

Internal Revenue Service

Appeals Office
San Jose Appeals, MS-7100
55 S. Market St., Suite 440
San Jose, CA 95113

Release Number: **201702041**

Release Date: 1/13/2017

Date: October 17, 2016

Department of the Treasury

Employer Identification Number:

Person to Contact:

Employee ID #:

Tel:

Fax:

UIL:

501.36-00

501.36-01

Certified Mail

Dear :

This is a final adverse determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Code section 501(c)(3).

The adverse determination was made for the following reason(s):

You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code § 501(c)(3) and Treasury Regulation § 1.501(c)(3)-1. While you conduct some educational and charitable activities, your primary activity is operation of food service establishments, a presumptively commercial activity, in a manner similar to comparable for-profit establishments.

Contributions to you are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892



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

Date: September 9, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B= Program
C= Program
D= Program
E= Organization
F= Program
G= Organization
H= Restaurant
K= Date
L= Program
M= State
N= Program
P= Restaurant
Q= Restaurant
R= Program
S= Program
T= Board Member
U= Board Member
V= Board Member
W= Board Member
X= Number
Y= Number
Z= Number
J dollar= Amount

UIL:

501.36-00
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 (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 stated below.

Facts

You formed as a nonprofit unincorporated association. Your organizing document states that your purpose is to, "Become West M's first public, 501(c)(3) Charitable Organization that re-innovates charity by helping an area where the unemployment rate is higher than the State and National averages through lessening Government burdens by providing financial assistance to volunteers, helping local vendors by using their products, helping Communities with the battle of obesity by serving locally grown ingredients in healthy, freshly prepared meals, helping others in need by donating to similar charities with known community service programs, helping domestic violence victims transition into world-impacting survivors through L, and helping end domestic violence by educating the public to the ugly truths about the #1 under-reported crime in the world, how to end it, and who to contact for help ." Your goals include teaching students and the public that violence is a choice and providing victims with the opportunity to safely transition to survivors through the L.

You plan to operate several programs, the first of which is the L where you will assist victims of domestic violence with transitional tools. You will begin this program once enough funds have been raised. Your second program is the R where you educate students about teen dating and domestic violence and provide resources to those who need help. You also have an S where you educate and provide resources to the general public.

Your previous work in the service industry showed you that people want to be rewarded for spending money so you came up with a concept of, "rewarding 'customers' with tax deductible receipts in areas where they are already spending the money as a 'thank you' for helping the foundation reach its goals of ending domestic violence and re-innovating charity through its N." Your N will be your primary source of funding and consists of the operation of two restaurants, P and Q. You have signed five year lease agreements for each of these locations and they will be "farm to table" public eateries. Through these restaurants, you will purchase goods from local vendors, serve locally grown ingredients, and compensate "volunteers" for the work they perform at the restaurants. You state that you will reward "customers" with tax deductible receipts for spending money on freshly prepared meals. Your financial projections show that approximately Y percent of your revenue will come from the restaurants and approximately Z percent of your expenses will be for salaries and wages. X percent of your monthly revenue will be donated to other organizations that are dedicated to helping others in need. In the future, you hope to expand your fundraising activities to include two additional N, one in the wedding industry and another in the entertainment industry.

Other fundraising activities you conduct include accepting donations on your website, holding a 5K run/walk, holding raffles for prizes, and soliciting donations via mail, email, and in person.

There are currently four members of your Board of Directors. The two founders, T and U, are married and serve as Co-Presidents. They have a combined experience of 46 years in the service and hospitality industries. The two remaining board members, V and W, are also married. Once the N are open to the public, T and U will

dedicate all of their time and efforts to operating the programs. V and W will also work full time for you once your finances are able to provide reasonable compensation for them.

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 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(c)(1) of the Regulations provides that an organization will be regarded as “operated exclusively” of one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(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 1.501(c)(3)-1(d)(3) of the Regulations provides that the term “educational” refers to the instruction or training of the individual for the purpose of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

In Rev. Rul. 69-177, 1969-1 C.B. 150, the Service held that an organization, wholly owned by a tax exempt college, that manufactures and sells wood products primarily to employ students of the college to enable them to continue their education does not qualify for exemption under section 501(c)(3) of the Code.

In Rev. Rul. 71-581, 1971-2 C.B. 236, the Service held that the operation of a separately incorporated thrift shop to raise funds for a group of organizations exempt under section 501(c)(3) of the Code qualifies for exemption under section 501(c)(3) of the Code. Substantially all of the goods in the thrift shop had been donated and more than half of the work was performed without compensation.

In Rev. Rul. 73-127, 1973-1 C.B. 221, the Service held that 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 the hard-core unemployed does not qualify for exemption from income tax.

In Rev. Rul. 76-94, 1976-1 C.B. 171, the Service held that an exempt organization's operation of a retail grocery store as part of its therapeutic program for emotionally disturbed adolescents, almost fully staffed by the

adolescents, and on a scale no larger than was reasonably necessary for the performance of the organization's exempt functions, was not unrelated 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 Nelson v. Commissioner, 30 TC. 1151 (1958), the court held that an applicant for tax exempt status under section 501(c)(3) has the burden of showing it "comes squarely within the terms of the laws conferring the benefit sought."

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 providing advice for purchases of individual securities. The Court concluded 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 Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the Court of Appeals upheld a Tax Court decision, T.C. Memo. 1990-484, that an organization operating restaurants and health food stores in a manner consistent with the doctrines of the Seventh Day Adventist Church does not qualify under section 501(c)(3) of the Code. The court found substantial evidence to support a conclusion that the organization's activities furthered a substantial nonexempt purpose, including:

- a. The organization's operations were presumptively commercial;
- b. The organization competed directly with other restaurants and food stores;
- c. The organization used profit-making pricing formulas common in the retail food business;
- d. The organization engaged in a substantial amount of advertising;
- e. The organization's hours of operation were competitive with other commercial enterprises; and
- f. The organization lacked plans to solicit donations.

Application of Law

Your L, R, and S consist of educating individuals about domestic violence and assisting victims of domestic violence. L, R, and S all serve charitable and educational purposes and fall under sections 1.501(c)(3)-1(d)(2) and 1.501(c)(3)-1(d)(3) of the Regulations. However, your N, which are your primary activities, consist of operating restaurants to raise funds and are not charitable or educational. For instance, compensating individuals, whom you described as volunteers, for the work they perform preparing and serving meals is not considered a "charitable" activity. Therefore, you are not described in section 1.501(c)(3)-1(a)(1) of the Regulations because you are not both organized and operated exclusively for charitable, educational, or religious purposes as specified in section 501(c)(3) of the Code.

You are not described in section 1.501(c)(3)-1(c)(1) of the Regulations because more than an insubstantial part of your activities, specifically the operation of two restaurants, is devoted to non-exempt purposes. Similarly, the operation of the restaurants is your primary activity and it is unrelated to, and not in furtherance of, your other charitable and educational activities.

You are similar to the organization in Rev. Rul. 69-177 that operated a business to obtain funds for scholarship purposes to enable individuals to continue their education. You are also operating businesses, your restaurants, in order to raise funds for your scholarship program. Engaging in a trade or business to obtain funds for the L is not an exempt activity merely because the profits will be used for this program.

You are also similar to the organization in Rev. Rul. 73-127. Like the organization in Rev. Rul. 73-127, several of your activities such as educating individuals about domestic violence and assisting victims of domestic violence are charitable and educational. However, you also have activities, the operation of your restaurants, that are commercial in nature and do not fulfill a charitable or educational purpose. Your operation of the restaurants does not fall under section 501(c)(3) of the Code.

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

You are similar to the organizations described in the American Institute for Economic Research v. United States and Living Faith, Inc. v. Commissioner. You plan to operate two restaurants in competition with other for-profit restaurants. Your restaurants are viewed as commercial. Your sources of revenues are mainly from restaurant sales and your expenses are mainly for the restaurant operation. Taken in totality, your restaurants are a significant non-exempt commercial activity that is not incidental.

As held in Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), a single non-exempt purpose, if substantial, will preclude tax exemption under section 501(c)(3) of the Code. The operation of your restaurants, a substantial part of your activities, is a non-exempt purpose; therefore, you are not operating exclusively for an exempt purpose as described in Section 501(c)(3) Code.

