



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

Release Number: **201702042**  
Release Date: 1/13/2017  
UIL Code: 501.03-05  
501.35-00  
501.36-00

**Date:** October 17, 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: August 23, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = Director  
C = Director  
D = Director  
E = Director  
F = Foundation  
G = Food Bank  
X = Date  
Y = State  
p = Amount  
q = Amount  
r = Amount

**UIL:**

501.03-05

501.35-00

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 stated below.

**Facts**

You were incorporated on X in the state of Y.

Your Articles of Incorporation indicate that: "Said organization is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under the section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code. The business activity for said organization is as follows: For every shirt that is purchased, we will donate one to someone in need. With all profits, we will donate custom shirts to nonprofits who were looking to purchase them".

Your planned activities as described in your Form 1023 application are to design and sell clothing online to consumers. For every article of clothing sold, you will donate a similar article of clothing to those in need. You

plan to reach out to F to set up an arrangement where you can provide clothing and or money to the vets. If there is any money left, you plan to donate it to those in need or to G. You will start off by selling your designed t-shirts and then expand to all product categories. Your sales activities consume 100% of your time and will take place 24 hours a day, 7 days a week since you are an online business. However, your website has not been built yet.

B, C, D, and E are your officers and/or directors, all of whom are compensated. B and E will be compensated for q dollars and C and D will be compensated for r dollars in 2017.

You state that you will initially advertise your activities through grass roots marketing, word of mouth, email, social media, and personal contacts. You will be funded through T-shirt sales and donations from family, friends, and general public. The shirts will be sold at 150% above cost. The main goal is to raise funds through everyday purchases/sales to provide to those in need.

Your planned revenue for 2017 is p dollars which is from the sales of your products. You do not expect any donations in 2017. You further state that donations are welcomed but they do not help you to be successful in the industry. Any charitable donations received will be applied 100% toward helping others in need and not toward the operational costs of the business.

Your projected expenses include officers'/directors' salaries, professional fees, program, promotional items, office supplies, internet, delivery and postage, shirt costs, printing and transportation costs including gas, lodging, etc.

Your additional information states that you plan to distribute t-shirts to homeless persons as you run into them. Your officers and directors will carry shirts with them just in case they see someone who is homeless. You also plan to develop future partnerships with other organizations to extend your reach to more individuals. You describe a needy person as someone who does not have the ability to purchase the clothing for himself or herself.

#### **Law**

Internal Revenue Code (IRC) Section 501(c)(3) exempts from federal income tax: corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, 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) provides that, in order to be exempt as an organization described in IRC Section 501(c)(3), 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 charitable purposes only if it engages primarily in activities that accomplish one or more of the following purposes: religious; charitable; scientific; testing for public safety; literary; educational; fostering national or international sports competition; and prevention of cruelty to children or animals. It is not so operated if more than an insubstantial part of its activities do not further these purposes.

Treas. Reg. Section 1.501(c)(3)-1(d)(2) provides that the term “charitable” is used in IRC Section 501(c)(3) in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes.

Treas. Reg. Section 1.501(c)(3)-1(e) provides that an organization may meet the requirements of IRC 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 purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

Revenue Ruling 68-167, 1968-1 C.B. 255 held that a nonprofit organization formed to market the cooking and needlework of needy women may be exempt from federal income tax under IRC Section 501(c)(3). The organization relieved the poor and distressed and operated in a noncommercial manner.

Revenue Ruling 71-581, 1971-2 C.B. 236 held that the operation of a separately incorporated thrift shop to raise funds for a group of specified exempt organizations may qualify for exemption under IRC Section 501(c)(3). Substantially all of the merchandise sold had been contributed and more than half of the work in operating the thrift shop was performed without compensation. The primary purpose of the organization was to serve the group of exempt organizations that created it by performing an essential function for them; that is, to solicit contributions of goods on behalf of the exempt organizations and to convert the contributed goods to cash for charitable uses with a minimum of expense by the use of volunteer labor.

Revenue Ruling 73-127, 1973-1 C.B. 221 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 to the hard-core unemployed does not qualify for exemption under IRC Section 501(c)(3).

Revenue Ruling 73-128, 1973-1 C.B. 222 held that while charitable organizations may engage in commercial endeavors for the production of income to be used for carrying on charitable programs and activities, the manufacture and sale of commercial items as an end in itself does not constitute a charitable purpose. However, the provision of vocational training and guidance to the unskilled and under-employed may qualify as a charitable purpose so long as the manner of its achievement is otherwise charitable.

Revenue Ruling 75-472, 1975-2 C.B. 208 held that an organization that operated a halfway house and at the same time operated a furniture shop, any profits realized from the furniture shop operations were applied toward the cost of operating the halfway house, and the furniture shop’s activities were related to the organization’s exempt purposes. Therefore, the organization qualified for tax exemption and its income was not treated as unrelated trade or business income.

Revenue Ruling 76-37, 1976-1 C.B. 149 held that an organization that assists a public vocational training center in its home construction training program and uses the income from home sales to finance new projects and equipment for the public school system qualifies for exemption under IRC Section 501(c)(3). The completed

houses the organization sells are products of its training program; they are sold in substantially the same state they are in upon completion of the training program. Further, the organization builds only as many houses as needed for its on-the-job training program.

