



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

Release Number: **201641025**  
Release Date: 10/7/2016  
UIL Code: 501.00-00  
501.36-01

Date: July 11, 2016

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,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

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: May 18, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = State

C = Date

**UIL:**

501.00-00

501.36-01

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 incorporated in the state of B on C. Your organizing document states you are organized for purposes that qualify for exemption from federal income taxes under Section 501(c)(3) of the Code and for the following specific purposes:

- to promote buying local B agricultural products within the restaurant and hospitality industry and to match the demand for B-raised agricultural products with supply from local farms;
- to serve as a clearinghouse of information regarding current supplies of agricultural products and to consult with restaurants on their options for sourcing local agricultural products;
- to develop an infrastructure for farms to get B-grown agricultural products to market in B through logistics support;
- to increase the amount of locally sourced agricultural products sold and eaten in B, boosting employment, farm revenue, and overall public health;
- to assist farms in promoting themselves to the public; and
- to advocate for the production and provision of locally grown agricultural products through legislative and policy advocacy in addition to developing grassroots support.

To achieve your stated purposes, you plan to operate food hubs across the state of B where you receive locally grown food that meets the needs of restaurants and retailers. You confirm local produce needs from restaurants and retailers and use the information to help farms in your network plan their production for the season. Once the crops are harvested, you receive them from the local farmers, repackage and then deliver them to the buyers. You provide planning, warehousing, sales, marketing, distribution and communication services to small farms so farmers can focus on growing food.

You plan to build a network of growers by visiting farms and entering into signed agreements with farmers (vendors). You initially identified over 100 small farms in B that could be potential partners and began an inventory of what agricultural products are currently being produced in B. The terms of the agreement specify certain conditions that must be met by the farmer. The agricultural products delivered to you are only products that have been grown on the farm listed in the agreement. The farmer agrees to pack the products in adherence to quality standards listed as US#1 grade and the agricultural products must be delivered to you within 24 hours of harvest. You also have the right to refuse product that does not fall into a US#1 grade category.

You explained that there is a demand by both restaurants and local farmers for your services. Local farmers have very little time to market themselves, to engage with social media, to build websites, or to reach out to restaurants directly. Most end up taking their harvest to regional brokers where they know it will be loaded into trucks and taken all over the country. Chefs and restaurant operators would like to be able to explain where the ingredients in their dishes originate. The restaurants and retailers you sell to know that local food that was picked recently tastes better, has more nutrients, is more genetically diverse, generally safer, easier on the environment and supports the local economy. Operating food hubs in areas across the state also assists with transportation costs for small farmers, restaurants and retailers.

Your start-up funding will be from a small group of donors and pending grant applications. You described yourself as unlike many nonprofit organizations that have to annually raise funds. You plan to become self-sustaining by the end of your third year of operations by selling your products to restaurants and retailers.

#### **Law**

Section 501(c)(3) of the Code provides that corporations may be exempted from tax if they are organized and operated exclusively for charitable or educational purposes and no part of their net earnings inures to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) provides 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.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) 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). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

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

In Rev. Rul. 72-369, 1972-2 C.B. 245, an organization was formed to provide managerial and consulting services for organizations described in Section 501(c)(3) of the Code to improve the administration of their charitable programs. The organization enters into agreements with unrelated Section 501(c)(3) organizations to furnish managerial and consulting services on a cost basis. This ruling stated that:

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test,' the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of Section 501(c)(3) and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of Section 501(c)(3). Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

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 court found that a corporation formed to provide consulting services did not satisfy the operational test under Section 501(c)(3) of the Code 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. The court stated that although an organization is not disqualified from tax-exempt status solely because its primary activity constitutes a business, when it conducts a business with an apparently commercial character as its primary activity, "that fact weighs heavily against exemption." The court also found that "competition with commercial firms is strong evidence of the predominance of non-exempt commercial 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) of the Code. 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 included:

- 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 Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for an exempt purpose. The court stated that among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.

### **Application of law**

You are not described in Section 501(c)(3) of the Code because you are not operating exclusively for charitable purposes as required under Treas. Reg. Section 1.501(c)(3)-1(a)(1). You were formed to promote local agricultural products within the restaurant and hospitality industry by establishing and operating food hubs across the state.

You are not described in Treas. Reg. Section 1.501(c)(3)-1(c)(1) because more than an insubstantial part of your activities are devoted to non-exempt purposes. The provision of food hubs that assist with warehousing, marketing, repackaging, sales and distribution services are not charitable, educational or religious activities within the meaning of Section 501(c)(3) of the Code. You are not described in Treas. Reg. Section 1.501(c)(3)-1(d)(2) because your activities do not further a charitable or educational purpose. Your clientele consists of farmers, restaurants and retailers.

You are like the organization described in Rev. Rul. 72-369 because you are operating in a commercial manner. A substantial portion of your activities consists of soliciting agreements with farmers in order to receive timely delivery of agricultural products that are repackaged and sold to restaurants and retailers. You provide warehousing, sales, marketing and distribution services. Although you did not specify the fees for your services, you plan for your food hubs to become self-sustaining by selling agricultural products to restaurants and retailers. The organization described in this ruling was conducting commercial services only for organizations exempt under Section 501(c)(3) of the Code and was still found to be conducting commercial activities. The fact that you sell agricultural products to restaurants and retailers shows that you are operated in even more of a commercial manner than the organization described in this ruling.

Because you are primarily engaged in the collection, repackaging and resale of agricultural products you are not operating for one or more exempt purposes. To be exempt under Section 501(c)(3) of the Code, an organization must be both organized and operated for one or more exempt purposes specified in the section. Although “exclusively” does not mean “solely” or “without exception,” the presence of a single nonexempt purpose, if substantial, will preclude exemption regardless of the number or importance of exempt purposes. Better Business Bureau. 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 purposes specified in Section 501(c)(3).

You are operating like the organization in B.S.W. Group because you are substantially engaged in the commercial activity of receiving, repackaging, marketing and selling agricultural products. Much like the organization described in In Living Faith you are operating as a business and are in direct competition with other agricultural wholesale businesses. In addition, you will be entirely self-sustaining by selling your repackaged products to restaurants and retailers. These activities constitute the conduct of a commercial business of the sort which is ordinarily carried on by enterprises organized for profit.

In Airlie Foundation the court relied on the “commerciality” doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for an exempt purpose. In the same way, you are operating for nonexempt commercial purposes and do not qualify for exemption under Section 501(c)(3) of the Code.

**Your position**

You explained that you work with B farmers who wish to sell agricultural products to restaurants and retailers in their region. Currently there are no mechanisms available for farmers to connect with local restaurants or hospitality venues. Through the food hubs you provide a service that helps farmers sell to local restaurants or hospitality venues. Otherwise, farmers are forced to sell to large, regional organizations which may resell their produce in markets nationally or internationally. You also assist with transportation costs for small farmers, restaurants and retailers by establishing food hubs in various regions across the state. You will be a bridge between individual farmers and businesses.

**Our response to your position**

Although you provide a service for local farmers, restaurants and retailers, your operations are commercial in nature and do not achieve a charitable purpose.

**Conclusion**

Based on the facts and information provided, you are not operated exclusively for exempt purposes. Rather, you are operating for substantial non-exempt commercial purposes and do not qualify for exemption under Section 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](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure:  
Publication 892