



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities

Number: 202306009
Release Date: 2/10/2023

UIL: 501.03-00

Date:
October 4, 2022
Taxpayer ID number (last 4 digits):

Form:

Tax periods ended:

Person to contact:

Name:

ID number:

Telephone:

Fax:

Last day to file petition with United States
Tax Court:

CERTIFIED MAIL - Return Receipt Requested

Dear

Why we are sending you this letter

This is a final determination that you don't qualify for exemption from federal income tax under Internal Revenue Code (IRC) Section 501(a) as an organization described in IRC Section 501(c)(3), effective . Your determination letter dated , is revoked.

Our adverse determination as to your exempt status was made for the following reasons: You have not demonstrated that you are operated exclusively for charitable, educational, or other exempt purposes within the meaning of IRC Section 501(c)(3) because the organization's assets inure to the benefit of a private shareholder or individual.

Organizations that are not exempt under Internal Revenue Code (IRC) Section 501 generally are required to file federal income tax returns and pay tax, where applicable. For further instructions, forms and information please visit [IRS.gov](https://www.irs.gov).

Contributions to your organization are no longer deductible under IRC Section 170.

What you must do if you disagree with this determination

If you want to contest our final determination, you have 90 days from the date this determination letter was mailed to you to file a petition or complaint in one of the three federal courts listed below.

How to file your action for declaratory judgment

If you decide to contest this determination, you can file an action for declaratory judgment under the provisions of Section 7428 of the Code in either:

- The United States Tax Court,
- The United States Court of Federal Claims, or
- The United States District Court for the District of Columbia

You must file a petition or complaint in one of these three courts within 90 days from the date we mailed this determination letter to you. You can download a fillable petition or complaint form and get information about filing at each respective court's website listed below or by contacting the Office of the Clerk of the Court at one of the addresses below. Be sure to include a copy of this letter and any attachments and the applicable filing fee with the petition or complaint.

You can eFile your completed U.S. Tax Court petition by following the instructions and user guides available on the Tax Court website at ustaxcourt.gov/dawson.html. You will need to register for a DAWSON account to do so. You may also file your petition at the address below:

United States Tax Court
400 Second Street, NW
Washington, DC 20217
ustaxcourt.gov

The websites of the U.S. Court of Federal Claims and the U.S. District Court for the District of Columbia contain instructions about how to file your completed complaint electronically. You may also file your complaint at one of the addresses below:

US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20439
uscfc.uscourts.gov

US District Court for the District of Columbia
333 Constitution Avenue, NW
Washington, DC 20001
dcd.uscourts.gov

Processing of income tax returns and assessments of any taxes due will not be delayed if you file a petition for declaratory judgment under IRC Section 7428.

Information about the IRS Taxpayer Advocate Service

The IRS office whose phone number appears at the top of the notice can best address and access your tax information and help get you answers. However, you may be eligible for free help from the Taxpayer Advocate Service (TAS) if you can't resolve your tax problem with the IRS, or you believe an IRS procedure just isn't working as it should. TAS is an independent organization within the IRS that helps taxpayers and protects taxpayer rights. Contact your local Taxpayer Advocate Office at:

Internal Revenue Service
Taxpayer Advocate Office

Or call TAS at 877-777-4778. For more information about TAS and your rights under the Taxpayer Bill of Rights, go to taxpayeradvocate.irs.gov. Do not send your federal court pleading to the TAS address listed above. Use the applicable federal court address provided earlier in the letter. Contacting TAS does not extend the time to file an action for declaratory judgment.

Where you can find more information

Enclosed are Publication 1, Your Rights as a Taxpayer, and Publication 594, The IRS Collection Process, for more comprehensive information.

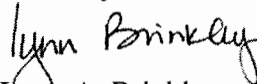
Find tax forms or publications by visiting IRS.gov/forms or calling 800-TAX-FORM (800-829-3676). If you have questions, you can call the person shown at the top of this letter.

If you prefer to write, use the address shown at the top of this letter. Include your telephone number, the best time to call, and a copy of this letter.

You may fax your documents to the fax number shown above, using either a fax machine or online fax service. Protect yourself when sending digital data by understanding the fax service's privacy and security policies.

Keep the original letter for your records.

