

Exempt Organizations - Report of Examination (Proposed Status Changes)

1. Form No. 990	2. Area Office Gulf Coast	3. Date of Report 6/13/2017
4. Name and Address of Taxpayer Panera Bread Foundation, Inc. c/o William Moreton 3630 S. Geyer Road, Suite 100 St. Louis, MO 63127		5. Employer Identification No. [REDACTED]
		6. Tax Period(s) Ending 2012
7. Report Preparer's Name James Brophy		8. Agreement Secured Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>
9. Findings Discussed with (Name and Title) Stace Faulder Rep.		10. Agreement Date
11. Current Foundation Status Classification (Enter description and IRC reference.) 501(c)(3) 509(a)(1) & 170(b)(1)(A)(vi).		

12. Nature of Proposed Status Change (“X” applicable line, enter IRC ref., & effective date)

X	Revocation of exemption under IRC Section 501(c)(3), effective (date) Jan.1, 2012
	Modification of exempt status from IRC Section 501(c)() to 501(c)() effective (date)
	Modification of foundation status from current classification shown in item 11 above, to a private non-operating foundation (IRC Section 509(a)), effective (date)
	Modification of foundation status from current classification shown in item 11 above, to an operating foundation (IRC Section 4942(j)(3)), effective (date)
	Modification of foundation status from current classification shown in item 11 above, to an organization described in IRC Section 509(a)(), effective (date)
	Modification of foundation status from current classification shown in item 11 above, to an organization described in IRC Section 509(a)(1) and 170(b)(1)(A)(), effective (date)

13. Remarks

Panera Bread Foundation, Inc. conducted a substantial nonexempt cafe activity that is not within the meaning of Section 501(c)(3). Therefore, the Foundation's tax-exempt status should be revoked.

14. Attachments:

Form 886-A

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer Panera Bread Foundation, Inc.		Year Ended December 31, 2012

Issues:

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

Facts: Operations:

Panera Bread Foundation, Inc. "hereafter referred to as the Foundation" was granted exemption under Section 501(c)(3) of the Internal Revenue Code from January 10, 2002, the date that they incorporation with the State of Missouri.

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 2012 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 Panera Care, a program that consists of three cafes which operate similar to a traditional Panera Bread Cafe. 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 Panera Care cafes for high-risk individuals between the ages of 16 and 21 that are referred by local non-profit organizations to the Foundation.

Contributions/Assist in Procuring Food and Feeding America

During tax year 2012 the Foundation made grants and other assistance of \$1,229,045 to other charitable organizations.

Panera Care - Operations of Three Cafe Facilities

Panera Care is a program that consists of three cafes which operate similar to traditional Panera Bread cafes. The cafes are located in areas that are not economically depressed and compete with other eating facilities that are located in the areas. The Panera Care cafes were located in Clayton, MO, Dearborn, MI and Portland, OR. The cafes were open seven days a week. The menus at the Foundation's cafes include all of the soups, sandwiches, and salads of a traditional Panera Bread Cafe. **Please refer to Exhibit I.**

The Panera Care cafes 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 cafes menu board. Approximately, 60 percent of the customers pay more than the value of the meal, 20 percent of the customers pay the value of the meal and 20 percent of the

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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 cafes were initially opened it was estimated that they served over four thousand people each week. During the 2012 tax year the Foundation received \$3,675,695 in receipts for the sale of food and drinks items provided at the cafes.

Job Training Program

During the tax year ending Dec. 31, 2012 Panera Bread Foundation, Inc. had eight individuals graduate from their Panera Care job training program. Clayton, MO – three graduates, Portland, OR – five graduates and Detroit, MI – Zero. During the years 2011, 2012, 2013 and 2014 the job training program has had 42 high-risk individuals graduate. The program provides training for youth so they can get jobs in the food service industry.

Employees

The Foundation had 190 workers that were compensated for Panera Care cafe related services and the Foundation paid total compensation of \$1,537,535.31 for the cafe workers during tax year 2012.

Foundation Controlled by Related For-profit

The Foundation is controlled by the members of a related for-profit organization, Panera LLC. All of the officers and directors of the Foundation are employees of Panera LLC. The worker's compensation were paid by Panera LLC and then Panera LLC 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, 2012, the Foundation had the following revenues:

\$1,914,620 – Panera, LLC – Donated of bread, bagels, pastries and, property and equipment.
 \$1,005,105 – Panera LLC – Cash: Operation Donation.
 \$3,675,695 – Panera Cares – Receipts for food and drinks items from the general public.
 \$68,765 – Vendor support contributions.
 \$1,052,321 – Cafe Donation Boxes at Panera for-profit facilities.

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

The cafes activities are operated at a loss, even though they receive donations of bread, bagels, pastries and, property and equipment from Panera LLC. It was stated that the Panera Care cafe 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 cafes.

LAW:

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

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

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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 cafes only request donations in return for the food and drinks that the cafes are charitable in nature.

Government's Position:

The Foundation primary activity is to operate cafes in affluent areas, the cafes provided food and drinks to the general public, and at times to persons in need. The cafes were not operated primarily for the purpose of providing food and drinks to individuals in need. The cafes activities are **substantial**, the Foundation had 190 workers that were employed to operate the cafes during tax year 2012. The job training activities are insubstantial in nature since there were very few participants, eight during tax year 2012 and forty-two over a four year period.

The Foundation has posted suggested menu prices in the cafes. 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 Panera LLC a for-profit organization. Panera LLC donated of bread, bagels, pastries, property and equipment and cash. It was determined that most of the support during the tax year was from donations made by Panera LLC. The employees of Panera, LLC control the Foundation, the officers and directors of the Foundation are employees of Panera LLC.

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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 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

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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 cafes. But the cafes 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 cafes 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, 2012.

Conclusion:

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, 2012.