



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street
Dallas, TX 75242

501.03-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: September 7, 2012

Number: 201252022
Release Date: 12/28/2012

LEGEND

ORG - Organization name
XX - Date Address - address

Person to Contact:
Badge Number:
Contact Telephone Number:
Phone
Fax
Contact Address:

ORG
ADDRESS

Employer Identification Number:

CERTIFIED MAIL

Dear

This is a final notice of adverse determination that your exempt status under section 501(c) (3) of the Internal Revenue Code is revoked. Recognition of your exemption under Internal Revenue Code section 501(c)(3) is revoked effective September 1, 19XX the following reason(s):

1. You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3) and Treasury Regulations section 1.501(c) (3)-1(d). You did not engaged primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3). You are operated for a substantial non-exempt purpose, which is not an exempt purpose.
2. Your net earnings inure to the benefit of private shareholders and individuals, which is prohibited by IRC section 501(c)(3).
3. You are operated for a substantial private purpose rather than a public purpose, which is prohibited by Internal Revenue Code section 501(c)(3) and Treasury Regulations section 1.501(c) (3)-1(d)(1)(ii).

Since your exempt status has been revoked, you are required to file Form 1120, U.S. Corporation Income Tax Return, for all years beginning on or after January 1, 20XX.

Income tax returns for subsequent years are to be filed with the appropriate Service Center identified in the instructions for those returns.

It is further determined that your failure to file a written appeal constitutes a failure to exhaust your available administrative remedies. However, if you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia before the (ninety-first) 91st day after the date that this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. To secure a petition form, write to the following address: United States Tax Court, 400 Second Street, NW, Washington, DC 20217.

Please understand that filing a petition for a declaratory judgment under IRC section 7428 will not delay the processing of subsequent income tax returns and assessment of any taxes due.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in 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.

This letter should be kept within your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE EO Examinations

3251 N Evergreen Dr NE

Grand Rapids, MI 49525

May 23, 2012

**ORG
ADDRESS**

Taxpayer ID Number:
Form:
Tax Year(s) Ended
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We propose to revoke our recognition of your exempt status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). We enclose our report of examination explaining why we are proposing this action.

If you accept our proposal, please sign and return the enclosed Form 6018, Consent to Proposed Action - Section 7428, unless you have already provided us a signed Form 6018. We will issue a final revocation letter determining you are not an organization described in section 501(c)(3). After the issuance of the final revocation letter we will publish an announcement that you have been deleted from the cumulative list of organizations contributions to which are deductible under section 170 of the Code. If you do not respond to this proposal, we will similarly issue a final revocation letter. Failing to respond to this proposal may adversely impact your legal standing to seek a declaratory judgment because you may be deemed to have failed to exhaust administrative remedies.

If you do not agree with our proposed revocation and wish to protest our proposed revocation to the Appeals Office of the Internal Revenue Service, then you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. This written request is called a protest. For your protest to be valid it needs to contain certain specific information which generally includes a statement of the facts, the applicable law, and arguments in support of your position. For the specific information needed for a valid protest, please refer to page 6 of the enclosed Publication 3498, *The Examination Process*, and page 2 of the enclosed Publication 892, *Exempt*

Organizations Appeal Procedures for Unagreed Issues. These documents also explain how to appeal an IRS proposed action.

If you do submit a valid protest, then an Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498 and Publication 892 explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Tract Mediation Services referred to in Publication 3498, generally do not apply after issuance of this letter.

You may also request that we refer this matter for Technical Advice as explained in Publication 892 and an annual revenue procedure. Please contact the individual identified on the first page of this letter if you are considering requesting Technical Advice. If we issue a determination letter to you based on a Technical Advice Memorandum issued by the EO Rulings and Agreements function, then no further administrative appeal will be available to you within the IRS on the matter.

If you agreed with the proposed revocation or if you receive a final revocation letter, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 30 days of the date you agreed with the revocation or the date of your final revocation letter, whichever is sooner, unless a request for extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

We will notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code. Currently, only certain states are eligible to receive notification of proposed revocation actions. You can call the person at the heading of this letter to find out if your State is eligible to receive a notice of revocation of your tax-exempt status.

You 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. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M Downing
Director EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination

In lieu of Letter 3618

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX

LEGEND

ORG - Organization name XX - Date State - state Founder - founder
 motto - motto

ISSUE

The activities of ORG have never operated in a manner that qualifies for tax exempt status; the organization was granted exemption in error.

FACTS

According to the application Form 1023 dated October 1, 19XX, the activities of the organization are to "provide day care for minority and low income families" and "distress on single parents". The application also states that the organization will be funded by government grants and public contributions.

The examination revealed that the sources of income for the organization are "program service revenue". Some motto clients receive assistance from the State of State and the organization is paid directly by the state program, other clients pay out of pocket for their childcare as they do not qualify based on income level for childcare assistance. (The State of State paid childcare is not a grant program. It is a financial assistance program for low income parents)

The other source of income is a program from the State of State that pays childcare organizations a certain amount of money per child for meals served to them, on a tier system based on the child's family income level. (This is not a grant program)

The sources of income for the organization are not the same as what was listed in the Form 1023.

On November 12, 19XX the Service sent a letter to the organization requesting additional information required to process the application Form 1023. The additional information requested included:

- Some blank portions of the Form 1023
- A modification to the Board of Directors (since Founder, the founder, was the only listed board member)
- More detailed information on the educational or charitable activities of the motto

Founder responded to the additional information request. Founder stated in her letter December 2, 19XX that:

- She was unable to obtain any additional board members other than herself

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- Her clientele is limited to children who qualify for their childcare to be paid for by the State of State due to low income.

The examination revealed that Founder has continued to be the only board member, and her clientele has not been limited to low income children. The examination revealed she services children that paid the organization directly for the services. (Often referred to in the industry as "straight pay" kids who are not from low income families)

On December 3, 19XX the Service sent a letter indicating they had not yet received the additional information requested; information required to process the application 1023. (The information was received shortly after in the form of the response directly above)

On December 9, 19XX the Service sent the organization a letter requesting additional information (again) to process the application 1023. The information requested included:

- Lease details since the lease was not at an arms length transaction
- Another request for a modification to the Board of Directors (since at that time Founder was still the only board member)
- More detailed information on the educational and charitable activities of the organization

On January 15, 19XX the Service sent the organization a letter indicating that the additional information the service requested to make a determination on the application 1023 had not yet been received, and the determination was being closed. The organization was not granted tax exempt status.

On February 13, 19XX the organization responded to the request for additional information. The response indicated:

- A market value of the home, but not a market lease value
- The organization was still unable to obtain any additional board members
- A response stating "This organization is able to improve & promote educational opportunities for children by making it possible for the minority & low income children to attend structured learning environments and school while parents, who cannot afford childcare, can be employed"

It was determined during the examination that Founder has been the only board member for the life of the organization.

All other documents reviewed in the application Form 1023 indicated that the children were too young for educational activities and that the primary charitable cause was the fact that the children were from low income families.

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The claim by the organization for the basis of qualifying for tax exemption has alternated between servicing exclusively low income families, and providing educational services to children. The organization has done neither during its existence. (All children regardless of income level are accepted, and no educational material is presented to the children, as stated by Founder in her December 2, 19XX letter to the Service) ("These pre-school children are under age four. No structured educational services are provided")

In the records secured for the 20XX calendar year, Founder listed five cash paying customers. Her motto license is for a maximum of 12 children. Her cash paying customers were not an insubstantial amount of business, and further shows that her clientele was not limited to low income children.

APPLICABLE LAW AND ANALYSIS

Internal Revenue Code section 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treasury Regulation section 1.501(a)-1(c) defines a private shareholder or individual for section 501 purposes as those persons having a personal and private interest in the activities of the organization.

Treasury Regulation section 1.501(c)(3)-1(a)(1) provides that, 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.

Treasury Regulation section 1.501(c)(3)-1(b)(1) states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

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Treasury Regulation section 1.501(c)(3)-1(c)(1) states 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.

Treasury Regulation section 1.501(c)(3)-1(c)(2) states, in part, 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.

Treasury Regulation section 1.501(c)(3)-1(d)(1)(i) provides that an organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

- (a) Religious,
- (b) Charitable,
- (c) Scientific,
- (d) Testing for public safety,
- (e) Literary,
- (f) Educational, or
- (g) Prevention of cruelty to children or animals.

A ruling or determination letter that recognizes exemption under IRC 501(c)(3) is a written statement to an organization that applies the law to the facts and representations in an organization's Form 1023. Should that letter recognizing exemption be revoked, as long as (a) there has been no misstatement or omission of material facts, (b) the facts subsequently developed are not materially different from the facts and representations on which the ruling or determination letter was based, (c) there has been no change in the applicable law, and (d) the organization acted in good faith in reliance on the ruling or determination letter, the revocation will be prospective. See Rev. Proc. 84-46, 1984-1 C.B. 541.

A ruling or determination letter recognizing exemption may be revoked or modified by (1) a notice to the taxpayer to whom the ruling or determination letter originally was issued, (2) enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) issuance of temporary or final regulations, or (5) issuance of a revenue ruling, revenue procedure, or other statement published in the Internal Revenue Bulletin. The revocation or modification may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which section 503 applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization. Where there is a material change,

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inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change. In cases where a ruling or determination letter was issued in error or is no longer in accord with the holding of the Service, when section 7805(b) relief is granted (see sections 15 and 18 of Rev. Proc. 90-4), retroactivity of the revocation or modification ordinarily will be limited to a date not earlier than that on which the original ruling or determination letter is modified or revoked. See Rev. Proc. 90-27, 1990-1 C.B. 514

An educational day care center that enrolls children on the basis of family financial need and the child's need for the care and development program of the center qualifies for exemption under Section 501(c)(3) of the Code. See Rev. Rul. 70-533, 1970-2 C.B. 112

The organization did not enroll children on the basis of family financial need, or the child's need for the care and development program of the center.

Section 501(k) of the code defines the term "educational purposes" to include the providing of care of children away from their homes if--

- (1) substantially all of the care provided by the organization is for purposes of enabling individuals to be gainfully employed, and
- (2) the services provided by the organization are available to the general public.

The organization does not provide substantially all of their care to enable individuals to be gainfully employed. Nearly half of the clientele pays for their children(s) care out of pocket. These individuals use the care as they see fit. Some may be putting their children in care so they can attend school, do volunteer work, or simply a desire to socialize their children with others. There is no guarantee that the children are enrolled so that the parents may work.

The children that receive their child care as paid for through the State of State normally either have parents who are working, or attending school. (Those are the two requirements by the State for the families to qualify for assistance paying for their childcare)

TAXPAYER'S POSITION

At a meeting with Founder on March 23, 20XX, she was agreeable to revoking the exempt status of the organization back to the date of exemption. She had already started the process with the State of State to switch her motto license to one of a sole proprietorship in her own name.

GOVERNMENT'S POSITION

After review of the facts, and the relevant law and analysis, it is the government's position that the Exemption Determination was done so in error. The responses given to the items the

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Determinations Agent identified as issues needing further examination were not answered in a way that supported the organization being granted tax exempt status.

It is also the government's position that the organization operated in a manner materially different from that originally represented in the application Form 1023.

CONCLUSION

Accordingly, the organization's status as an organization described under section 501(c)(3) should be revoked, because the organization was granted exemption in error. The effective date of the revocation should be September 1, 19XX (revoking the Determination Letter) because the organization operated in a manner materially different from that originally represented.

The 20XX Form 990 showed that the organization had a \$ excess, in 20XX there was a \$ deficit, and the Form 990 for 20XX shows a \$ excess. It was determined during the examination that there were additional expenses of \$ that were not reported on the 20XX Form 990. Had the Form 20XX been completed correctly the organization would have reported a \$ deficit for 20XX.

The tax that would be due on a Form 1120 on the open statute years is immaterial; therefore Forms 1120 are not being secured as a part of the revocation.