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Internal Revenue Service
Director, Exempt Organizations
Rulings and Agreements

Department of the Treasury
P.O. Box 2508 – RM 7008
Cincinnati, OH 45201

Date: APR 05 2004

UIL: 501.00-00

Employer Identification Number:

Person to Contact – I.D. Number:

Contact Telephone Numbers:

Phone

Fax

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

This letter supercedes our 1045 letter dated August 28, 2003 that was issued in error.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax and you are a corporation, it will be necessary for you to file an annual income tax return on Form 1120.

Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

DR-054-2004

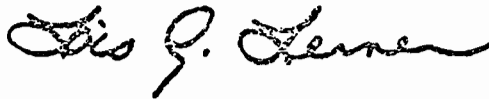
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If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

A handwritten signature in cursive script, appearing to read "Lois G. Lerner".

Lois G. Lerner
Director, Exempt Organizations
Rulings and Agreements

Enclosures: 3

ENCLOSURE I

Issues:

- 1) Does the operation of an adult retreat that offers manicures, pedicures, massages, a hot tub & Jacuzzi, exercise equipment, swimming, tennis, and personal counseling serve an exempt purpose as described in Section 501(c)(3) of the Code?
- 2) Does the compensation derived by the three related officers of the organization cause the net earnings of the organization to inure to their benefit?
- 3) Does the building and operation of a facility on land owned by one of the related directors cause the net earnings of the organization to inure to his benefit?

Facts:

Your organization was incorporated on _____ under the nonprofit corporation laws of the _____

Amendments to your Articles of Incorporation were filed on _____ and _____ under the nonprofit corporation laws of the _____ to include the required language of Section 501(c)(3) of the Code.

You were formed for the purpose of providing children and adults with a high quality, safe, friendly, effective and enjoyable environment in which to learn and grow.

The file indicates the "Mission" of your organization is to _____

Your organization is located outside of the small _____ town of _____ which is _____ miles _____ of _____

Your organization is not a membership organization.

The activities of your organization are to provide counseling and recreational activities to the children via a camp that features counseling, archery, swimming, tennis, soccer, football, golf and a pro shop. The organization will also provide a ' _____ for adults. The _____ will offer manicures, pedicures, massages, a hot tub & Jacuzzi, exercise equipment, swimming, tennis, and personal counseling. Your facility will be open to the general public and to adults and children who cannot afford summer camp and private retreats.

The business plan located in the file indicates that you are a [redacted] and financial information submitted with the application indicates that the President is the [redacted] of your organization. An attachment to the business plan indicates the President runs the organization. Below the President are the Vice-President and the Secretary. An [redacted] board of directors appears to give advice to these three officers, but the board appears to have no control over the President. No indication exists in the file that the board can override the President's wishes.

Your organization will derive revenue from service fees and donations from [redacted] organizations who will [redacted] youth and adults from the inner city. An attachment to Form 1023 indicates that 65% of your revenue will be from the adult camp and 35% will be from the children's camp.

The expenses of the organization are listed as compensation of officers and directors, salaries and wages, utilities, employee benefits, payroll taxes, capital purchases, travel, marketing/advertisement, training/development, database and website and other [redacted] expenses.

Page 9 of the Form 1023 indicates a Contribution, gift, grant, etc. payable of [redacted] No other information exists in the file regarding this item.

The file indicates that any [redacted] earned from your services will be used to help and support youths and adults in the inner city, award scholarships, and expand your facility.

Annual compensation will be paid to the President /CEO in the amount of [redacted] to the Vice President in the amount of [redacted] and to the Secretary/Treasure in the amount of [redacted]

Law:

Section 501(c)(3) of the Code grants tax exempt status to organizations organized and operated exclusively for charitable, educational, religious, scientific, literary purposes no part of the net earnings of which inures to any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations 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.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that 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 states 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. Thus, to meet the requirement of this subdivision, 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.

Regulations 1.162-7(b)(3) states reasonable compensation is that amount that would ordinarily be paid for like services by like organizations in like circumstances. The "like" rule applies to total compensation, not just that portion of an individual's salary, and includes contributions to pension plans, payments of personal expenses, and bonuses.

Revenue Ruling 59-310, 1959-2 CB 146 described a nonprofit corporation organized for the purpose of establishing, maintaining and operating a public swimming pool, playground and other recreation facilities for the children and other residents of a community is exempt from Federal income tax under Section 501(c)(3). Residents of the community making use of such facilities consist principally of low-income groups who are unable to pay the cost of privately sponsored recreation facilities for themselves and their children. The funds of the association were raised by public subscription with the exception of small amounts derived from nominal charges made for admission to the swimming pool. It appears that the income derived from charges for admission to the swimming pool were minor in amount and that such charges were purely incidental to the orderly operation of the pool.

Revenue Ruling 65-2, 1965, 1965-2 CB 227 states exemption may be granted under Section 501(c)(3) to an organization which is organized and operated for the purpose of teaching a particular sport to children by holding clinics conducted by qualified instructors in schools, playgrounds, and parks, and by providing free instruction, equipment, and facilities.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179, 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.

Operating for the benefit of private parties constitutes a substantial nonexempt purpose. Old Dominion Box Co. v. United States, 477 F. 2d 340 (4th Cir. 1973), cert. denied 413 U.S. 910 (1973).

John Marshall Law School v U.S., 81-2 U.S.T.C. 9514 (Ct. Cl. 1981) in part states the Tax Court found that the Commissioner acted properly in revoking exempt status under Section 501(c)(3) to an organization on the grounds of inurement to the controlling officers and their families.

Birmingham Business College, Inc. v Commissioner, 276 F2d 476(5th Cir. 1960) in part involves unreasonable compensation and states those in control of an organization may not withdraw its earnings under the guise of salary payments.

In Texas Trade School v. Commissioner, 30 T.C. 642, affirmed 272 F. 2d 168 (5th Circ. 1959), the officers of a school leased property owned by the officers to the school and caused it to erect improvements which benefited them individually. The officers shared in the schools net earnings as the result of the improvements erected on the officer's property.

Application of the Law:

Unlike the organization in Revenue Ruling 59-310, your revenue will come primarily from gross receipts from the _____ Your fees are not _____ and are more than _____ to your operation. Also, your organization is not a _____ organization, but will be open to the general public from various communities.

Unlike the organization in Revenue Ruling 65-2, you do not primarily provide free instruction to children.

Your primary activity is the provision of for-profit like services such as manicures, pedicures, massages, a hot tub & Jacuzzi, exercise equipment, swimming, tennis, and personal counseling. While it appears that discounted rates will be offered to low-income individuals, it has not been established how such activities accomplish charitable purposes under Section 501(c)(3) of the Code.

The other substantial activity of your organization is a children's camp that features counseling, archery, swimming, tennis, soccer, football, golf and a pro shop. While correspondence received February 4, 2004 indicated that low-income families would be provided a discount to attend the camp, no indication was given as to how your organization would attract substantial amounts of disadvantaged children.

Even though a substantial purpose, the provision of services to disadvantaged children, of your organization may be charitable in nature as defined in section 1.501(c)(3)-1(d)(3)(i) of the regulations, similar to Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179, the presence of a single non-exempt purpose, the provision of for-profit related services to adults, that is substantial in nature destroys a claim for exemption regardless of the number or importance of truly exempt purposes.

Like the organization in Old Dominion Box Co. v. United States your organization is operated for the benefit of private parties, specifically the related directors.

Like the organization in John Marshall Law School v U.S. your funds inure to the controlling officers of the organization through excessive compensation and improvement to the property owned by the President and CEO.

Like the organization in Birmingham Business College, Inc. v Commissioner those in control of your organization are withdrawing its earnings under the guise of salary payments.

Like the organization in Texas Trade School v. Commissioner, your directors will share in your organization's net earnings as the result of the improvements erected on an officer's property.

Applicant's Response:

In a letter dated March 18, 2003, you were asked to explain and provide additional information regarding your organization and how the _____ for-profit like activities further an exempt purpose or is affordable to low income families and individuals. Your responding letter of April 9, 2003 contained a page from your business plan that highlights the statement that _____ is a minority owned nonprofit organization, the profit earned will be used to help and support youths and adults in the inner cities, award scholarships and expand the facilities to be able to accommodate more people. It was not indicated how the _____ is affordable to low income families and individuals or served an exempt purpose.

Since all three members of your original board were related and receiving compensation, we asked you to expand your board of directors by three to four non-related members of the community. On April 16 2003, a fax transmission provided the profile of one new board member. However, minutes of a special meeting of the board of directors held on July 7th, 2003, lists two additional individuals which brings the total number of board members to six. Three members of your board of directors are the founding family members who hold the position of President, Vice-President, and Secretary/ Treasurer. At the present time these directors receive a total combined compensation of _____. The file does not indicate that the current board will put the organization's exempt interests above the interests of the three related board members.

You were further asked in the letter dated March 18, 2003, to provide documentation on the ownership of the retreat property and explain the use of the _____ of property that is involved with the retreat. A copy of the land purchase agreement for _____ of land located in the _____ within the _____ was submitted. This document executed by the seller _____ (a third party) and the buyer _____ (the organization's president), is dated _____. Thus it appears the retreat property is owned by the president. No other information was provided regarding the retreat property.

