

200447048

Internal Revenue Service  
Director, Exempt Organizations  
Rulings and Agreements

Department of the Treasury  
P.O. Box 2508-TE/GE, Room 7008  
Cincinnati, OH 45201

Date: MAY 18 2004

Employer Identification Number:

Person to Contact:

U/L: 501.00-00

Contact Telephone Numbers:

FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

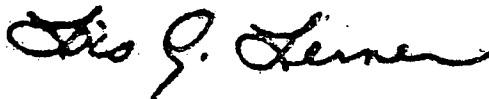
You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,



Lois G. Lerner  
Director, Exempt Organizations  
Rulings and Agreements

Enclosures: 3

FACTS

The information submitted reflects that you were formed as a corporation on  
According to your articles of incorporation, your specific purpose is to

In other words, your  
purpose is to facilitate economic development in the  
Your articles of  
incorporation also contain the language necessary to comply with the organizational  
requirements of IRC section 501(c)(3).

Your bylaws contain generally acceptable provisions regarding your internal governance,  
with the exception that there is no provision regarding the potential removal of directors  
as is present regarding officers.

You were created by local merchants, businesses, and professionals, and such entities  
also comprise your membership. There are no membership dues. Membership benefits  
include networking opportunities, updates on community issues and events, and  
advocacy. As your name implies, you consider yourself "a voice for the merchants".

The area in which your activities are conducted has been deemed "distressed" per a study  
prepared for the Department of Development.

According to your application for tax exemption, your primary activity (70% of your time  
and resources) is to market and administer the program. The  
card provides consumers with discounts on shopping, dining, and  
entertainment activities at participating merchant locations. You consider this an  
economic development tool that will attract consumers and generate revenue in the  
downtown area by encouraging increased patronage of downtown merchants.

More specifically you state in your

(emphasis added)

A letter of support dated 2-17-04 from the states, in  
part, regarding the program, "This wide-ranging program needs to be  
expanded for the benefit of the participating retailers ..." (emphasis added)

FACTS (continued)

According to your Background Information packet regarding the \_\_\_\_\_ program, you offer throughout the year \_\_\_\_\_

(emphasis added)

One such promotion described in volume \_\_\_\_\_ of your newsletter \_\_\_\_\_ is the \_\_\_\_\_ prize package. Your description of said package specifies the names of the participating merchants by stating that the package includes the following:

Participation in the \_\_\_\_\_ program is open to "anyone and everyone". The program is free to consumers, who need only complete an application to receive a \_\_\_\_\_ card. Merchants may participate by submitting a \$ \_\_\_\_\_ enrollment fee, however, such fee is waived for those merchants experiencing a financial hardship.

The consumer application for the \_\_\_\_\_ program requests the consumer's name, home address, telephone number, and e-mail address. The application stipulates that all of the foregoing information must be provided in order to receive the \_\_\_\_\_ card. The application further stipulates that by providing such information, the consumers \_\_\_\_\_

Merchants participating in the \_\_\_\_\_ program are given a password so as to access a section of your website in which they can design and update their own merchant websites. Your website is otherwise freely accessible by the general public, and it provides direct links to the merchants' websites.

Your other activities include \_\_\_\_\_ and \_\_\_\_\_  
Of the \_\_\_\_\_ submitted for review, approximately 1/8 of each is comprised of content regarding your organization and its programs \_\_\_\_\_ above-noted promotion package). The remaining 7/8 of each is comprised entirely of paid advertisements and your membership list.

200447048

FACTS (continued)

Your sources of income include grants, fundraising events, enrollment fees, and advertising. Total income for \_\_\_\_\_ was \$ \_\_\_\_\_ of which \$ \_\_\_\_\_ was from \_\_\_\_\_ enrollment fees (approximately \_\_\_\_\_ % of income). Total income for \_\_\_\_\_ is projected to be \$ \_\_\_\_\_ of which \$ \_\_\_\_\_ will be from enrollment fees (approximately \_\_\_\_\_ % of income). \$ \_\_\_\_\_ enrollment fees for \_\_\_\_\_ and \_\_\_\_\_ combined represent approximately \_\_\_\_\_ % of total income.

Your expense items include website design and fees, legal services, \_\_\_\_\_ card printing and marketing, and various office expenses. Total expenses for \_\_\_\_\_ were \$ \_\_\_\_\_ of which \$ \_\_\_\_\_ was directly attributable to \_\_\_\_\_ program costs (approximately \_\_\_\_\_ % of expense). Total expenses for \_\_\_\_\_ are projected to be \$ \_\_\_\_\_ of which \$ \_\_\_\_\_ will be directly attributable to \_\_\_\_\_ program costs (approximately \_\_\_\_\_ % of expense). \_\_\_\_\_ program costs for \_\_\_\_\_ and \_\_\_\_\_ combined represent approximately \_\_\_\_\_ % of total expense. Please note that our previous correspondence regarding \_\_\_\_\_ expense data erroneously omitted website design fees, which are now included in the foregoing figures.

LAW

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

Section 1.501(a)-1(c) of the Income Tax Regulations defines a private shareholder or individual as a person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated for any purpose under section 501(c)(3) unless it serves a public rather than a private interest. Thus, to meet the requirements of this subparagraph, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Moreover, even though an organization may have exempt purposes, it will not be considered as operating exclusively for such purposes if more than an insubstantial part of its activities serves private interests.

LAW (continued)

Section 1.501(c)(3)-1(e) of the Regulations provides that 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), even though its net profits do not inure to the benefit of individual members of the organization.

Revenue Ruling 74-587, 1974-2 C.B. 162, holds that a nonprofit organization providing low-cost financial assistance, either through loans or through purchase of equity interest in various business enterprises in economically depressed areas, qualifies for exemption under IRC section 501(c)(3). Loans and equity financing are granted only to those individuals or corporations who are unable to obtain funds from conventional sources because of the poor financial risks involved in operating businesses within the depressed area.

Revenue Ruling 77-111, 1977-1 C.B. 144, holds that an organization formed to increase business patronage in a deteriorated area by providing information on the area's shopping opportunities, local transportation, and accommodations is not operated exclusively for charitable purposes and does not qualify for exemption under IRC section 501(c)(3). The Ruling gives two examples. In *Situation 1*, the organization accomplishes the aforesaid purpose by presenting television and radio advertisement describing the advantages of shopping in the area; by creating a speaker's bureau composed of local businessmen who discuss the shopping environment with various groups; by operating a telephone service providing information to prospective shoppers on transportation and accommodations in the area; and by informing the news media on the area's problems and potential. Although these activities may contribute to the achievement of purposes described in IRC section 501(c)(3), they lack the qualities of the activities described in Revenue Ruling 74-587 where services were limited to businesses experiencing difficulty because of their location in an economically depressed area. In the instant case, assistance is available to all businesses in the area, including those that are not experiencing difficulty. Therefore, it is held that the organization's overall thrust is to promote business rather than to accomplish exclusively 501(c)(3) objectives.

Revenue Ruling 78-86, 1978-1 C.B. 151, holds that an organization formed by merchants to establish and operate a public off-street parking facility to alleviate a lack of parking space in the central business district of its community, and that provides free or reduced-rate parking for the merchants' customers does not qualify for tax exemption under IRC section 501(c)(3). The names of participating merchants were advertised by printing them on parking vouchers and on signs at the parking facility. Although there may be some public benefit derived from the construction and operation of the parking facility, it cannot be said to be operated exclusively for charitable purposes under IRC section 501(c)(3). Under the circumstances, such an arrangement substantially serves the private interests of the merchants by encouraging the public to patronize their stores. Rather than providing their own parking, merchants are able to join together to provide a common parking facility in which all share the benefits.

