



**Department of the Treasury  
Internal Revenue Service**

P.O. Box 2508  
Cincinnati, OH 45201

Release Number: **201710033**  
Release Date: 3/10/2017  
UIL Code: 501.03-30  
501.36-01  
501.36-03

Date: December 15, 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.

We sent a copy of this letter to your representative as indicated in your power of attorney.

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: September 30, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = Formation date  
C = Organization  
D = Company  
E = Individual  
F = State  
G = Website  
H = Company  
J = Religious group  
K = Date  
L = Individual  
m = Percentage  
n = Percentage  
x dollars = Amount

**UIL:**

501.03-30  
501.36-01  
501.36-03

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 incorporated in the state of F on B. Your Articles of Incorporation state that you shall be operated exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code. The Membership provision in your Articles of Incorporation and Section 1 of your bylaws state that your sole member is C, a F nonprofit corporation. Section 2 of your bylaws states that you shall be wholly owned by C. Your board shall consist of an Executive Committee appointed by the board of C. You and C currently have

overlapping board members. Your bylaws further state that the board of C may remove any director from his or her position and may fill any vacancies on your board.

You were formed to provide publishing and marketing services for authors. You publish books of interest to the J community including resource materials for churches for youth and adults. Your website states that, “(You) is

.” You stated in your application that you will, “provide authors with the latest in publishing technology and customized marketing for their publications.” You will also publish some sponsored books based on charitable gifts from individuals and organizations. You limit your services to those materials that you determine to be compatible with your mission and purpose.

An article on the website by L dated K explained that you formed from an idea between L, an executive editor with C, and E, a fellow church member who leads a created services company called D. The two individuals came up with the idea for you as, “a new, collaborative venture to publish books and other resources.” The article explained that E had extensive experience in book and curriculum publishing as well as knowledge of the latest technology and D can make a creative idea into a resource. The staff at C also has experience and C has built-in marketing for everything it produces and entry into a primary audience through its news journal subscribers. The article goes on to explain that the new book publishing effort should engage authors, should share rewards with authors, and should get books to press quickly and make them widely available. It states, “Authors have the opportunity to benefit immediately from the early sales of books – and to receive a much larger cut of the royalties in the long term.” The article also explains that your imprints will get exposure through print and web advertising in C in addition to social media and an online store.

E is the majority owner of D. While D is a third party contractor and shares no common board members, officers, or members with you, E does serve as a member of your book acquisitions team. The following services are provided to you by D as needed: copy editing, interior typesetting/design, cover design, print on demand set-up, ebook set-up, IT services for you online bookstore, and entry of product information into the online bookstore. You indicated that you did not consider any other companies besides D because D is, “uniquely experienced in this approach to book publishing and trusted relationships were in place.” You said that a primary consideration was that using D as a vendor working cooperatively with your staff creates an immediate and complete book publishing operation. You stated that the fees paid to D are based on market value and are commensurate with other designers and copyeditors used for these services. You also stated that you use other independent contractors for services when production needs demand it. However, no other providers were listed as having received payments.

You submitted a consulting agreement between you and D where D and its owner, E, were retained to provide their services and offer valuable skills and experience to help your mission. Among the listed services provided by D are: recruit authors, develop marketing, promote and generate sales through its (D’s) website, and generate ebook sales. You paid a one-time fee of x dollars to D. Then, for services rendered you pay to D half of all the net income derived from the sale of books or other resources published by you under the direct involvement and participation of D. You also make payments to C. You stated that n% of any profit is split between C and D at the year-end in order to support the ministry of C.

You accept proposals for books and educational resources on your website. There is an online form that individuals can complete and then upload their proposal or manuscript. Books are selected by the book acquisition committee of E, L, and one other individual. Book selection is made based on quality of writing and

the positive ministry impact on readers, especially church leaders. The book acquisition committee sets the price of the books being sold based on fair value determination and the ease of using consistent pricing. You have printed books that are available at G and ebooks that are available on your website, on G, and on the H site.

You have author subvention payments, or fees that allow the authors to share in the investment of the production of their books. This also allows for more generous royalties for them and lower author purchasing options. The fees are set to cover actual hard costs including design, copyrighting, and author copies of publishing the book so that the publisher can immediately provide higher royalties to the author. While the fees support the publishing program they do not cover the full cost of producing and promoting each book. Fees may vary depending on the length and complexity of the volume. You hold all author subvention payments as other liabilities until the initial publication and all other expenses have been incurred and paid. This is usually a period of six months or more. If any amount remains the amount is moved to an income account for use as general operating funds.

You pay m% royalties to authors. This is based on the standard in the industry while taking into consideration the amount of the author subvention payment.

You explained that you differ from a commercial publishing company because you seek to allow ministry related books to be published that would otherwise not likely meet the profit based requirements of commercial publishing firms. You also encourage authors to purchase books at cost (printing and shipping) plus a small admin fee. You state that this allows books to support the author's ministry goals and more easily reach their readers with no profit made by you while commercial firms only offer a discount of 40% off the list price plus shipping to protect their sales and make a profit.

