

Another Feeder Organization Denied Tax Exemption

08.25.17 | Linda J. Rosenthal, JD



In “[All Profits to Charity?: Not a 501\(c\)\(3\).](#)” we noted that from time to time, folks come into our office with the idea of doing something like [Newman’s Own](#); that is, starting a business and donating all the proceeds to charity. They ask us to help them set up a 501(c)(3) organization.

They are generally surprised to learn that Newman’s Own is set up as a for-profit business, and that giving all proceeds to charity is not, by itself, enough to support a tax exemption.

There’s a specific name for that in the tax code: it is a “[feeder organization](#).” Long-established legal precedent makes clear that feeder organizations don’t qualify for 501(c)(3) tax exemption. See, for instance, [Piety, Inc. v. Commissioner](#), 82 T.C. 193 (1984) [a company that holds bingo games and contributes profits to charities is operated for the primary purpose of carrying on a trade a business, and *not* operated exclusively for an “exempt” purpose under section 501(c)(3)]

Recently, in “[Trying to Wriggle Out of Feeder Organization Status?: Not Easy](#),” we [highlighted an example](#) of yet another feeder organization trying – but failing – to qualify for 501(c)(3) status. There, the entity was called Zagfly, Inc. Its business plan was to sell flowers at market rates to online customers and then expand into other goods and services. The special feature that the Zagfly folks hoped would seal the deal was the founder’s connection to a special new-age philosophy that would permeate this enterprise and ... well, who knows. The gambit failed, like so many others before it.

Is Christian Coffee House Entitled to Tax Exemption?

Last year, a [denial of tax exempt status](#) specifically referenced the [Zagfly](#) Tax Court ruling along with other decisions reinforcing how difficult it is to overcome a “feeder organization” characterization.

In Private Letter Ruling (PLR) [201645017](#) (11/4/16) – with the customary significant redactions of key identifying information – the IRS explains why a Christian coffee house does not qualify for tax exemption. As [one commentator](#) put it succinctly: “A coffee shop with some light fare, free wifi and

plentiful outlets in a downtown area sounds like a great idea. The question the IRS had to answer was whether such an enterprise, with a charitable religious twist, can qualify as a 501(c)(3) organization.”

The coffee shop was formed with the following purposes:

- “(i) Proclaiming earnestly the gospel message and to urge its personal acceptance.
- (ii) Promoting prayer, Bible study, missions, Christian fellowship, evangelism, Christian service and encouraging, in every possible way, a lifetime commitment to Christ.
- (iii) Providing a forum in which the Gospel of Jesus Christ can be discussed with non-believers outside of a formal church setting.
- (iv) Generously extending the grace of God by giving away 100% of all profits (except those retained for capital expenditures) to community ministries, other local, national or international non-profits or organizations, or those in financial need.”

A local minister had the “vision of a coffee shop ‘where believers could interact with non-believers in a safe and friendly environment to convey the Gospel in a non-confrontational manner ...’” It was hoped that other churches and groups would participate.

In submissions to the IRS in support of the Form 1023, Application for Exemption from Tax, the organization set out a number of additional features it asserts distinguishes it from an ordinary commercial coffee shop. These include, for instance:

- Using a common, low-key, evangelical technique involving “a donor paying for a certain amount of coffee in advance. Then, when a customer comes in they are told by the staff that the coffee has already been paid for and, ‘that the coffee is not free’ but that the price has already been paid for it – just like Jesus already paid the price for all of our sins by dying on the cross for us.”
- Buying coffee sourced directly from coffee farmers, which benefits these growers 50-100% over the price paid for “Fair Trade” coffee.
- Locating the facility in an area in downtown where there is no other similar business, and filling an unmet need there for a “gathering space that is open late and offers the community a safe place to gather” – all helping to revitalize downtown.
- Relying on the church minister and members to serve on the coffee house board.
- Offering the space as a location “for both formal and informal Bible study, church group meetings,” and meetings for other groups or events like book signings, birthday parties, community business meetings, game nights, and live music.
- Not typically charging a fee for use of the space by groups or organizations, although advising users that a “suggested donation in the amount of x dollars per hour is welcome”; however, no denial of access or use due to inability to pay or decision not to donate.
- Working with other ministries, missionaries, and nonprofits by highlighting their activities in displays in the coffee shop and on social media as well as collecting donations for them.
- Giving away coffee and gift baskets, and offering meals and drinks to the homeless and helping them connect with local ministries for lodging and jobs.

Of course, counterbalancing these purported special features are elements that the IRS says are just like an ordinary commercial enterprise, including, for example: keeping extended hours, offering a full range of food and drink, and selling roasted coffee beans at the shop and online in the future. The IRS compared and contrasted earlier cases and precedent including *Zagfly* (no exemption allowed) as well as Revenue Ruling 68-72, 1968-1 C.B. 250 (operating supervised “coffee house” to bring young people together with church leaders to further the college students’ religious, intellectual, and moral development; held, eligible for exemption). The tax agency concluded that this Christian coffee house, despite its pledge to donate 100% of profits to charity, does not qualify for 501(c)(3) exemption. A substantial portion of the operations would be similar to a commercial operation.

Conclusion

“The coffee shop ruling is a common problem in the Exempt Organizations world. Can you take a business activity and give it enough of an overlay of religious, educational, or charitable activity to then conclude that is operated primarily for exempt purposes?”

This same commentator wonders “why they really need to bother with the aggravation of exempt status. They aren’t making any profits yet and if they did would it really kill them to render a little unto Caesar?” As we observed in our post about *Zagfly*, this sounds a lot like a social enterprise: a better fit for that business as well as this proposed religious coffeehouse.