Sincerely,



Lynn A. Brinkley

Acting Director, Exempt Organizations Examinations

Enclosures:

Publication 1

Publication 594

Publication 892

cc:



**Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities**

Date:
August 31, 2021
Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:
Name:
ID number:
Telephone:
Fax:
Address:

Manager's contact information:
Name:
ID number:
Telephone:

Response due date:

CERTIFIED MAIL – Return Receipt Requested

Dear :

Why you're receiving this letter

We enclosed a copy of our audit report, Form 886-A, Explanation of Items, explaining that we propose to revoke your tax-exempt status as an organization described in Internal Revenue Code (IRC) Section 501(c)(3).

If you agree

If you haven't already, please sign the enclosed Form 6018, Consent to Proposed Action, and return it to the contact person shown at the top of this letter. We'll issue a final adverse letter determining that you aren't an organization described in IRC Section 501(c)(3) for the periods above.

After we issue the final adverse determination letter, we'll announce that your organization is no longer eligible to receive tax deductible contributions under IRC Section 170.

If you disagree

1. Request a meeting or telephone conference with the manager shown at the top of this letter.
2. Send any information you want us to consider.

3. File a protest with the IRS Appeals Office. If you request a meeting with the manager or send additional information as stated in 1 and 2, above, you'll still be able to file a protest with IRS Appeals Office after the meeting or after we consider the information.

The IRS Appeals Office is independent of the Exempt Organizations division and resolves most disputes informally. If you file a protest, the auditing agent may ask you to sign a consent to extend the period of limitations for assessing tax. This is to allow the IRS Appeals Office enough time to consider your case. For your protest to be valid, it must contain certain specific information, including a statement of the facts, applicable law, and arguments in support of your position. For specific information needed for a valid protest, refer to Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status.

Fast Track Mediation (FTM) referred to in Publication 3498, The Examination Process, generally doesn't apply now that we've issued this letter.

4. Request technical advice from the Office of Associate Chief Counsel (Tax Exempt Government Entities) if you feel the issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS.

If you're considering requesting technical advice, contact the person shown at the top of this letter. If you disagree with the technical advice decision, you will be able to appeal to the IRS Appeals Office, as explained above. A decision made in a technical advice memorandum, however, generally is final and binding on Appeals.

If we don't hear from you

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final adverse determination letter.

Contacting the Taxpayer Advocate Office is a taxpayer right


The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

For additional information

You can get any of the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

If you have questions, you can contact the person shown at the top of this letter.

Sincerely,


for Sean H. O'Reilly
Director, Exempt Organizations
Examinations

Enclosures:
Form 6018
Form 4621-A
Form 886-A
Pub 892
Pub 3498

Form 886-A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended

**Revocation of Tax-Exempt Status
Treas. Reg. § 1.501(c)(3)-1(f)(2)(ii).**

Issues:

1. Whether () continues to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code?
2. Whether revocation of exempt status under IRC §§ 501(c)(3) and 170(b)(1)(A)(vi) should be made retroactive to

Facts:

()

1. was incorporated in the state of on as () signed the Articles of Incorporation as Incorporator.
2. Form 1023 was submitted on (), wife of Administrator, signed the form as Admin. Assistant. is listed as Administrator.
3. received its Initial Determination Letter on . It received its Final Determination Letter on
4. On , amended its Articles of Incorporation to change its name from to
5. On merged with with being the surviving organization.
6. signed the merger agreement as Secretary of

()

1. was incorporated in the state of on , as

2. received its determination as a 501(c)(3) organization in as
3. On amended its Articles of Incorporation to become
4. On changed its address from to (same address as).
5. On merged with , with being the surviving organization.
6. was the Executive Director of prior to the management Agreement with .

()

1. was incorporated in the state of on , wife of , was listed as the sole Director.
2. Form 1120-S, U.S. Income Tax Return for an S Corporation, returns filed for tax years through lists one Schedule K-1, Shareholder's Share of Income, Deductions, Credits, etc., recipient. That Schedule K-1 was issued to r and lists her as having % of Shareholder's percentage of stock ownership for tax year in I. (Part 1-F)
3. In Form 1120-S listed Schedule K-1s for shareholders, , and . (Parts 1-F)
4. Form 1120-S returns for through lists the same K-1 recipients with an equal Shareholder's percentage of stock ownership for tax year in .

Management and Administration Agreement (Agreement)

1. The Agreement between and , dated states:

-

- () is a management services company established by founder and former Executive Director to provide management consultation on an Agreement for services basis to and other organizations as appropriate opportunities arise. will provide executive,

fiscal, strategic and program development management for . The Agreement will be based upon industry standards and should be established at % initially and potentially grow, based on reaching program and fiscal goals, to % or whatever industry standard, fair market-fees are determined to be.

Due to the current challenges involved in assimilating into and other budgetary constraints, recommends an 'incremental transition' into the management services Agreement relationship. The Agreement will begin at a rate supported by fiscal ability and include executive management and as the budget allows, the other services listed above will be added as fiscally appropriate with corresponding increases in the Agreement fees to %.

- The contractual Agreement between and will be presented to the board for review and approval upon its completion for retroactive initiation date of
- New Executive Director
 - ... As of , will assume the title of Executive Director and will continue to perform his duties under the authority and direction of per the management Agreement.
 - last day on the payroll of was to be ; the pay period ended on and was inadvertently paid extra days on the payroll.

2. The Agreement between and , dated states:

This Management and Administrative Services Agreement ("**Agreement**") is made on ,- , by and between , an Corporation (**herein " " or Manager or Administrator**) and (a not-for-profit corporation) (herein " **" ".**

a. Administration and Management.

- i. hereby retains to provide management and administrative services to to facilitate in carrying out its various contractual Agreements and obligations to

provide stable and caring placements for youth in need of out-of-home care according to the highest standards of professionalism as follows:

- ii. shall recruit, recommend for selection and provide oversight Executive Director who is responsible for the fulfillment of contractual obligations.
- iii. shall provide, supervise and administer a comprehensive program of quality standards and assurance in compliance with applicable state and referring agency regulations, standards and policies.
- iv. shall provide, supervise and administer appropriate budgeting processes for to assure fiscal responsibility in accordance with generally accepted accounting practice and shall insure satisfactory completion of an annual independent audit in compliance with state and agency regulatory standards.
- v. shall have responsibility for program development and strategic planning to accomplish program objectives and to provide for long term growth.

b. Manner & Place of Performance.

- i. During the term of this Agreement shall have exclusive discretion to determine the means, manner, methods and place of its performance

c. Intellectual Property.

- i. acknowledges that pursuant to the terms of this Agreement will use and further develop confidential means and methods and proprietary information that it has previously used and developed relating to the administration the programs and contractual obligations of and it is agreed that this confidential information is and shall be the property of .
- ii. further agrees that all ideas, programs, software, works of authorship and other trade secrets developed or improved shall not be considered to be "works made for hire" and that shall be deemed the author thereof under the U.S. Copyright Act.

signed the Agreement as Director of

3. A new Agreement was agreed to _____, with an effective date of _____. The differences between this Agreement and the Agreement are:

a. Administration and Management.

- (d) _____ shall have responsibility for program development and strategic planning to accomplish program objectives and to provide for long term growth.

- (d) _____ shall provide, supervise administration for program development and strategic planning to accomplish program objectives and to provide for long term growth.

Added:

(e) _____ shall provide data management tools, specifically the use of the _____ for case management duties, quality assurance reporting and invoicing and payments.

b. Term.

- This Agreement shall be in effect for a term of () years commencing from the date of execution hereof and shall be automatically renewed for successive () year periods thereafter unless either party shall give notice in writing of an intention to not-renew not less than _____ days prior to any termination date.

- This Agreement shall be in effect for a term often () years commencing _____ and shall be automatically renewed for successive () year period thereafter unless either party shall give notice in writing of an intention to not-renew not less than _____ days prior to any termination date.

c. Compensation.

- During an initial transition period, compensation paid to _____ for the services it provides pursuant to the terms of this Agreement shall be paid pursuant to the following transition schedule:

% of _____ receipts for the period from _____ through _____ % of _____ receipts

for the period from _____ through _____ % of
receipts for the period from
through _____ % of _____ receipts for the
period from _____ and thereafter.

This transition schedule may be accelerated by mutual Agreement of the parties. In any event, after the phase-in period, the compensation to be paid to _____ for the services it provides pursuant to the terms of this Agreement shall be paid monthly and adjusted annually to current market standard rate or is equal to _____ percent (%) of gross receipts.

- Compensation rates are in accordance with general business standards as researched and verified through organization _____ filings, ranging from % to _____. Current rate is % of gross revenue as adjusted for corrections and refunds less bad debt with adjustments made for annual reconciliation. Compensation may be increased based on current market analysis and mutual Agreement between both parties during the life of the Agreement.

d. General Terms.

Added-

(h) Assessment. Assessment and evaluation of the stated objectives will be performed by the board of directors at a regularly scheduled board meeting annually. Documentation of the periodic assessment and evaluation will be recorded in the meeting minutes.

signed the Agreement as Director of _____.

4. An addendum to the Agreement dated _____, dated _____, with an effective date of _____, states that the addendum was entered into by and between _____, an _____ Corporation (herein " _____" or Manager or Administrator) and _____ (a not-for-profit corporation) (herein " _____"). It states that this amendment is to adjust the Agreement entered between said parties dated _____, specifically the rate of compensation.

a. The term of _____ () years remains in effect beginning with automatic renewal for successive _____ years.

b. The compensation will increase from % to % of gross revenue as

adjusted for corrections and refunds less bad debt with adjustments made for annual reconciliation.

- c. It was also discussed, since the rate of % is lower than the industry standard of % - %, the rate may be increased to % within the next quarter.
- d. This rate increase was discussed and voted into effect at the Board Meeting of the Directors

signed the addendum as Asst. CEO of .

- 5. An addendum to the Agreement dated , was entered into on , by and between , an Corporation (herein " " or Manager or Administrator) and (a not-for-profit corporation) (herein " "). It states that this amendment is to adjust the Agreement entered between said parties dated , specifically the rate of compensation.

- a. The term of () years remains in effect beginning with automatic renewal for successive years.
- b. The compensation will increase from % to % of gross revenue as adjusted for corrections and refunds less bad debt with adjustments made for annual reconciliation.
- c. The effective date for said increase is retroactive to .
- d. This rate increase was discussed and voted into effect at the Board Meeting of the Directors

signed the addendum as Asst. CEO of .

- 6. A new Agreement between and and was signed on . The differences between the Agreement and the Agreement dated (effective) with addendums effective , and are noted below.

1. Administration and Management.

:

- (b) shall provide, supervise and administer a comprehensive program of quality standards and assurance in compliance with applicable state and referring agency regulations, standards and

policies;

- (c) shall provide, supervise and administer appropriate budgeting processes for to assure fiscal responsibility in accordance with generally accepted accounting practice and shall insure satisfactory completion of an annual independent audit in compliance with state and agency regulatory standards;
- (d) shall provide, supervise administration for program development and strategic planning to accomplish program objectives and to provide for long term growth.

(b) shall provide evaluation of a comprehensive program of quality standards and assurance in compliance with applicable state and referring agency regulations, standards and policies;

(c) shall provide direction and evaluation of appropriate budgeting processes for to assure fiscal responsibility in accordance with generally accepted accounting practice and shall assist in the satisfactory completion of an annual independent audit in compliance with state and agency regulatory standards;

(d) shall provide direction and evaluation for program development and strategic planning to accomplish program objectives and to provide for long term growth.

Added:

10. Contractual Compliance

is a provider to state and county agencies for child welfare services and is subject to audits for such program, fiscal and contractual performance. provides direction and evaluation to the Agreement but does not perform the duties outlined in the state Agreements, i.e., case management, licensing, foster parent training. is a vendor providing a service to as outlined in Section 1. Administration and Management.

signed the Agreement as Director of .

Information Document Request (IDR)

1. An Information Document Request (IDR) dated _____, was issued to _____ (IDR #2). Questions were asked concerning the Management and Administrative Agreements. _____ answered those questions in a response dated _____.

Question #1 - Why did _____ decide that it needed a management services company?

Answer - _____ (hereafter referred to as _____) retained _____ (hereafter referred to as _____) to provide management administrative services to _____ to facilitate its mission of providing _____ foster care. _____ had grown into a larger more technologically complex organization. There was a growing need for more technological sophistication in the areas of support as well as a need to develop financial management, strategic planning, legal and Agreement management, audit support as well as the need to develop a more effective IT system. _____ became aware of the trend among foster care providers to look to management companies that would bring specialized technical knowledge and expertise, allowing the core activities of child placement and family support to remain the primary focus and priority of the program staff, whose training and competency is in the area of social work. The management services would bring technological support in an increasingly more complex administrative environment.

In addition, a management company could supervise and administer appropriate budgeting processes for _____ to assure fiscal responsibility in accordance with generally accepted accounting practice.

Question #2 (a) Did _____ have a different management services company in the years before _____ was incorporated? If yes, what was the compensation rate paid to any other management services companies? Please provide a copy of any other management services Agreements before _____ was hired.

Answer – N/A

Question #2 (b) If _____ did not hire any other management services companies before it hired _____, who previously performed the services that are now being performed by _____?

Answer – The key administrators of _____ performed these duties.

Question #3 - Did _____ put the management services out for competitive bidding before awarding it to _____ ?

Answer - _____ board of directors did not see a need to solicit bidding as the team brought an extensive knowledge base in executive leadership and the challenges that _____ would face in the ever-challenging field of foster care. The board of directors was careful to ensure that the Agreement with _____ was within fair market values. The Agreement was actually established at a lower than market standard fee structure, as evidenced by the _____ reviewed and included in this report.

Question #8 - Please provide a narrative description of the typical services _____ performs for _____ in a given week including (c), Who performs those services

Answer - _____ is located in _____ where a substantial amount of the services are provided and travels extensively to all the locations across _____ states.

- During these office visits, _____ team provides on-site and in-person executive, financial, technology, legal, contract relationships and program quality support. _____ works closely on a daily basis with _____ executive management and top managers in the departments on administrative issues, progress, strategies, reports, upcoming projects, etc. _____ works daily with _____ staff on items including but not limited to:
 - Handling the weekly and monthly financial reporting along with ongoing assistance daily with _____ accounting staff on accounting/coding related questions.
 - _____ works closely with _____ human resource staff on personnel issues, including hiring and any disciplinary actions that _____ may need to address with personnel.
 - _____ oversees the IT department and assists with networking and data integrity and availability. _____ works daily with IT department to assist with any problems, offer solutions and help ensure the infrastructure is in place to support all of

current offices as well as planned growth. Included in the fee is the use of a database tracking system called [redacted] which was developed to

[redacted] and the requirements necessary per individual state standards. Also, all required documentation for the foster youth cases and foster homes are stored in [redacted]. [redacted] drives [redacted] strategic quarterly goals including but not limited to recruitment of new foster homes, dashboards on financial data, dashboards on personnel data, quality program outcomes, and generates a host of reports that [redacted] uses on a daily basis. The [redacted] team works with staff on configurations/requirement issues that arise in various states.

- [redacted] on behalf of the [redacted] board of directors provides executive support and consultation to the [redacted] executive director and management team. The primary focus of this is strategic planning around the achievement of economy of scale which is essential for organizational survival in an environment where small to medium sized programs are finding it increasingly difficult to compete with the larger, more technically astute, scale driven companies. The board looks to [redacted] to guide [redacted] management to leverage resources in the most forward-looking entrepreneurial way in order to compete successfully in this challenging and competitive environment. [redacted] meets daily with [redacted] management leading the process of metrics based decision-making, coordinating the development of strategic growth plans for each [redacted] region. The process involves demographic analysis and tracking of recruitment metrics and foster parent training participation and progress. Daily discussion with [redacted] managers revolves around the pressing constraint of remaining viable through continuous and effective strategic activity. [redacted] executive support professionals are experienced social program providers with extensive training and experience in business and organizational management.

Question #9 - Please provide a narrative description of the services performed occasionally or on a set schedule e.g., monthly, quarterly, or yearly and the services performed on an ad hoc/as needed basis, including: c.) Who performs these?

Answer - staff regularly travel to the sites in , and staff plan and conduct at least all staff in-services a . These are conducted in various locations across the country. leads these day in-services and provides an array of training and leadership for the organization, following up training events with transfer of learning sessions. also leads quarterly director of strategy and development meetings. These meetings again move from state to state. Full office updates are presented for every office in . leads and provides critical input on how to move each office forward with quality and strategic growth. administrative team attends bi-weekly department head meetings in . All departments discuss the challenges they are experiencing in their departments and receive support and technical assistance from .