Your website contains information about additional activity experiences which are highly personalized travel and learning opportunities that combine inspiration and adventure. Although this activity is on your website and contains your name as part of the activity name you stated that these experiences are operated by C.

## **Law**

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax to organizations organized and operated exclusively for charitable, religious or educational purposes where 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 that 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)(1)(ii) provides that an organization is not organized and operated exclusively for exempt purposes under Section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of private

interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Rev. Rul. 60-351, 1960-2 C.B. 169, a corporation is organized and operated on a non-profit basis. It publishes a foreign language magazine containing fiction, poetry, book reviews and articles which it states is of a literary, scientific and educational character. The magazine is available to the general public through regular paid subscriptions. The corporation's income is derived mainly from subscriptions and sales of individual copies of the publication, and some is from advertising and contributions. Its expenditures consist of fees paid to authors for their works, salaries, printing, advertising, shipping packing, postage and other operating costs incurred in the publication of the magazine. It is devoted to publishing a magazine and selling it to the general public in accordance with ordinary commercial publishing practices. It is held that the corporation is not an exempt charitable, scientific, literary or educational organization within the meaning of section 501(c)(3) of the Code.

In Rev. Rul. 68-26, 1968-1 C.B. 272, an organization incorporated without stock by a church provides a standardized source of educational and religious material for the church's parochial school system. Its affairs are managed by a board of directors composed of clergymen appointed by the church and responsible to the church for the organization's finances and operations. The organization prints material which is prepared and edited by the school system. The organization sells the material exclusively to the parochial schools system. All profits are returned annually to the school system. The ruling states that although a technical parent-subsidiary relationship between the church and the organization is lacking because of the nonstock character of the organization, a substantially similar relationship does in fact exist through the control and close supervision of its affairs by the church. In printing material which has been prepared for the parochial school system, the organization is carrying out an integral part of the activities of the church, the parent organization. Accordingly, it qualifies for exemption under § 501(c)(3) because it is operated as an integral part of the exempt activities of the parent.

Rev. Rul. 73-164, 1973-1 C.B. 223 states that a church-controlled commercial printing corporation whose business earnings are paid periodically to the church, but which has no other significant charitable activity, is a feeder organization as described in section 502 of the Code and does not qualify for exemption under section 501(c)(3).

In Rev. Rul. 77-4, 1977-1 C.B. 141, 1977 WL 43049, a nonprofit organization, whose only activities are preparing and publishing a newspaper of local, national, and international news articles with an ethnic emphasis, soliciting advertising and selling subscriptions to that newspaper in a manner indistinguishable from ordinary commercial publishing practices, is not operated exclusively for charitable and educational purposes and does not qualify for exemption.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In Fides Publishers Assn. v. United States, 263 F. Supp. 924 (1967) the government retroactively revoked the taxpayer's exempt status, concluding that, for the previous five years, the taxpayer was engaged primarily, if not solely, in publishing activities. The court noted that, to qualify for section 501(c)(3) exemption, the taxpayer must be "organized and operated exclusively for" an exempt purpose. The court rejected the taxpayer's argument that, rather than its primary activity, the court should focus on the end to which that activity was taken, namely, religious education. The court pointed out that the taxpayer's sole activity and purpose was the carrying on of the publishing trade and held that the taxpayer's purpose, rather than its goals, were the focus of section 501(c)(3).

In Old Dominion Box Co. v. United States, 477 F.2d 344 (4th Cir. 1973), cert denied, 413 U.S. 910 (1973), the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

In Living Faith Inc. v. Commissioner 60 T.C.M., 710, 713 (1990), affd 950 F. 2d 365 (Cir. 1991) the court said that the activities were conducted as a business and the organization was in direct competition with other restaurants and health food stores; thus, it did not qualify for exemption under Section 501(c)(3). The appellate court stated the factors that the court relied upon to find commerciality and thus offered the best contemporary explanation of the commerciality doctrine. These factors include:

1. The organization sold goods and services to the public.
2. The organization was in direct competition with for profit businesses.
3. The prices set by the organization were based upon pricing formulas common in retail food businesses.
4. The organization utilized promotional material 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 laid out the factors for determining whether an organization's activity is of a commercial nature. It said, "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...whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations." The court also decreed that the organization derived substantial income from business entities that rented the facility, but that the center did not provide services at substantially below cost to other section 501(c)(3) organizations nor did it show that the facility was used by organizations to promote educations with the meaning of section 501(c)(3).

In Christian Manner International, Inc. v. Commissioner of Internal Revenue, 71 T.C. 661 (1979), the petitioner published and sold books that its founder wrote. The Tax Court found that the organization's actual purpose was to benefit the founder by publishing his books and promoting his theories. Even if the publication of his books in part furthered religious or educational purposes, petitioner would still not qualify for exemption under section 501(c)(3) because a substantial part of its activity benefited him personally.

### **Application of law**

You are not operated exclusively for charitable, religious, or educational purposes consistent with section 501(c)(3) of the Code or Treas. Reg. Section 1.501(c)(3)-1(a)(1) and therefore fail to meet the operational test. Specifically, the facts above indicate that you are not operated for exempt purposes but that you are operated in a commercial manner. Although your publishing activities consist of creating educational materials, more than an insubstantial part of your operations consist of providing goods for fees comparable to for-profit entities.

Per Treas. Reg. Section 1.501(c)(3)-1(c)(1), you are not operated exclusively for one or more exempt purposes because you do not engage primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). You are not like the organization in Rev. Rul. 68-26 because your publishing activities are not for the exclusive use of C but rather to sell to the general public, and although you were created by C, E, the majority owner of D, also had a part in your creation and benefits from your activities. Instead, you are similar to the organization in Rev. Rul. 73-164. While you are related to C and some of your revenue is periodically paid back to C, you are set up as a commercial printing operation with no other charitable activities. You were formed to provide publishing and marketing services for authors. You collect subvention fees from authors to allow authors to share in the investment of their books. You pay m% royalties to authors. This is based on the standard in the industry while taking into consideration the amount of the author subvention payment. A website article explained that your new book publishing effort should engage authors, should share rewards with authors, and should get books to press quickly and make them widely available. It states, "Authors have the opportunity to benefit immediately from the early sales of books – and to receive a much larger cut of the royalties in the long term." Your book acquisition committee sets the price of the books being sold based on fair value determination and the ease of using consistent pricing. Like the organization in Rev. Rul. 77-4, your operations are indistinguishable from ordinary commercial publishing practices.

You are similar to the organization in Fides Publishers Assn. v. United States, which printed, published and sold products to promote religious culture. These products were sold at cost plus a markup. The organization argued that, rather than focusing on its primary activity, the court should focus on the end to which that activity was taken, namely religious education. You have indicated your purpose to be advancing religion through the distribution of products. Much like the organization in this case you mark up and sell your products and generate revenue. You pay royalties to authors and part of your revenue to D, a for-profit entity. Much like the organization in the ruling, your activities and purpose are focused on publishing as a regular trade rather than 501(c)(3) activities of being religious or educational. Since you are operating a regular trade or business, you have an underlying commercial motive as noted in Better Business Bureau of Washington D.C.

Like the organization in Rev. Rul. 60-351, your main activity consists of publishing. You publish religious material on a regular basis and offer the material for sale online through your own website and the websites of G and H. You receive revenue from these sales as well as subvention fees from your authors. You pay royalties to the authors and you also pay D half of all the net income derived from the sale of books or other resources published by you under the direct involvement and participation of D. Like the organization in Rev. Rul. 60-351, your operations are similar to those of ordinary commercial publishing practices and you do not qualify for exemption under section 501(c)(3) of the Code.

You are similar to the organizations in Living Faith Inc. v. Commissioner and Airlie Foundation v. Commissioner because your activities are similar to those of a commercial publishing company. Although you were created with religious principles in mind and publish religious based books, your primary purpose is the operation of a trade or business. You have printed books that are available for sale at G and ebooks that are available on your website, on G, and on the H site. While you indicated that you differ from a commercial publishing company because you seek to allow ministry related books to be published that would otherwise not likely meet the profit based requirements of commercial publishing firms, you are still selling books to the public in a commercial manner based on fair value determination and paying royalties to authors. In comparison to the entities in each ruling, you exhibit similar factors indicative of commercial operations including regular and ongoing book sales, competition with other publishers, common retail pricing structures, marketing and advertising, and the reliance on sales and fees versus contributions.



Like the organization in Old Dominion Box Co. v. United States, your operations result in benefit to private parties more than incidentally and therefore constitute a substantial nonexempt purpose. You were formed to provide a publishing and marketing service for authors. You stated in your application that you will, “provide authors with the latest in publishing technology and customized marketing for their publications.” While you do select the items that you publish, you pay the authors royalties from the sales of their books. A website articles stated, “Authors have the opportunity to benefit immediately from the early sales of books – and to receive a much larger cut of the royalties in the long term.” The article also explains that your imprints will get exposure through print and web advertising in C in addition to social media and an online store. Since your activities serve the private interests of D, E, and various authors, you are also not organized and operated exclusively for exempt purposes. (Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii))

Similar to the organization in Christian Manner International, Inc. v. Commissioner of Internal Revenue, you serve the private interests one of your creators, E, the majority owner of the for-profit D. You were formed as an idea between L, an executive editor with C, and E, a fellow church member who leads a creative services company called D. The two individuals came up with the idea for you as, “a new, collaborative venture to publish books and other resources.” Not only did the majority owner of D help create you, you stated that you did not consider any other companies because D is “uniquely experienced in this approach to book publishing and trusted relationships were in place.” Per your Consultant Agreement with D, for services rendered you pay to D half of all the net income derived from the sale of books or other resources published by you under the direct involvement and participation of D.

### **Conclusion**

Based on the information submitted, you are not operating exclusively for one or more purposes described in section 501(c)(3) of the Code. Even though some of your activities may be religious and educational in nature, you are operating in a commercial manner and your activities benefit the private interests of authors as well as D and E. Therefore, you are not described in 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.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure:  
Publication 892