



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

Number: **202021026**
Release Date: 5/22/2020

UIL Number: 501.00-00, 501.03-30,
501.33-00, 501.36-01

Date:
February 25, 2020
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear _____ :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

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:
December 23, 2019
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date
C = State
D = Date
F = Program
G = Type
M = Number
n dollars = Amount
p dollars = Amount
q dollars = Amount
r dollars = Amount
s dollars = Amount
t dollars = Amount
v dollars = Amount
w dollars = Amount

UIL:

501.00-00
501.03-30
501.33-00
501.36-01

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 IRC Section 501(c)(3)? No, for the reasons stated below.

Facts

You incorporated on B as a business corporation in the state of C, authorized to issue M shares of common stock. You filed Articles of Amendment on D, converting to a non-profit corporation and canceling the previously issued shares of stock. According to your amended articles, you are a charitable or religious corporation. Upon dissolution, your remaining assets shall be distributed for one or more exempt purposes within the meaning of IRC Section 501(c)(3).

You explained that a non-profit business model would present the best opportunity for developing the analytical database and other applications that you intend to deploy to address the problem of organized retail theft. Also, you anticipate receiving support from people who care about the issues of opioid/heroin addiction and treatment.

Your specific objectives and purposes, as spelled out in your bylaws, are to:

- a. enlist retail enterprises to subscribe to your services as a means of creating funds to resist the drug addiction that is fueled by theft from their stores;
- b. direct grants/scholarships to local nonprofit community drug recovery programs for selected addicts; and
- c. support law enforcement Organized Retail Crime (ORC) unit efforts in the form of innovative software for longer term theft reduction and grants to enhance their efforts directed against retail crime which funds drug abuse.

According to your bylaws and mission statement, your purpose is to facilitate collaboration between consumers, subscribing retailers, and law enforcement partners engaged in the investigation of ORC by providing innovative software support for longer term theft reduction.

Revenue from subscribing retailers is directed to local nonprofit community drug recovery programs, with grants/scholarships for qualifying persons addicted to drugs. Revenue will also support law enforcement ORC unit efforts in the form of grants to enhance their efforts directed against retail crime which funds drug abuse.

Your initiatives and activities are called the F Project and are divided into four parts: database, data analytics, return fraud, and drug epidemic mitigation.

You explained that many retailers tag a growing amount of merchandise with electronic tags (RFID). As the tags are scanned throughout the supply chain this passage is documented in their inventory system. If an audit scan at the store shows an item is missing without a matching point of sale (POS) transaction, the item number is automatically moved by the retailer's inventory system into the F database G List that is accessible to law enforcement, creating a local and, later, a nationwide repository of information about what has been stolen from all participating retailers.

When a suspected stolen item is retrieved by law enforcement, an electronic query to the G List identifies the retailer, the theft location, and the date it was last scanned. In the event of a large recovery of products, an RFID scan can be made of the entire seizure and which will quickly recognize the history of every tagged item, showing that specific items were stolen and serving as an inventory of the event. As needed, you will overnight RFID scanners to ORC units who are planning a raid so that they are better prepared to identify the origin of the seized products and begin building a criminal case. Stolen goods will be returned to their rightful owner by cross-checking the information on the recovered item and the F Project database.

After recovery of stolen property, input into the database is made by law enforcement and loss prevention personnel that fleshes out the circumstances of the theft, including where it was recovered and the identities of those in possession of it.

The F Project will also develop proprietary algorithms, one of which is regression analysis using various types of statistical analysis, process the extensive data collected in the database, and define the what, when, where, how, and who of the theft process. Each subscriber can use this data, customized for their specific operations

and needs, to help predict and possibly prevent future thefts. Further, information gleaned from analyzing the combined data from all subscribers will paint a picture of global theft activity far more precisely than limited industry surveys.

You do not share a specific retailer's information with competitors and do not use any non-secure network to store and transmit their data. Subscribers see only the results of their own analytics as well as the anonymous combined data analytics.

Your return fraud initiative focuses on the return of merchandise that is without a receipt, which often results in the issuance of a gift card. These cards are then sold by drug addicts for up to 80 percent of their value. You state that it is generally acknowledged that a large part of retail theft is committed by persons addicted to drugs. This is not the fault of retailers, as they generally use all available measures to manage theft. However, by playing a part in community recovery assistance, retailers can benefit from the positive public relations brought about by their financial support via F grants made in their corporate name to communities' drug treatment and deterrence programs. With the F Project, local drug recovery facilities garner funds to support their programs. ORC teams gain financial assistance to enhance their efforts directed at retail theft.

Your approach is to have your subscribers making the return, and, along with the gift card (return card) data loaded by their POS system, transmit both to your database. When the card is used for a purchase, on file. Thus, the card cannot be sold since it has no value without would also match with those submitted by all subscribing retailers and identify excessive returns industry wide, a sure sign of theft. An instant response is sent to the store showing the number of times has been associated with a return within a specified time period and the retailer can take action based on its policy. would be automatically dropped from the database after expiration of the stated return period.

