

Internal Revenue Service

Appeals Office
San Jose Appeals, MS-7100
55 S. Market St., Suite 440
San Jose, CA 95113

Department of the Treasury

Employer Identification Number:

Person to Contact:

Date: December 20, 2018

Number: **201911010**
Release Date: 3/15/2019

UIL: 501.36-00
501.36-01

Certified Mail

Dear :

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

We have hereby revoked the favorable determination letter to you dated July 1, 20XX and you are no longer exempt under Section 501(a) of the Code effective January 1, XX.

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

You are not operated exclusively for charitable or other exempt purposes, as required by section 501(c)(3) of the Code. Your primary activity was operating community located in former locations, and . Providing food and drink to members of the general public absent a showing of need is not a charitable purpose under section 501(c)(3). In addition, open to the general public during commercial business hours and accepting retail cost or greater in payments from individuals receiving the food items indicates a substantial non-exempt commercial purpose. Also, this activity was and through the operation of similar in appearance and operation to the , rather than through donations or other support indicating community oversight from the general public, further showing that the operations of the were for substantial non-exempt private rather than public purposes.

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

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

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

attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

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

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

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

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

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

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

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

Please refer to the enclosed Publication 892, How to Appeals an IRS Determination on Tax -Exempt Status, for more information about the Appeals process.

You also have the right to contact the Taxpayer Advocate Service (TAS). TAS is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You If you qualify for TAS assistance, which is always free. TAX will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

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

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

Sincerely,

Appeals Team Manager

Enclosure: Publication 892

cc:



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities
Exempt Organizations Examinations
Suite 101
2850 NE Independence Ave.
Lee's Summit, MO 64064

Date:
March 23, 2017
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact / ID Number:

Employee ID:
Contact numbers:
Telephone:
Fax:
Manager's Name / ID Number:

Employee ID:
Manager's Contact Number:

Response Due Date:

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 15 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 IRS Appeals office by submitting a written request to the contact person at the address listed above within 15 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,

Maria Hooke
Director, EO Examinations

Enclosures:
Report of Examination
Form 6018
Publication 892
Publication 3498

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| Form 886-A | EXPLANATION OF ITEMS | Schedule or Exhibit No. |
| Name of Taxpayer | | Year Ended December 31, 20XX |

Issues:

Whether 501(c)(3) tax-exempt status should be revoked because of the existence of a substantial nonexempt activity.

Facts: Operations:

"hereafter referred to as the Foundation" was granted exemption under Section 501(c)(3) of the Internal Revenue Code from January 10, 20XX, the date that they incorporation with the State of

Initially, the Foundation activities consisted of organizing and implementing campaigns for contributions and soliciting requests for donations. The contributions were then directed toward providing assistance to organizations and programs that missions fell within the following categories: Health and Welfare, Education, Culture and Arts, Civic and Community.

During tax year 20XX the Foundation's activities consisted of the following:

- To provide contributions to exempt organizations throughout the United States for the following activities: health and welfare, education, cultural and arts, and civic and community.
- To assists in procuring food and feeding America through a network of food banks.
- To run , a program that consists of which operate similar to a traditional . Customers are encouraged to take what they need and make a suggested donation in return for the food and drinks received.
- To provide a job training program at the for high-risk individuals between the ages of and that are referred by local non-profit organizations to the Foundation.

Contributions/Assist in Procuring Food and Feeding America

During tax year 20XX the Foundation made grants and other assistance of \$ to other charitable organizations.

- Operations of Facilities

is a program that consists of which operate similar to traditional . The are located in areas that are not economically depressed and compete with other eating facilities that are located in the areas. The were located in and . The were open seven days a week. The menus at the Foundation's include all of the of a traditional . **Please refer to Exhibit I.**

The request suggested donations for the food and drinks that are provided, and will accept whatever the customer wants to pay. The customers are **not required** to make any payments in return for the food and drinks provided. The suggested donations are listed on the menu board. Approximately, percent of the customers pay more than the value of

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the meal, percent of the customers pay the value of the meal and percent of the customers pay less than the value of the meal. Customers that pay more than the suggested menu price are not advised of the amount that should be treated as a contribution. When the were initially opened it was estimated that they served over people each week. During the 20XX tax year the Foundation received \$ in receipts for the sale of food and drinks items provided at the

Job Training Program

During the tax year ending Dec. 31, 20XX had individuals graduate from their job training program. graduates, graduates and During the years and the job training program has had high-risk individuals graduate. The program provides training for youth so they can get jobs in the food service industry.

Employees

The Foundation had workers that were compensated for related services and the Foundation paid total compensation of \$ for the workers during tax year

Foundation Controlled by Related For-profit

The Foundation is controlled by the members of a related for-profit organization, All of the officers and directors of the Foundation are employees of The worker's compensation were paid by and then was reimbursed by the Foundation for the compensation that was paid. The Foundation does have some volunteers, the volunteers are not permitted to handle food or collection monies, the volunteers are restricted to cleaning tables, windows and floors.

During tax year ending December 31, 20XX, the Foundation had the following revenues:

- \$ - Donated of , and, property and equipment.
- \$ - Cash:
- \$ - Receipts for food and drinks items from the general public.
- \$ - Vendor support contributions.
- \$ - Donation Boxes at for-profit facilities.

The majority of the Foundation's support is from the related for-profit organization.

The activities are operated at a loss, even though they receive donations of and, property and equipment from . It was stated that the activity was started because the Foundation intended to make a profit from the receipts obtained from the food and drinks that were provided at the

LAW:

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Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax 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 lessening of the burdens of government.

An organization described in section 501(c)(3) of the Code, must, among other requirements, be organized and operated exclusively for certain purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states: "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 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." Section 1.501(c)(3)-1(c)(1) of the regulations states: "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). 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)(1)(ii) of the regulations state that: "An organization is not organized and operated exclusively for one or more of the purposes specified. . . unless it serves a public rather than a private interest. Thus, to meet the requirements. . . 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." Section 1.501(c)(3)-1(e)(1) of the regulations 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 determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes."

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). 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 170 of the Code provides for allowance of deductions for charitable contributions, subject to certain requirements and limitations. To the extent here relevant a charitable contribution is defined 105 by that section as "a contribution or gift to or for the use of" certain specified types of organizations. To be deductible as a charitable contribution for Federal income tax purposes under section 170 of the Code, a payment to or for the use of a qualified charitable organization must be a gift. To be a gift for such purposes in the present context

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there must be, among other requirements, a payment of money or transfer of property without adequate consideration.

Section 512(a) defines "unrelated business taxable income" as the gross income from any "unrelated trade or business" regularly carried on by the organization as computed in the manner provided in section 512.

The term "unrelated trade or business" is defined in section 513(a) of the Code as any trade or business the conduct of which is not substantially related (aside from 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.

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from 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 charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code provides that for the purposes of this section the term "trade or business" includes any activity that is carried on for the production of income from the sale of goods or the performance of services.

Taxpayer's Position:

The Foundation believes that since the _____ only request donations in return for the food and drinks that the _____ are charitable in nature.

Government's Position:

The Foundation primary activity is to operate _____ in affluent areas, the _____ provided food and drinks to the general public, and at times to persons in need. The _____ were not operated primarily for the purpose of providing food and drinks to individuals in need. The _____ activities are **substantial**, the Foundation had _____ workers that were employed to operate the _____ during tax year 20XX. The job training activities are insubstantial in nature since there were very few participants, _____ during tax year 20XX and _____ o over a _____ year period.

The Foundation has posted suggested menu prices in the _____. The customers are requested to pay suggested menu prices for the food and drink items, but the Foundation does not require the customers to pay anything for the food and drinks. The Foundation did not provide any specific documentation to show when the customers paid more than the suggested meal price. Therefore, there was not anything documentation provided to show how much of the food and drinks revenues should be considered a contribution.

