



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

Release Number: 201545031  
Release Date: 11/6/2015  
UIL Code: 501.36-01

Date: August 11, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear \_\_\_\_\_ :

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

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

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

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

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

Sincerely,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



**Department of the Treasury  
Internal Revenue Service**

P.O. Box 2508  
Cincinnati, OH 45201

**Date:** June 11, 2015

**Employer ID number:**

**Contact person/ID number:**

**Contact telephone number:**

**Contact fax number:**

**Legend:**

B = Date  
C = State  
D = Name  
F = Organization  
q = Percent  
r = Percent  
s = Percent  
t = Percent  
v = Percent  
w = Percent  
x dollars = Amount  
y dollars = Amount  
z dollars = Amount

**UIL:**

501.36-01

Dear \_\_\_\_\_ :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

**Issues**

Do you meet the operational test for exemption under section 501(c)(3) of the Internal Revenue Code? No, for the reasons stated below.

**Facts**

You were formed as a corporation on B in the state of C.

You were formed for public and charitable purposes. The specific purposes listed in your Articles of Incorporation are to:

- Provide low cost laptop computer stations to students of public colleges and universities, primary and secondary educational institutions, and all forms of extension and enrichment programs.
- Provide free laptops to students of qualifying household incomes (criteria and available quantities to be established by the F board).
- Provide 4 years of computer support and education to student participants.
- Provide low cost laptop computer stations to primary and secondary educational institutions, extension and enrichment programs, Title I programs, and libraries.

Your bylaws state that you were formed for charitable purposes, specifically the advancement of education. Your mission is to address the digital divide by increasing the availability of technology to all education providers as well as individual students of all income levels. The term education provider includes: colleges, primary and secondary schools, charter schools, homeschool families, and learning centers provided by municipalities, libraries, churches, and day care facilities.

You will achieve this by:

- Creating a functional bridge between the computer secondary market and purchasing public agencies (education providers)
- Providing a functional (nonprofit) storefront and fulfillment process
- Providing a functional (nonprofit) free 4-year warranty service capability
- Providing a functional (nonprofit) free 4-year user support service

Article 7, Section 3, of your bylaws states that your initial Board of Directors was chosen by the incorporator and will serve until their successors have been selected by the initial board. However, the founding director, D, will hold office until death, resignation, or removal. There are no family or business relationships between the directors on the first board.

You plan to accomplish your purpose by expanding the purchasing power of every dollar spent for a classroom ready computer in order to increase the number of on-campus computers available for student use. You will lower the procurement cost per unit and increase the lifespan of the computer once in use. You will create a supply channel connecting the secondary computer market to education providers and you will offer a free (nonprofit) 4-year service warranty. This will eliminate the high percentage of profit taking within computer servicing and allow the computers to remain in use for a longer period of time. You estimate that when a computer is purchased from you as opposed to a for-profit retailer, the purchase will save a maximum of z dollars per unit over four years with estimated expenses including purchase, repair, and software maintenance.

There are currently many operational barriers for public entities purchasing computers such as the varying cosmetic and technical quality of inventory, cash and carry purchasing, limited availability, and no warranties. These barriers are remedied through your activities of product and service procurement and fulfillment, audience outreach, and corporate organization and development. All of your operational activities address the barriers blocking the educational system from using the secondary computer market. You address the barriers in the following ways:

Barrier 1 — Mixed cosmetic and technical quality of inventory. Education providers require classroom-ready computers. Suppliers within the secondary computer market do not guarantee the condition of the computer or accept returns. You establish quality standards and test each computer against these standards. You install

necessary hardware upgrades and software installations and return unsatisfactory units to the supplier. This is performed by your lab which is funded by your sales.

Barrier 2 — Undependable availability of computer models. Obtaining the correct computer for the intended use is critical to the success of the school or program. Therefore, you obtain the correct computer for the intended use. You fill each order with one specific computer model. The order fulfillment is achieved by sourcing the order out to over 50 suppliers across the country. You purchase the quantity available from each supplier until the order is filled. Your purchasing conducts this activity and it is funded through your sales.

Barrier 3 — As is purchasing with no warranties. Purchasing agencies are dependent on long-term warranties for purchased technology to manage costs. In most cases when the warranty is up, it is cost prohibitive to keep the computer operational. Suppliers within the secondary computer market do not provide warranties. You implement a free 4-year warranty for schools. Your lab, which is funded through your sales, receives and completes all warranty work.

Barrier 4— Cash and carry purchasing. Suppliers within the secondary computer market do not accept purchase orders. Payment must be made in full prior to shipping the inventory. Federal and state funding guidelines stipulate that product must be received by the agency prior to payment being made. You develop quotes for, and receive purchase orders from, purchasing public agencies. You make cash payments to suppliers to fill the orders. Your business management, which is funded by your sales, conducts this activity.