By subscribing to the F Project, retailers benefit from:

- The presence of their stolen product numbers in your database that leads to additional arrests and product recoveries.
- The analytics produced by the database give the subscribers more insight into their own theft cycles as well as broader knowledge about regional and national theft trends.
- The ability to identify recovered property via the RFID scan reduces the time that retail loss prevention staffs expend in the recovery process and further facilitates the reverse logistics path of the merchandise.
- that is uploaded with the card data curtails gift cards being used to purchase drugs in addition to reducing losses from stolen merchandise being returned. It does not impact the privacy of consumers since no personal data is recorded.

Your planned activities will be directed at addressing the incidence of organized theft and fraud that supports drug addicts and drug addiction. Your goal is to make an important contribution to the effort to stem the flow of illegal drugs and the addiction that drives demand for illegal drugs.

You provided print-outs from your website, which describes the role that consumers, retailers, and law enforcement play in theft prevention. Your role is to link consumers, retailers, law enforcement, and addiction treatment resources as you address the retail theft that can fuel drug addiction. Your mission is to mitigate financial loss to your clients by providing support to their loss prevention staff and to law enforcement through

innovative software which then enables you as a non-profit to provide financial support to organizations, helping to stem the opioid epidemic and promote recovery.

You provided supplemental information to your application that at the initial stages of the project, you will be building the database and enlisting retailers to demonstrate a “proof of concept” for your approach. Retail clients will sign subscription agreements that include terms allowing access to the database.

The fee structure will be based on return on investment that you can demonstrate by reducing theft and aiding the companies in recovering missing product. You intend to charge a fee for this service that approximates 10 percent of the return on investment to the participating subscriber. You believe that demonstrating a return on investment will both motivate the retailer to participate in your project while generating revenue that can be used on other aspects of your project. The other aspects include grants/scholarships for qualified persons addicted to drugs and grants to law enforcement that will enhance their enforcement efforts.

You intend to fund your initial activities by applying for grants from businesses or entities that will benefit from and support your initiatives. You anticipate that the ongoing cost of maintaining the database capability and soliciting new subscribers will be sustained by the user fees. The cost of providing the service on an on-going basis will approximate n dollars per subscriber and p dollars per subscriber location.

You provided a sample copy of your services and license agreement that you would enter into with commercial users, which sets forth your fee structure as follows:

- A single authorized user seeking access to the database and software – q dollars
- Up to five authorized users seeking access to the database and software – r dollars
- More than 5 but less than 101 authorized users seeking unlimited access to the database and software – s dollars
- More than 100 authorized users but less than 1,000 users seeking unlimited access to the database and software – t dollars
- More than 1,000 authorized users seeking unlimited access to the database and software – v dollars, and
- Unlimited number of authorized users seeking limited access – w dollars per user.

Law

IRC Section 501(c)(3) provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, educational and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) provides that in order to be exempt under IRC Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the exempt purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it does not qualify for exemption.

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 IRC 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)(i) states, in part, that an organization may be exempt as an organization described in IRC Section 501(c)(3) if it is organized and operated exclusively for charitable purposes.

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest.

Treas. Reg. Section 1.501(c)(3)-1(d)(2) states, in part, that the term "charitable" in IRC Section 501(c)(3) includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; lessening of the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purposes.

Treas. Reg. Section 1.501(c)(3)-1(d)(3)(i) provides that the term "educational" relates to: (a) the instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community.

Treas. Reg. Section 1.501(c)(3)-1(e)(1) provides that an organization may meet the requirements of IRC Section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in Section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. 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).

Revenue Ruling 77-111, 1977-1 C.B. 144, held that an organization formed to increase business patronage in a deteriorated area by providing information about the shopping opportunities is not operated for charitable purposes and is not exempt under IRC Section 501(c)(3). Increasing business patronage and reviving lagging sales are not charitable purposes.

Rev. Rul. 80-287, 1980-2 C.B. 185, provides that a nonprofit lawyer referral service does not qualify for exemption under IRC Section 501(c)(3). The organization aided persons who did not have an attorney by helping them select one, in exchange for a nominal service charge. Any attorney who was a member of a local bar association could apply for placement on the referral list, in exchange for an application fee. Because a substantial purpose of the organization was aiding the legal profession, the organization was not organized or operated exclusively for charitable purposes, even though its lawyer referral service did provide some public benefit.

In Better Business Bureau of Washington D.C., Inc. v. U.S., 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that a trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university, and therefore, the association did not qualify for exemption.

In American Institute for Economic Research v. United States, 157 Ct. Cl. 548 (1962), the claims court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual

securities. The court noted that education is a broad concept and assumed *arguendo* that the organization had an educational purpose. However, 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 indicative of a business. Therefore, the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), Tax Court considered an organization that provided consulting services to groups that were mostly IRC Section 501(c)(3) organizations. The organization charged fees for its services set at or close to its own cost. The court concluded that there was nothing to distinguish these activities from those of an ordinary commercial consulting enterprise and affirmed the Service's denial of exemption under Section 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C. 2003), the court concluded that an organization did not qualify for tax-exemption under IRC Section 501(c)(3) because it was operated for nonexempt commercial purposes rather than for exempt purposes. Among the major factors the court considered in reaching this conclusion was the organization's competition with for-profit commercial entities, the extent and degree of below cost services provided, the pricing policies, and the reasonableness of financial reserves. Additional factors included whether the organization used commercial promotional methods, such as advertising, and the extent to which the organization received charitable donations.

Application of law

To be exempt as an organization described in IRC Section 501(c)(3), you must be both organized and operated exclusively for one or more of the purposes specified in such section. Your primary activity is the provision of retail theft prevention and mitigation services to retail businesses for a fee. You are not operating exclusively for charitable purposes as required under Treas. Reg. Section 1.501(c)(3)-1(a)(1).

To satisfy the operational test under Treas. Reg. Section 1.501(c)(3)-1(c)(1) an organization must establish that it is operated exclusively for one or more exempt purposes. You were formed for the non-exempt purpose of providing a retail theft prevention and mitigation service for a fee. Providing a service for a fee to retail stores, is not a charitable, educational, or religious activity within the meaning of Section 501(c)(3) of the Code.

You are not described in Treas. Reg. Section 1.501(c)(3)-1(d)(2) because you are not providing 'charitable' services; rather, you are providing services for a fee to any interested retailer. Your activities are also not exclusively educational as described in Treas. Reg. Section 1.501(c)(3)-1(d)(3)(i). Any charitable or educational components to your activities are incidental to your overall purpose of providing a service for a fee to retailers.

Your proposed activities are, in substantial part, intended to increase revenues of retailers by reducing theft. Although you assert that reducing theft will help address the opioid epidemic, your activities primarily benefit retailers. Because your operations substantially benefit retailers, you have not demonstrated that your operations serve a public rather than a private interest, as required under Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii).

The Service recognizes charities as exempt because they benefit either the community as a whole or members of a charitable class. Providing services of an ordinary commercial nature in a community, even though the undertaking is beneficial to the community, is not regarded as conferring a charitable benefit on the community unless the service directly accomplishes a tax-exempt purpose as described in Rev. Rul. 77-111 and Rev. Rul. 80-287. You provide services to retailers to reduce their losses due to theft. The services you provide are

ordinary commercial activities, which, absent special circumstances, do not qualify as charitable activities. You do not provide services to members of a charitable class, such as the poor or the underprivileged, in a charitable manner. While you propose that profits you realize as a result of your services will be given as grants or scholarships for charitable purposes, the purpose of the service itself does not further an exclusively charitable purpose.

Generally, providing services on a regular basis for a fee is a trade or business ordinarily carried on for profit and is not an activity that is substantially related to any exempt purpose except insofar as it provides revenue. Organizations that operate a trade or business as a substantial part of their activities will only meet the requirements of IRC Section 501(c)(3) if the activity relates to and furthers an exempt purpose as described in Treas. Reg. Section 1.501(c)(3)-1(e)(1). You offer theft reduction services to retailers at established rates per user/location. To meet the requirements of Section 501(c)(3), these activities must be substantially related to one or more exempt purposes. The services you provide are not related to any exempt purpose.

The court in both B.S.W. Group, Inc. and Airlie Foundation have considered whether organizations that conducted a trade or business furthered public or private, commercial purposes. Some of the factors that the courts relied upon included the corporation's failure to demonstrate that its services were not in competition with commercial businesses, the organization's financing, which did not resemble that of a typical Section 501(c)(3) organization, the organization's failure to solicit and lack of voluntary contributions from the general public, and the fact that the corporation's only source of income was from fees for services and the fees were set high enough to recoup all costs. Like the organizations in Airlie Foundation and B.S.W. Group, you are not organized exclusively for an exempt purpose. Your service agreements recover your costs plus and you are competing with for-profit businesses.

You are similar to the organization described in American Institute for Economic Research. Your primary activity is providing services to retailers for a fee, which is unrelated to any exempt purpose. Your primary activities serve substantial non-exempt purposes, which precludes exemption, as described in Better Business Bureau of Washington, D.C., Inc.

Conclusion

You are formed for the substantial non-exempt purpose of operating a theft prevention system for retailers via a subscription service. You are operated primarily for the benefit of your members, the retailers. Therefore, you are not exempt under IRC Section 501(c)(3).

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 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 or call 877-777-4778.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements