

Internal Revenue Service

Appeals Office
312 Elm Street, Suite 2330
Cincinnati, OH 45202-2763

Department of the Treasury

Taxpayer Identification Number:

Number: **201218041**
Release Date: 5/4/2012

Person to Contact:

Tel:
Fax:

Date: February 7, 2012

- A
- B
- C
- D

Tax Period Ending:

Certified Mail

UIL: 501.00-00
501.03-00
501.03-05

Dear :

This is our final adverse determination as to your application for recognition of exempt status under section 501(a) of the Internal Revenue Code (the "Code"), as an organization described in section 501(c)(3). It is determined that you do not qualify as exempt from federal income tax under section 501(a) of the Code effective May 24, 2010, the date of your incorporation in the State of F.

Our adverse determination was made for the following reason(s):

You do not satisfy the operational test for recognition of exemption as an organization described in section 501(c)(3) of the Code. The manner in which your activities are conducted results in more than an insubstantial degree of private benefit to individuals controlling your organization. In doing so, you further a nonexempt purpose. Since more than an insubstantial part of your activities further this nonexempt purpose, you are not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code.

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

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: FEB 07 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

C = Officer/Board Member
D = Officer/Board Member
E = Officer/Board Member
O = State
P = City
Q = Date
R = Compensation

UIL:

501.00-00
501-03-00
501-03-05

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue 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.

Issues

- Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons described below.

Letter 4034 (CG) (11-2005)
Catalog Number 47628K

Facts

You were formed as a corporation on date Q, in the State of O. Your Articles of Incorporation state your purpose is as an educational, home daycare and afterschool care services organization for children ages 0-12 years.

Your governing body is comprised of three individuals, including a CEO (board member C) and two individuals just listed as board members (board members D and E). Board members C and D are related. It is not clear if board member E is related to the other board members as you failed to address this issue. Board member C will receive compensation of \$R per year. You were asked to explain how this amount was determined, but failed to provide any detail. Based on the budgets provided with your application, compensation will make up the majority of your expenses.

Your application, bylaws and Articles of Incorporation states that board member C will not be able to be removed by the Board of Directors. Board member C stated that this was done to insure that she can protect her interest in the organization. Your organization was asked to expand the Board of Directors multiple times which you failed to do.

You were formed to provide a daycare and afterschool program primarily for children of board members, family members, and the general public. The daycare program will run from 6:00 am to 6:00 pm with the afterschool program offered from 6:00pm to 12:00 am. The daycare conducts various educational activities such as arts and craft programs along with group play activities. The afterschool program offers similar activities. All activities are conducted at the home of board member C. Expenses will include meals, supplies, and transportation to and from the day care as well as personal home expenses such as utilities and phone service. You indicate that services are advertised to the general public by word of mouth through friends and families and also by providing fliers. We requested copies of advertising materials demonstrating how you publicize your services and these were not provided.

You will charge fees for your services. Parents with low income will have a co-payment to pay and a person with higher income has to pay the full fee. You were asked to provide more details regarding your fee structure, but failed to explain your fees. You will also be supported by grants and by the State of O in receiving direct subsidies for child care services. You did not, however, provide a detailed breakdown of what percentage of fees are from grants, the State of O, or from fees directly from parents.

You are currently licensed by the State of O Department of Children and Family Services to have a maximum capacity of eight children for the daycare program and five children for the afterschool program. The license is in C's name. Currently, only four children are enrolled in the program, all of which are relatives of board members. You

have indicated the Department of Children and Family Services will allow you to have up to twenty children with the help of an assistant, however, you provided no documentation stating this policy.

Law

Section 501(c)(3) of the Internal Revenue Code provides, in part, for exemption from federal income tax of organizations organized and operated exclusively for charitable, religious or educational purposes, 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)(1) of the Regulations states that in order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

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.

Revenue Procedure 2011-9: A favorable determination letter or ruling will be issued to an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from federal income tax is claimed. A determination letter is issued based solely upon the facts and representations contained in the administrative record. The applicant is responsible for the accuracy of any factual representations contained in the application. The failure to disclose a material fact or misrepresentation of a material fact on the application may adversely affect the reliance that would otherwise be obtained through issuance by the Service of a favorable determination letter or ruling. Exempt status may be recognized in advance of the organization's operations if the proposed activities are described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption pursuant to the section of the Internal Revenue Code under which exemption is claimed. A mere restatement of exempt purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe all of the activities in which it

expects to engage and the nature of contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that it qualifies for exemption the Service will generally issue a proposed adverse determination letter or ruling.

