

Internal Revenue Service

Appeals Office
300 North Los Angeles Street
MS LA-8000 Room 3054
LOS ANGELES, CA 90012

Date: **JUL 15 2020**

Number: **202041016**
Release Date: 10/9/2020

Department of the Treasury

Employer Identification Number:

Person to Contact:

Employee ID Number: ****

Tel: ****

Fax: ****

UIL Index:

501.03-00

Certified Mail

Dear :

This is a final adverse determination that you do not qualify for exemption from federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Section 501(c)(3).

We made the adverse determination for the following reason(s):

You have not demonstrated that you will be operated exclusively for exempt purposes as required by section 501(c)(3) of the Internal Revenue Code. You will be operated for the primary non-exempt purpose of carrying on an unrelated trade or business, including the purchase and development of land as a pistachio farm. In addition, you have not established that you will be engaged in carrying on a real and substantial charitable program reasonably commensurate with your financial resources. Also, a more than insubstantial part of your activities furthers non-exempt purposes, including serving the private interests of your creators, donors and other designated individuals or businesses rather than serving public interests.

Contributions to your organization are not deductible under section 170 of the Code.

You're required to file Federal income tax returns on Forms 1120, U.S. Corporation Income Tax Return, or 1041, U.S. Income Tax Return for Estates and Trusts. Mail your form to the appropriate Internal Revenue Service Center per the form's instructions. You can get forms and instructions by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

We'll make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in either:

- United States Tax Court,
- The United States Court of Federal Claims,
- The United States District Court for the District of Columbia.

You must file a petition or complaint in one of these three courts within 90 days from the date we mailed this determination letter to you. Contact the clerk of the appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment. You can write to the courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

Note: We will not delay processing income tax returns and assessing any taxes due even if you file a petition for declaratory judgment under section 7428 of the Code.

You also have the right to contact the Taxpayer Advocate Service (TAS). 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 you've tried but haven't been able to resolve your problem with the IRS. Please contact the Taxpayer Advocate for the IRS office that issued this letter. 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.

TAS assistance is not a substitute for established IRS procedures, such as the formal appeals process. TAS cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court.

If you have any questions, contact the person at the top of this letter.

Sincerely,

Appeals Team Manager



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

JUL 15 2020

Date:
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Employer ID number:

Legend:

B = Date
C = State
D = Organization
E = Individual
F =
G = Company
H = LLC
J = Organization
k dollars = Amount
m dollars = Amount

UIL:

501.00-00
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 Section 501(c)(3) of the Code? No, for the reasons stated below.

Facts

You were formed as a nonprofit corporation on B in the state of C. The amendment to your Articles of Incorporation states that you are organized exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Code. Your specific purpose is to be organized and at all times operate exclusively for the benefit of, to perform the functions of, and to carry out the purposes of D, a C nonprofit corporation described in Section 509(a)(1). Your purposes may include any activity or project which D states is consistent with the mission, purposes, and objectives of D.

You assert that you are a Type I supporting organization of D. Per the Letter of Understanding between you and D, D's activities consist of providing residential programs, shelter care, intervention, treatment for problematic sexual conduct, family and individual therapy, mental health services, supervised therapeutic visitation and other community-based wrap-around services to youth and families, including those who have been the victims of human trafficking. You are a supporting organization for D with respect to D's current and future programs and efforts to raise awareness of and to combat human trafficking.

The Letter of Understanding states that one of the key pieces of revenue generation will be the development of F orchards. It is agreed that you will fund the development and operations of the orchards on your own and will not seek any funds from D for any reason. You will also submit an annual report to D's Board of Directors as well as interim financial statements throughout the year upon request.

Your Bylaws provide that you shall be managed by a Board of Directors and D shall appoint a majority of the members of that Board. It is agreed that you shall keep your current board members and that D shall appoint the additional number of board members as is necessary to constitute a majority of the members of the Board of Directors. D may remove and replace any director that it appoints and shall fill any vacancy resulting from the resignation or other inability of such director to serve. Your President, E, may remove and replace any current directors of your Board of Directors and may appoint an individual to fill any vacancy resulting from the resignation or other inability of such a director to serve.

You intend to develop F orchards to create an ongoing source of revenue generation. Your board includes individuals with knowledge of F farming and development. You recognize that by becoming a supporting organization for D, what happens to your assets is at the discretion of the board of D, and that D ultimately has control of all of your assets. If funds are diverted from orchard development, it will lengthen the time it takes to develop the orchards or may even prevent their development completely if funds are depleted so that ongoing care and maintenance of the orchards is threatened. Accordingly, both parties agree that allowing development of the orchards as a long-term asset is in the best interest of both parties and both parties agree not to divert any funds away from the orchard development. To that end, the Letter of Understanding states that prior to the development of the orchards, any funds you provided to D will be limited to m dollars per year, so your funds can be used to make sure the orchards are developed.

The initial property for the F farm has been purchased by two for-profit corporations, G and H. G and H have been holding the land for the past several years while you were in the process of being established. Once you obtain your Section 501(c)(3) status and have been properly funded, you will immediately pursue the purchase the land from G and H. You will purchase the land from G and H at the lesser of the price initially paid for the land or its fair market value on the date of purchase as established by an independent valuation.

G and H are both owned by members of a single family. Specifically, your President, E, holds percent of the ownership rights of G and the remainder is held by other family members. H is owned by E and his father equally. G has been growing considerably over the past several years as it has developed product lines for grocery stores.

After you purchase the land, you will then enter into a lease agreement with G, whereby G will operate the farm, package, market, and distribute the product and pay you a fair market value for the crop rental.

It is the intent to clear and plant F trees on the property so that the orchards can be leased to G to generate revenue. You will hire an independent contractor to assist in clearing, planting, and grafting F trees that will provide a source of income. Substantial funds will be necessary to develop this model. F trees require to reach full maturity and crop-bearing potential. Rental income should begin to flow in Development of the property includes clearing, irrigation system design and installation, fertilizer system installation, tree planting, tree budding, wind machine installation, as well as ongoing cultivation of the orchard.

The lease agreement between you and G has not been developed. You indicated that the rental price will be researched at the time of execution to ensure that G pays no less than fair rental value. The term of the lease will be years with automatic renewals of additional years. The lease will require a one-year notice if G chooses not to renew the lease.

D will be aware of the status of orchard development from the start. As crop production begins (roughly) and you can begin leasing the orchard (and subsequently begin generating income), a joint meeting will be held to discuss budgets, ongoing operations, and funds that will be available to fund causes.

It is expected there shall be some funds available to be used to perform the functions of and to carry out the purposes of D prior to the complete development of the orchards. It is understood and agreed upon that funds generated by you that are available for distribution to causes will be split as follows 30 percent directed by the D Directors; 30 percent directed by the wishes of both D and your board; and 40 percent directed according to the wishes of your board, subject to the requirement that all such expenditures shall be consistent and shall support the mission, purposes and objectives of D.

You provided no financial data for the first two years of your existence. The third year included no revenue and no expenses. The fourth year included a large unusual grant in the amount of k dollars. You stated that this unusual grant was from a donor advised fund. The donor advised fund was created and directed by E's parents through J. They will request that J make the grant to you to fund the all of initial development costs for the orchard. Most, if not all, of the development capital will come from this fund.

Law

Section 501(c)(3) of the Code provides that corporations may be exempted from tax if they are organized and operated exclusively for charitable, educational, or other enumerated purposes, and no part of their net earnings inures 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 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 that 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)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

In Revenue Ruling 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 hardcore 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 Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (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. The Petitioner's activities were largely animated by non-exempt purposes directed fundamentally to ends other than that of education.

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 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 Old Dominion Box Co. v. United States, 477 F.2d 344 (4th Cir. 1973) cert. denied, 413 U.S. 910 (1973), the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

In B. S. W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978) the organization provided consulting services for a fee to various tax-exempt and non-profit organizations. The organizations fees were set at or close to cost. The court concluded that those activities are not inherently charitable because they are of the type typically conducted by for-profit organizations. Even though the organization argued that its fees may in fact be lower than those charged by other firms, the court concluded that it was not enough to prove that organization's purposes are primarily exempt. The Court concluded that the petitioner is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), several for-profit est organizations exerted significant indirect control over est of Hawaii, a nonprofit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the nonprofit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion that the organization did not qualify as an organization described in Section 501(c)(3) of the Code.

In Schoger Foundation v. Commissioner, 76 T.C. 380 (1981), it was held that if an activity serves a substantial non-exempt purpose, the organization does not qualify for exemption even if the activity also furthers an exempt purpose.

In Church by Mail, Inc. v. Commissioner, T.C. Memo 1984-349, affd 765 F. 2d 1387 (9th Cir. 1985) the court upheld that an organization operated for the substantial non-exempt purpose of providing a market for a for-profit corporation was not exempt under Section 501(c)(3) of the Code. In this case, a non-profit organization

was formed to promote religion through the distribution of printed religious messages. The non-profit organization was related to a for-profit corporation that provided the printing and mailing services for the nonprofit organization. The for-profit corporation also provided similar services to others as part of its normal commercial operations. The court determined that the non-profit organization was operated for the non-exempt purpose of providing a market for the for-profit corporation's services and that this non-exempt purpose would preclude exemption under Section 501(c)(3) of the Code.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the Court of Appeals upheld a Tax Court decision, T.C. Memo. 1990-484, 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 under Section 501(c)(3) of the Code. The court found substantial evidence to support a conclusion that the organization's activities furthered a substantial nonexempt purpose, including that the operations were presumptively commercial. The organization competed with restaurants and food stores, used profit-making pricing formulas consistent with the food industry, and incurred significant advertising costs.

Application of law

You are not exempt under Section 501(c)(3) of the Code. You fail the operational test as described in Treas. Reg. Section 1.501(c)(3)-1(a)(1) because you are formed for the substantial non-exempt purpose of preparing and lease an F farm to a for-profit entity which is owned and controlled by your President and his family. 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 substantial non-exempt purpose of financing, preparing, and cultivating a farm for the benefit of G, a for-profit entity. Because your activities do not exclusively accomplish an exempt purpose you do not qualify for exemption. You were established to provide a benefit to a private business, which is owned by E and his family. Furthering private, rather than public, interests, does not further an exempt purpose as explained in Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii).

You are similar to the organization described in Rev. Rul. 73-127. You have three purposes: to provide financial support to support D, to provide educational information regarding human trafficking, and to purchase, prepare and cultivate land for G. You indicated that for your first eight years of operations, you will limit any contributions to D to m dollars. Any education you provide is incidental to your primary purpose of establishing a farm for the benefit of G.

As discussed in Old Dominion Box Co., operating for the benefit of private parties constitutes a substantial non-exempt purpose and prevents you from qualifying from exemption under Section 501(c)(3). You intend to be funded by an unusual grant from another non-profit organization. The source of the funding is a donor advised fund directed by E's parents. This "donation" is a way for E's parents to provide a tax-deductible funding mechanism for their son's for-profit business. Otherwise, using their own money to purchase land to lease to a for-profit business is not a deductible event. To grant exemption in this situation would be in contravention to the intention of the Internal Revenue Code.

You are operating for the private benefit a family through a series of transactions. First, you were funded by what you describe as an "unusual grant" through a donor advised fund controlled by related parties. This "grant" is to be used to develop land to be used by E's business to further their own interests. If a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be

operated exclusively for exempt purposes, as explained in est of Hawaii. G will use you for their own non-incidentally private benefits, causing you to fail to be operated exclusively for exempt purposes and precluding exemption under Section 501(c)(3) of the Code.

You are like the organizations described in B.S.W. Group, Inc. and Living Faith, Inc. because you are operating for a substantial non-exempt purpose rather than exclusively for a tax-exempt purpose. You are also similar to the organization described in the American Institute for Economic Research. You will be establishing an F farm to allow G to compete with other commercial markets. You were formed for the specific purpose of purchasing land to be prepared and cultivated so that it could be leased to G. Any revenue you may receive to support D in the future (you said it would take about eight years to make money) is incidental to your non-exempt purposes. Your activities are neither inherently charitable, nor in furtherance of a charitable purpose, but rather further the private interests of E and his family.

You are similar to Church by Mail because you are controlled by the same persons who control the for-profit company from which you will purchase land and then lease back to them. E maintains dual control over both you and the for-profit organization.

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) of the Code. The establishment of an F farm, a substantial part of your activities, is a non-exempt purpose. As explained in Schoger Foundation, if an activity serves a substantial non-exempt purpose, the organization does not qualify for exemption even if the activity also furthers an exempt purpose. You serve a substantial non-exempt, private purpose of benefitting E through G while only incidentally benefitting D.

Your position

You state your primary purpose is to perform the functions of and carry out the purposes of D. Your specific purpose will be to assist victims of human trafficking. This requires restoration of not only mind, body and spirit, but also _____, your goal is not only the rescue of someone

but also the prevention of _____ if possible. You indicate your activities consist of:

- Education of the public about what human trafficking is, how it can be discovered, and how it can be prevented. This will take place at school facilities, PTA presentations, church presentations, county and state fairs and any other venue where it is felt that individuals can be reached.
- Partnerships with local, state, and federal law enforcement to help in the prevention of human trafficking,
- Working with D to identify victims of human trafficking, as well as at risk individuals before they become victims.
- Production and sale of books, videos, and other supporting merchandise to further education the public about human trafficking. Partnering with D and possibly other groups to minister to the physical needs of victims of human trafficking. This may include partnering with groups that have proven effective and running shelters and safe houses specifically for victims of human trafficking.
- Partnering with and supporting other 501(c)(3) organizations involved in similar activities.
- Participation in local, national and global conferences on human trafficking.

You will attempt to raise funds through donations at your informational talks as well as donations through your website. You will also look to solicit funds from other 501(c)(3) organizations with common goals as you seek to build the F farm into an income-generating asset that can fund programs to fight human trafficking for many years to come.

You said you will not engage in any commercial activity, nor will you conduct any commercial venture. Although you will develop the orchard, all commercial activity related to it will be conducted by G as lessee of the property. Your role will be limited to that of lessor of the property and you will recoup your costs and generate income in the form of rent. G will sell the products of the orchard, although they will donate some of their sale proceeds to you.

In this manner you will effectively create an endowment to fund the tax-exempt activities and purposes of D as the supported organization and of you. Note that D is a public charity and appoints the majority of your board. Therefore, D could veto the development of the orchard if it did not deem that it would contribute importantly to its tax-exempt purposes.

Although the development of the orchard will take time, you will be conducting its charitable activities in the interim. You will not delay the active pursuit of such tax-exempt purposes until you are deriving rental income from the orchard.

The key question in determining whether or not you are entitled to tax exemption is whether its primary purpose is charitable as per Treas. Reg. Section 1.501(c)(3)-1(c)(1). The development of the orchard for the purpose of leasing it to G to conduct commercial farming operations does not mean that you have a substantial nonexempt purpose. An organization satisfies the test if no substantial nonexempt purpose exists. Copyright Clearance Center, Inc. v. Commissioner, 79 T.C. 793 (1982).

Both IRS and judicial authority indicate that the development of real estate, such as the orchard, for the purpose of generating rental income to provide a source of funds for the tax-exempt activities of a charity is not considered to be the conduct of commercial activity.

Under the operational test, the purpose towards which an organization's activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a Section 501(c)(3) organization exempt from tax under section 501(a). B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978).

Rev. Rul. 64-182, held that an organization organized exclusively for charitable purposes that derives its income principally from the rental of space in a large commercial building which it owns, maintains and operates satisfies the "principal purpose" test and is entitled to exemption under Section 501(c)(3) of the Code.

You also cited a CPE article and a Private Letter Rulings ("PLRs"). These are not citable authorities.

Our response to your position

Although you state that your purpose is to support D, your primary purpose is to establish an F farm for the benefit of G. G is a for-profit company owned by your President, E, and his family. You are funding the preparation of the land, planting of the trees and cultivating the crops for the benefit of G. Although you will

receive funds from G through a lease agreement, which has not yet been executed, this is more than an incidental purpose. Therefore, you do not qualify for exemption under Section 501(c)(3).

Conclusion

You do not qualify for exemption under Section 501(c)(3) of the Code because you fail the operational test. Your activities further substantial non-exempt purposes and provide a substantial private benefit to insiders via G. Therefore, you are not exempt 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