According to the findings in Nelson v. Commissioner, you have the burden of proving that you satisfy the requirements of the particular exemption statute. Whether you meet this requirement is a statement of fact. The facts indicate that your primary activity is the operation of restaurants that are similar to other for-profit restaurants. Thus, you do not qualify for exemption under Section 501(c)(3) Code.

Applicant's Position

You state your activities are charitable because it is your goal to help the less fortunate. You financially compensate volunteers for their services to help maintain your charitable status while lessening the population's need for government assistance. You also supply resources to those in need. You will develop qualified teams to teach students and the public about violence prevention. You will also develop age appropriate material for younger children and provide resources to victims.

Service Response to Applicant's Position

Although several of your activities consist of educating students and the public as well as providing resources to victims, which are charitable and educational in nature, your main activity consists of operating two restaurants, which are in competition with other for-profit restaurants in the area. Your restaurants are commercial in nature and not described under Section 1.501(c)(3)-1(a)(1) of the Regulations. Additionally, compensating individuals, whom you describe as volunteers, for the work they perform in the restaurants is not a charitable activity.

Applicant's Protest

You state that your community development programs fulfill the requirements of section 1.501(c)(3)-1(d)(2), section 1.501(c)(3)-1(d)(3) and section 1.501(c)(3)-1(c)(1). You state that your charitable mission is different than the findings in Living Faith, Inc. v. Commissioner because your operations are to primarily help the disadvantaged and educate the public. You cannot compete with commercial restaurants due to the fact that your hours of operation are based upon volunteer schedules. You must use a type of profit making pricing formula similar to those in the retail food business to ensure that expenses are covered and disadvantaged employees have a paycheck. Additionally, your advertising is solely for fundraising purposes to solicit donations and you solicit for donations at your fundraising locations/resource centers.

Your fundraising locations/resource centers, P and Q, provide the public with opportunities to donate to charities and provide resources regarding how to recognize the signs of dating abuse and family violence and who to contact for help. At your N, P, and Q you have monitors that show PowerPoint presentations that solicit donations and provide electronic resources and foundation information. You also have televisions that display local, national, and global resources and information about resources for help is located in the public restrooms. There is also free WIFI and I-Pad use as well as free cell phone charging. Your N, P and Q, also provide the recipients of L with employment. Disadvantaged "volunteers" are employed at P and Q and your sponsors are advertised on the back of their uniforms. You submitted a menu for Q which shows a variety of breakfast and lunch items and lists the hours for Q as Monday-Friday from 7a.m.-8p.m. and Saturday 8a.m.-4p.m.

You added several new activities:

- B: You collect gently used and new clothing and basic necessities at your fundraising locations/resource centers for those in need at local domestic violence and homeless shelters.
- C: You teach youth the aspects of growing, producing, and maintaining sustainable food systems and participants can explore career possibilities in various aspects of food preparation. Eligible participants can also become employees at your fundraising locations/resource centers. The produce grown under this program is provided to the public for donations for meals at your fundraising locations/resource centers.
- D: At your fundraising locations/resource centers you provide healthy food produced by local farmers and C to individuals who want a home-cooked meal in a restaurant type environment.
- F: This program is currently under development and will be a 5 week summer camp program for at risk children of family violence, sexual abuse, and neglect. It will be funded from donations and from your fundraising locations/resource centers.

Service Response to Applicant's Protest

Several of your programs such as B, F, L, R, and S are charitable and educational and meet the requirements of section 1.501(c)(3)-1(d)(2) and section 1.501(c)(3)-1(d)(3) of the Regulations. C has an educational component, but also benefits P and Q by providing produce that is used for meals. Additionally, there is education provided at P and Q through the televisions, monitors, and signs, but it is insubstantial compared to the operation of the restaurants.

You do not meet the requirements of section 1.501(c)(3)-1(c)(1) of the Regulations because you are not operated exclusively of one or more exempt purposes. You do not primarily engage in activities which accomplish one or more exempt purposes specified in section 501(c)(3) of the Code. Your main activity, the operation of your N, P and Q, is commercial in nature and is not in furtherance of an exempt purpose. You are open daily during daytime hours and the restaurant space can be reserved for meetings on Sundays. Your hours of operation are competitive with other commercial enterprises and you therefore compete directly with other restaurants. The menu submitted for Q is a typical menu with a listing of the food you serve with the corresponding price. Meals range from j dollars with additional charges for side items and additions. Aside from the listing and pricing of meals, the menu states that you are a fundraising location for the G and that 100% of the net proceeds are donated to L for survivors of family and violence. Operating restaurants to raise funds is not a charitable activity.

The educational and charitable activities your organization conducts make up an insubstantial part of your overall activities. Your primary activity is the daily operation of the restaurants. Engaging in a trade or business to obtain funds for your other educational and charitable activities is not an exempt activity merely because the profits will be used for those programs. Additionally, compensating individuals, whom you described as volunteers, for the work they perform preparing and serving meals is not considered a charitable activity. Your activities are commercial in nature and not described under section 1.501(c)(3)-1(a)(1) of the Regulations.

Applicant's Second Protest

You state that as of K the only programs that you will be conducting are those mentioned in your protest letter. All others were vetoed by your governing board. You will H, a fundraising and resource center. You will also have the L which now consists of allowing children of family violence, sexual assault, and neglect the opportunity to attend F for free. The children will then be eligible to apply for college grants from you in their senior year of high school that will be renewable based on grades and continued education. For adults, you will be offering much needed employment to survivors of family violence. You will not be branching out into the wedding or entertainment industries for monetary donations because you were unable to acquire the historic location.

You explain that the first stages of seeking help from family violence are the most dangerous. When you put take out menus from H into the hands of the public, M's 24 hour crisis hotline number is printed on them so when a victim is ready he/she can seek the help needed. You reinvent charity and combine providing on the job training to the disadvantaged with the desire to help end violence in your community. You offer reasonably priced meals prepared by survivors of abuse.

You compare yourself to E whose activities include thrift shops and argue that the only difference between you is donated food being prepared and served by the disadvantaged compared to donated used items refurbished

and sold by the disadvantaged in order to fundraise and support each charity. You state, "Both charities "compete" with non-charitable/commercial businesses. To help raise financial support for both charities, each have set "hours of operation" and set, individual, itemized donation "pricing" that helps provide a "hand-up" in the form of financial resources to the disadvantaged earning their living and improving their qualities of life instead of being forced to beg for a "hand-out" and depend on Government Welfare for their livelihoods." You state that you mimic E's charitable mission of providing employment to the disadvantaged. You indicate that you both provide the disadvantaged with opportunities for employment and extended education that improves the quality of life and you both collect new and gently used items. You are educational because you provide information about family violence and dating abuse to the public. You are different from E because you have your charitable program B which gives to those in need who do not have the money to replace the necessities left behind or for food. You are also different because you provide the public with information and technology and you offer healthy meals prepared by survivors of family violence who desire to better their community by breaking the cycle of abuse. The money from meals purchased provides support for C, a charitable program for underserved public schools that promotes extended education and offers dating violence resources to students. Proceeds are also used to help a lunch ministry for disadvantaged children.

Service Response to Applicant's Second Protest

You compared yourself to E, a thrift shop. However, you are not like the organization in Rev. Rul. 71-581 that operates a thrift shop. Unlike the organization in Rev. Rul. 71-581, your activities at P and Q are conducted by compensated individuals, not volunteers. In fact, approximately Z% of your revenue will go toward salaries and wages. Additionally, all though you mention donated food in your protest, you previously stated that P and Q would be "farm to table" public eateries and you would purchase goods from local vendors for the restaurants. Therefore, unlike the organization in Rev. Rul. 71-581, you are not selling donated items. You are purchasing items from local vendors for the meals that you sell to the public.

You are also like the organization in Living Faith, Inc. v. Commissioner. Your restaurants P and Q serve a substantial nonexempt purpose. Although you do use the restaurants to provide some educational and charitable items to the public, the main activity of the restaurants is providing food to the public for a fee. P and Q are open daily and are in direct competition with other restaurants. Although you state you will provide a meal for free if someone cannot afford it, your normal prices, or suggested donations for the food items, are in line with other retail food businesses. Your sources of revenues are mainly from restaurant sales and your expenses are mainly for the restaurant operations. Your activities are commercial in nature and not described under section 1.501(c)(3)-1(a)(1) of the Regulations.

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 restaurant activities are indistinguishable from similar activities of an ordinary commercial enterprise. Accordingly, you must file federal tax returns and contributions to you are not deductible under section 170 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,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892