing awareness on the need for spaying and neutering animals you are similar to the organization in Rev. Rul. 74-194. However, unlike the organization in Rev. Rul. 74-494, this is not your primary activity and only an insubstantial portion of your activities is devoted to the prevention of cruelty to animals.

You are similar to the organization in Rev. Rul. 73-127 because the operation of your pet boarding, veterinary, fitness and spa, and grooming services is an independent objective of your organization. Although a portion of your revenue may be used provide public awareness on the need for spaying and neutering animals, free or reduced boarding and veterinary care for stray and rescued animals, or financial support for other like-minded organizations, the boarding, veterinary, fitness and spa, and grooming services are conducted on a scale larger than is reasonably necessary for the performance of your educational and charitable activities.

You are similar to the organization in Rev. Rul. 73-587 in that you are providing pet boarding, fitness and spa, and grooming services, as well as veterinary services, to the public for a fee. These ordinary commercial services make up a substantial portion of your activities and have no relationship to the prevention of cruelty to animals under Section 1.501(c)(3)-1(d)(1)(i)(g) of the Income Tax Regulations. The services are being provided to animals which are neither unwanted nor the victims of any form of inhumane treatment. Only an insubstantial amount of services are provided to animals from rescue organizations. Therefore, the pet boarding, grooming, fitness and spa, and veterinary services do not accomplish an exempt purpose and are considered a trade or business per Section 1.513-1(b) of the Regulations.

You do not meet the requirements of Reg. 1.501(c)(3)-1(c)(1) because more than an insubstantial amount of your activities are furthering non-exempt purposes. Your operation includes pet boarding, grooming, fitness and spa, and veterinary services to the public for a fee. You are similar to the organization in Better Business Bureau of Washington, D. C., Inc. v. United States, in that you have a substantial commercial purpose to provide pet services for a fee, an activity which is not in furtherance of any exempt purpose within the meaning of Section 501(c)(3). You are also similar to the organization in B.S.W. Group, Inc. v. Commissioner because your primary purpose is commercial. Your pet services resemble a trade or business that is ordinarily carried on by commercial ventures organized for profit. You charge fees for your services that are based on those of existing boarding facilities in your area.

You are also like the organization in Living Faith Inc. v Commissioner because you are operating as a business and are in direct competition with all other businesses that provide pet services in the area. You are a successor to a for-profit entity and have made no substantial changes in the way you are conducting business. You charge fees at market rates, use the same facility, and are being managed by the same individuals.

Per section 1.501(c)(3)-1(c)(2) of the Regulations, an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private individuals. A portion of your earnings may inure to C if she leaves her position as President because your organization is

guaranteeing compensation of the first five years of service even if C should for any reason leave her capacity as President and director of your organization. Additionally, per section 1.501(c)(3)-1(d)(1)(ii) of the Regulations, an organization must serve a public rather than a private interest. By providing discounted services to your employees, friends, family, and employees of G, you are serving private interests.

Like Schoger Foundation v. Commissioner, 76 T.C. 380 1981, your organization serves a substantial nonexempt purpose and will not qualify for exemption under section 501(c)(3) of the Code.

### **Your Position**

You will promote public awareness of the need for spaying and neutering animals, provide free or reduced boarding and veterinary care for stray and rescued animals, and provide financial support of like-minded organizations. These activities will be funded from the proceeds of boarding, grooming, and veterinary care of dogs and cats. Financial support will come from fees for services and the sale of products. You anticipate that additional funding will come from the public in the form of garage sale, bake sales and the like.

### **Service Response to Your Position**

While it is generally recognized that promoting public awareness of the need for spaying and neutering animals, providing free or reduced boarding and veterinary care for stray and rescued animals, and providing financial support of like-minded organizations constitute a charitable purpose, you have more than an insubstantial amount of activities that do not fulfill 501(c)(3) purposes. Your main activities of providing pet services for fees are commercial in nature and do not fulfill a 501(c)(3) purpose. The existence of one non-exempt purpose that is substantial in nature is cause for denial of exemption. Furthermore, an organization will not qualify for exemption if it is operated for a mixture of exempt and non-exempt purposes.

### **Conclusion**

Based on the facts and circumstances presented, we conclude that you do not qualify for recognition of exemption from federal income tax as an organization described in Section 501(c)(3) of the Code. Your pet boarding, fitness and spa, grooming services, and veterinary services are indistinguishable from similar activities of an ordinary commercial enterprise.

### **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](http://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