In Rev. Rul. 69-175, 1969-1 C.B. 149, a nonprofit organization, formed by parents of pupils attending a private school, that provides school bus transportation for its members' children serves a private rather than a public interest and does not qualify for exemption under section 501(c)(3) of the Code.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of statutorily exempt purposes. Thus, the operational test standard prohibiting a substantial non-exempt purpose is broad enough to include inurement, private benefit, and operations that further nonprofit goals outside of the scope of section 501(c)(3).

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

Application of Law

You are not organized and operated exclusively for charitable, educational, or religious purposes consistent with Section 501(c)(3) of the Code nor Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations and therefore fail to meet the operational test.

Specifically, the facts above indicate that you are not operated for exempt purposes but rather for the private benefit to C, D and E by providing child care services for their relatives.

You are not described in Section 1.501(c)(3)-1(c)(2) as your earnings will inure to insiders. You are providing compensation to C to take care of C's own relatives, and are operating out of the residence of C for which you pay a share of the costs. Further, you are providing care for relatives of all board members including D and E which is being subsidized with public funding.

You are not described in Section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Your organization currently has four children enrolled all of whom are related to board members. Even though your application states that you are open to the public, at this time you are only benefitting the board members by providing daycare services for their relatives. You are licensed to supervise eight children. At a minimum, 50% of the children who make up your program will still be relatives of your board members. At

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night, you are only licensed to supervise five children, which would mean that at minimum 80% of the children participating in your afterschool program would be relatives of the board members. Twice you were asked to modify your Board of Directors and place control in the hands of unrelated individuals and both times you stated that you are unable to modify your board. While you did eventually provide procedures for the removal of a Board member, it still appears unlikely that board member C would be removed from her position. This is based on your statement that C would protect herself and her interest in the program by being assured she could not be eliminated from the Board. For the above reasons you are serving substantially private rather than public interests.

In Rev. Rul. 69-175, the organization is providing a service to only certain individuals that belong to a certain school. You are similar to this organization in that you are only providing services for relatives of your board members. While members of the general public are not prohibited from participation in your programs, the majority of participants are and/or will be children who are related to board members. Even though you have indicated you advertise services you have been unable to substantiate how you recruit additional enrollees from the general public and your entire enrollment is comprised of four related children.

An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single non-charitable purpose that is substantial (See Haswell v. United States) in nature. This is true regardless of the number or importance of the organization's charitable purposes as specified in Better Business Bureau v. United States. Although you are conducting child care services, in and of itself a qualifying exempt activity, your organization is serving private rather than public purposes. The substantial personal benefits outweigh any public good and for this reason you are serving non charitable purposes. As seen in Old Dominion Box Co, because you are operating for the benefit of private parties, specifically C,D and E (your directors), through the provision of personal services, you do not meet qualification for exemption under 501(c)(3).

You have failed to provide sufficient details regarding certain activities, expenditures and publicity of services. Per Revenue Procedure 2011-9, a favorable determination letter or ruling will be issued to an organization only if its application and supporting documents establish that it meets the particular requirements for the section under which exemption is claimed. Since you have been unwilling or unable to provide requested details it can only be concluded based on the present facts that you are serving private rather than public interests in operating your child care.

Applicant's Position

You state that you qualify under section 501(c)(3) of the Code because you are open to recruitment of children both inside and outside of your community, you can serve up to twenty children with the help of an assistant, and you will expand your Board of Directors.

Service Response to Applicant's Position

You have failed to show how you serve a public rather than a private interest. All children participating in your program are relatives of board members. You were asked to expand your Board of Directors and failed to do so and have structured your board so that private interests are protected.

Conclusion

Based on the above we conclude that you are operated for private rather than public purposes and do not qualify for exempt status under Section 501(c)(3) of the Code. The facts show that you operate primarily for the benefit of your founders/Board members and the majority of your expenses are in compensation to your CEO. You were formed and are operating to benefit insiders rather than the public at large.

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 that information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. To be represented during the appeal process, 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 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 to you. That letter will provide information about filing tax returns and other matters.

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

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

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.

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

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure, Publication 892

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