



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201041046**

Release Date: 10/15/10

Date: July 20, 2010

Uniform Issue List:

501.00-00

501.03-00

501.03-08

501.33-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, 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 Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: May 12, 2010

Contact Person:

Uniform Issue List Number:

501.00-00

501.03-00

501.03-23

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

- Taxpayer =
- State =
- County =
- Date =
- Case =
- Number =
- Sum =
- Association =
- Year1 =
- Year2 =
- Year3 =
- Year4 =
- Year5 =
- Year6 =
- Year7 =
- Year8 =

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code ("Code") section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

FACTS:

You, Taxpayer, are a not-for-profit corporation organized under the laws of State. You filed a Form 1023 seeking exemption from federal taxation under section 501(c)(3) of the Code. You are a private school providing educational services to children from pre-kindergarten to twelfth grade. You were formed in State on Date, which was during the time that the public schools in County were subject to court-supervised desegregation plans. In the mid-1980's you amended your charter and adopted a racial nondiscrimination policy.

You previously applied for, and were denied, exemption from taxation under section 501(c)(3) of the Internal Revenue Code. The prior denial was supported by the following facts: you were formed during the time of desegregation, you had an absence of black students despite a sizeable black population in your county, and you did not operate your nondiscrimination policy in good faith.

In denying exemption, the Service stated that you did not operate your nondiscrimination policy in good faith because you had not made any affirmative efforts to recruit black students, you had not made contacts within the black community, and you did not provide reduced tuition rates as a method to recruit black students. It was the Service's position that waiting for black students to enroll without taking any affirmative attempts to recruit those students was insufficient to meet your burden on demonstrating that you are operated in a nondiscriminatory manner. The denial of your exempt status was upheld in Case. There the court noted that even though you had published statements of your nondiscriminatory policy in a variety of sources, you had not demonstrated that you were operated in a racially nondiscriminatory manner.

For the current school year, your racial composition is as follows: black students; Asian students; Hispanic student; and white students. According to the data from the United States Census Bureau (available at <http://quickfacts.census.gov/>), the racial composition of County is approximately % white, % black, % Hispanic, and less than % Native American, Asian, or other. Additionally, you identified four students as "other." It is unclear whether "other" is a reference to the student's ethnicity or to their nationality because you included non-minority European exchange students in your list of minority students, stating that "their ethnic origin is different from that of the majority of [Taxpayer's] students, which is American."

You "do not engage in recruitment for any students." You do not participate in any outreach efforts to increase the number of black and other minority students in your school. Other than advertising on a yearly basis your non-discriminatory policy, you do not communicate with the black or other minority communities in your area or actively work to increase the number of black and minority students in your school. All of the black and minority students currently enrolled in your school approached you for admission.

When asked why more black or minority students were not in attendance at your school, you provided two reasons. First, you stated that "income level is a major factor in determining who can attend [your institution]." The second reason you cited is poor academic performance, stating that you are a "college preparatory institution" and that "applicants are not qualified academically."

While you recognize that money is an issue that prevents students from attending your school, you do not provide scholarships or tuition assistance to any of your minority or black students. You do not plan on offering any tuition assistance programs. You claim that instituting such a program would cause "an undue burden to be placed on many families who struggle to send their own children to [you] if they were required to pay increased tuition to assist other families." You were asked whether you would consider adopting a minority scholarship program if granted tax exempt status. You responded that you may consider such a program if adequate funds were available.

You have never employed a black teacher or staff member. You have a total of 50 faculty and staff. These numbers are broken down into 36 teachers, ten aides, and six staff members. Since your inception, you have only had four minority faculty or staff members. One was Asian, one was Indian, and two were Hispanic. You have not employed a minority teacher or staff member since _____ when you employed one Hispanic teacher.

Both Hispanic individuals that you employed were only employed by you for a short period of time. Each individual was from a Latin or South American country, was hired only to teach advanced Spanish classes, and returned to their county of origin after their tenure had finished. You do not actively recruit teachers. In fact, you state that you "have no active recruitment procedure for administrative or teaching positions." And you only discuss positions if "any person asks about the availability of a position." Finally, you provide that the majority of your teachers are the same individuals employed by your school since the time it was deemed discriminatory. You attribute the lack of applications for teaching positions to the salary that you pay and the fact that you do not offer any form of benefits.

You claim that your membership in Association demonstrates that you are operated in a nondiscriminatory manner because Association requires schools to adopt nondiscriminatory practices. However, you were a long standing member of Association at the time your application for exemption was previously denied.

