



**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**TE/GE EO Examinations**

1100 Commerce Street

Dallas, TX 75242

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

Date: February 23, 2017

Taxpayer Identification Number:

Release Number: **201732030**

Person to Contact:

Release Date: 8/11/2017

Employee Identification Number:

UIL Code: 501.03-00

Employee Telephone Number:

**CERTIFIED MAIL – Return Receipt Requested**

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the Code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

Organizations described in Section 501(c)(3) of the Code and exempt under section 501(a) of the Code must be both organized and operated exclusively for exempt purposes. You have not demonstrated that you are operated exclusively for charitable, educational, or other exempt purposes within the meaning of 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. You have not established that you have operated exclusively for an exempt purpose.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. If you have not already filed these returns and the agent has not provided you instructions for converting your previously filed Form 990 to Form 1120, you should file these income tax returns with the appropriate Service Center for the tax year ending December 31, 20XX and for all tax years thereafter in accordance with the instructions of the return.

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 Internal Revenue Code.

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: United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed before the 91st day after the date this determination was mailed to you if you wish to seek review of our determination. Please contact the clerk of the respective court for rules and the appropriate forms regarding filing petitions for declaratory judgment by referring to the enclosed Publication 892. Please note that the United States Tax Court is the only one of these courts where a declaratory judgment action can be pursued without the services of a lawyer. 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

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 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 [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov) or call 1-877-777-4778.

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

Sincerely yours,

Mary A. Epps  
Acting Director, EO Examinations

Enclosures:  
Publication 892



**Department of the Treasury**  
**Internal Revenue Service**  
**Tax Exempt and Government Entities Division**  
Exempt Organizations Examinations

Date:  
January 5, 2017  
Taxpayer Identification Number:

Form:  
990-N Postcard  
Tax year(s) ended:  
December 31, 20xx; December 31, 20xx  
Person to contact / ID number:

Contact numbers:  
Phone Number:  
Fax Number:  
Manager's name / ID number:

Manager's contact number:  
Phone Number:  
Response due date:  
February 6, 20XX

**Certified Mail - Return Receipt Requested**

Dear

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the

calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Mary A. Epps  
Acting Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	<b>Schedule No. or Exhibit 990</b>
<b>Name of Taxpayer</b>		<b>Year/Period Ended</b> December 31, 20xx December 31, 20xx

**ISSUE:**

1. Whether \_\_\_\_\_ is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3)?
2. Whether \_\_\_\_\_ is engaged primarily in activities that accomplish an exempt purpose?
3. Whether more than an insubstantial part of \_\_\_\_\_ activities are in furtherance of a non-exempt purpose?
4. If revocation is upheld what is the effective date?

**FACTS:**

**Background:**

\_\_\_\_\_ was recognized as exempt from Federal income tax under section 501 (c) (3) of the Internal Revenue Code by letter dated June 6, 20XX.

\_\_\_\_\_ original articles of incorporation filed with the Secretary of State states their purpose as organized and operated exclusively for religious, charitable, educational and scientific purposes under section 501 (c)(3) of the Internal Revenue Code of 1986; no specific activities of the organization were described.

By-Laws states their "...purpose to provide a better \_\_\_\_\_ to have fun, be entertained and meet other motivated, successful people in the community. It is mostly focused on the youth and young adults".

**Form 1023 – Application for Recognition of Exemption**

On February 12, 20XX, \_\_\_\_\_ filed a Form 1023-Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, with the Internal Revenue service, hereinafter "IRS" or the "Service". The application described their activities in part, as:

1. Make \_\_\_\_\_ the center of entertainment and/or events.

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2. To have social network with teenagers and young adults who will make them aware that being a \_\_\_\_\_ can be fun and secular or popular culture is not necessarily the only means of enjoyment.
3. Entertainment that will bring a message to all, that people can have fun without drinking, smoking or listening to music with profanity.
4. Events such as bowling, the movies, comedy show, a rap session where individuals get the opportunity to discuss and learn about relevant topics, current events and issues that may affect them or peers they relate to; karaoke nights, concerts to bring to those at risk kids, cruises, and trips to amusement parks.
5. Opportunity to meet other motivated successful people in the community two Fridays in every month.

Activities:

In a letter dated May 12, 20XX, \_\_\_\_\_ was notified that its Form 990 for tax year ended December 31, 20XX had been selected for examination.

The initial Information Document Request (IDR) asked the organization for a description of its activities and how the activities furthered their exempt purpose.

In their response, organization explained that in order to further their exempt purpose, they are able to bring attention to the community and obtain volunteers to work with kids to help run workshops, distribute school supplies, tutor and create an environment to give hope to kids. They also work with students from local college to display their talent of artwork at their facility and earn notoriety and also showcase their musical talent at certain nights of the week.

\_\_\_\_\_ meeting minutes described activities, such as summer trips, recruiting young people for cooking classes, and etiquette workshops. Organization reinstates their mission: "To empower, encourage, and prepare youth to become leaders through life-changing mentoring, training, and skill-building opportunities."

The second IDR was issued requesting more information about activities engaged during 20XX. \_\_\_\_\_ described that their activities were taking place at their

location at \_\_\_\_\_ and included but not limited to:

- Book drive; back to school events, participate in food and health fair, Martin Luther King weekend festival, and church events.

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- Targeting children ages K through 12; trained them to enhance their social skills, cooking, etiquette and how to handle their finances. No fees were charged to perform these services, and also provided food and snacks free of cost.
- These and others events took place at least once or twice a month.

In addition, the organization described their \_\_\_\_\_ program, which is a local full service restaurant. \_\_\_\_\_ offers post-development to those 18 years and older who desire to re-integrate into the workforce. This training program helps employ, train and minister to young men and women who express interest in career development. The program seeks to enhance all the necessary aspects to personal and leadership development. Through outreach and targeted fulfillment, the goal is to collaborate and positively impact youth, adults and families through effective programming.

An initial interview was conducted with \_\_\_\_\_, president of \_\_\_\_\_ on May 23, 20XX at \_\_\_\_\_ (organization's place of business). He restated that the organization conducts activities as described in the Form 1023; and the activities that he described in both IDRs. No substantiation was provided to support that the organization conducted activities as described in both the Form 1023 and both IDs. During the interview he stated that \_\_\_\_\_ was DBA \_\_\_\_\_. The examination was extended to include the tax year that ended December 31, 20XX.

\_\_\_\_\_ is a restaurant that provides lunch, brunch, dinner, live music, catering, and host events at \_\_\_\_\_. They are open to the public Tuesday through Thursday from 11:30 am to 9:00 pm, Fridays from 11:30 am to 11:00 pm, Saturdays from 5:00 pm to 11:00 pm, and Sundays from 10:00 am to 3:00 pm. It is described as a Louisiana-style dishes, drinks & regular jazz offered in casual, contemporary surrounds.

\_\_\_\_\_, President of the organization stated that the restaurant is open and operating to provide funds for their exempt programs.

Financial Examination:

The bank account statements of \_\_\_\_\_ DBA \_\_\_\_\_ were reviewed for years ended December 31, 20XX and December 31, 20XX. Income was generated from loans from the organization's president, restaurant sales, and rent from events such as birthdays, meetings, and Christmas events. Expenditures were all related to the restaurant business. No income or expenditures were identified as the organization's exempt activities.

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**LAW:**

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized and 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.

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 the relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that 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 purposes of carrying on an unrelated trade or business.

In *Better Business Bureau of Washington D.C., Inc. v United States*, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.



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The Court found that the trade association had an “underlying commercial motive” that distinguished its educational program from that carried out by a university.

In *American Institute for Economic Research v. United States*, 302 F.2d 93 (Ct. Cl. 1962), the Court considered an organization that provided analyses 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 arguendo that the organization had an educational purpose. However, 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 indicative of a business. Therefore, the court held that the organization had a significant non-exempt purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

In *Easter House v U.S.*, 12 Ct. Cl. 476 (1987), aff’d 846 F.2d 78 (Fed Cir 1988), the court found that adoption services were the primary activity of the organization. In deciding that the organization conducted adoption services for a business purpose rather than a charitable purpose, the court considered the manner in which the organization operated. The record established a number of factors that characterize a commercial activity and which were evident in the operations of Easter House also. The court determined that the organization competed with other commercial organizations providing similar services; fees were the only source of revenue; it accumulated very substantial profits, because it set its fees in order to generate a profit; the accumulated capital was substantially greater than the amounts spent on charitable and educational activity; and the organization did not solicit and did not plan to solicit contributions. The court also found a corporate-type structure in the classes of memberships (including a single life member having inherent power that the holder could transfer like stock), and dependence on paid employees.

**TAXPAYER’S POSITION:**

The exempt organization’s position has not been determined.

**GOVERNMENT’S POSITION:**

Based on the examination conducted, it has been concluded that \_\_\_\_\_ does not continue to qualify for tax-exempt status as an organization described in section 501(c)(3) of the Code. \_\_\_\_\_ does not operate exclusively for section 501(c)(3) purposes, rather it has a substantial non-exempt purpose. Although it does appear that \_\_\_\_\_ conducted some

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit 990
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charitable activities, its primary activity consists of restaurant services and such services are in furtherance of a substantial non-exempt purpose.

is similar to the organization is American Institute for Economic Research that the court concluded had a significant non-exempt commercial purpose. In that case the organization sold periodicals and provided services to individuals relating to the purchase of securities. Like the organization in American Institute for Economic Research, is providing food services to the public for a fee. While may provide some charitable activities, the manner in which it operates is indicative of a business, rather than an organization described in 501(c)(3) of the Code.

In Easter House the court decided that the organization conducted adoption services for a business purpose rather than a charitable purpose. In reaching its decision, the court considered the manner in which the organization was operated. The following factors were established:

- The organization competed with other commercial organizations;
- Fees were the only source of revenue;
- The organization accumulated very substantial profits because of its fee structure;
- The accumulated capital was substantially greater than amounts spent on charitable and educational activity; and
- The organization did not solicit and did not plan to solicit contributions.

Several of the factors present in the Easter House case are also applicable to

During the examination years ended December 31, 20XX and 20XX, substantially all of revenue was derived from the restaurant services. Additionally, did not provide any documentation to show that they actually conduct the exempt activities described in their Form 1023. appears to compete with other commercial entities; the restaurant services are comparable to some of the services provided by similar for-profit companies. Organization could not substantiate that they conduct charitable activities.

While may have provided some charitable activities, they are incidental when weighed against its restaurant services. As provided in Better Business Bureau of Washington D.C., Inc. the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

are substantial and commercial in nature, and as such, the services defeat its claim to be an organization described in section 501(c)(3) of the Code.

### CONCLUSION:

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In summary, \_\_\_\_\_ is not operated exclusively for exempt purposes, because it does not engage primarily in activities that accomplish an exempt purpose. More than an insubstantial part of \_\_\_\_\_ activities are in furtherance of non-exempt purposes that are commercial in nature.

It is recommended that \_\_\_\_\_ tax-exempt status be revoked effective January 1, 20XX.