- Recruitment activities, marketing, strategizing around demographics utilizing technology, and other analytical tools. Director of Development and Marketing is the coordinator of these activities, assisting program directors with ongoing marketing and recruitment strategy.
- supports program staff in the utilization of the data management system, () following up on help-desk requests and solving configuration problems as identified through our ongoing systems analysis process. I develops and maintains the internal IT infrastructure and consults with software program writers. supports and trains staff in the utilization of and other software applications for case management processes. develops and expands the utilization of the database features as the need for more information evolves. coordinates the installation and maintenance of low voltage hardware, networking systems in offices and troubleshoots system shutdowns. These and other support activities are performed by the operational support team of several IT systems specialists.

- o provides fiscal oversight including accounts receivable, accounts payable, and payroll processes. produces monthly as well ad hoc financial reports for the executives and board. Financial reports are presented quarterly to the board by . coordinates audit activities with state contract audits and leads the annual independent audit process with the independent auditing firm. ensures that all appropriate processes and procedures are being followed in accordance with GAAP and GAGAS and ensures all state specific regulations and policies are complied with. State specific cost reports are an ongoing process conducted by staff. The financial activities and processes of are directed by an professional with credentials and is assisted by an st ate cost report specialist. organizes the annual independent audit and works closely with staff and independent auditors to ensure all information is available and accurately report ed. works closely with staff and other outside auditors when is audited by other departments in the different contract regions in which they do business. produces annual budgets and reports quarterly results at board meetings.

LAW:

Internal Revenue Code (IRC) §501(a) provides that an organization described in §501(c) (3) is exempt from income tax.

IRC §501(c)(3) exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Regulations §1.501(a)-1 (c) defines “private shareholder or individual” in section 501 as persons having a personal and private interest in the activities of the organization.

An IRC §170(b)(1)(A)(vi) organization is defined as an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under §501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public.

IRC §170(c)(2)(B) defines a charitable organization as a corporation, trust, or community

chest, fund, or foundation that is organized and operated exclusively for religious, charitable, scientific, 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;

Regulations §1.501(a)-1(c) states that the words private shareholder or individual in section 501 refer to persons having a personal and private interest in the activities of the organization.

Regulations §1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in Code §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.

Regulations §1.501(c)(3)-1(b)(1) provides 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; (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.

Regulations §1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in Code §501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945).

Regulations §1.501(c)(3)-1(c)(2) provides that the operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private benefit rather than public interests.

Regulations §1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than private interest. Thus, 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. Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

Regulations §1.501(c)(3)-1(f)(ii) provides that In determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization described in section 501(c)(3) that engages in one or more excess benefit transactions that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and

circumstances, including, but not limited to, the following -

- (A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;
- (B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;
- (C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;
- (D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and
- (E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6) and § 53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Bus. Bureau v. United States, 326 U.S. 279, 238, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. V. Commissioner, 92 T.C. 1053, 1065 (1989). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. Am. Campaign Acad. V. Commissioner, supra at 1065-1066.

Rev. Proc. 2008-9, I.R.B. 2008-2 (January 14, 2008), Section 12, states that a determination letter or ruling recognizing exemption may be revoked or modified by a notice to the taxpayer to whom the determination letter or ruling was issued. It went on to say that the revocation or modification of a determination letter or ruling recognizing exemption may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or engaged in a prohibited transaction and where there is a material change, 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.

People of God Community v. Commissioner, 75 T.C. 127 (1980) - "We hold here that paying over a portion of *gross* earnings to those vested with the control of a charitable organization constitutes private inurement as well. All in all, taking a slice off the top should be no less prohibited than a slice out of net".

United Cancer Council, Inc. v. Commissioner, 165 F.3d 1173, 1176 (1999). - "The term "any private shareholder or individual" in the inurement clause of section 501(c)(3) of the Internal Revenue Code has been interpreted to mean an insider of the charity. A charity is not to siphon its earnings to its founder, or the members of its board, or their families, or anyone else fairly to be described as an insider, that is, as the equivalent of an owner or manager. The test is functional. It looks to the reality of control rather than to the insider's place in a formal

table of organization. The insider could be a “mere” employee-or even a nominal outsider, such as a physician with hospital privileges in a charitable hospital, a case involving a founder's siphoning of charitable donations, or for that matter a fundraiser. (Cites omitted)

Church by Mail, Inc. v. Commissioner, 765 F.2d 1387, 1392 (9th Cir. 1985), aff'g T.C. 1984-349; - tax-exempt status was denied for Church by Mail (Church) on the grounds that Church operated for the non-exempt purpose of providing a market for the services of Twentieth Century Advertising Agency (Twentieth), a for-profit organization. The court found that “the critical inquiry is not whether the particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit entity benefits substantially” from the operation of the exempt organization, even if that organization is furthering some exempt purpose.

Government’s Position:

It is the position of the Government that after () entered into a Management and Administration Agreement (Agreement) with () no longer continued to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code, as it no longer operated exclusively for one or more charitable purposes.

In order to be exempt as an organization described in Code §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. (Regulations §1.501(c)(3)-1(a)(1))

An organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in Code §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. (Regulations §1.501(c)(3)-1(c)(1))

Organizational Test

meets the part of qualifying for exempt status, the organizational test. is organized to provide placement of children in foster homes, to provide adoption services, and to provide counseling services and training to foster parents. The placement of children in foster homes and the providing of services and training of foster parents are some of the exempt purposes specified in Code §501(c)(3).

Operational Test

The operational test is not satisfied where any part of the organization’s earnings inure to the

benefit of private shareholders or individuals, and where the organization serves a private benefit rather than public interests. (Regulations §§1.501(c)(3)-1(c)(2) and 1.501(c)(3)-1(d)(1)(ii))

Private Benefit

1. At the time of the negotiations for the management agreement between [redacted] and [redacted], [redacted] was the founder and Executive Director of [redacted]. His wife, [redacted], was the incorporator and sole shareholder of [redacted]. They both meet the definition of "private individual or shareholder" in relation to [redacted] and [redacted] respectively, as they have a personal and private interest in the activities of the each organization (Treas. Reg. § 1.501(a)-1(c)). Typically, those covered under this regulation are referred to as "insiders," such as founders, directors, officers, or their families, or anyone else fairly to be described as an insider, that is, as equivalent of owner or manager (See Treas. Reg. §§ 1.501(a)-1(c), 1.501(c)(3)-1(d)(1)(i, ii); United Cancer Council, Inc. v. Commissioner, 165 F.3d 1173, 1176 (1999)).
2. Since its incorporation on [redacted], [redacted] has been controlled by [redacted] and his wife, [redacted] ([redacted]). They are [redacted] of the [redacted] listed officers of [redacted] and are [redacted] % shareholders of the corporation. As an officer of [redacted], [redacted] has substantial control of the operations of [redacted] as evidenced by his signing of the Agreements. [redacted] also exercises control over [redacted] as evidenced by her signing addendums to the Agreement as Asst. CEO of [redacted]. Therefore, both [redacted] and [redacted] meet the definition of a private shareholder or individual with respect to [redacted]. (Treas. Reg. §1.501(a)-1(c)).
3. The Management and Administration Agreement
 - a. The [redacted], Executive Board Meeting minutes for [redacted], stated that:

[redacted] ([redacted]) is a management services company established by founder and former Executive Director [redacted] to provide management consultation on an Agreement for services basis to [redacted] and other organizations as appropriate opportunities arise. [redacted] will provide executive, fiscal, strategic and program development management for [redacted]. The Agreement will be based upon industry standards and should be established at [redacted] % initially and potentially grow, based on reaching program and fiscal goals, to [redacted] % or whatever industry standard, fair market-fees are determined to be.

Due to the current challenges involved in assimilating [redacted] into [redacted] and other budgetary constraints, [redacted] recommends an 'incremental transition' into the [redacted] management services Agreement relationship. The Agreement will begin at a rate

supported by fiscal ability and include executive management and as the budget allows, the other services listed above will be added as fiscally appropriate with corresponding increases in the Agreement fees to %.

The minutes go on to state that:

The contractual Agreement between and will be presented to the board for review and approval upon its completion for retroactive initiation date of

As of , will assume the title of Executive Director and will continue to perform his duties under the authority and direction of per the management Agreement.

last day on the payroll of was to be ; the pay period ended on and was inadvertently paid extra days on the payroll.

- b. The minutes indicate that , while Executive Director of , had considerable input into the terms of the Agreement. This is evidenced by his recommendation of an 'incremental transition' into the management services Agreement relationship and his statement "The Agreement will begin at a rate supported by fiscal ability and include executive management and as the budget allows, the other services listed above will be added as fiscally appropriate with corresponding increases in the Agreement fees to %".