While it has been over twenty years since you adopted your nondiscriminatory policy, you only submitted advertisements for eight of those years. You submitted photocopies of advertisements of your nondiscriminatory policy from Year1, Year2, Year3, Year4, Year5, and Year6. You also submitted a mock up from Year7, which was not even a photocopy from the newspapers. You submitted one mock-up that was accompanied by a sworn and notarized statement from the advertising director of the newspaper. This advertisement, for Year8, does not have any other advertisements or text around it that demonstrated how many columns the advertisement occupied, its font size, when it was printed in the newspaper, etc. One advertisement could not be identified because the photocopy did not provide the name of the newspaper or its date of publication.

Of the photocopies you submitted, most have similar language regarding your nondiscriminatory policy. The Year1 advertisement states that "TAXPAYER ADMITS STUDENTS OF ANY RACE, COLOR, and NATIONAL OR ETHNIC ORIGIN." The Year2 photocopy occupies two newspaper columns in width and states in small text that "Taxpayer admits students of any race, color, national or ethnic background." You submitted a copy of the page in which the advertisement appears as well as a blown up copy of the advertisement. The Year3 photocopy states "Taxpayer has a nondiscriminatory policy and seeks students of all races, creeds, nationalities, and ethnic backgrounds." The Year4 photocopy takes up two column widths of the newspaper and states in small text that "Taxpayer has a nondiscriminatory policy and seeks students of all races, creeds, nationalities, and ethnic backgrounds." The Year5 advertisement takes up two column widths of the newspaper and states in small bold text that "Taxpayer has a nondiscriminatory policy and seeks students of all races, creeds, nationalities, and ethnic backgrounds." The Year6 article states that "Taxpayer admits students of any national or ethnic origin, race, or color." The Year7 mock-up states that "Taxpayer has a nondiscriminatory policy and seeks students of all races, creeds, nationalities, and ethnic backgrounds." The Year8 mock up states "Taxpayer seeks students of all races, creeds, nationalities, and economic backgrounds. The school adheres to a policy nondiscrimination in its admission policies,

academic, athletic, and extracurricular programs.” The undated advertisement contains larger text and has identical language to the Year8 mock-up.

LAW:

Section 501(c)(3) of the Internal Revenue Code (“Code”) provides that corporations will be exempted from tax if they are “organized and operated exclusively for . . . educational” purposes and “no part of the net earnings of which inures to the benefit of any private shareholder or individual”

Section 1.501(c)(3)-1(a) of the Treasury Regulations (“regulations”) provides 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.”

Revenue Ruling 71-447, 1971-2 C.B. 230 provides that a private school that does not have a racially nondiscriminatory policy as to students does not qualify for exemption from federal income tax under section 501(c)(3) of the Code. It defines a racially nondiscriminatory policy as meaning that “the school admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school and that the school does not discriminate on the basis of race in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school administered programs.”

Revenue Procedure 75-50, 1975-2 C.B. 587 provides guidelines and recordkeeping requirements for private schools. Under the Rev. Proc., schools must have racially nondiscriminatory policies as to students. Section 2.02 provides that a school must show affirmatively both that it has adopted a racially nondiscriminatory policy as to students that is made known to the general public and that since the adoption of that policy the school has operated in accordance therewith. Section 4.032(c) provides, in part, that whether a particular school follows a racially nondiscriminatory policy will be determined on the basis of the facts and circumstances of each case. Additionally the Rev. Proc. states that schools should advertise, at least annually, notices of their racial nondiscrimination policy. These advertisements must appear in a section of the newspaper likely to be read by prospective students and their families, must occupy at least three column inches, must be captioned in at least 12 point bold face type as a notice of nondiscriminatory policy as to students, and its text must be printed in at least 8 point type. The Rev. Proc. states that the following notice is acceptable:

NOTICE OF NONDISCRIMINATORY POLICY AS TO STUDENTS

The M school admits students of any race, color, national and ethnic origin to all the rights, privileges, programs, and activities generally accorded or made available to students at the school. It does not discriminate on the basis of race, color, national and ethnic origin in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.

In Bob Jones University v. United States, 461 U.S. 574 (1983), the Supreme Court found that petitioner, a nonprofit private school that prescribes and enforces racially discriminatory admissions standards on the basis of religious doctrine, did not qualify as a tax-exempt organization under section 501(c)(3) of the Code. The court held that racially discriminatory private schools violate a fundamental public policy and cannot be viewed as conferring a public benefit within the meaning of common law standards of charity and congressional intent underlying section 501(c)(3).

