

Internal Revenue Service

Appeals Office

Department of the Treasury

Employer Identification Number:

Date: AUG 02 2017

Person to Contact:
Employee ID Number:
Tel:
Fax:

Number: **201743018**
Release Date: 10/27/2017

A = Name
B = Address

UIL: 501.03-05
501.03-30
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):

Treasury Regulation Section 1.501(c)(3)-1(a)(1) provides that to be exempt as an organization described in 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.

Treasury Regulation Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. We have determined that you are operating a business in competition with for profit entities that provide a similar service to members of your community. Therefore, your application for exemption is denied.

Contributions to your organization 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

Cc:



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

Date: DEC 19 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

X = State

Y = Date

UIL:

501.03-05

501.03-30

501.36-01

Dear .

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do the available facts show you have failed the operational test, therefore disqualifying you from exemption under Section 501(c)(3) of the IRC? Yes, for the reasons described below.

Facts

You were formed as a corporation on Y in the state of X. You stated you were formed:

To help alleviate the burden of poverty by rendering pharmacy services in a charitable manner to the poor and disabled; and to provide pharmacy services to the clients and employees of non-profit corporations; and to become informed regarding the medical, social and economic problems of underprivileged, mentally challenged and aging members of our population; and to promote the establishment of such other related educational, wellness and supportive social services.

You will operate a not-for-profit pharmacy. Prescription pricing will be based upon usual and customary pricing for clients with private insurance or Medicare. However, for the poor, indigent and underinsured population, prescription pricing will be at pharmacy cost (i.e., wholesale cost plus cost of labor, shipping and packaging).

Your services are available to the general public. You state that your purpose is to serve individuals who are already receiving services from other non-profit organizations serving the indigent and underinsured. Many of these individuals are disabled and impoverished as a result of their disabilities.

You state that any profit derived from serving those who are insured and economically stable will be used to support the disadvantaged population; that you will engage in fund raising efforts to benefit the economically

disadvantaged customers of the pharmacy; and that you will seek to defray the costs of co-pays by identifying available funds from other sources such as the grant programs offered by most major pharmaceutical firms or private foundations.

During your first three years of operations you project that from to percent of your revenue will be receipts from sales of goods and services, and the remainder from grants and contributions and investment income. Your primary expenditures will be cost of goods sold (, and percent respectively) and personnel costs (, and percent respectively). In your second and third years you expect to net percent and percent, respectively, of your gross receipts.

Law
Section 501(c)(3) of the Internal Revenue Code exempts from income tax organizations organized and operated exclusively for charitable purposes.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) provides that to be exempt as an organization described in 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 one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. Section 1.501(c)(3)-1(e)(1) 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 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. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3).

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 B. S. W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Court stated that free or below cost service is only one of several factors to consider in making a determination. Others include the particular manner in which the organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. All of these must be considered, for no single factor alone is determinative. The Court concluded that the petitioner was not an organization described in section 501(c)(3) because its primary purpose was neither educational, scientific, nor charitable, but rather commercial.

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979) aff'd 625 F.2d 804 (8th Cir. 1980), the Tax Court stated that the sale of prescription drugs to senior citizens and handicapped persons is a trade or

business normally carried on for-profit. The court ruled that sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. The court said it was clear that petitioner's exclusive purpose for being was to sell drugs, an activity that is normally carried on by commercial profit making enterprises. The Tax Court said that they failed to see how the fact that it happened to deal in drugs could convert it to a section 501(c)(3) organization. If it could be so converted, then so could a store selling orthopedic shoes, crutches, health foods, or any other product beneficial to health. Virtually everything we buy has an effect, directly or indirectly, on our health. They concluded that they did not believe that the law requires that any organization whose purpose is to benefit health, however remotely, is automatically entitled, without more, to the desired exemption.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the District Court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. As the court stated: "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, among other things, whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations."

Application of law

You are not exempt under Section 501(c)(3) of the Code because you are not operated exclusively for charitable purposes.

You have failed to meet the operational test for exemption under Section 501(c)(3) because you are not operated exclusively for one or more of the purposes specified in Section 501(c)(3) as required by Treas. Reg. Section 1.501(c)(3)-1(a)(1). You are not operated exclusively for one or more of the purposes specified in Section 501(c)(3) because you do not engage primarily in activities which accomplish such exempt purposes as required by Treas. Reg. Section 1.501(c)(3)-1(c)(1). More than an insubstantial part of your activities is not in furtherance of an exempt purpose.

Specifically, you operate a business, which sells pharmaceutical products to the general public in a manner indistinguishable from a commercial pharmacy. Your primary source of revenue is from the sales of pharmaceutical products. You do not expect to receive a significant amount of your total support from grants and contributions. Your activities indicate that you are operated primarily for a non-exempt commercial purpose.

Like Airlie Foundation your pharmacy is in competition with for profit commercial pharmacies and is operated in a commercial manner. Your pharmacy is open to the public and provides no services below cost. The court in Airlie noted that factors courts have considered in assessing commerciality are the extent of below cost services provided and the extent to which the organization receives charitable contributions. You sell nothing at below cost and you do not rely to a significant extent on contributions. Because of the commercial manner in which you, like Airlie Foundation, conduct your business, you are operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose.

The court in B. S. W. Group also cited as a factor to be considered in assessing commerciality the provision of free or below cost service. Even though B.S.W. Group provided some free or below cost services, the court

nevertheless determined that they were operated for commercial purposes. You provide some services at pharmacy cost, but none below cost, and otherwise operate in a strictly commercial manner. The court also found an indication of commerciality in the existence of annual profits. You have projected that you will be profitable beginning in your second year.

Like Federation Pharmacy Services you are engaged in the sale of pharmaceutical products, some to indigent or underinsured persons at cost. The Court in Federation Pharmacy Services found that the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for profit. Sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. Your sales to indigent and underinsured persons, even at cost, likewise are not in furtherance of a charitable purpose.

Furthermore, also following Federation Pharmacy Services, you are operated for the primary purpose of carrying on an unrelated trade or business, and cannot be exempt under Section 501(c)(3) of the Code per Treas. Reg. Section 1.501(c)(3)-1(e)(1).

Even if selling pharmaceutical products to indigent and underinsured persons at cost were in furtherance of a charitable purpose, you would fail to meet the operational test for exemption. Like Better Business Bureau of Washington, D.C., your purposes include providing pharmaceutical services to the general public at a profit in a purely commercial manner. Like the organization in this court case, this single nonexempt purpose would destroy your claim for exemption under Section 501(c)(3) of the Code.

Your position

Your mission is to inform the poor, indigent and underinsured population of the importance of proper care and provide this population with access to pharmaceutical solutions for their health care which are affordable.

Our response to your position

Although you serve the poor, indigent and underinsured you also serve those individuals who are insured and economically stable. You have not distinguished your activities from those of a commercial pharmacy providing service to the public.

Conclusion

In summary, you fail the operational test because you are not operated exclusively for charitable purposes. Specifically, you fail the operational test for exemption under section 501(c)(3) of the Code because you operate a pharmacy for a commercial purpose. Furthermore, since you are operated for the primary purpose of carrying on an unrelated trade or business, you are precluded from exemption by Treas. Reg. Section 1.501(c)(3)-1(e)(1). Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns. Contributions to you are not deductible under section 170.

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