To sum up your activities, your process flow starts when a school places an order for computers and supplies you with a purchase order. You source out the order to over 50 suppliers in the secondary computer market including brand distributors, industry distributors, and industry refurbishers. You pay cash to the suppliers for the computers and the suppliers send the ordered computers to you. Once received, you qualify the computers, install upgrades, install software, and apply the 4-year warranty. You then ship the ready computers to the school and issue an invoice to the school for the computers. The school then submits the payment to you. You provide warranty service to the computers as needed.

Your initial board members will fund your purchase order fund through an x dollars no interest loan. As the fund grows larger you will be able to assist more schools and programs. The balance in the fund never decreases. You draw funds from the account equal to the purchase orders you receive to pay the suppliers. When a school or program pays your invoice, you deposit the payment in the purchase order fund. You will also seek corporate and foundation contributions for the fund.

Your program outreach consists of providing information about your products and services and will target educational institutions and individual students. Individual students and families can purchase your computers with the same cost and service benefits. Your current and immediate future outreach activities include reaching school or program administrators for Title I Grants in classroom technologies, reaching program directors and teachers for public school special education programs, reaching IT staff and teachers at public charter schools, reaching homeschool families and networks, and reaching college students at colleges located close to your offices. You will conduct PR campaigns and mail brochures to inform these groups about you. Promotional materials will be funded by a y dollars no interest loan from your initial board.

The qualifications of individuals and organizations who are able to purchase your laptops include the following:

- College students who are enrolled in or who are applying for college
- Individuals who are enrolled in or are applying for a GED, trade, or distance education/programs

- Primary and secondary students under “Bring Your Own Device” requirements in public schools
- Homeschool students – Families conducting homeschool who are in possession of documentation as determined by their respective state laws
- Public schools, charter schools with the appropriate state charter or application, and private primary and secondary schools with the appropriate accreditation
- Organizations involved in Title I educational programs
- Private learning centers and day cares with incorporation or a mission statement
- Churches, libraries, and educational assistance organizations with incorporation or a mission statement
- Local/civic governmental agencies providing educational support

Volunteer hours and personal resources fund all activities at this time. Future funding will be provided through your product sales. As your revenue increases, budgets will be implemented for operations and staff salaries.

Your revenue will be from your sales and fees. You predict that of that income, s% will be distributed to cost of goods provided to schools, v% will be for operation and administration, r% will be for outreach and marketing, and q% will be unrestricted net income.

You will not sell any laptops below cost in your first year. In the following years you will sell a maximum of w% of laptops below cost. Laptops sold below cost will be funded through net unrestricted funds so any growth in the percentage is tied to the growth in net unrestricted funds. You will not seek donations or grants for laptops sold below cost. If in the future your board decides to seek donations to support sales of laptops sold below cost, the percentage will increase above w%. The pricing for laptops sold below cost is v% under cost. The pricing will only be available on standard performance laptops for in-classroom use for public schools serving low-income areas presently classified as Title I by the Department of Education.

The laptop warranty for parts and labor will be provided at no cost for the first year of the warranty. Then the laptop warranty for labor will be provided at no cost for the second, third, and fourth year of the warranty and the laptop warranty for parts will be at cost for these years.

Your revenue, after receiving your no-interest loan for your purchase order fund, will be derived exclusively from the sale of laptops. In future years revenues received from the sale of laptops will exceed your expenses for occupancy, salaries, and cost of goods sold. You will maintain a t% ratio of above cost pricing for laptops since cost of goods, operational costs, warranty costs, and administrative costs will be paid through laptop sales. You will not seek donations for these costs. If you do seek donations to support the free 4-year warranty in the future then the percentage of laptops sold above cost will decrease from t%.

### **Law**

Section 501(c)(3) of the Internal Revenue 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.

Section 513(a) of the Code defines the term ‘unrelated trade or business’ as any trade or business of an organization subject to tax under section 511 the conduct of which is not substantially related (aside of the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt functions. Such term does not include any trade or business 1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or 2) which is carried on by the organization primarily for the convenience of its

members, students, patients, officers, or employees, or 3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (“Regulations”) provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations 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.

Section 1.501(c)(3)-1(d)(2) of the Regulations provides that the term “charitable” is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.501(c)(3)-1(e) states an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities if the operation of such trade or business is in furtherance of the organization’s exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513.

In Rev. Rul. 73-127, 1973-1 C.B. 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 to the hard-core unemployed does not qualify for exemption from income tax.

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 Fides Publishers Assn. 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 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 is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial.

In Living Faith Inc. v Comm’r, 60 T.C.M., 710, 713(1990), aff’d 950 F.2d 365 (& 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 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 include:

- 1) The organization sold goods and services to the public.
- 2) The organization was in direct competition with for profit businesses (food stores and restaurants).
- 3) The prices set by the organization were based on pricing formulas common in retail food businesses.
- 4) The organization utilized promotional materials 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 Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the District Court relied on the “commerciality” doctrine in applying the operational test for an organization that operates a conference center. Because of the commercial manner in which this organization conducted its activities, the court found that it operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. “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, *inter alia*, 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).

#### **Application of law**

You are not as described in section 501(c)(3) of the Code because you are not organized and operated exclusively for exempt purposes. You fail the operational test as you are not operated exclusively for exempt purposes as described in section 1.501(c)(3)-1(a)(1) of the Regulations. Your activities are commercial in nature and include securing computers from suppliers and selling them for a fee to education providers and students. As explained in section 1.501(c)(3)-1(c)(1) of the Regulations, you will not be regarded as “operated exclusively” for one or more exempt purposes because more than an insubstantial amount of your activities are not charitable as described in section 1.501(c)(3)-1(d)(2) of the Regulations.

Section 1.501(c)(3)-1(e) states an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities if the operation of such trade or business is in furtherance of the organization’s exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. Per section 513(a) of the Code, you are carrying on an unrelated trade or business. You are conducting a business activity that does not fulfill an exempt purpose under section 501(c)(3) of the Code. Your work will be performed by compensated individuals and you sell computers that you purchase from suppliers.

You are similar to the organization in Rev. Rul. 73-127 in that you are selling your product, computers, to students and education providers at prices substantially lower than those charged by other businesses. You are operated in a manner similar to other profit-making businesses with paid employees and sales prices set above your costs. You will maintain a t% ratio of above cost pricing for laptops since cost of goods, operational costs, warranty costs, and administrative costs will be paid through laptop sales and you will not seek donations for those costs. You expect



to only sell w% of your laptops below cost in future years at a rate of v% under cost. Like the organization in Rev. Rul. 73-127, you have a smaller markup than competing businesses. However, you are still operating as a business. Selling computers at low prices does not fulfill a charitable purpose under section 501(c)(3) of the Code.

You are operating like the organization in B.S.W. Group, Inc. v. Commissioner because you are engaged in the commercial activity of marketing and selling computers. You are providing computers to education providers and students at a fee that is above cost. An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. This activity constitutes the conduct of a commercial business of the sort which is ordinarily carried on by commercial ventures organized for profit.

You are also like the organization in In Living Faith Inc. v Comm'r. Like the organization in In Living Faith Inc. v Comm'r, your main activity involves the sale of goods. You are in direct competition with other for-profit businesses that resell computers and you conduct program outreach targeted at students and educational institutions to let them know about your products and services. You also have PR campaigns and mail brochures with information about your services. Although your activities are currently being conducted by volunteers, as your revenue increases they will be conducted by paid staff. Additionally, like the organization in In Living Faith Inc. v Comm'r, your prices are set to cover the costs of the goods and services you provide and you do not plan on receiving donations to cover these costs. Therefore, you are operating a business. Although you set your prices below other organizations reselling computers, you are involved in the same activity of selling computers as your for-profit competitors.

You are like the organization in Fides Publishers Assn. v. United States in that your primary activity consists of operating in a commercial manner. Your sole activity consists of securing purchase orders, securing computers from suppliers, installing software, sending the computers to the education providers, collecting fees for services, and providing a warranty for parts and maintenance. Providing these services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services are provided at a rate lower than a for-profit retailer and solely for education providers and students is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code.. Although the end result may be that students have access to computers, you are operating a business to achieve that result. Therefore, you are not organized and operated exclusively for an exempt purpose.

Like the organization in Airlie Foundation v. Commissioner, you operate for a non-exempt commercial purpose rather than for a tax-exempt purpose. By purchasing computers from suppliers and reselling them to students and education providers, you are in direct competition with other for-profit commercial entities that sell computers. Although your sales prices may be lower than some of your for-profit competitors, your fees are still set above your costs, you will have paid staff, and you do not solicit charitable donations. In addition, like Airlie Foundation v. Commissioner, you use commercial promotional methods such as PR campaigns and the mailing of brochures to advertise your products and services.

As held in Better Business Bureau of Washington, a single non-exempt purpose, if substantial, will preclude tax exemption under section 501(c)(3) of the Code. Your primary activity consists of selling computers which is a commercial activity. Your activity is also carried on by normal, profit-making businesses and you are in direct competition with these for-profit businesses. Therefore, you are not operating exclusively for an exempt purpose as described in section 501(c)(3) of the Code.

**Your position**

You believe that your activities serve a charitable purpose under section 501(c)(3) of the Code because you provide computers at a lower cost than other sources and you provide a free 4-year warranty that lowers the cost of ownership.

**Our response to your position**

You have failed to prove that your activities are exclusively charitable within the meaning of section 501(c)(3) of the Code. You will sell refurbished computers above cost to education providers and students. Only a small portion of the computers will be sold below cost.

**Conclusion**

You are marketing and selling computers for a fee that is above cost. You are therefore operating in a commercial manner and you do not qualify for exemption under section 501(c)(3) of the Code because your activities do not fulfill a charitable purpose.

**If you don't agree**

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

**For an officer, director, trustee, or other official who is authorized to sign for the organization:**

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

**For authorized representatives:**

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts 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 he or she hasn'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 provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office 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 at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

**Where to send your protest**

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You can also fax your statement 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 he or she received it.

**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.

You can find all forms and publications mentioned in this letter on our website at [www.irs.gov/formspubs](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Director, Exempt Organizations

Enclosure:  
Publication 892