In Prince Edward School Foundation v. United States, 478 F. Supp. 107 (D.D.C. 1979), the court held that a private school administering a racially discriminatory admissions policy is excluded from tax-exempt status under section 501(c)(3) of the Code. The court further held that the organization had failed to meet its burden of establishing its entitlement to exemption under section 501(c)(3) because the record was devoid of evidence that the organization was administering a nondiscriminatory admissions policy. The court also stated that the inference that the plaintiff administered a racially discriminatory policy may be drawn from the circumstances surrounding the school's establishment.

In Norwood v. Harrison, 382 F. Supp. 921, 924-925 (N.D. Miss. 1974), the court determined that a "prima facie case of racial discrimination arises from proof (a) that the school's existence began close upon the heels of the massive desegregation of public schools within its locale, and (b) that no blacks are or have been in attendance as students and none is or has ever been employed as teacher or administrator at the private school."

In Brumfield v. Dodd, 425 F.Supp. 528, 535 (E.D. La. 1976), the court, in looking at West End Academy, provided that the enrollment of one black student is not enough to rebut an inference of discrimination. This was particularly true because the school did not have any black teachers or staff members and did not have a recruitment policy to enroll black students or employ black teachers.

In Calhoun Academy v. Commissioner, 94 T.C. 284 (1990), the Tax Court held that a private school failed to show that it operated in good faith in accordance with a nondiscriminatory policy toward black students. The school, which was formed at the time of desegregation of the public schools, had never enrolled a black student or employed a black teacher. The court also stated that after an inference of racial discrimination has taken hold, an organization must prove with "clear and convincing" evidence that it is operated in a nondiscriminatory manner.

ANALYSIS:

In order to be recognized as exempt from taxation, an organization must be both organized and operated exclusively for exempt purposes. I.R.C. § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(a). An organization that is not operated in a nondiscriminatory manner is not operated exclusively for exempt purposes. See Bob Jones University v. United States, 461 U.S. 574 (1983) (racially discriminatory private schools violate a fundamental public policy and cannot be viewed as conferring a public benefit within the meaning of common law standards of charity and congressional intent underlying section 501(c)(3)); Prince Edward School Foundation v. United States, 478 F. Supp. 107 (D.D.C. 1979); Rev. Rul. 71-447, 1971-2 C.B. 230 (a private school which does not have a racially nondiscriminatory policy as to students does not qualify for exemption from federal income tax under section 501(c)(3) of the Code). Because you have not

demonstrated that you are operated in a racially nondiscriminatory manner, you are not operated exclusively for exempt purposes and do not qualify for exemption from taxation.

Private schools must have a racially nondiscriminatory policy and they must publish annually a statement of racial nondiscrimination in order to receive and maintain tax exempt status. See Rev. Rul. 71-447, 1971-2 C.B. 230; Rev. Proc. 75-50, 1975-2 C.B. 587. While you adopted a racially nondiscriminatory policy in the mid-1980's, you have not demonstrated that you publish your nondiscriminatory policy on an annual basis. A number of years have passed since you adopted your racial nondiscriminatory policy, yet you only provided a handful of advertisements to demonstrate that you meet the publishing requirements. In addition to the annual publishing requirement, Rev. Proc. 75-50 also requires that newspaper advertisements made during the school's registration period must occupy at least three column inches, must be captioned in at least 12 points bold face type font, and the text of the policy must be at least 8 point type. Your advertisements do not meet these requirements. They do not satisfy the type face and font size requirements. Most do not satisfy the column width size. And none satisfy the captioning and language requirements.

As such, you have failed to comply with the requirement that you publish your statement of racial nondiscrimination. However, even if you had met all of the requirements for publishing your nondiscriminatory policy, this alone is not sufficient to demonstrate that you are operated in a racially nondiscriminatory manner. Calhoun Academy v. Commissioner, 94 T.C. 284 (1990) (“[m]ere adoption and publication of a policy of racial nondiscrimination is insufficient for such a school to demonstrate that it is operating in a bona fide nondiscriminatory manner in accordance with Rev. Proc. 75-50”).

Generally, an organization must demonstrate by a preponderance of the evidence that it is operated in a nondiscriminatory manner. Calhoun Academy, 94 T.C. at 297. The Tax Court in Calhoun Academy opines that an organization previously adjudicated as operating in a racially discriminatory manner must provide clear and convincing evidence that it is no longer operated in a racially discriminatory manner. Id. at 297 (a “‘clear and convincing standard’ . . . applies on rebuttal only after an inference of racial discrimination has taken hold. The ‘preponderance of the evidence’ standard, in contrast, begins with a clean evidentiary slate”); Id. (a “taxpayer faced with an unfavorable evidentiary inference at the outset plainly bears a heavier burden from that point forward, however articulated, than a taxpayer with no such unfavorable inference yet established”). Given the determination in Case, you may face a heavier standard in demonstrating that you are operating your racially nondiscriminatory policy in good faith. However, even under a preponderance of the evidence standard you have still failed to demonstrate that you are operated in a non-discriminatory manner.

In Calhoun Academy, the Tax Court noted that the organization had never enrolled a black student, despite a large black population in the organization's county. 94 T.C. at 299. Unlike the school in Calhoun Academy, you have enrolled some minority students. Specifically, you have enrolled black students, Asian students, and Hispanic student. You also have white students enrolled, despite a county population that is % white. However, enrolling black students, does not automatically demonstrate that you are operated in a racially nondiscriminatory manner. See Brumfield v. Dodd, 425 F.Supp. 528, 535 (E.D. La. 1976). You justify this low number of black and other minority students by stating that tuition is expensive and many applicants are not academically qualified.

While you state in your application that financial issues prevent black and other minority students from attending your school, you do not plan to offer scholarship programs or other tuition assistance. You are hesitant to institute such a program because it would cause “an undue burden to be placed on many families who struggle to send their own children to [you] if they were required to pay increased tuition to assist other families.” However, according to your statement of revenues and expenses, you expect to spend around \$Sum a year in corporate taxes. The granting of exempt status would enable you to use that sum for the provision of almost 20 scholarships (a number calculated using the highest possible tuition rates for your high school students). According to your financial statements, you had over _____ in your fund balances at the end of your fiscal year. It is not clear why you believe that funds are not available for a tuition assistance program, or why you believe that families of non-minority and non-black students would have to pay increased tuition amounts to support such a program.

There are currently a few black or other minority students attending your school, though these students arrived there through pure happenstance and not through any efforts on your part. You do not have an active recruitment program to encourage black or other minority students to apply for admission. Your unwillingness to provide scholarships to minority students or conduct any form of outreach to minority communities creates a strong inference that you do not wish to increase the enrollment of black and other minority students in your institution. See Norwood v. Harrison, 382 F. Supp. 921, 926 (N.D. Miss. 1974) (schools may overcome an inference of discrimination by demonstrating “proof of affirmative steps instituted by the school.” Such steps include proof of recruitment programs aimed at securing black teachers or students, financial aid programs, and outreach efforts to the black community).

The second reason you listed for why students are not attending your school is academic performance. You state that you are a “college preparatory institution” and that many “applicants are not qualified academically.” However, according to your student handbook, you have three different high school tracks that result in a diploma. They are the college preparatory academic, the college preparatory general diploma, and the basic general diploma. It is not clear why you would offer a “basic general diploma” when you claim that you are only a college preparatory institute.

Even if academic qualifications provided some insight into student enrollment figures for your middle and high school programs, it does not explain the enrollment figures for your pre-kindergarten, kindergarten, and early elementary school classes. For example, in your pre-kindergarten classes the only requirements are that the child be of a certain age and be toilet-trained. Your justification fails to explain why you do not have any black or minority students enrolled in your pre-kindergarten classes. Similarly, the academic requirements for your elementary school, particularly at the lower grades, do not explain why there were no black students enrolled in your elementary school during the last school year.

In Calhoun Academy, the Tax Court noted that the organization had never employed a black teacher or staff member. 94 T.C. at 287. Similarly, you do not employ any black or other minority faculty members and have not employed any since your inception. Admittedly, you have previously employed two Hispanic teachers and two other minority teachers, but the hiring of a few minority teachers implies “nothing about [your] policy toward blacks.” Calhoun Academy, 94 T.C. at 301. You do not make any effort to recruit black or other minority individuals for faculty or staff positions. As such, you have not demonstrated that you are

operating in a nondiscriminatory manner. See *Brumfield v. Dodd*, 425 F.Supp. 528, 535 (E.D. La. 1976) (when a school did not have any black teachers or staff members and did not have a recruitment policy to enroll or employ black students or teachers, the enrollment of one black student did not rebut the inference of discrimination). While you have attributed the lack of minority faculty and staff to the salary you offer and a lack of benefits, these factors do not explain why you still hired non minority staffers and why there is little turnover of existing teachers, many of whom worked for you since your founding during the time of desegregation.

CONCLUSION:

Based on the information provided in your Form 1023 and supporting documentation, we conclude that you are not operated exclusively for purposes described in section 501(c)(3) of the Internal Revenue Code.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Internal Revenue Code and you must file federal income tax returns.

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

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

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

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE
1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements