



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Release Number: **201645017**
Release Date: 11/4/2016
UIL code: 501.36-00

Date: August 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: June 20, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date

C = Date

D = State

F = Organization

G = Organization

H = City

J = Date

K = Program

L = Program

x dollars = Amount

UIL:

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 were formed as a nonprofit corporation on B in the State of D. Per your Amended and Restated Charter filed on C, you were formed for the following purposes which the Charter states shall be exclusively religious, charitable, or educational within the meaning of section 501(c)(3) of the Code:

- (i) Proclaiming earnestly the gospel message and to urge its personal acceptance.
- (ii) Promoting prayer, Bible study, missions, Christian fellowship, evangelism, Christian service and encouraging, in every possible way, a lifetime commitment to Christ.

- (iii) Providing a forum in which the Gospel of Jesus Christ can be discussed with non-believers outside of a formal church setting.
- (iv) Generously extending the grace of God by giving away 100% of all profits (except those retained for capital expenditures) to community ministries, other local, national or international non-profits or organizations, or those in financial need.

Your Bylaws and Executive Summary also list the same four purposes.

The Minister of F, who is one of your founding board members, came up with the vision to form a coffee shop where believers could interact with non-believers in a safe and friendly environment to convey the Gospel in a non-confrontational manner in word and deed. You were formed as a separate entity from F in order to encourage other Christian churches and organizations to participate in your vision. F granted the funding for your start up and your board members are all members of F. Article 3, Section 2, of your Bylaws indicates that at least one of your directors must be an Elder of F. Additionally, a majority of your directors should be members of F.

Once you legally formed, you proceeded with your plan and opened a coffee shop in J using the business name G. You own the trademark to your logo and tagline. You sell coffee locally and plan to eventually sell it online as well. You state in your Executive Summary that the coffee house will exist for four purposes in your community:

1. give away 100% of profits,
2. provide a safe, inviting, and informal gathering place,
3. serve excellent coffee, espresso drinks, light fare, and
4. help revitalize downtown H.

Your Executive Summary also states that you believe the location of the coffee house is ideal for the following reasons:

- There is no other similar business in downtown.
- There is an unmet need in the downtown area for a gathering space that is open late and offers the community a safe place to gather.
- The previous renter also sold coffee and the general setup is close to what we envision as a helpful footprint.

Your website states that your mission is,

You are committed to

giving away 100% of your profits to community based non-profit organizations and individuals who are already doing great work. You decided to not create another nonprofit community organization that did what other existing organizations already do well but rather help them expand their services by providing them with financial support.

You are open Monday through Friday from 6 a.m. to 8 p.m. and Saturday from 7 a.m. to 8 p.m. You have free Wi-Fi and power outlets throughout for customer use. You use coffee that is sourced directly from coffee farmers. Therefore, the coffee you buy benefits the coffee farmers 50-100% over the price paid for "Fair Trade"

coffee. Your drink selection includes coffee, tea, smoothies, frappes, soft drinks, and juices. Your food items include baked goods, soups, sandwiches, salads, and desserts. Copies of your menu can be found on your website. The menu shows the various food and beverages you serve and the prices you charge for each. You also plan to sell your roasted coffee beans online in the future but you do not have the capability at this time. Your customers can currently purchase roasted beans at the coffee shop.

You state that at the coffee shop you provide a location for both formal and informal Bible study, church group meetings, and meetings for other organizations. So far, your location has been used for a Women's Bible Study, a Men's Bible Ministry, meetings of the Elders of F, book signings, birthday parties, baby and bridal showers, community business meetings, game nights, live music, and similar events. You do not typically charge a fee for the use of space by groups or organizations but your General Manager advises users that a "suggested" donation in the amount of x dollars per hour is welcome. You have never denied access or use of your room due to an inability to pay or a decision not to donate.

You stated that your promotion of the Gospel of Jesus Christ is subtle and indirect. Several times a year the Gospel has been promoted through a program referred to as "L". This program consists of a donor paying for a certain amount of coffee in advance. Then, when a customer comes in they are told by the staff that the coffee has already been paid for and, "that the coffee is not "free" but that the price has already been paid for it – *just like Jesus already paid the price for all of our sins by dying on the cross for us.*"

You also have your "Monthly Mission" where you partner with other ministries, missionaries, and non-profit organizations by regularly highlighting their activities to help raise funds, supplies, and recognition for them. You select a "partner" and provide information about the person or organization to your customers on display in your shop, on social media, and at F. You also collect donations for your partner. This has occurred on a quarterly basis. You have also been able to give away some items to other organizations for their fundraising events. You have donated coffee and gift baskets. You also give away meals and drinks to the homeless and help connect them with local ministries for lodging and jobs.

You previously took part in a training program that helps train underserved youth by placing them in a local business for a six week internship so they can gain firsthand experience.

You have participated with F in the K program which is a prison ministry that connects you and your customers to children with incarcerated parents. The program allows your customers to share gifts with the children and the true message of Christmas at a party bringing together the children, their caregivers, your staff, and customer angels at F. You have also participated in multiple community activities.

You have a Fund-giving Policy that explains how you will select the recipients of your funds. First, you have an application that organizations must complete that asks for their IRS classification, description of activities, and what they will do with the funds received. Every six months your board will review the applications and select two applicants. The two applicants selected will each receive half of the fundraising and proceeds from operations for six months. You will distribute funds to the recipient organizations every three months. There is no maximum to the amount that you will distribute but it will be limited to the money received from fundraising and the proceeds from your operations that exceed operating expenses, debts, and capital expenditures.

Your activities are run by compensated staff as well as volunteers. You estimated that approximately 15% of the total time expended toward your operations has been provided by volunteers. Volunteers help with operational aspects to promote the Gospel of Jesus Christ through service, roasting beans for G, assisting in waiting on

customers and interacting with them, and helping with the maintenance and physical needs of the shop and equipment. Your Board Members regularly participate with planning your activities and the members of F generously give to assist with your operations and utilize the coffee shop as a forum for Christian fellowship.

Almost all of your revenue is from the sale of food items. Your largest expense is for salaries and wages. You also have occupancy expenses and expenses for cost of goods sold, advertising, licenses and permits, insurance, supplies, payroll, and repairs and maintenance. You have not yet earned profits that have allowed you to give away any substantial amount of money but you hope to be able to do that in the near future. F continues to provide donations to you to assist with your operations.

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.

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

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) 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.

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 relief of the poor and distressed or of the underprivileged as well as the advancement of religion.

Rev. Rul. 68-72, 1968-1 C.B. 250, states that a nonprofit organization that operates a supervised facility to bring together young people of college age with church leaders, educators, and leading businessmen of the community may be exempt from federal income tax under Section 501(c)(3) of the Code. The organization was formed by local churches for the purpose of furthering the religious, intellectual, and moral development of persons of college age through the operation of the “coffee house”, a supervised facility where church leaders, educators, and leading businessmen of the community meet and mingle with young people in an informal atmosphere. They hold discussions on such subjects as religion, current events, and social problems. Personal counseling and vocational guidance are provided. A nominal charge is paid upon admission, but there are no additional charges for the refreshments and entertainment. The organization meets its expenses from contributions and the admission charges.

Rev. Rul. 71-581, 1971-2 C.B. 236, stated that an organization that operated a thrift store where substantially all of the merchandise sold had been contributed and where more than half of the work performed at the thrift shop was performed without compensation, may be exempt under Section 501(c)(3) of the Code. The organization was organized by a group of nonprofit organizations exempt under Section 501(c)(3). The primary purpose for which the organization was formed was to serve the group of exempt organizations by performing an essential function for them of soliciting contributions of goods on their behalf and converting the contributed goods to cash for charitable uses.

In Rev. Rul. 73-127, 1973-1 C.B. 221, the Service held that an organization that operated a cut-price retail grocery outlet and allocated a small portion of its earnings to provide on-the-job training to the hard-core unemployed did not qualify for exemption. The organization's purpose of providing job training for the hardcore unemployed was charitable and educational within the meaning of the common law concept of charity; however the organization's purpose of operating a retail grocery store was not. The ruling concluded that the operation of the store and the operation of the training program were two distinct purposes. Since the former purpose was not a recognized charitable purpose, the organization was not organized and operated exclusively for charitable purposes.

In Rev. Rul. 76-94, 1976-1 C.B. 171, an organization whose purpose is to provide a resident facility and therapeutic program for emotionally disturbed adolescents, operates a grocery store as part of its therapy program. The grocery store is supervised by a manager who is experienced in both the retail food industry and in working with disturbed adolescents. All other employees are emotionally disturbed adolescents who are participating in the organization's program. The store is operated at a level to utilize only the number of adolescents residing at the facility. The Service held that since the grocery store is almost fully staffed by the adolescent residents and is operated at a scale no larger than is reasonably necessary for the organization's training and rehabilitation program, the operation of the grocery store is not a related trade or business.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (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 American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analysis of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services included providing advice for purchases of individual securities. The Court noted that education is a broad concept, and assumed that the organization had an educational purpose. The Court concluded, however, that the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was more indicative of a business than that of an educational organization. The Court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and that the organization was not entitled to be regarded as exempt.

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 was ordinarily carried on by for-profit commercial businesses. The Tax Court stated: "We must agree with the Commissioner that petitioner's activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit."

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the court affirmed that Living Faith did not qualify for exemption under Section 501(c)(3) of the Code since it operated its restaurants and health food stores for a substantially commercial purpose. Its underlying religious purposes did not mitigate the clear commercial purpose of its operations.

In Airlie Foundation v. I.R.S., 283 F. Supp. 2d 58 (D. D.C. 2003), the District Court found that the organization was formed principally to organize, host, conduct, and sponsor educational and other charitable functions on its facilities. The organization's patrons were not limited to tax-exempt entities, but included patrons of a private

and corporate nature. The organization paid significant advertising and promotional expenses and derived substantial income from weddings and special events held at its conference center. The court determined that the organization's activities competed with a number of commercial, as well as non-commercial entities, which strongly evidenced a commercial nature and purpose. The court concluded that although the organization carried out a number of charitable and educational activities, these were incidental to its primary activity of operating a for-profit conference center.