The Foundation was also set-up for the purpose of accepting donated items from _____ a for-profit organization. _____ donated of _____, _____, property and equipment and cash. It was determined that most of the support during the tax year was from donations

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made by . The employees of control the Foundation, the officers and directors of the Foundation are employees of

Revenue Ruling 67-246 clarifies Section 170 of the Code that provides for allowance of deductions for charitable contributions, subject to certain requirements and limitations. To be deductible as a charitable contribution for Federal income tax purposes under Section 170 of the Code, a payment to or for the use of a qualified charitable organization must be a gift. To be a gift for such purposes in the present context there must be, among other requirements, a payment of money or transfer of property without adequate consideration.

In Rev. Ruling 72-369, an organization was formed to provide managerial and consulting services for section 501(c)(3) organizations to improve the administration of their charitable programs. The organization enters into agreements with unrelated section 501 (c)(3) organizations to furnish managerial and consulting services on a cost basis. This revenue ruling stated that: An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test,' the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative intent element necessary to establish this activity as charitable.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. The Tax Court stated: "We must agree with the Commissioner that petitioner's activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit."

In Airlie Foundation v. Internal Revenue Service, 283 F. Supp. 2d 58 (D.D.C. 2003), the District Court found that that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions on its facilities. The organization's patrons were not limited to tax-exempt entities, but included patrons of a private and corporate nature. The organization paid significant advertising and promotional expenses and derived substantial income from weddings and special events held at its conference center. The court determined that the organization's activities competed with a number of commercial, as well as noncommercial entities, which strongly evidenced a commercial nature and purpose. The court concluded that although the organization carried out a number of charitable and educational activities, these were incidental to its primary activity of operating a for-profit conference center. The court stated: "While plaintiffs organizational purpose is exempt and the foundation operates, in important respects, in an exempt fashion, there is a distinctive 'commercial hue' to the way Airlie carries out its business"

In American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and

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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 for the sake of argument that the organization had an educational purpose. The Court concluded, however, that the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was more indicative of a business than that of an educational organization. The Court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and that the organization was not entitled to be regarded as exempt.

In United States v. American Bar Endowment, 106 S. Ct. 2426 (1986), the Supreme Court held that an 501(c)(3) organization's insurance program constituted both the sale of goods and performance of services and, therefore constituted a trade or business for purposes of the computation of tax on unrelated business income. The court determined that the manner in which the American Bar Endowment conducted the activity was like that of a for-profit insurance broker.

The Foundation is providing dining services that are similar to those provided by commercial businesses. The Claims Court in Easter House v. United States, 12 Cl. Ct. 476 (1987) held that an organization that provided health services to unmarried mothers and their children as a part of its adoption service did not operate exclusively for an exempt purpose since the health services were provided only as a part of the adoption services that were similar to those provided by commercial businesses.

The Foundation is involved in some other charitable activities besides the . But the are the Foundation's **primary activity**. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945). Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. **The providing of restaurant facilities to the general public is not a charitable activity and not within the meaning of Internal Revenue Code 501(c)(3).**

The Foundation has a substantial non-exempt activity and does not qualify under Section 501(c)(3) of the Internal Revenue Code. Providing food and drinks primarily to a non-charitable class for a fee is not within the meaning of Section 501(c)(3) of the Internal Revenue Code. In fact, the Foundation is conducting a commercial unrelated business that is substantial in nature. Therefore, since the Foundation primary activity is to operate that serves the general public, the Foundation is involved in a substantial nonexempt activity and the Foundation's 501(c)(3) tax-exempt status should be revoked as of January 1, 20XX.

Conclusion:

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The Foundation is not "operated exclusively" for one or more exempt purposes specified in section 501(c)(3). Accordingly, the Foundation's tax-exempt status is revoked effective January 1, 20XX.