



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

Number: **202007019**  
Release Date: 2/14/2020

Date:  
November 14, 2019  
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

**UIL: 501.03-00, 501.03-20**

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,

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:  
September 23, 2019  
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = business 1  
C = business 2  
E = date  
F = state  
G = city  
H = address  
w dollars = amount

**UIL:**

501.03-00  
501.03-20

Dear \_\_\_\_\_ :

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

**Issues**

Do you qualify for exemption under Section 501(c)(3) of the Internal Revenue Code? No, for the reasons stated below.

**Facts**

You were formed as a corporation on E in the state of F. Your Articles of Incorporation state that you are organized for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Code.

Your stated purpose is to help finance Christian missionary activities in your state and abroad. You will do so by providing small grants to teenagers and college students going on Christian mission trips. You have not yet established, but are developing, a grant application process to request distributions. This will likely include a written section requiring an essay on the mission and the grantees role in the mission.

Applicants must be from, supported and endorsed by a Christian church from G, a city in F, indicating that the applicant is going on a church mission trip. Applications will be reviewed quarterly by your board. Applicants

who meet your criteria will receive a grant to help support their mission trip. You will require verification from the church that the recipient of your grant went on a mission trip. A report from their church and a grant receipt will be required at the end of the mission trip to ensure funds were used appropriately.

You will also provide grants to organizations that participate in Christian missionary endeavors. The organizations you select for assistance must be sent on their missions from G. Grant applications for these distributions will be reviewed semi-annually. You will maintain a grant report for each grant that is distributed.

Financial support for your programs will be generated from the sale of coffee and baked goods, specifically, you will operate a coffee shop doing business as B. You purchase roasted beans and grind them on site to make either hot or cold coffee. You purchase baked goods that are frozen and reheat them on site for sale to the public. A salaried manager and hourly employees will be responsible for the day to day operation of the coffee shop/bakery. You lease a retail space located at H in G. Per your lease agreement, your sole activity will be to operate a coffee shop style restaurant under the name C. All revenues generated from the sale of coffee and baked goods will go towards the support of the Christian missions.

You will also provide coffee and donuts to churches as a fund raiser. You prepare coffee as well as the baked goods and sell them at the fundraising events. You do not provide the coffee and baked goods for free. You charge a fee for the sale of the coffee and baked goods.

Despite stating that the main source of revenue will be charitable donations, your statement of revenue demonstrates that nearly all funding is derived from gross receipts. Over % in each of your years comes from this source - the sale of coffee and baked goods. Your expenses are almost exclusively allocated to the operation of the coffee shop/bakery. Less than % of your expenses are budgeted toward charitable donations – nearly all are budgeted for salaries and rental expenses.

You have an outstanding loan of w dollars used to fund the construction of the interior of the coffee shop/bakery as well as the purchase of equipment used to conduct your activities. Per your lease agreement, you will install appropriate lighting, kitchen area, and bar/counter area appropriate for the operation of a coffee shop/bakery. The majority of your daily activities and resources revolve around the operation and maintenance of your coffee shop/bakery.

## **Law**

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

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 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) provides that the term “charitable” is used in Section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged as well as the advancement of religion.

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 “coffee house”, 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.

Rev. Rul. 71-581, 1971-2 C.B. 236, stated that an organization that operated a thrift store where substantially all of the merchandise sold had been contributed and where more than half of the work performed at the thrift shop was performed without compensation, may be exempt under Section 501(c)(3) of the Code. The organization was organized by a group of nonprofit organizations exempt under Section 501(c)(3). The primary purpose for which the organization was formed was to serve the group of exempt organizations by performing an essential function for them of soliciting contributions of goods on their behalf and converting the contributed goods to cash for charitable uses.

In Rev. Rul. 73-127, 1973-1 C.B. 221, the Service held that an organization that operated a cut-price retail grocery outlet and allocated a small portion of its earnings to provide on-the-job training to the hard-core unemployed did not qualify for exemption. The organization’s purpose of providing job training for the hard-core unemployed was charitable and educational within the meaning of the common law concept of charity; however the organization’s purpose of operating a retail grocery store was not. The ruling concluded that the operation of the store and the operation of the training program were two distinct purposes. Since the former purpose was not a recognized charitable purpose, the organization was not organized and operated exclusively for charitable purposes.

In American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analysis of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services included providing advice for purchases of individual securities. The Court noted that education is a broad concept, and assumed that the organization had an educational purpose. The Court concluded, however, that the totality of the organization’s activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was more indicative of a business than that of an educational organization. The Court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and that the organization was not entitled to be regarded as exempt.

In 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 Section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and was 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 Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the court affirmed that Living Faith did not qualify for exemption under Section 501(c)(3) of the Code since it operated its restaurants and health food stores for a substantially commercial purpose. Its underlying religious purposes did not mitigate the clear commercial purpose of its operations.

In Zagfly, Inc. v. C.I.R., T.C. Memo 2013-29, the court held that Zagfly’s primary activity, the operation of a web-based broker that would sell flowers at market rates, was not a charitable activity, but rather a commercial activity that amounts to an unrelated trade or business. Therefore, the organization did not meet the requirements of Section 501(c)(3) of the Code because its primary activity did not further a 501(c)(3) purpose.

### **Application of law**

You are not described in 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 Section 501(c)(3) purposes because a substantial portion of your activities consists of the operation of a coffee shop/bakery in a retail space open to the general public.

While donating funds to other non-profit community organizations is charitable as described in Treas. Reg. Section 1.501(c)(3)-1(d)(2), your primary activity is the operation of a coffee shop/bakery similar to other commercial operations of that nature. Additionally, while some of the activities you conduct aim to advance Christian missions, more than an insubstantial portion of your activities serve a nonexempt commercial purpose. Per Treas. Reg. Section 1.501(c)(3)-1(c)(1), you are not regarded as “operated exclusively” for one or more exempt purposes because you do not engage primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3) of the Code.

Additionally, you do not meet the requirements of Treas. Reg. Section 1.501(c)(3)-1(c)(1) because more than an insubstantial amount of your activities are furthering non-exempt purposes. The organization in BSW Group did not qualify as it was engaged in an activity characteristic of a trade or business operated typically by commercial ventures. You operate a coffee shop/bakery that consists of providing food and beverage to the public for a fee. Your coffee shop resembles a trade or business that is ordinarily carried on by commercial ventures organized for profit. You are similar to the organization in BSW Group v. Commissioner in that you have a substantial commercial purpose to operate a coffee shop not in furtherance of any exempt purpose within the meaning of Section 501(c)(3) of the Code.

You are distinguishable from the organization in Rev. Rul. 68-72 in that a substantial portion of your activities are to operate a coffee shop in a commercial manner. The organization in Rev. Rul. 68-72 ran a supervised facility where church leaders, educators, and leading businessmen of the community met and mingled with young people in an informal atmosphere. They held discussions on such subjects as religion, current events, and social problems. Personal counseling and vocational guidance were provided. You do not conduct any regular religious or educational activities at your facility. You allow your space to be used by the public for all activities, not just those that are religious, charitable, or educational. While activities such as selling coffee and baked goods at church fundraisers may provide a benefit to the church, you do not conduct the activities in an exempt manner. 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 at your shop and at

church fundraisers.

You are distinguishable from Rev. Rul. 71-581 in that the products sold at your coffee shop are not donated and all of the work performed at the coffee shop is done by paid employees. While you may have the common goal of donating the funds you make for charitable purposes, you have not yet issued any grants for the financial support of any Christian mission trips. Even if you do, contributing net profits to charitable purposes does not make a business exclusively charitable.

You are similar to the organization described in Rev. Rul. 73-127 because the operation of the coffee shop, your support of Christian missions through grants, and your participation in church fundraisers are separate and distinct activities. Since the operation of the coffee shop is a substantial part of your activities and is not a recognized charitable purpose, you are not organized and operated exclusively for Section 501(c)(3) purposes.

You are similar to the organizations described in the American Institute, Living Faith and Zagfly cases in that you have a significant non-exempt commercial purpose. You are operating a coffee shop that is open to the public in competition with other commercial markets. This is indicative of a business. Your primary sources of revenues are from coffee shop sales. Your expenses are mainly for salaries, cost of goods sold, and occupancy expenses to support the operation of the coffee shop. Taken in totality, the operation of your coffee shop constitutes a significant non-exempt commercial activity.

### **Conclusion**

Based on the facts and circumstances presented, we conclude that you do not qualify for recognition of exemption from federal income tax as an organization described in Section 501(c)(3) of the Code. Your coffee shop activities are indistinguishable from similar activities of an ordinary commercial enterprise.

### **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.

### **If you don't agree**

You have a right to protest if you don't agree with our proposed adverse determination. To do so, send us a protest within 30 days of the date of this letter. You must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A statement of the facts, law, and arguments supporting your position
- A statement indicating whether you are requesting an Appeals Office conference
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization or your authorized representative
- The following declaration:

**For an officer, director, trustee, or other official who is authorized to sign for the organization:**

Under penalties of perjury, I declare that I have examined this request, or this modification to the request, including accompanying documents, and to the best of my knowledge and belief, the request or the modification contains all relevant facts relating to the request, 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 they haven'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 gave us a basis to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't given us a basis for reconsideration, we'll send your case to the Appeals Office and notify you. You can find more information 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 later because the law requires that you use the IRC administrative process first (IRC Section 7428(b)(2)).

**Where to send your protest**

Send your protest, Form 2848, if applicable, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service  
EO Determinations Quality Assurance  
Mail Stop 6403  
P.O. Box 2508  
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Mail Stop 6403  
Cincinnati, OH 45202

You can also fax your protest 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 they received it.

You can get the forms and publications mentioned in this letter by visiting our website at [www.irs.gov/forms-pubs](http://www.irs.gov/forms-pubs) or by calling 800-TAX-FORM (800-829-3676). If you have questions, you can contact the person listed at the top of this letter.

**Contacting the Taxpayer Advocate Service**

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or if you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit [www.taxpayeradvocate.irs.gov](http://www.taxpayeradvocate.irs.gov) or call 877-777-4778.



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Sincerely,

Stephen A. Martin  
Director, Exempt Organizations  
Rulings and Agreements