In Zagfly, Inc. v. C.I.R., T.C. Memo 2013-29, the court held that Zagfly's primary activity, the operation of a web-based broker that would sell flowers at market rates, was not a charitable activity, but rather a commercial activity that amounts to an unrelated trade or business. Therefore, the organization did not meet the requirements of Section 501(c)(3) of the Code because its primary activity did not further a 501(c)(3) purpose.

Application of law

You are not described in Section 501(c)(3) of the Code nor Treas. Reg. Section 1.501(c)(3)-1(a)(1) because you fail the operational test. Specifically, the facts show you are not operated exclusively for Section 501(c)(3) purposes because a substantial portion of your activities consists of the operation of a coffee shop in a commercial manner.

While donating funds to other non-profit community organizations is charitable as described in Treas. Reg. Section 1.501(c)(3)-1(d)(2), your main focus is the operation of a coffee shop. Additionally, while some of the activities that take place in the coffee shop such as the "L" aim to advance religion, more than an insubstantial portion of your activities serve a commercial purpose. Per Treas. Reg. Section 1.501(c)(3)-1(c)(1), you are not regarded as "operated exclusively" for one or more exempt purposes because you do not engage primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. Your primary activity is the operation of a coffee shop in a commercial manner. You are open to the public Monday through Friday from 6 a.m. to 8 p.m. and Saturday from 7 a.m. to 8 p.m. You have free WiFi and power outlets throughout for customer use. You have space that can be used for gatherings such as meetings and parties. You have a selection of food and beverage items that can be purchased at the coffee shop. Your hours and menu can be found on your website and your Executive Summary indicates that you believe the location of the coffee house is ideal because there are no other similar businesses downtown. Therefore, the operation of your coffee shop to raise funds is a commercial activity, not a charitable activity.

Additionally, 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 of a coffee shop consists of providing food and beverage 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 operate a coffee shop 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 coffee shop resembles a trade or business that is ordinarily carried on by commercial ventures organized for profit. You chose your location because there is no other similar business downtown. You charge fees for your food and beverages and plan to eventually sell your coffee beans online.

You are distinguishable from the organization in Rev. Rul. 68-72 in that the majority of your activities are to operate your coffee shop in a commercial manner. The organization in Rev. Rul. 68-72 ran a supervised facility where church leaders, educators, and leading businessmen of the community met and mingled with young people in an informal atmosphere. They held discussions on such subjects as religion, current events, and social problems. Personal counseling and vocational guidance were provided. You do not conduct any regular

religious or educational activities at your facility. While activities such as Bible studies may be conducted at your coffee shop, they are not conducted by you. They are conducted by groups that are coming to use your space. You allow your space to be used by the public for all activities, not just those that are religious, charitable, or educational. For instance, business meetings, birthday parties, and baby and bridal showers have all taken place at your coffee shop. Additionally, unlike the organization in Rev. Rul. 68-72 that charged a nominal admission fee but did not charge for refreshments or entertainment, you charge for the food and beverages at your shop. The majority of your expenses which are devoted to the operation of the coffee shop are met by the funds from these sales.

You are distinguishable from Revenue Ruling 71-581 in that the products sold at your coffee shop are not donated and only 15% of the work performed at the coffee shop is from volunteers. While you may have the common goal of donating the funds you make for charitable purposes, you stated that you have not yet earned profits that have allowed you to give away any substantial amount of money. Even if you do, contributing net profits to charity does not make a business exclusively charitable.

You are similar to the organization described in Rev. Rul. 73-127 because the operation of the coffee shop and your programs to further the Gospel of Jesus Christ, partner with other organizations, and participate in community activities are separate and distinct activities. Since the operation of the coffee shop is a substantial part of your activities and is not a recognized charitable purpose, you are not organized and operated exclusively for 501(c)(3) purposes.

You are not similar to the organization ruled in Rev. Rul. 76-94 because the operation of your coffee shop is your main function and your planned religious and charitable programs are secondary to your overall coffee shop activities.

You are similar to the organizations described in the American Institute for Economic Research v. United States, B.S.W. Group, Inc. v. Commissioner, Airlie Foundation v. I.R.S., Living Faith, Inc. v. Commissioner, and Zagfly, Inc. v. C.I.R. because you have a significant non-exempt commercial purpose. You are operating a coffee shop that is open to the public six days a week in competition with other commercial markets. This is indicative of a business. Your primary sources of revenues are from coffee shop sales. Your expenses are mainly for salaries, cost of goods sold, and occupancy expenses to support the operation of the coffee shop. Taking in totality, the operation of your coffee shop constitutes a significant non-exempt commercial activity.

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 coffee shop activities 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. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Director, Exempt Organizations

Enclosure:
Publication 892