The articles of incorporation have no indication that the organization has any stock. Correspondence dated June 13, 2003, was received regarding a special meeting of your board of directors held on June 9, 2003. At this meeting it was authorized and agreed upon by the members that _____ owned by the President/CEO would be donated to the corporation and _____ owned by Vice President

_____ would be donated to the corporation effective _____ has been provided.

No further explanation

In the letter dated March 18, 2003 you were further asked to provide a complete list of any fees or charges. Your responding letter of April 9th indicates that the Summer Session fee is _____ per week, _____ per weekend and the _____ fee is _____ per week. In a subsequent document dated August 20, 2003 it was declared that _____ - Winter Session fee is _____

Correspondence dated May 15, 2003, provided a list of _____ camps and fees that the organization feels is comparable to the organization. However, in reviewing this information it is not shown how these camps are comparable to the organization as in location, types of activities and fees. Also, no mention has been made as to whether these entities are tax exempt under Section 501(a) of the Code.

In a letter dated November 14, 2003 you were asked if the organization has adopted bylaws and to submit a copy of your bylaws or to provide a statement declaring that bylaws have not been adopted. Your responding letter of December 11, 2003, indicated that you have adopted bylaws. However, only pages 7 and 8 of your bylaws were submitted. Later, a fax was received on February 4, 2004 that included pages 3 and 4 of your bylaws. A full copy of your approved bylaws have not been received by the Service. The limited information provided indicates that the _____ may appoint and remove the directors. The _____ appear to be the three related directors.

In the November 14th letter you were asked to explain who determines the terms of compensation for your board of directors and the basis used to make the determination and to furnish a copy of the minutes of your board of directors meeting that discussed and approved the terms of compensation. Your responding letter of December 11, 2003 stated, _____ No information exists in the file to substantiate that the \$ _____ in total yearly compensation paid to the related directors is reasonable.

We also asked your organization to explain in detail how adult services of the organization differs from that of a for profit spa, how adults are selected or referred to the organization and how the adult services further one or more purposes of Section 501(c)(3). Your responding letter of December 11th states _____

_____ You also, stated,

It appears that the President, _____ who is referred to as the _____ in the application, has total control of the operation of your organization. When asked to explain what role the _____ has in the operation of the organization, you responded that the bylaws do not allow the President to have total

control. No response was provided regarding the role of the

When asked the anticipated construction date of your facility, no response was provided.

Correspondence was received February 4, 2004 to establish income qualification for
A household income of _____ qualifies for a full
paid tuition. Income ranging from _____ qualifies for half tuition paid
and income of _____ and above must pay full tuition. Check stubs and prior year taxes
would be required to determine eligibility. But, information was not submitted that
indicates that your facility will benefit any charitable class in a significant manner.

Conclusion:

Your organization was formed by the President, Vice-President, and Secretary, who are
_____. It appears the President, who is referred to as the _____ controls the
organization. You pay unreasonable compensation to the President, Vice-President, and
Secretary and the land where you will build your facility appears to be owned by the
President. Over half of your revenue is from the adult services, which do not appear to
serve a charitable purpose. In fact, the adult services appear similar to a "for-profit" spa.
Also, it is unclear if your children's services are truly charitable because it has not been
shown that a charitable class, such as disadvantaged children, has significant
representation in your program.

Therefore, it appears that:

- 1) The operation of your adult retreat that offers manicures, pedicures, massages, a hot tub & Jacuzzi, exercise equipment, swimming, tennis, and personal counseling does not serve any exempt purpose as described in Section 501(c)(3) of the Code. Regardless of the possible charitable purposes of your children's retreat, the adult retreat is a single non-exempt purpose that is substantial in nature and destroys any claim for exemption.
- 2) The salaries of _____ paid to the related officers are unreasonable compensation and causes those in control of your organization to withdraw its earnings under the guise of salary payments.
- 3) The building and operation of your facility on land owned by one of the related director's causes a significant portion of your net earnings to inure to the benefit of that director.

Based on the information submitted by your organization, we conclude that your organization serves the private interests of the related officers and does not meet the operational test, as it is not operated exclusively for one or more exempt purposes within the meaning of Section 501(c)(3) of the Code.

Therefore, your organization does not qualify for tax-exempt status under Section 501(c)(3) of the Code.

Form 6018
(Rev. Aug. 1983)

Department of the Treasury - Internal Revenue Service
Consent to Proposed Adverse Action
(All references are to the Internal Revenue Code)

Case Number
403203039

Date of Latest Determination Letter

Employer Identification Number

Date of Proposed Adverse Action Letter

APR 05 2004

Name and Address of Organization

I consent to the proposed adverse action relative to the above organization as shown below. I understand that if Section 7428, Declaratory Judgements Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

Denial of exemption

Revocation of exemption, effective.

Modification of exemption from section 501(c)() to section 501(c)(), effective

Classification as a private foundation described in section 509(a), effective ****

Classification as an private operating foundation described in sections 509(a) and 4942(j)(3), effective for

Classification as an organization described in section 509(a)(), effective

Classification as an organization described in section 170(b)(1)(A)(), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgement under section 7428.

(Signature instructions on Back)

Name of Organization:

Signature and Title

Date

Signature and Title

Date