



Department of the Treasury
Internal Revenue Service
Independent Office of Appeals

Date: **JAN 11 2022**

Person to contact:
Name:
Employee ID number:
Telephone:
Fax:
Hours:
Employer ID number:

Number: **202214014**
Release Date: **4/8/2022**

Uniform issue list (UIL):
501.03-00
501.03-30
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) of the Code.

We made the adverse determination for the following reasons:

You are not organized and operated as an exempt organization because your operations accomplish a non-exempt purpose of operating a commercial design business

You're required to file federal income tax returns on Forms . 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 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 Section 6110 of the Code after deleting certain identifying information. We 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 can file an action for declaratory judgment under the provisions of Section 7428 of the Code in either:

- The United States Tax Court,
- The United States Court of Federal Claims, or
- 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	US Court of Federal Claims	US District Court for the District of Columbia
400 Second Street, NW	717 Madison Place, NW	333 Constitution Avenue, NW
Washington, DC 20217	Washington, DC 20005	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. If you qualify for TAS assistance, which is always free, TAS 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 questions, contact the person at the top of this letter.

Sincerely,

Enclosures:

cc:



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

March 16 2021

Date:
 Employer ID number:
 Contact person/ID number:
 Contact telephone number:
 Contact fax number:

Legend:

B = Date
 C = State
 D = number
 h dollars= amount
 j percent = amount
 k percent = amount
 m percent = amount
 n percent = amount

UIL:

501.03-00
 501-03-30
 501.36-00
 501.36-01

Dear :

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

Issues

Do you qualify for exemption under IRC Section 501(c)(3)? No, for the reasons stated below.

Facts

Per your Form 1023 application, you were formed as a limited liability company on B in the state of C. However, you also submitted, with your application, a document titled, "Articles of Incorporation", which shows no evidence of being filed with the Secretary of State. We requested a filed copy of your organizing document to determine if you are a legal entity and, if so, what type; however, it was never provided.

The unfiled document titled "Articles of Incorporation" states that you are organized exclusively for charitable, religious, educational, and scientific purposes and that you will accept donations, and will service clients with an educational and altruistic mission of empowerment through knowledge and skill, by making design for clients that they are taught to take care of themselves.

Your primary activity is making _____ designs for client's homes. Anyone can request a _____ design and the fee for the service is h dollars per client. As part of the _____ design, you educate clients on how to maintain, and sometimes even install, the design. In addition to the design, payment of the fee gives clients access to an education manual and maintenance calendar and allows them to _____ your founder up to D times annually with questions. The fee is based on the fair market value of services provided by an individual with your founder's experience and expertise in the _____ industry. The fee charged is all inclusive and includes the _____ design and accompanying educational material. If the client does not want the educational material, and just wants the _____ design for their home, the fee is the same. You stated you do not anticipate offering any educational programs to the public that are not part of the _____ design service. The public learns about the service via online advertisements and other online platforms.

Your other intended activities include designing, installing, and maintaining a headquarters and awarding scholarships to individuals pursuing formal _____ studies. You have stated that the _____ may be at a home owned by your founder's close relative or you may purchase a separate property for this purpose.

Your founder is your only board member and you stated that you don't anticipate any other officers, directors, trustees, or employees. She conducts all your activities, working approximately _____ hours/week. Her most significant duties include meeting with clients and creating _____ designs. Creation of educational materials for clients constitutes only approximately j percent of her time.

Financials submitted show that all receipts are from client fees from _____ designs. The founder's salary is your most significant expense and accounts for approximately k percent of revenue. Minimal expenses include program expenses (items such as gas, office supplies, books, technology and gifts to clients) which account for approximately j percent of revenue and scholarship distributions which account for approximately m percent of revenue. You stated that the significant excess revenue, n percent, will be available for future growth and development.

Law

IRC Section 501(c)(3) provides for the exemption from federal income tax of organizations organized and operated exclusively for religious, charitable or other purposes as specified in the statute. No part of the net earnings may inure to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) states that in order to qualify under IRC 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 or 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" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in IRC 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.

Treas. Reg. Section 1.501(c)(3)-1(d)(2) provides the term "charitable" is used in IRC Section 501(c)(3) in its generally accepted legal sense and includes relieving the poor and distressed or the underprivileged, combating community deterioration, lessening neighborhood tensions, and eliminating prejudice and discrimination.

Treas. Reg. Section 1.501(c)(3)-1(d)(3)(i) provides that the term “educational,” as used in IRC Section 501(c)(3), relates 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.

Revenue Procedure 2021-5, 2021-1 I.R.B. 250, Section 3 states that a determination letter or ruling on exempt status is issued based solely upon the facts and representations contained in the administrative record. The applicant is responsible for the accuracy of any factual representations contained in the application. Section 7 provides that a favorable determination letter or ruling will be issued to an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from federal income tax is claimed.

In Rev. Rul. 72-369, 1972-2 C.B. 245, an organization was formed to provide managerial and consulting services for IRC 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) 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). Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Rev. Rul. 73-127, 1973-1 C.B. 221, 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 under IRC Section 501(c)(3). 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.

In Better Business Bureau of Washington, D.C., Inc v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States interpreted the requirement in IRC Section 501(c)(3) that an organization be “operated exclusively” by indicating that an organization must be devoted to exempt purposes exclusively. The presence of a single non-exempt purpose, if more than insubstantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes.

In American Institute for Economic Research v. United States, 302 F.2d 934, 157 Ct. Cl. 548 (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. It 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 Universal Life Church v. United States, 372 F. Supp. 770 (E.D. Cal. 1974), the court concluded that “one seeking a tax exemption has the burden of establishing his right to a tax-exempt status.”

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court held that an organization did not qualify for exemption under IRC Section 501(c)(3) because it was primarily engaged in an activity that was characteristic of a trade or business and was ordinarily carried on by for-profit commercial businesses.

In Easter House v. United States, 12 Cl. Ct. 476 (1987), aff'd, 846 F. 2d 78 (Fed. Cir. 1988) cert. denied, 488 U.S. 907, 109 S. Ct. 257, 102 L. Ed. 2d 246 (1988), the court found an organization that operated an adoption agency was not exempt under IRC Section 501(c)(3). The organization was operated for a substantial nonexempt purpose rather than for the exempt purposes of providing educational and charitable services to unwed mothers and children. The court stated that “adoption services do not in and of themselves constitute an exempt purpose.” The court found that the adoption agency was operated in a commercial manner. The agency’s operation was funded completely by the fixed fees charged to adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. Ultimately, the agency was not entitled to tax exempt status on the basis that it was “not distinguishable from a commercial adoption agency.” The court found that the adoption agency’s primary goal was furthering of a “business purpose” rather than the advancement of an educational or a charitable purpose.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the court affirmed that an organization did not qualify for exemption under IRC Section 501(c)(3) because it operated its restaurants and health food stores for a substantially commercial purpose. Its underlying religious purposes did not mitigate the clear commercial purpose of its operations.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D. D.C. 2003), the court found 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 non-commercial entities, which strongly evidenced a commercial nature and purpose. The court concluded that although the organization carried out a few charitable and educational activities, these were incidental to its primary activity of operating a for-profit conference center.

Application of law

IRC Section 501(c)(3) sets forth two main tests for an organization to be recognized as exempt. An organization must be both organized and operated “exclusively” for purposes described in Section 501(c)(3) and Treas. Reg. Section 1.501(c)(3)-1(a)(1).

Because you have not established that you are formed as a legal entity in C, you fail the organizational test. Per Rev. Proc. 2021-5, a ruling on exempt status is based on the facts provided by the applicant and you have not

established that you meet the organizational test. As in Universal Life Church, you have the burden of establishing that you qualify for tax exemption.

You also fail the operational test because a substantial portion of your activities consists of providing design services in a commercial manner. You are not operating “exclusively” for exempt purposes as required by Treas. Reg. Section 1.501(c)(3)-1(c)(1). Your primary activity of providing design services on a regular basis for a fee is a trade or business ordinarily carried on for profit; a commercial activity. Like the American Institute for Economic Research case, you have a more than insubstantial non-exempt commercial purpose that is not incidental to any educational or charitable purpose. While you indicated you will include educational materials for your clients during the design and will also provide scholarships to students as a separate activity, the facts show these activities to be secondary to your primary purpose and their presence does not characterize the totality of your activities as educational per Treas. Reg. Section 1.501(c)(3)-1(d)(3)(i) or charitable per Treas. Reg. Section 1.501(c)(3)-1(d)(2). Like in the Living Faith case, any underlying educational or charitable purposes do not mitigate a clear commercial purpose. This commercial purpose is more than an insubstantial portion of your activities and, as noted in the Better Business Bureau case, 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.

You are like the organization described in Rev. Rul. 72-369 because you are operating in a commercial manner and the fees you charge for services are not substantially below cost. The organization in the revenue ruling did not meet IRC Section 501(c)(3). They were conducting commercial services at cost and only for organizations exempt under Section 501(c)(3). You provide landscape design services to anyone who will pay your fee and the fee is based on the market value of the service and your founder’s expertise. Thus, like the ruling, your provision of services for a fee is a trade or business ordinarily carried on for profit and not an exclusively charitable or educational activity.

You are also similar to Rev. Rul. 73-127 because, although you may have more than one purpose and activity, your landscape design services are a substantial part of your activities and do not further exclusively educational or charitable purposes. The manner in which you provide the design services furthers a substantial commercial purpose.

The organizations described in B.S.W. Group, Inc., Easter House and Airlie were determined to have a substantial non-exempt commercial activity which precluded exemption. Similarly, your design services are commercial in nature. You share many of the major factors the courts considered in determining a commercial use such as financial projections showing only revenue from fixed service fees, pricing set based on fair market value, total fee revenue recouping all costs with substantial reserves for growth of operations, clientele not limited, competition with commercial enterprises, and indistinguishable from a commercial company.

Conclusion

Based on the information submitted, you do not qualify for exemption under IRC Section 501(c)(3). You do not meet the organizational test because you have not established you are legally formed. You do not meet the operational test because you are operated for a substantial non-exempt commercial purpose.

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.

If you don't agree

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

- Your name, address, employer identification number (EIN), and a daytime phone number
- A statement of the facts, law, and arguments supporting your position
- A statement indicating whether you are requesting an Appeals Office conference
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization or your authorized representative
- The following declaration:

For an officer, director, trustee, or other official who is authorized to sign for the organization:
Under penalties of perjury, I declare that I have examined this request, or this modification to the request, including accompanying documents, and to the best of my knowledge and belief, the request or the modification contains all relevant facts relating to the request, 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 they haven'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 gave us a basis to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't given us a basis for reconsideration, we'll send your case to the Appeals Office and notify you. You can find more information 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 later because the law requires that you use the IRC administrative process first (IRC Section 7428(b)(2)).

Where to send your protest

Send your protest, Form 2848, if applicable, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Mail Stop 6403
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Mail Stop 6403
Cincinnati, OH 45202

You can also fax your protest 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 they received it.

You can get the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676). If you have questions, you can contact the person listed at the top of this letter.

Contacting the Taxpayer Advocate Service

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 if 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 www.taxpayeradvocate.irs.gov or call 877-777-4778.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements