



Department of the Treasury
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

Release Number: **201509039**
Release Date: 2/27/2015

501.01-00

Date: December 5, 2014

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear :

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

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

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

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

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

Sincerely,

Mary Jo Salins
Acting Manager, EO Technical

Enclosures:

Notice 437

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

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



Department of the Treasury
Internal Revenue Service
1111 Constitution Ave. NW
Washington, DC 20224

Date: August 19, 2014

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

State =

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.

Issue

Whether you qualify for exemption as an organization described in § 501(c)(3).

Facts

You are a nonprofit corporation incorporated under State law. Fewer than 27 months after formation, you submitted Form 1023 for recognition of exemption under I.R.C. § 501(a) as an organization described in § 501(c)(3). You also requested classification as a public charity under § 509(a)(2).

Your articles of incorporation state that you are organized exclusively for charitable purposes. They provide that upon dissolution, your assets will be distributed to a tax-exempt, charitable organization for charitable purposes. Under your bylaws, you are governed by a board of directors comprised of between five and eleven members. Your CEO and CFO/Secretary are husband and wife. One of your board members is the CEO's brother. Your CEO and

CFO/Secretary will be full-time employees. Board members will not be paid for their services; however, they will receive reimbursement for out-of-pocket travel expenses to the annual board meeting, subject to a \$2,000 annual cap.

In your narrative description of activities, you state that your primary activity will be assisting small businesses in areas that have been affected by natural or man-made disasters. You state that following disasters, many small businesses in stricken areas do not have adequate capital to continue their operations. You will benefit these businesses by connecting them with consumers who wish to buy from them. In turn, these businesses will receive additional capital and have a greater chance of being able to continue their operations and avoid shutdowns and layoffs of their employees. You point out that businesses in disaster stricken areas often must wait several months to receive insurance payments and government relief. In the interim, many of these businesses fail. Overall, your plan is for your operations to offer small businesses in local economies much-needed infusions of capital during the time periods immediately following disasters.

You will operate throughout the country. In order to receive your assistance, a small business will have to register with you before a disaster occurs in its area. To register with you, a small business will submit information about itself, including: owners' names, website, address, products or services offered, and photographs. In order to keep its registration current, a small business will be required to pay an annual registration fee of \$150. These fees will provide a majority of your revenue. You stated that you will verify that each registrant is a legal entity, but otherwise you will not impose any restrictions on the types of small businesses that may use your services.

When a disaster occurs in an area, you will "help facilitate economic recovery and tax-base stabilization process." You will market on your website and through social media those small businesses that have previously registered with you and are located in the stricken area. You will advertise these businesses to consumers and encourage them to purchase goods or services by entering into "futures contracts" with these businesses. You describe "futures contracts" as "standardized contract[s] that require[] delivery of a product or service, at a specified price, on a specified future date." Consumers will be able to enter into these contracts with these businesses and pay for these orders on your website. You state that your work will allow consumers "to consume with a conscience and directly support disaster-stricken businesses."

You also will charge a 10-percent processing fee on each contract that you facilitate on your website. These fees will be placed in a reserve fund to support a money-back guarantee to consumers who enter into futures contracts on your website. You state that having a money-back guarantee policy is necessary, because some of the small businesses that take orders on your website will ultimately fail and not be able to deliver the goods and services under contract.

In addition to connecting consumers with small businesses, you will also document the recovery process in disaster stricken areas. Each week, you will share this information with consumers who have purchased goods, so that they can track the impacts of their payments and the conditions in the affected areas. Consumers will continue receiving information until their

orders have been filled.

You plan to establish relationships with local chambers of commerce and will ask these organizations to promote your operations to small businesses in their areas. You expect that some of the small businesses that register with you will be affiliated with their local chambers of commerce. For those registrants, you will donate \$25 of their \$150 yearly registration fees to their local chambers of commerce. You noted that chambers of commerce are generally not exempt from taxation under § 501(c)(3), but did not state that you will restrict the manner in which chambers of commerce may expend the donations that you will provide.

You state that you are similar to for-profit entities that promote third party businesses over the internet and social media and allow consumers to make purchases from these businesses through a website. However, you distinguish yourself from these entities by stating that you will allow your registrant small businesses to set their own prices and will not require them to offer discounts. Further, you state that you will work exclusively in areas affected by disaster. You say that you are "not designed as a for-profit enterprise because the outcomes and impact of [your] work is based on charitable purposes only."

Finally, you project in Part XI and supplemental materials that you have explored the possibility of obtaining contributions from the general public and from private foundations. In Part XI you project contributions that would equal less than 10 percent of your total receipts over the three projected taxable years.

