



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

Number: **202032008**
Release Date: 8/7/2020

UIL Number: 501.00-00, 501.03-05,
501.31-00, 501.33-00, 501.35-00

Date:
May 12, 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.

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 4034, *Proposed Adverse Determination Under IRC Section 501(a)*

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:
March 11, 2020
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date
C = State
D = Region, City
E = Restaurant
f dollars = Amount
g dollars = Amount
h dollars = Amount
J = Region
k percent = Number
m percent = Number
n percent = Number

UIL:

501.00-00
501.03-05
501.31-00
501.33-00
501.35-00

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) of the Code? No, for the reasons described below.

Facts

You were incorporated on B in the state C for charitable purposes. Your specific purpose is to supply food to the indigent.

In furtherance of your purposes you will operate a farm to table restaurant, E, with a J inspired menu. In the future, you will own a farm. Until the farm is producing, food for the menu will be sourced from local farmers, forest growers, and fishermen. You specifically state the factory farms will never be sourced as purveyors for your menu.

Your restaurant will be open to the public. It will be a place where people gather to enjoy good food, good atmosphere, good company, and give back to the community all at the same time. The restaurant accounts for the majority of your activities, k percent, and you plan to devote f dollars of your funds for the operations of E. Each evening n percent of tables will be reserved for non-paying families. No one except the wait staff will know who the non-paying customers are. Non-paying families will enjoy the same service and the same menu choices as the paying customers. You will operate the restaurant in D.

You plan to provide training programs for young people of underserved populations who want to enter the food business by operating “pop-up” restaurants in city parks to feed the homeless. You estimate the training program will be m percent of total activities with g dollars invested.

The rest of your activities consist of cooperation with other charitable foundations to host fundraising and charitable events at your restaurant. You plan to spend h dollars for these programs.

You plan to solicit grants from government programs and private foundations aimed at relieving food insecurity. Your Board of Directors are all members of one family. Each of three Directors is entitled compensation for the services performed. You describe your Founder as the “owner” of E.

We requested additional information on two occasions. We received a response to our first request for additional information. We sent a second request for additional information to obtain more details about the planned operations of your restaurant and have not received a response. Some of the details requested in our second request included your pricing strategies, advertising methods, and hours of operation. Several telephone calls were made to you and your representative regarding our request for additional information, but no calls were returned.

Law

IRC Section 501(c)(3) 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 IRC 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 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(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 activities, if 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 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 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 Procedure 2020-5, 2020-1 I.R.B. 241, Section 3 states that a determination letter or ruling on exempt status is issued based solely upon the facts and representations contained in the administrative record. The applicant is responsible for the accuracy of any factual representations contained in the application. Section 6 (and its predecessors) provides that a favorable determination letter or ruling will be issued to an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from federal income tax is claimed.

In Revenue Ruling 73-127, 1973-1 CB. 221, the Service held that a nonprofit organization that operates a cut-price retail grocery outlet and allocates a small portion of its earnings to provide on-the-job training the hard-core unemployed does not qualify for exemption from income tax.

In Rev. Rul. 76-94, 1976-1 CB. 171, the Service held that an exempt organization's operation of a retail grocery store as part of its therapeutic program for emotionally disturbed adolescents, almost fully staffed by the adolescents, and on a scale no larger than was reasonably necessary for the performance of the organization's exempt functions, was not unrelated trade or business.

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 Universal Life Church v. United States, 372 F. Supp. 770 (E.D. Cal. 1974), the court concluded that "one seeking a tax exemption has the burden of establishing his right to a tax-exempt status."

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 IRC Section 501(c)(3) because its primary purpose was neither educational, scientific, nor charitable, but rather commercial.

In Federation Pharmacy Services, Inc. v. Commissioner, 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 profitmaking 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 be 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.

Pius XII Academy, Inc. v. Commissioner, T.C. Memo. 1982-97, affd. 711 F.2d 1058 (6th Cir. 1983), provides that an organization must establish through the administrative record that it operates as an exempt organization. Denial of exemption may be based solely upon failure to provide information describing in adequate detail how the operational test will be met.

In La Verdad v. Commissioner, 82 T.C. 215 (1984), the administrative record did not demonstrate that the organization would operate exclusively in furtherance of an exempt purpose. Therefore, denial of organization's request for tax-exempt status was reasonable.

In Living Faith Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the court wrote that the activities were conducted as a business and the organization was in direct competition with other restaurants and health food stores; thus, it did not qualify for exemption under IRC Section 501(c)(3). The appellate court stated the factors that the court relied on to find commerciality and thus offered the best contemporary explanation of the commerciality doctrine. These factors included:

- The organization sold goods and services to the public.
- The organization was in direct competition with for profit businesses (food stores and restaurants).
- The prices set by the organization were based on pricing formulas common in retail food businesses.
- The organization utilized promotional materials and "commercial catch phrases" to enhance sales.
- The organization advertised its services and food.
- The organization did not receive any charitable contributions.

New Dynamics Foundation v. United States, 70 Fed. Cl. 782 (2006), was an action for declaratory judgment that the petitioner brought to challenge the denial of his application for exempt status. The court, in finding that the actual purposes displayed in the administrative record supported the Service's denial, stated "It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant." The court noted that if the petitioner had evidence that contradicted these findings, it should have submitted it as part of the administrative process. The court also highlighted the principle that exemptions from income tax are matters of legislative grace.

Application of Law

You are not exempt under IRC Section 501(c)(3) because you are not operated exclusively for charitable or educational purposes as required by Treas. Reg. Section 1.501(c)(3)-1(a)(1). You conduct a small portion of charitable and educational activities, but your primary activity of operating a restaurant is neither charitable nor educational. The paying customers subsidize the small percent who don't pay. 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).

You are similar to the organization in Rev. Rul. 73-127. Like that organization, several of your activities are charitable and educational. However, your primary activity is the operation of a restaurant, which does not fulfill a charitable or educational purpose. You are not similar to the organization ruled in Rev. Rul. 76-94 because the operation of your restaurant is your main function and your planned educational and charitable programs are secondary to your total activities.

Even though the organization described in B.S.W. Group provided some free or below cost services, the court nevertheless determined that they were operated for commercial purposes. Like that organization, only a small

percentage of your services are free. Therefore, you are operated for the non-exempt purpose of operating a restaurant.

Like Federation Pharmacy Services, Inc., you are operated for the primary purpose of carrying on an unrelated trade or business and cannot be exempt under IRC Section 501(c)(3) per Treas. Reg. Section 1.501(c)(3)-1(e)(1). As held in Better Business Bureau of Washington, D.C., Inc., a single non-exempt purpose, if substantial, will preclude tax exemption under Section 501(c)(3). The operation of your restaurant, a substantial part of your activities, is a non-exempt purpose. Accordingly, you are not operating exclusively for an exempt purpose as described in Section 501(c)(3).

You are similar to the organization described in Living Faith Inc., which operated a business and was in direct competition with other businesses. In the same manner, you operate a restaurant, which is largely used by paying customers. This activity has minimal charitable or educational elements. Therefore, you are not exempt under IRC Section 501(c)(3).

As explained in Universal Life Church, you have the burden of establishing that you qualify for tax exemption. You have not provided supporting documentation to establish you meet the requirements of IRC Section 501(c)(3) as outlined in Pius XII Academy, Inc., and La Verdad. You have not provided the requested operational details of your restaurant, including pricing policies, hours of operation, and how you advertise your services to potential customers. Therefore, there is not sufficient documentation to establish that you are exempt from taxation as required by Section 501(c)(3) and Rev. Proc. 2020-5.

Because you failed to provide the requested additional documentation regarding your operations, you have not established that you meet the requirements for exemption under IRC Section 501(c)(3). As provided in New Dynamics Foundation, any gaps in the administrative record will be resolved against the applicant. You did not provide supplemental information; therefore, we are unable to determine that you qualify for exemption. However, based on the information we do have, it appears that even if you had provided the required information, you would not qualify for exemption under Section 501(c)(3).

Conclusion

Based on the information submitted, you fail the operational test because you are not operated exclusively for charitable or educational purposes within the meaning of IRC Section 501(c)(3). You operate a restaurant for substantial non-exempt purposes. Additionally, you failed to provide additional information regarding your operations; therefore, you have failed to establish that you are operated exclusively for exempt purposes. Therefore, based on the administrative record, you fail to qualify for exemption under 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.

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