

**Internal Revenue Service
Appeals Office**

Date: October 5, 2020

Number: 202053020
Release Date: 12/31/2020

Department of the Treasury

Employer Identification Number:

Person to Contact:

Employee ID Number:
Tel:
Fax:

UIL: 501.33-00, 501.35-00

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 Code Section 501(c)(3).

The adverse determination was made for the following reason(s):
You have not demonstrated that you will be operated exclusively for charitable, educational or other exempt purposes as required by section 501(c)(3) of the Internal Revenue Code. Furthermore, you are organized and operated for the primary purpose of carrying on an unrelated trade or business. Additionally, your operations more than incidentally benefit the private interests of your founder and officer rather than public interests.

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

We will 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 one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules and

the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may 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

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate 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. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892



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

Date: May 8, 2019

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date
C = State
D = President
E = Film #1
F = Individual #1
G = Film #2
H = Film Franchise
J = Production Company
K = Actor
x dollars = \$
y dollars = \$

UIL:

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.

Issue:

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

Facts:

You were incorporated on B in the state of C. Your Articles of Incorporation states you "...write and seek writers for : to obtain funding for these films as well as oversee the production and distribution of these films." The articles do not contain a dissolution clause. You listed four officers and directors on your Form 1023 application, one of which is . You submitted bylaws which provide in Article 4.02 that all decisions are made by majority vote, however, in cases of a tie the vote of D is the tiebreaker. Articles 4.05 and 6.01 state that D designates all officers and directors. In addition, Article 6.03 provides that any officer except D may be removed from office. D is your president, founder and one of your directors.

The narrative description of activities included with your application states your primary purpose is to create . You plan to produce and distribute various films based on scripts written by D. D has written screenplays prior to your formation and will donate copyrights to you. D states that: “ ”

You state that D and God have collaborated in writing three other screenplays that will be donated to you. D has donated the films at no charge because he “ ”

You plan to produce and distribute various films based on scripts written by D. D wrote the screenplays prior to your formation and will donate the copyrights to you.

In addition, you indicated that oversees all aspect of your operations. D estimated that the fair market value of the donated scripts is x dollars. Your first film, E, will be produced and directed by F, who is represented by one of the top agencies for film professionals in the United States. F is experienced in all facets of film making and has . You sent out over pitch letters for E. You anticipate her upfront fee to be much less than she would normally charge in exchange for receiving a backend percentage of the gross box office receipts. You expect actors and other film professionals to have the same type of arrangement. These backend contracts are beneficial because they reduce the cost of producing the film and shares the risk with the various professionals and the investors.

Funding for your films will be solicited from various Churches. You will contact prospective churches via a fundraising packet. When a church is interested in funding one of your films, you and the investor (church) will have a separate agreement detailing the arrangement. You will donate the screenplay to the investor on the project. All proceeds the investors receive from the film will be used to fund that church's various charities. One of the problems that you expect to have in convincing churches to fund your films is the fear that they will lose money as an investment. You will rebut this fear by showing churches that % of all church plants fail within the first four years while films don't fail at the box office at the same rate. You will also show that the films will most likely return extra proceeds which can be used by the church investors. To show how successful E is likely to be financially you submitted printouts from similar movies on an internet database. You plan to secure the services of one or two actors who are the most famous actors and actresses in the industry. You believe this will guarantee large audiences as well as major film distributors. You plan to distribute and show your films worldwide in movie theaters, on television and on the internet.

You submitted over pages of copies of D's relating to a that he believed was disintegrated by . You state that:

You use pitch letters typical in the industry to locate producers and directors for your films. You also submitted your screenplays in various contests to obtain professional feedback and make various revisions.

You estimate that E will cost about y dollars to produce. You will seek an extra % in funding because films typically go over budget. E will be your first film and you believe it will propel you forward to make more films. The churches will not donate the money directly to you, rather they will provide guarantee letters that they have the funds available and you will submit them individual bills to pay. After the film plays in movie theaters it will go on television where it will play for years to come. Your film is different from other films which are poorly written, cheaply produced and don't have actors. This prevents them from attaining major distribution which results in the films appearing on cable television at undesirable times and not in movie theaters. In addition, audiences will not realize that they are seeing a film until the very end. You state your films "

You submitted a copy of the Licensing and Non-Disclosure Agreement between you and D. The agreement states that the purpose is to develop the authored work into first-rate screenplays. To accomplish this the films need to be "

" In addition, any changes, revisions or modifications to the authored works may only be written by D or D's delegates. Finally, D will oversee the production of the films and all contracts, arrangements and agreements you make with third parties regarding the authored work must first be approved by him or his legal guardian.

You will not receive funds directly from the distribution of the films. Rather, the church investor and the film professionals with backend percentage contracts will receive the proceeds from the films' distribution. You will solicit donations from both your church investors as well as other religious organizations. Your submitted financial data indicates that you expect to have minimal donations and expenses for the first few years. All of the costs of producing the films will be funneled through your church investors for payment. Your officers/directors will not receive compensation directly from you. They will receive fringe benefits in the form of meals, lodging and travel expenses related to the production of the films. These costs will be paid through the church investors. Finally, some compensation may also be paid by church investors to officers/directors to oversee the production of each film.

You submitted additional information regarding your activities including your newest screenplay, G, with two versions. One version is generic; however, the second version is the H version. The H version is intended to produce another H full feature film. You indicated that your films differ from commercial ones in that you retain control over the content of the film. Although there will be some artistic interpretation retained by the directors, actors and other film professionals. Your films are designed to be to be profitable. The "top-flight" production company you have in mind for E is J, a well-known production company, that is headed by K, an actor. You plan to hire a production company and distributor with or without a backend percentage because you will have the funds to hire a "top flight" company. You foresee a contract with the owners of the rights to H to produce G. Since your script differs from the traditional H storyline you expect to pay the owners a sizable share of the revenue generated from G.

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, to be exempt as an organization described in Section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. Section 1.501(c)(3)-1(b)(1)(i) provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes and do not expressly empower it to engage, otherwise than as an insubstantial part, in activities which in themselves are not in furtherance of one or more exempt purposes.

Treas. Reg. Section 1.501(c)(3)-1(b)(4) holds that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or operation of law, be distributed for one or more exempt purposes.

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

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(i) lists exempt purposes under Section 501(c)(3) and includes: religious, charitable, scientific, testing for public safety, literary, education and prevention of cruelty to children and animals.

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. It must not be operated for the benefit of designated individuals or the persons who created it.

In Revenue Ruling 60-351, 1960-2 C.B. 169, a corporation was organized and operated on a non-profit basis. It published a foreign language magazine containing fiction, poetry, book reviews and articles which it states is of a literary, scientific and educational character. The magazine was available to the general public through regular paid subscriptions. The corporation's income was derived mainly from subscriptions and sales of individual copies of the publication, and some was from advertising and contributions. Its expenditures consisted of fees paid to authors for their works, salaries, printing, advertising, shipping packing, postage and other operating costs incurred in the publication of the magazine. It was devoted to publishing a magazine and selling it to the general public in accordance with ordinary commercial publishing practices. It was held that the corporation was not an exempt charitable, scientific, literary or educational organization within the meaning of Section 501(c)(3) of the Code.

In Rev. Rul. 68-26, 1968-1 C.B. 272, an organization incorporated without stock by a church provided a standardized source of educational and religious material for the church's parochial school system. Its affairs were managed by a board of directors composed of clergymen appointed by the church and responsible to the church for the organization's finances and operations. The organization printed material which was prepared and edited by the school system. The organization sold the material exclusively to the parochial school's system. All profits were returned annually to the school system. The ruling stated that although a technical parent-subsidiary relationship between the church and the organization is lacking because of the nonstock character of the

organization, a substantially similar relationship does in fact exist through the control and close supervision of its affairs by the church. In printing material which had been prepared for the parochial school system, the organization was carrying out an integral part of the activities of the church, the parent organization. Accordingly, it qualified for exemption under Section 501(c)(3) because it was operated as an integral part of the exempt activities of the parent.

Rev. Rul. 73-164, 1973-1 C.B. 223 states that a church-controlled commercial printing corporation whose business earnings are paid periodically to the church, but which has no other significant charitable activity, is a feeder organization as described in Section 502 of the Code and does not qualify for exemption under Section 501(c)(3).