Law

I.R.C. § 501(c)(3) provides that a corporation will be exempt from federal income taxation if it is organized and operated exclusively for charitable, educational, and other purposes, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in I.R.C. § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in this section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(i) states that an organization may be exempt as an organization described in I.R.C. § 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) 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.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense. It also includes the promotion of social welfare by

relieving the poor and distressed or the underprivileged, combating community deterioration, lessening neighborhood tensions, and eliminating prejudice and discrimination.

Better Business Bureau of Washington, D.C., Inc. v. U.S., 326 U.S. 279 (1945), holds that the presence of a single non-exempt purpose, if substantial in nature, will preclude exemption, regardless of the number or importance of statutorily exempt purposes.

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 I.R.C. § 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. The court found that the corporation had completely failed to demonstrate that its services were not in competition with commercial businesses. The court found that the organization's financing did not resemble that of the typical I.R.C. § 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees for 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." And finally, the corporation had failed to limit its clientele to organizations that were § 501(c)(3) exempt organizations.

In Wendy Parker Rehabilitation Foundation, Inc. v. Commissioner, T.C. Memo 1986-348, 52 T.C.M. (CCH) 51 (1986), the organization was created by the Parker family to aid an open-ended class of "victims of coma." However, the organization stated that it anticipated spending 30 percent of its income for the benefit of Wendy Parker, significant contributions were made to the organization by the Parker family, and the Parker family controlled the organization. Wendy Parker's selection as a substantial recipient of funds substantially benefited the Parker family by assisting with the economic burden of caring for her. The benefit did not flow primarily to the general public as required under Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Therefore, the Foundation was not exempt from federal income tax under § 501(c)(3).

In Easter House v. United States, 12 Cl. Ct. 476, 486 (Cl. Ct. 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 for a charitable purpose, the court considered the manner in which the organization operated. The record established a number of factors that characterized 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.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C. 2003), the court laid out

the factors for determining whether an organization's activity is of a commercial nature. It said, "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include...whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations." Id. at 63.

In Rev. Rul. 68-489, 1968-2 C.B. 210, an organization exempt under § 501(c)(3) distributed part of its funds to organizations that were not themselves exempt under § 501(c)(3). The exempt organization ensured use of the funds for § 501(c)(3) purposes by limiting distributions to specific projects that were in furtherance of its own exempt purposes. It retained control and discretion as to the use of the funds and maintained records establishing that the funds were used for § 501(c)(3) purposes.

Rev. Rul. 71-529, C.B. 1971-2 234, considered an organization that provided investment management services for a fee to specified colleges and university. The organization's board was composed of representatives from the schools receiving its services. The fee was set substantially below the organization's costs, so the organization obtained contributions to cover all or part of the cost of its management services. It also used those contributions to provide supplemental income or capital to be used exclusively for the charitable, educational, or scientific purposes of the organizations it served. The fees paid by the member organizations represented less than fifteen percent of the total costs of operation. The Service ruled that the organization was exempt under I.R.C. § 501(c)(3).

In Rev. Rul. 72-369, 1972-2 C.B. 245, an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under I.R.C. § 501(c)(3). The services consisted of writing job descriptions and training manuals, recruiting personnel, constructing organizational charts, and advising organizations on specific methods of operation. The ruling stated that an organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. 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 are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of I.R.C. § 501(c)(3). Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

In Rev. Rul. 74-587, 1974-2 C.B. 162, an organization that devoted its resources to programs that stimulated economic development in economically depressed, high-density, urban areas, inhabited mainly by low-income minority or other disadvantaged groups qualified for exemption under § 501(c)(3). The ruling said, "Although some of the individuals receiving financial assistance in their business endeavors under the organization's program may not themselves qualify for charitable assistance as such, that fact does not detract from the charitable character of the organization's program. The recipients of loans and working capital in such cases are merely the instruments by which the charitable purposes are sought to be accomplished."

Rev. Rul. 75-286, 1975-2 C.B. 210, describes an organization formed by the residents of a city block to preserve and beautify that block. Its activities consisted of paying the city government to plant trees on public property within the block, organizing residents to pick up litter and refuse in the public streets and on public sidewalks within the block, and encouraging residents to take an active part in beautifying the block by placing shrubbery in public areas within the block. Membership in the organization was restricted to residents of the block and those owning property or operating businesses there. The revenue ruling concluded that the organization did not qualify for exemption under I.R.C. § 501(c)(3) because it operated to serve private interests by enhancing members' property rights.

Application of law

Your application does not meet the requirements for exemption as a charitable organization described in I.R.C. § 501(c)(3). Under Treas. Reg. § 1.501(c)(3)-1(a)(1), an exempt organization must be organized and operated for exempt purposes. You are not operated for exempt purposes.

Your articles of incorporation contain the required purposes and dissolution clauses. As such, your articles satisfy the organizational test. However, you do not pass the operations test. You do not benefit a defined charitable class, you operate for a commercial purpose, and you do not restrict expenditures of your funds to the accomplishment of your exempt purposes. Each of these three factors precludes your exemption.

