

**Internal Revenue Service**

Appeals Office  
300 North Los Angeles Street  
MS LA-8000 Room 3054  
LOS ANGELES, CA 90012

Date: JAN 16 2020

Number: 202015034

Release Date: 4/10/2020

A

B

Redaction legend:

A= taxpayer name

B= taxpayer address

C= taxpayer identification number

**Department of the Treasury**

Employer Identification Number:

C

Person to Contact:

\*\*\*\*

Employee ID Number: \*\*\*\*

Tel: \*\*\*\*

Fax: \*\*\*\*

UIL Index:

501.03-00

**Certified Mail**

Dear :

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

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

You do not operate exclusively for exempt purposes under I.R.C. § 501(c)(3) because the size and extent of your training activities for disabled veterans, which are imbedded within your for-profit activities, are incidental compared to the size and extent of your activities. Such activities are not in furtherance of an exempt purpose under Treas. Reg. § 1.501(c)(3)-1(d).

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, or 1041, U.S. Income Tax Return for Estates and Trusts. 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](http://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 a petition for declaratory judgment under section 7428 of the Code.

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. Please contact the Taxpayer Advocate for the IRS office that issued this letter. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit [www.taxpayeradvocate.irs.gov](http://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,

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Appeals Team Manager



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

Date:  
November 19, 2018  
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = Date  
C = State  
D = Individual  
E = Individual  
F = Individual  
G = Individual  
h dollars = Amount  
j dollars = Amount  
k dollars = Amount  
m dollars = Amount  
n dollars = Amount

**UIL:**

501.00-00  
501.03-08  
501.35-00  
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 qualify for exemption under Section 501(c)(3) of the Code? No, for the reasons stated below.

**Facts**

You were incorporated on B in the state of C. Your Articles of Incorporation state that you are organized exclusively for religious, charitable, educational, and scientific purposes. Specifically, you will provide educational programs to those in need.

Your activities include providing a job training program for disabled individuals, focusing on veterans. By providing job training programs, you are helping individuals living with disabilities to develop valuable job skills that will help them to regain and maintain a level of self-sufficiency while also improving their self-esteem.

Your job training program is accomplished through \_\_\_\_\_ are scheduled according to \_\_\_\_\_ funding availability. Training will take place during the \_\_\_\_\_ and job training will take place at various locations, based on \_\_\_\_\_, which will change with each project.

You contract with long-time \_\_\_\_\_ professionals that will train disabled individuals on how to make \_\_\_\_\_ and ultimately work with \_\_\_\_\_ professionals to develop \_\_\_\_\_. Your application states that you will have over 100 job training positions. You later clarified that there will be 30-50 positions available to train veterans for each \_\_\_\_\_. If donations permit, you can conduct multiple projects concurrently which would allow you to train 100-200 veterans per year.

You will work with other organizations, non-profits, and social service organizations to identify and select potential job training program participants. Once selected, you will interview and assess each participant to determine which job each participant is interested in working and if their functionality will allow them to perform their desired job. Upon completion of your programs, you will work with participants to meet union requirements and obtain union status where necessary. You said that educational training sessions will be scheduled as \_\_\_\_\_ are prepared and as funding is available.

You will own the rights to all \_\_\_\_\_ produced during the job training programs and will \_\_\_\_\_. You note that many \_\_\_\_\_ in the manner you do, as this is custom practice in distributing such material. Your sample " \_\_\_\_\_ Agreement" between the \_\_\_\_\_ and \_\_\_\_\_ resembles a commercial contract.

The board of directors has elected to hire D, E, F, and G (currently serving as President/Treasurer, Secretary, and Directors of the board, respectively) as contracted employees. You will pay your employees wages typical of those in the industry. D has extensive experience as a \_\_\_\_\_, and \_\_\_\_\_; E has \_\_\_\_\_; F worked as a \_\_\_\_\_ for many years, and G is an experienced \_\_\_\_\_.

with knowledge of \_\_\_\_\_. Although it is noted that the board set the contracted amounts, a detailed description of the duties or the contractors responsibilities were missing. Many of your other officers and directors have widespread knowledge in the \_\_\_\_\_ and the salaries are commensurate with those in the \_\_\_\_\_.

Your President/Treasurer, D, provided a copy of his resume. As a part of the resume D provided the reason he formed you. D worked his entire adult life in the \_\_\_\_\_, but as a result of \_\_\_\_\_ was left permanently disabled. The disability is severe enough that he'll never be able to work as a \_\_\_\_\_ and in most situations, a \_\_\_\_\_ again. Although D's chronic pain along with his physical disability precludes him from \_\_\_\_\_ or from having the physical mobility to \_\_\_\_\_, the skills, knowledge and passion he's always possessed for \_\_\_\_\_ has never diminished. There are other jobs within the \_\_\_\_\_ that D could still perform, if given the opportunity, even with his disability. Being offered the opportunity is what is nearly impossible. This is what gave D the idea of starting a charity that will teach other disabled people all of the jobs that a reutilized on a \_\_\_\_\_ while actually \_\_\_\_\_.

You indicated that you have hired D for two positions for which he will receive compensation on your first \_\_\_\_\_. Those positions are \_\_\_\_\_ and \_\_\_\_\_. You will compensate D based on a particular scale used for a \_\_\_\_\_ budgeted at h dollars. You said that of that amount D will earn as \_\_\_\_\_ he will donate a \_\_\_\_\_.

portion back to you. Also, D will be a \_\_\_\_\_ for said \_\_\_\_\_. D will be compensated at the same rate as the other \_\_\_\_\_ at a flat rate of j dollars per week for 52 weeks. You will hire E as a \_\_\_\_\_ who will also be compensated j dollars per week for 52 weeks. F will be a \_\_\_\_\_ and \_\_\_\_\_. He will also be compensated j dollars per week for 52 weeks for his \_\_\_\_\_ role and paid using the \_\_\_\_\_ for a \_\_\_\_\_ budgeted at h dollars. You guarantee him 11 weeks of employment at a certain rate plus a location fee, for a total of k dollars per week. G will be hired as a \_\_\_\_\_ of \_\_\_\_\_ as well as \_\_\_\_\_ and paid at a rate of m dollars per week.

You provided a list of the \_\_\_\_\_ jobs and the descriptions of those jobs. You will have about 100 different job positions. Of those positions, you said that you will place and pay a minimum of 30-50 disabled veterans on every \_\_\_\_\_ you make in any of the jobs as a "trainee" or "paid intern." Participants will be compensated for their work on a \_\_\_\_\_ basis at a rate of n dollars per week.

You said that your budget will fall in the medium budget \_\_\_\_\_ range for a \_\_\_\_\_. The agreed upon formula within the industry is that a \_\_\_\_\_ Monetary returns generated from \_\_\_\_\_ will generate \_\_\_\_\_ percent of all your future income received and will be used to finance more \_\_\_\_\_ so more veterans can be trained.

We asked for a breakdown of the time you spend on your training programs and \_\_\_\_\_ activities. You explained that it is impossible to separate your training program and \_\_\_\_\_ activities because every function of \_\_\_\_\_ s being used in your job training program. You stated that 100 percent of your activities are devoted to the job skills training of veterans coping with mental and physical disabilities to teach them the \_\_\_\_\_ through \_\_\_\_\_

We also asked for a breakdown of your total funds are devoted to your training program and your \_\_\_\_\_. You said that 99.98 percent of your expenses are generated from the jobs skills training program, which is the \_\_\_\_\_. However, based on the financial data you provided, trainee pay makes up less than three percent of your overall expenses. Your budgets indicate that about 32 percent of your budget is allocated for the ' \_\_\_\_\_ " \_\_\_\_\_," and " \_\_\_\_\_ " Your other expenses are for things expected of a \_\_\_\_\_ such as \_\_\_\_\_ etc.

## Law

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

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

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

Treas. Reg. Section 1.501(c)(3)-1(d)(2) 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 under privileged as well as the advancement of education.

Treas. Reg. Section 1.501(c)(3)-1(d)(3) provides that the term "educational" refers to the instruction or training of the individual for the purpose of improving or developing his capabilities or the instruction of the public on subjects useful to the individual and beneficial to the community.

In Rev. Rul. 59-6, 1959-1 C.B. 121, a professional association was held not exempt under Section 501(c)(3) of the Code where its educational program is only an incidental part of activities that had as a principal purpose the professional advancement of the members as a group.

In Rev. Rul. 73-127, 1973-1 C.B. 221, the Service held that an organization that operated a cut-price retail grocery outlet and allocated a small portion of its earnings to provide on-the-job training to the hard-core unemployed did not qualify for exemption. The organization's purpose of providing job training for the hardcore unemployed was charitable and educational within the meaning of the common law concept of charity; however, the organization's purpose of operating a retail grocery store was not. The ruling concluded that the operation of the store and the operation of the training program were two distinct purposes. Since the former purpose was not a recognized charitable purpose, the organization was not organized and operated exclusively for charitable purposes.

Rev. Rul. 73-128, 1973-1 C.B. 222, describes an organization that qualifies for exemption under Section 501(c)(3) of the Code which provides educational and vocational training to unemployed and underemployed persons. The organization operates a number of community programs including classes in remedial reading and language skills, general counseling services, and job training programs. The organization's job training program centers around the manufacture and sale of a line of toy products. The organization recruits unskilled individuals who are, for the most part, residents of a particular economically depressed community and who are unemployed or under-employed, and it provides them with new skills through on-the-job training while they are earning a living. In addition, a substantial number of the management and administrative staff are unskilled trainees. Any income resulting from the organization's manufacturing operation is used to finance the organization's other community service activities. The organization was granted exemption under Section 501(c)(3) as it was found that the manufacturing activities were an integral part of the training process and there was no evidence to suggest that it is being conducted on a scale larger than reasonably necessary.

Rev. Rul. 75-284, 1975-2 C.B. 202, describes an organization that qualifies for exemption under Section 501(c)(3) of the Code that provides high school graduates and college students with work experience in selected trades or professions. To help these individuals, the organization provides actual work experiences outside the normal school setting through a 30-week training program. The organization contracts with skilled craftsmen and professional people to provide training on a one-to-one basis. Although many of these skilled craftsmen and professional people volunteer their time, the organization offers a per-student stipend to them to pay for the training.

In Rev. Rul. 76-94, 1976-1 C.B. 171, an organization whose purpose is to provide a resident facility and therapeutic program for emotionally disturbed adolescents, operates a grocery store as part of its therapy program. The grocery store is supervised by a manager who is experienced in both the retail food industry and

in working with disturbed adolescents. All other employees are emotionally disturbed adolescents who are participating in the organization's program. The store is operated at a level to utilize only the number of adolescents residing at the facility. The Service held that since the grocery store is almost fully staffed by the adolescent residents and is operated at a scale no larger than is reasonably necessary for the organization's training and rehabilitation program, the operation of the grocery store is not a related 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 a claim for exemption regardless of the number or importance of truly exempt purposes.

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 analysis of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services included providing advice for purchases of individual securities. The Court noted that education is a broad concept, and assumed 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 B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under Section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. Additionally, the court found that the organization's financing did not resemble that of the typical Section 501(c)(3) organization. It had not solicited or received voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." Finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In Christian Manner International, Inc. v. Commissioner, 71 T.C. 661 (1979), the court held that for purposes of exemption under Section 501(c)(3) of the Code, both the actual as well as the stated purposes for the existence of an organization and the activities it engages in to accomplish those purposes must be considered.

Senior Citizen Stores, Inc. v. U.S., 602 F.2d 711 (5th Cir 1979), described an organization that was to provide training, jobs, places of recreation to the elderly and to improve their physical and mental conditions. It operated three retail stores, which sold used clothing, furniture, and household appliances to the general public. No training program was conducted beyond the training of employees for the shops. No health care or housing facilities were provided. The court found that it was neither a charitable nor educational organization because the retail sales operation was an end in itself rather than a means of accomplishing a charitable goal.

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), involved an organization established by the Seventh Day Adventist Church to carry out its "health ministry" through the operation of two vegetarian restaurants and health food stores. The court sustained the IRS's denial of exemption under Section 501(c)(3) of the Code because the organization was operated for a substantial non-exempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in

competition with other restaurants, engaged in marketing, and generally operated in a manner similar to commercial businesses.

### Application of law

You are not described in Section 501(c)(3) of the Code and Treas. Reg. Section 1.501(c)(3)-1(a)(1) because you do not meet the operational test as described in Treas. Reg. Section 1.501(c)(3)-1(c)(1). Your training programs are not exclusively educational or charitable.

The presence of a single non-exempt purpose that is substantial in nature will destroy a charitable exemption as explained in Treas. Reg. Section 1.501(c)(3)-1(c)(1) and Better Business Bureau. While you will conduct job-training, you have not established that the activities conducted in connection with this mission is exclusively educational. In the conduct of your job training activities you will \_\_\_\_\_ that will be released for \_\_\_\_\_ Most of your time, money, and efforts are spent on \_\_\_\_\_ This is your primary purpose. The training you provide is incidental to your \_\_\_\_\_ activities.

While providing job training for veterans is charitable and educational as described in Treas. Reg. Section 1.501(c)(3)-1(d)(2) and Treas. Reg. Section 1.501(c)(3)-1(d)(3), your primary focus is the

Per Treas. Reg. Section 1.501(c)(3)-1(c)(1), you are not regarded as "operated exclusively" for one or more exempt purposes because you do not engage primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. Your primary activity is the \_\_\_\_\_ in an ordinary commercial manner. Therefore, your operations primarily accomplish a substantial non-exempt purpose, not a charitable activity.

You are similar to Rev. Rul. 59-6, in that only an incidental part of your activities has a purpose of providing job training. Therefore, you are not entitled to exemption as an exclusively educational organization.

Like the organization in Rev. Rul. 73-127, you have an element of your activities which is charitable and educational. However, you also have substantial activities, the \_\_\_\_\_ which are produced and distributed in a commercial nature, which do not fulfill a charitable or educational purpose. Your operation of a \_\_\_\_\_ company does not fall under Section 501(c)(3) of the Code.

You are dissimilar to the organization described in Rev. Rul. 75-284, which was granted exemption under Section 501(c)(3). The organization in this ruling contracted with skilled craftsmen and professional people to provide training on a one-to-one basis, but many of these skilled craftsmen and professional people volunteered their time or were paid a per-student stipend. Although your trainees are getting experience, you don't have staff dedicated to training them and you have no volunteers. Your staff and crew are compensated based on industry standards for a \_\_\_\_\_

Unlike the organizations granted exemption in Rev. Rul. 73-128 and Rev. Rul. 76-94, the scale of your \_\_\_\_\_ is much larger than reasonably necessary to accomplish your charitable and educational purposes. Your budgets are those of a \_\_\_\_\_ company.

\_\_\_\_\_ is not necessary to provide veterans job training. A very small portion of your budget is used for paying the trainees. Most of your staff earns salaries on par with other \_\_\_\_\_. You provided no indication that you have special training for your trainees, but that they just the benefit of working \_\_\_\_\_



When we asked for a breakdown of the time you spend on your training and activities you stated that your training programs cannot be separated from your activities. You said that almost all of your funds and 100 percent of your time is devoted to your training program. While training can occur during , any training you provide is incidental to your overall activity. Similar to Better Business Bureau of Washington D.C., Inc., B.S.W. Group, Inc., American Institute for Economic Research, and Living Faith, Inc., you do not qualify under Section 501(c)(3) because you will operate for the substantial non-exempt purposes of in a commercial manner.

In a few years you anticipate having a stream of revenue from royalties to help fund your activities. You will be in direct competition with for-profit businesses that perform identical activities. You plan to in a manner similar to ordinary companies. Hiring low-skill individuals, such as trainees and interns, for less money is something that many companies and other companies do to fill positions. While it is charitable to hire veterans that are in need of jobs, this is not your purpose. Your purpose is to make while helping veterans is a side benefit. In determining whether an organization satisfies the requirements for exemption, both the organization's actual and stated purposes for which it exist and the activities that it conducts to further those purposes are considered. See Christian Manner International. A substantial amount of your time and resources are devoted to rather than operating an educational job training program for disabled veterans. Your job training programs are conducted on a project-by-project basis, you schedule according to funding availability, training is dependent on and your financials demonstrate that a small amount of your funds are devoted to your training program.

Similar to Senior Citizen Stores, Inc. your production of feature films is an end themselves, rather than a means, of accomplishing a charitable goal. The facts indicate that your primary activity is the commercial and are similar to other for-profit entities. Thus, you do not qualify for exemption under Section 501(c)(3) Code.

### **Your position**

You assert that in all projects you will be producing and training disabled veterans. Your purpose is to provide job skills training to a charitable class of veterans coping with physical and mental disabilities. You state that each dollar spent on training programs will facilitate the projects and during these processes intellectual property will be created. You state that is a byproduct of the training and the final is a necessity of training. You contend that the final product will not be sold, but licensed to distributors, and the fee is intended to be treated as royalty payments. You contend that licensing the use of the byproduct supports another class of participants to learn the same skills.

You cited Rev. Rul. 65-271, which discusses an organization found to be exempt under Section 501(c)(3) of the Code because they were presenting periodic jazz festivals or concerts, which was found to promote an appreciation of jazz music as an art form.

You also cited Rev. Rul. 73-128 and Rev. Rul. 75-284 which describes organizations exempt under Section 501(c)(3) of the Code that either advances education by providing one-on-one training of a trade or profession with the direction of an expert or the ruling exempt an organization on the basis that the commercial activity is a means of accomplishing your charitable objective.