LAW (continued)

Revenue Ruling 69-632, 1969-2 C.B. 120, holds that an organization composed of members of a particular industry, and that was formed to develop new and improved uses for existing products of the industry, does not qualify for recognition under IRC section 501(c)(3). The organization's activities are performed only for persons who are (directly or indirectly) its creators and which are not entities described in IRC section 501(c)(3). The organization's projects may result in new products and processes that benefit the public, but such benefit is secondary to that derived by the organization's members. The members select projects in order to increase their sales by creating new uses and markets for their product. Therefore, it is held that the primary purpose of the organization is to serve the private interests of its creators rather than the public interest.

Revenue ruling 76-206, 1976-1 C.B. 154, describes an organization formed to promote the broadcasting of classical music in a particular community. The organization accomplishes its purpose by engaging in a variety of activities designed to stimulate public interest in the classical music programs of a for-profit radio station, and thereby enable the station to continue broadcasting such music. The Ruling concludes that the organization's activities enable the radio station to increase its total revenues and, therefore, benefit the for-profit radio station in more than an incidental way. Therefore, the organization is serving a private rather than a public interest and does not qualify for tax exemption.

Revenue Ruling 71-395, 1971-2 C.B. 228, holds that a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting, renting, and selling their works serves the private interests of its members, even though the exhibition and sale of paintings may be educational in other aspects.

Revenue Ruling 75-200, 1975-1 C.B. 163, holds that the sale of advertising by the paid employees of an exempt organization, which raises funds for an exempt symphony orchestra and publishes a weekly concert program distributed free at the symphony performances, is a business subject to unrelated business income tax.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the Court stated that the "presence of a single ... [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly ... [exempt] purposes."

POSITION

Although your activities may serve to facilitate economic development in your community, they are not conducted in the manner described in Revenue Ruling 74-587. Specifically, your services are not limited to businesses that are experiencing difficulty because of their location in a deteriorated area. Your services are available to "anyone and everyone".

Aside from the fact that your services are not limited to "depressed" businesses, the type of assistance offered also differs from that described in Revenue Ruling 74-587. The organization described in Revenue Ruling 74-587 merely offered financial assistance to qualifying businesses, which could then use those funds to conduct their own improvement programs. Your services cross the line between charitable activities and business activities.

Specifically, the \_\_\_\_\_ program, links to merchants' websites, joint promotional efforts, and content of your \_\_\_\_\_ are all designed to market and increase the patronage of participating merchants and, thus, are all considered forms of advertising. This is substantiated by your statements that the \_\_\_\_\_ program is intended to provide "unique advertising opportunities to \_\_\_\_\_ members" and "generate economic dollars for downtown merchants", and that your joint promotional efforts are intended "to present opportunities to members in which to pool their advertising and promotional resources." This is further substantiated by the fact that in order for consumers to receive a \_\_\_\_\_ card, they must "agree to receive promotional information from the members of \_\_\_\_\_". As held in Revenue Ruling 75-200, advertising is considered a business activity that, if conducted by an exempt organization, would be subject to unrelated business income tax.

Although it is anticipated that your income from the \_\_\_\_\_ program will greatly subside after \_\_\_\_\_ your expense data reflects that said program will continue to be your primary function. This is also substantiated by the statement that the \_\_\_\_\_ program "needs to be expanded for the benefit of the retailers ... ."

Because your primary function essentially constitutes various forms of advertising, and advertising is considered a business activity, you are considered to be operated for the primary purpose of carrying on a regular business, which precludes recognition of tax exemption under IRC section 501(c)(3) per Regs. section 1.501(c)(3)-1(e).



POSITION (continued)

Further, and as is iterated throughout your application and attachments thereto, your advertising activity substantially serves to increase the patronage of the merchants participating in your program. Although this increased patronage may facilitate economic development, any such public benefit derived from your program is considered incidental to the private benefit primarily served thereby, as described in Revenue Rulings 77-111, 78-86, 69-632, 76-206, and 71-395. Such serving of private interests precludes recognition of tax exemption under IRC section 501(c)(3) as provided by Regs. section 1.501(c)(3)-1(d)(1)(ii).

Given all of the above, it appears that you are not a charitable organization within the meaning of IRC section 501(c)(3), but are instead a marketing business operated to serve the private interests of for-profit merchants in more than an incidental way. This is a substantial nonexempt purpose as described in Better Business Bureau of Washington, D.C., Inc.

Therefore, it is our position that you do not qualify for exemption from Federal income tax as an organization described in Section 501(c)(3) of the Code.

APPLICANT'S POSITION

You have substantiated that the area you serve is "distressed", and you maintain that services are available to all merchants, regardless of whether or not they are experiencing difficulty. You emphasize that you act "as an advocate for all of the merchants and organizations in \_\_\_\_\_ and that you "serve as a voice for the community of ALL merchants without discretion."

Those merchants who are experiencing a financial hardship may have their enrollment fee waived, and/or they may receive a free or reduced-fee advertisement in your \_\_\_\_\_. You state, "In essence, the businesses that are making money and are viable are carrying the weight for the depressed businesses."

You assert that the area you serve has a high poverty rate among its residents, and the card assists such residents by providing discounts on goods and services.

APPLICANT'S POSITION (continued)

It is indicated that the \_\_\_\_\_ program consumed the majority of your time and resources only at the program's inception due to initial start-up costs, and you state that a revised table of time and expenses has been submitted.

You state that "promotional efforts" (such as prize packages) are spin-off campaigns which are designed and managed by the merchants themselves. You claim not to support such efforts to promote the pooling of advertising resources, but to "spread the word of merchanting in \_\_\_\_\_ as an industry not as a specific merchant."

IRS RESPONSE TO APPLICANT'S POSITION

You maintain that your services are available to "ALL merchants without discretion." This substantiates that your "economic development" activities do not meet the standard described in Revenue Ruling 74-587 in that assistance is not limited to businesses experiencing difficulty. The fact that your merchant beneficiaries include "depressed" businesses does not negate or mitigate the fact that your services are also provided to businesses that are "making money and are viable."

Although the \_\_\_\_\_ program may provide relief to the area's impoverished residents, your program is not limited to such residents, nor was any information provided as to the percentage of such residents participating in the program. Regardless, the requirement that consumers must agree to receive promotional material from the members of \_\_\_\_\_ substantiates that your primary purpose is not to provide relief to the poor, but is instead to provide "unique advertising opportunities to \_\_\_\_\_ members."

We received no revised "time table" regarding the percentage of your time devoted to the \_\_\_\_\_ program. However, we did receive your revised financial data, which is reflected above in the "FACTS" section. Although it is anticipated that your income from the \_\_\_\_\_ program will greatly subside after \_\_\_\_\_ your expense data reflects that said program will continue to be your primary function. This is also substantiated by the \_\_\_\_\_ statement that the \_\_\_\_\_ program "needs to be expanded for the benefit of the retailers ... ." (emphasis added)

200447048

IRS RESPONSE TO APPLICANT'S POSITION (continued)

Your assertion that the purpose of your joint promotional efforts is not to support the pooling of advertising resources is directly contradicted by the information in your Background Information packet regarding the \_\_\_\_\_ program, which specifically states, "The purpose of these promotions is to attract more customers into downtown \_\_\_\_\_ as well as to present opportunities to members in which to pool their advertising and promotional resources." (emphasis added) As noted above regarding the \_\_\_\_\_ prize package, the description thereof in your \_\_\_\_\_ specifies the merchants participating in the package. This is not considered to be promoting "merchandising in \_\_\_\_\_ as an industry", but is instead considered to be promoting specific merchants.

The information provided in your application reflects, and your additional correspondence substantiates, that you are operated primarily to provide "unique advertising opportunities to \_\_\_\_\_ members", so as to "generate economic dollars for downtown merchants", primarily "for the benefit of the participating retailers." As previously noted herein, such marketing / advertising activities are not considered charitable activities, but are instead considered business activities. This is so regardless of the extent to which such marketing / advertising is limited to "depressed" businesses. The record substantiates that your primary purpose is to increase business patronage, and any public benefit that may be derived from your business activities is incidental to the private benefit primarily served thereby.

Therefore, it remains our position that you do not qualify for exemption from Federal income tax as an organization described in Section 501(c)(3) of the Code.