In Rev. Rul. 77-4, an organization's only activities were preparing and publishing a weekly newspaper that presented local, national and world news, solicited advertising, and sold subscriptions. The Service held that the newspaper's activities were indistinguishable from ordinary commercial publishing practices.

In *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in Section 501(c)(3) that an organization be "operated exclusively" by indicating that an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes.

In *Fides Publishers Assoc. v. United States*, 263 F. Supp. 924 (1967) the government retroactively revoked the taxpayer's exempt status, concluding that, for the previous five years, the taxpayer was engaged primarily, if not solely, in publishing activities. The court noted that, to qualify for Section 501(c)(3) exemption, the taxpayer must be "organized and operated exclusively for" an exempt purpose. The court rejected the taxpayer's argument that, rather than its primary activity, the court should focus on the end to which that activity was taken, namely, religious education. The court pointed out that the taxpayer's sole activity and purpose was the carrying on of the publishing trade and held that the taxpayer's purpose, rather than its goals, were the focus of Section 501(c)(3).

In *Old Dominion Box Co. v. United States*, 477 F.2d 340 (4th Cir. 1973), *cert denied*, 414 U.S. 910 (1973), the court held that operating for the benefit of private purposes constitutes substantial non-exempt purpose.

In *Living Faith Inc. v. Commissioner*, T.C. Memo 1990-484, *aff'd* 950 F. 2d 365 (7th Cir. 1991), the court said 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 Section 501(c)(3). The appellate court stated the factors that the court relied upon to find commerciality and thus offered the best contemporary explanation of the commerciality doctrine. These factors include:

1. The organization sold goods and services to the public.
2. The organization was in direct competition with for profit businesses.
3. The prices set by the organization were based upon pricing formulas common in retail food businesses.
4. The organization utilized promotional material and "commercial catch phrases" to enhance sales.
5. The organization advertised its services and food.

6. The organization did not receive any charitable contributions.

In *Airlie Found. v. IRS*, 283 F. Supp. 2d 58 (D.D.C. 2003), the court laid out the factors for determining whether an organization's activity is of a commercial nature. It said:

Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include . . . whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.

The court also decreed that the organization derived substantial income from business entities that rented the facility, but that the center did not provide services at substantially below cost to other Section 501(c)(3) organizations nor did it show that the facility was used by organizations to promote educations with the meaning of Section 501(c)(3).

In *Christian Manner International, Inc. v. Commissioner of Internal Revenue*, 71 T.C. 661 (1979), the petitioner published and sold books that its founder wrote. The Tax Court found that the organization's actual purpose was to benefit the founder by publishing his books and promoting his theories. Even if the publication of his books in part furthered religious or educational purposes, petitioner would still not qualify for exemption under Section 501(c)(3) because a substantial part of its activity benefited him personally.

Application of Law:

Organizational Test

To demonstrate that it is organized exclusively for exempt purposes, thus satisfying the organizational test, an organization must have a valid purpose clause and a valid dissolution clause. Treas. Reg. Sections 1.501(c)(3)-1(b)(1)(i) and 1.501(c)(3)-1(b)(4). A valid purpose clause limits the organization's purposes to one or more exempt purposes and does not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes. In addition, an organization's assets must be dedicated to an exempt purpose.

Nor do you have a _____ providing that your assets will be distributed exclusively for section 501(c)(3) purposes. Accordingly, you are not organized for exempt purposes.

Operational Test

You are not operated exclusively for charitable, religious, or educational purposes consistent with Section 501(c)(3) of the Code and Treas. Reg. Section 1.501(c)(3)-1(d)(1)(i) and therefore fail to meet the operational test under Treas. Reg. Section 1.501(c)(3)-1(c)(1). Specifically, the facts above indicate that you are not operated for exempt purposes but that you are operated in a commercial manner. Although your films will contain religious messaging and content, more than an insubstantial part of your operations consist of distributing the films in a manner comparable to for-profit entities.

Per Treas. Reg. Section 1.501(c)(3)-1(c)(1), you are not operated exclusively for one or more exempt purposes because you do not engage primarily in activities that accomplish one or more of such exempt purposes specified in Section 501(c)(3). Under this Treasury Regulation, an organization will not be regarded as exempt if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

You are not like the organization in Rev. Rul. 68-26 because your film making activities do not exclusively further religious purposes. While you do plan to partner with churches to produce and distribute the films, your backend contracts and other financial arrangements will benefit third parties to a more than insubstantial degree. Instead, you are similar to the organization in Rev. Rul. 73-164. While your church investors will receive some of the revenue derived from the distribution of the films, you are set up as a commercial film making operation with no other charitable activities. You were formed to create, produce and market films containing a religious message to evangelize lost souls. You will retain the services of A-list actors, producers and directors which you believe will guarantee large audiences and major film distributors. The film will be shown worldwide in movie theaters, on television and the internet. Like the organizations in Rev. Rul. 77-4 and Rev. Rul. 60-351 your operations are indistinguishable from ordinary commercial publishing practices.

You are similar to the organization in *Fides Publishers Assoc.* which printed, published and sold products to promote religious culture. These products were sold at cost plus a markup. The organization argued that, rather than focusing on its primary activity, the court should focus on the end to which that activity was taken, namely religious education. You have indicated your purpose to be advancing religion through the creation and distribution of films with a religious message. Much like the organization in this case you sell your films (products) to churches and generate revenue. Although you do not directly pay the film professionals that will be retained to produce and distribute the films you are a conduit and facilitate the backend percentage contracts which results in revenue sharing with noncharitable beneficiaries. Much like the organization in the ruling, your activities and purpose are focused on filmmaking as a regular trade rather than 501(c)(3) activities of being religious or educational. Since you are operating a regular trade or business, you have an underlying commercial motive as noted in *Better Business Bureau of Washington D.C.*

Like the organization in Rev. Rul. 60-351, your main activity consists of a commercial trade or business. You publish/distribute religious films on a regular basis and offer the material for sale through commercial distribution channels. While you will not receive revenue directly from these sales you plan to solicit donations from your church investors as well as other Christians entities based upon the profitability of your filmmaking activities. You will facilitate the percentage payment of revenue generated from the film's distribution to actors, directors, producers and other film professionals derived from the distribution of films created by your direct involvement and participation.

Your film making operations are analogous to those of ordinary commercial publishing practices and you do not qualify for exemption under section 501(c)(3) of the Code.

You are similar to the organizations in *Living Faith Inc.* and *Airlie Foundation* because your activities are like those of a commercial film making company. Although you were created with religious principles in mind and create/distribute religious based movies, your primary purpose is the operation of a trade or business. You pursue your filmmaking in the same manner as for-profit entities. You utilize pitch letters and other methods ordinarily used in the industry to obtain the involvement and services of producers, directors, actors, other film professionals as well as distributors in the creation of your film products. You will seek an extra % in funding because films typically go over budget. Also, your agreement with D states that films need to be "...

” You indicated that you differ from a commercial publishing company because you seek funding from churches and will retain control over the content of your films to a substantial degree. In addition, you stated that your films are designed to be profitable and you will solicit church investors utilizing data designed to demonstrate that the films will most likely return extra proceeds. However, you are still selling movies to the public in a commercial manner based on fair value determination and indirectly paying percentages of revenue to various film professionals. In comparison to the entities in each ruling, you exhibit similar factors indicative of commercial operations including regular and ongoing sales, competition with other films, common retail pricing structures, marketing and advertising,

Like the organization in *Old Dominion Box Co.*, your operations result in benefit to private parties more than incidentally and therefore constitute a substantial nonexempt purpose. You were formed to create and distribute films. Through the creation and distribution of said films you will facilitate the payment of revenue to private individuals. Although the church investors will also receive the proceeds of the films your activities serve the private interests of the film professionals to a more than insubstantial degree. (Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii))

Similar to the organization in *Christian Manner International, Inc.*, you serve the private interests of D. You were formed to create and distribute films written by D. D retains total control over your activities

In addition, D controls all content of the films. Finally, D will receive compensation from the church investors during the making of the films as well as food, lodging and travel expenses to oversee the making of the films.

Conclusion

You are not organized and operated for an exempt purpose under Section 501(c)(3) of the Code. Your Articles do not limit your purposes to one or more exempt purposes and your assets are not dedicated to an exempt purpose. In addition, your operations do not further an exempt purpose because they serve the private interests of D. More than an insubstantial part of your activities is not in furtherance of exempt purposes.

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.