First, you do not restrict the beneficiaries of your activity to a charitable class. In order for an organization to fulfill a charitable purpose, it generally must assist a charitable class of individuals. If an organization allows its activities to benefit individuals beyond a charitable class then it is not a charitable organization. See Wendy Parker Rehabilitation Foundation, Inc. v. Commissioner. Your activities are not restricted to a charitable class. Any legal entity that is a small business may register with you, and you will provide services and benefits to all of your registrants located in areas affected by a disaster. Small businesses in areas affected by a disaster are not a charitable class, *per se*. Some of these businesses may have large sums of cash in reserve. You will verify only that the small businesses are legal entities, but will not assess anything further about their ownership or finances. Thus, the small businesses that you will assist will not necessarily be members of a charitable class.

Further, you will not restrict your operations to low income or otherwise needy areas. This factor distinguishes you from the organization ruled as exempt in Rev. Rul. 74-587. That organization expended its resources to assist businesses, with the aim of improving economically depressed, high-density, urban areas. Thus although the businesses receiving its assistance were not members of a charitable class, the residents of the neighborhoods where the businesses were located were. In contrast you will offer assistance to businesses in any area affected by a disaster regardless of the economic climate of that area. Some of these areas may be populated by individuals who have the means to avoid the negative impact of the disaster. Your focus will be on assisting small businesses that have registered with you, not to assist an identifiable charitable class, directly or indirectly. As such, you do

not limit your operations to benefitting a charitable class.

In addition, characteristics of your operations indicate a non-exempt commercial purpose rather than a charitable purpose, specifically 1) your pricing structure and 2) your competition with for-profit entities. See Airlie Foundation v. Commissioner; Easter House v. United States. Under Better Business Bureau of Washington, D.C., Inc. v. U.S., operating for a single non-exempt purpose is a bar to exemption under § 501(c)(3).

With respect to your funding structure, most of your income will come from fees for services, namely registration fees and processing fees. First, small businesses will pay registration fees to you, in exchange for your assurance that you will market their products and allow them to collect orders on your website in the event of a disaster. Second, you will collect processing fees to be paid at the time when consumers enter into futures contracts. Thus, most of your funding will come from fees for services. Also, you plan to hold all of the processing fees in reserve, at least until the related contracts are fulfilled. As stated in Airlie Foundation, setting fees at a rate to cover costs and holding extensive financial reserves are major factors indicating a commercial purpose.

Further, by your own admission, you will provide services – connecting small businesses with buyers – that are similar to those provided by for-profit entities. In general, offering such services is not an exempt activity. See Rev. Rul. 72-369; B.S.W. Group, Inc. An exception exists when an organization provides services exclusively to tax-exempt entities at a fee substantially below cost. See Rev. Rul. 71-529. As stated above, your fees will not be set substantially below your costs, and you will not receive the majority of your funding from contributions. As previously noted, you project that contributions will be less than 10 percent of total receipts. Thus, you cannot rely on this exception.

Finally, you propose to make grants to chambers of commerce without any limitations on the use of the grants. As you acknowledged, chambers of commerce are generally not exempt under § 501(c)(3). Thus, they may engage in activities in which a charitable organization may not, such a political campaign intervention and substantial lobbying activities. Under Rev. Rul. 68-489, an organization exempt under § 501(c)(3) must exercise discretion and control over money that it grants to organizations that are not exempt under this section. A grantor must ensure that donated funds are used only for its exempt purposes. You will not be following this rule with respect to your granting unrestricted money to chambers of commerce. You will be giving these organizations the freedom to spend your resources in a manner that would be impermissible for you.

Conclusion

Since you will not benefit exclusively a charitable class, you will operate for a commercial purpose, and you propose to allow others to expend your income for non-exempt purposes, you do not operate for exempt purposes. You do not meet the requirements for exemption under § 501(c)(3).

If you don't agree

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

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

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

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

For an authorized representative:

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

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. You also have a right to a conference after you submit your statement. If you want a conference, you must request it when you file your protest statement.

You can also ask the Office of Appeals to review your application for tax-exempt status. Your right to request Appeals review is in addition to your right to a conference, as outlined

in Revenue Procedure (Rev. Proc.) 2014-4 and Rev. Proc. 2014-9. You must notify us in writing if you want us to forward your case to the Appeals Office. You can find more information about the process and the role of the Appeals Office in Section 7 of Rev. Proc. 2014-9 and Publication 4227, *Overview of the Appeals Process*.

If the person representing you in this process is not an officer, director, trustee, or other official who is authorized to sign for the organization, he or she must file Form 2848, as explained above, and otherwise meet the requirements in Publication 216, *Conference and Practice Requirements*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

Please send your protest statement, any request for consideration by the Office of Appeals, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Street address for delivery service:

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

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

Sincerely,

Michael Seto
Manager, Exempt Organizations
Technical

Enclosure: Publication 892