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974) held that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

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 IRC Section 501(c)(3) because it was primarily engaged in an activity that was characteristic of a trade or business and 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 United Missionary Aviation, Inc. v. Commissioner, T.C. Memo (CCH) 1990-566, the Tax Court held an organization formed to support religious missionary work not exempt under IRC Section 501(c)(3) because it had a substantial nonexempt commercial purpose. The court focused on how the organization carried on its primary activity, a tape and equipment supply division. Although no one factor was determinative, the court considered the following particularly relevant:

- a. The supply division was operated in the same manner as any profitable commercial enterprise;
- b. The majority of equipment and tapes sold by the organization were also sold by commercial firms;
- c. The organization priced its merchandise approximately 20 percent above cost, which produced a net profit margin of approximately eight percent; and
- d. The organization had substantial annual and accumulated profits.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), aff'g T.C. Memo 1990-484, the court determined that an organization that operated restaurants and health food stores in a manner consistent with the doctrines of the Seventh Day Adventist Church does not qualify under IRC Section 501(c)(3). 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; it sold goods and services to the public;
- 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**

You are not described in IRC 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 IRC Section 501(c)(3) purposes but for the purpose of designing, marketing, selling and distributing clothing in a commercial manner.

You do not meet the requirements of Treas. Reg. Section 1.501(c)(3)-1(c)(1) because you are not operated exclusively for charitable purposes. An organization is operated for charitable purposes only if it engages

primarily in activities that accomplish one or more exempt purposes. More than an insubstantial part of your activities furthers non-charitable purposes.

Your activities do not fall within the definition of charitable as found in Treas. Reg. Section 1.501(c)(3)-1(d)(2). While you state your purpose is to benefit a charitable class of individuals, you have not demonstrated that the activities you conduct are exclusively charitable.

You do not satisfy the requirement of Treas. Reg. Section 1.501(c)(3)-1(e). Your activities do not directly further an exempt purpose. You operate for the primary purpose of carrying on a trade or business that does not further an exempt purpose. A review of the facts indicates you operate a business where you design, print, market, sell and ship shirts from online orders. Your officers and directors will carry shirts with them and pass them out if they run into persons in need. Shirt distribution is dependent on your shirt sales.

You are unlike the organization described in Revenue Ruling 68-167. You do not market the goods of needy persons. You market t-shirts and clothing you designed and produced.

Unlike the thrift store described in Revenue Ruling 71-581, your activities are conducted entirely by compensated staff. You purchase the items that you sell. You do not operate in connection with or for the benefit of a charitable organization.

You are like the organization described in Revenue Ruling 73-127. Your activity of providing clothing to homeless people is charitable within the meaning of section 501(c)(3) of the Code. However, operating a retail clothing store online is not recognized as a charitable activity within the meaning of IRC Section 501(c)(3).

You are unlike the organization described in Revenue Ruling 73-128. There is no educational component to your activities. You operate an online retail business run by compensated officers and directors. No training program is provided to improve the skills and capabilities of unskilled and under-employed individuals.

You are unlike the organization described in Revenue Ruling 75-472. Your business activity is not operated in connection with the operation of a charitable or educational program.

You are unlike the organization described in Revenue Ruling 76-37. There is no educational component to your activities. The business activities of the organization described in this revenue ruling were a necessary part in training individuals in the construction trade. Additionally, the organization lacked a commercial appearance in that it only built enough homes as needed for its on-the-job training program. However, you operate an online retail business.

As indicated in *Harding Hospital, Inc. v. United States*, you have the burden to prove that you satisfy the requirements for exemption as a charitable organization described in IRC Section 501(c)(3). You have not provided evidence that you have a charitable program for the distribution of assistance to needy individuals. Your t-shirts will be distributed to the needy as you encounter them. You have failed to show that you have an established deliberate program for assisting the needy. Furthermore, random distribution of t-shirts to people on the street does not mean you were formed to aid the poor and distressed. You have only provided the evidence that you operate an online retail business.

You are like the organization described in *BSW Group, Inc. v. Commissioner* in that you primarily engage in an activity that is characteristic of a trade or business and ordinarily carried on by for-profit businesses.

You are like the organization described in *United Missionary Aviation, Inc. v. Commissioner*. You have a substantial business purpose. You operate like an online retail business. The items you sell or plan to sell are normally sold by for-profit retailers. Therefore, you operate in competition with other retail clothing businesses.

You are like the organization described in *Living Faith Inc. v. Commissioner* because you sell your products to the general public. Your activities are in direct competition with clothing stores that sell t-shirts. Your t-shirts are sold or will be sold to the general public at marked up prices. You advertise your products through regular channels of for-profit businesses and you do not rely on charitable contributions because your pricing allows you to be profitable.

#### **Your position**

You indicate that you differ from a for-profit business because your goal is not to make a profit. Instead of distributing excess profits as bonuses or dividends, your earnings will have an impact on the communities. You stated that for every shirt you sold, a similar shirt would be donated. Excess of revenue over expenses will be donated to charitable organizations.

#### **Our response to your position**

An organization that operates a trade or business that is normally carried on by for-profit businesses is not entitled to exemption under IRC Section 501(c)(3). You provide no evidence that you have any arrangement with charitable organizations. Your activities are commercial in nature and you are competing with other clothing manufacturers. You do not further charitable or educational purposes.

#### **Conclusion**

Based on the facts presented, we conclude that you do not qualify for exemption under IRC Section 501(c)(3). Your clothing sales are indistinguishable from similar activities of an ordinary commercial enterprise. You have not demonstrated that you operate a program to assist poor and distressed individuals. Furthermore, the activities you plan to conduct are those of regular trades or businesses.

#### **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