



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

Release Number: **201934008**
Release Date: 8/23/2019
UIL Code: 501.03-05, 501.33-00

Date: May 30, 2019

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

1120

Tax years:

All

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). Previously 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 you had filed a protest within 30 days. You subsequently withdrew the protest. Therefore, 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,

Stephen A. Martin
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: November 17, 2017

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date
C = State
D = Organization
E = Organization
F = Number
G = Number Range

x dollars = Amount

UIL:

501.03-05

501.33-00

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 B in the state of C exclusively for charitable and educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code.

Your primary activity consists of operating a coffeehouse which will act as both a fundraising organization for nonprofits that serve your community and act as a community launch point and gathering venue featuring local art and music. The coffeehouse will sell barista coffee, and coffee prepared in the style of local cultural groups as well as a limited breakfast and lunch menu. In addition, a much cheaper alternative "retro" style coffee will be offered that will be a no-frills /basic drip coffee.

You are still in the process of finalizing your regular menu and prices. You, however, provided a list of proposed prices showing how your coffees prices and other items compare to the prices of other coffeehouses in your locale. Your prices were the same as those of the other coffeehouses. The only exception is a basic drip coffee that will be offered at a discounted price for those who want to be part of your community, but do not want to pay for the higher priced coffee.

You plan the coffeehouse to be open during typical business hours for a coffeehouse in your metro area, which you anticipate will be from 6:00 AM to 9:00 PM seven (7) days per week. Furthermore, concerning staffing, your goal is to employ about F community members and pay them a living wage. You also plan to use in the range of G volunteer hours per week to augment the paid staff.

Your proposed budget shows for your first year of operations that you will rely on gifts, grants, and contributions for your financial support. In subsequent years, you project approximately % of your gross income is from the operations of your coffeehouse. Your profits will be funneled back to other nonprofit organizations which your customers and other community members will help in deciding where your profits will be donated. This, you project, will be between % and % of your gross sales. You will also solicit individual donations by word-of-mouth solicitation, and have a secure direct donation link on your website.

Your expenses will consist of construction costs and coffeehouse equipment in your first years of operations. Your primary expenses once your coffeehouse is operational consist of occupancy expenses and salaries. Your other projected expenses once you are open for business include banking and credit card fees, insurance, slippage, labor and parts, repair, office costs, and costs of goods (coffee, food, misc.).

Besides operating the coffeehouse, you will conduct community-building programming that may include:

- Forums with leaders from multiple religious groups to include educational/informational content, as well as dialogue and bridge-building conversations;
- Celebrations of holidays recognized by the many cultures living in C;
- Conversations about shared community values, and working together to set common goals and achieving them;
- A neighborhood talent show where all proceeds go to the winner's charity of choice.

You have also entered in a partnership with D, an entity exempt under Section 501(c)(3) of the Code, who serves as your fiscal agent until your 501(c)(3) exempt status is granted. Furthermore, you have received pro bono assistance with establishing your legal status, as well as with building design work associated with the renovations necessary at the site where you are considering locating. To date, you have also raised x dollars from E in C.

Your governing body currently consists of unrelated volunteers. Your founder serves as your president and treasurer and will transition into a management role in your operations. You currently do not have any printed materials for distribution and plan to rely on your website and word of mouth for advertising as well as radio advertising and building signage. Finally, although you have identified a suitable facility available from an unrelated party, you are waiting for your exemption before entering into a lease for the site.

Law

Section 501(c)(3) of the Code provides for the recognition of exemption of organizations that are organized and operated exclusively for religious, charitable or other purposes as specified in the statute. No part of the net earnings may inure 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(b)(4) holds that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or operation of law, be distributed for one or more exempt purposes.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. Section 1.501(c)(3)-1(d)(2) defines the term charitable as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes lessening of the burdens of government.

Treasury Regulation Section 1.501(c)(3)-1(e)(1) states an organization may qualify for tax exemption under Section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities,

1. if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes,
2. and also 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 of the Code.

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

In Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279, 283, 66 S. Ct. 112, 90 L. Ed. 67 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the 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 found that a corporation formed to provide consulting services did not satisfy the operational test under Section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the typical Section 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were Section 501(c)(3) exempt organizations.

In Schoger Found. v. Comm'r, 76 T.C. 380 (T.C. 1981), the court held that a not-for-profit corporation that owned and operated a mountain lodge as a religious retreat facility and made available to lodgers recreational and social activities comparable to activities offered by vacation resorts does not qualify for tax-exempt status as an organization described under Section 501(c)(3) of the Code.

In Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), *aff'd*, 846 F. 2d 78 (Fed. Cir.) cert. denied, 488 U.S. 907, 109 S. Ct. 257, 102 L. Ed. 2d 246 (1988), the court found an organization that operated an adoption agency was not exempt under Section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. The court concluded that the organization did not qualify for exemption under Section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in Section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (1991), the Court of Appeals upheld a Tax Court decision that an organization operating restaurants and health food stores in a manner consistent with the doctrines of the Seventh Day Adventist Church did not qualify for exemption under Section 501(c)(3) of the Code because the organization was operated for a substantial nonexempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in competition with other restaurants, engaged in marketing, and generally operated in a manner similar to commercial businesses.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the 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, inter alia, 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 as described in section 501(c)(3) of the Code because you have not established that you meet the operational test as per Treas. Reg. Section 1.501(c)(3)-1(a)(1). Your primary activity consists of operating a commercial coffeehouse. You operate in a manner consistent and in competition with other coffeehouses.

You are not operating exclusively for charitable purposes as required under Treas. Reg. Section 1.501(c)(3)-1(c)(1). Your primary activity is the operation of a coffeehouse open to the public. Your prices and your hours of operation are the same as those of other coffeehouses in your area. As required by Treas. Reg. Section 1.501(c)(3)-1(d)(2), you have not established that your operations accomplish exclusively charitable purposes.

Operating a coffeehouse on a regular and continuous basis is an unrelated trade or business for profit within the meaning of Section 513 of the Code. Pursuant to Treas. Reg. Section 1.501(c)(3)-1(e)(1), you do not meet the requirements for recognition of tax exemption under Section 501(c)(3) of the Code as your primary purpose is the operation of an unrelated trade or business for profit within the meaning of Section 513 of the Code.

You are not like the organization described in Revenue Ruling 68-072. You were not formed by local churches to further the religious, intellectual, and moral development of persons of college age through the operation of a supervised facility under the guise of a "coffeehouse." Additionally, unlike the organization in Rev. Rul. 68-72 that charged a nominal admission fee but did not charge for refreshments or entertainment, you charge for the food and beverages and have a paid staff. Most your expenses which are devoted to the operation of the coffeehouse are met by the funds from these sales. Unlike the organization in the revenue ruling, the social and commercial aspects of your operations are not incidental. Therefore, you fail to qualify under Section 501(c)(3) of the Code.

While you plan to make charitable contributions and some of your activities may be charitable within the meaning of Section 501(c)(3) of the Code, your primary activity is the operation of a coffeehouse open to the public. As the court found in Better Business Bureau of Washington, D.C. v. U.S., the presence of a single, substantial non-exempt purpose of operating a coffeehouse will preclude exemption regardless of the number of other exempt activities.

Your operations are like those of the organization described in Arlie Foundation, Inc. As the owner and operator of a coffeehouse, you are in direct competition with other coffeehouses in your area. Your prices are mostly the same as those of other coffeehouses. In addition, you will use advertising tools common to for-profit businesses such as radio advertisement and the internet. You will primarily be funded by coffeehouse profits. You will have a paid staff. Consequently, you meet most of the factors provided in Airlie Foundation, Inc., indicating that you are operated for a substantial nonexempt commercial purpose.

You are like the organizations described in B.S.W. Group, Inc., Easter House, Schoger Foundation and Living Faith because you are operating for a substantial nonexempt commercial purpose rather than for a tax-exempt purpose. You are open to the general public during regular business hours. You use your receipts from the coffeehouse to pay for the cost of sales, occupancy expenses, insurance and salaries. This is an activity normally carried on by for-profit businesses. Therefore, you conduct the activity in a manner like for profit businesses and are in direct competition with such businesses.

Conclusion

Based on the above facts and legal analysis, we conclude that you fail to meet the operational test of Section 501(c)(3) of the Code because you are operated in a commercial manner.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

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,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892

cc: POA