4. The Agreement was not an "arm's length" transaction. In Information Document Request #2, Form 4564, dated , the question was asked:

Question #3 - Did put the management services out for competitive bidding before awarding it to ?

Question #3 Answer –

board of directors did not see a need to solicit bidding as the team brought an extensive knowledge base in executive leadership and the challenges that would face in the ever-challenging field of foster care. The board of directors was careful to ensure that the Agreement with was within fair market values. The Agreement was actually established at a lower than market standard fee structure, as evidenced by the reviewed and included in this report.

5. The terms of the Agreement give a substantial amount of control over the operations of including in recruiting, recommending for selection, and oversight of the Executive Director; budgeting; involvement in the annual independent audit of ; and program development and strategic planning to, among other things, provide for long-term growth. According to IDR #2, Q #8C, also works closely with human resource staff on personnel issues, including hiring and any disciplinary actions that may need to address with personnel. According to IDR #2, Q #9C, also produces financial reports and coordinates audit activities with state contract audits. According to IDR #2, Q 8C, the primary focus of executive support and consultation to the executive director and management team is "strategic planning around the achievement of economy of scale," and " meets daily with management leading the process of metrics based decision-making, coordinating the development of strategic growth plans for each region...."
6. focus on strategic planning and growth of operations has the effect of increasing revenues, which in turn increases the fee paid to , as it is based on a percentage of gross revenue.
7. pays a substantial amount of money for management services, the vast majority of which pays out to and in the form of salaries and distributions to themselves and their trusts. A review of Forms , for the years under the current contract determined that approximately percent (%) of the management fee paid by was paid out to the and their trusts each year.
8. is the main client of . A review of Forms , for the years under the current contract determined that approximately percent (%) of the gross income reported by came from the management fee paid by .
9. This case is similar to Church by Mail, Inc. v. Commissioner, 765 F.2d 1387, 1392 (9th Cir. 1985), aff'g T.C. 1984-349. In this case tax-exempt status was denied for Church by Mail (Church) on the grounds that Church operated for the non-exempt purpose of providing a market for the services of Twentieth Century Advertising Agency (Twentieth), a for-profit organization.

The court found that "the critical inquiry is not whether the particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit entity benefits substantially" from the operation of the exempt organization, even if that organization is furthering some exempt purpose.

In this case, benefits substantially from the operations of . According to the Agreement, receives a percentage of the gross income of . Over the course of the Agreement, received approximately % of its income from the management

fees produced by the Agreement. Without the fees generated by the Agreement, would not be a going concern. This indicates, as in Church, the entire enterprise is carried on in such a manner that the for-profit entity benefits substantially.

With these facts in mind, does not meet the requirements of Regulations §§1.501(c)(3)-1(c)(2), as earnings serve a private benefit to and the by their "Insider" status in , rather than public interests.

Inurement

Since its incorporation on , has been controlled by and his wife, (). They are of the listed officers of and are % shareholders of the corporation. As an officer of , has substantial control of the operations of as evidenced by his signing of the Agreements. also exercises control over as evidenced by her signing addendums to the Agreement as Asst. CEO of . Therefore, both and meet the definition of a private shareholder or individual with respect to . (Treas. Reg. §1.501(a)-1(c)).

Operation prior to the Agreement

1. Prior to the Agreement all management functions of were performed by administrators of . This is confirmed by answers to questions asked in Information Document Request #2, Form 4564, dated , the question was asked:

Question #2(b) – If did not hire any other management services companies before it hired , who previously performed the services that are now being performed by ?

answered this question in a response dated .

Answer (b) – The key administrators of performed these duties.

The Management and Administration Agreement

2. The , Executive Board Meeting minutes for , stated that:

() is a management services company established by founder and former Executive Director to provide management consultation on an Agreement for services basis to and other organizations as appropriate opportunities arise. will provide executive, fiscal, strategic and program development management for . The Agreement will be based upon industry standards and should be established at % initially and potentially grow, based on reaching program and fiscal goals, to % or whatever industry standard, fair market-fees are determined to be.

Due to the current challenges involved in assimilating [redacted] into [redacted] and other budgetary constraints, [redacted] recommends an 'incremental transition' into the [redacted] management services Agreement relationship. The Agreement will begin at a rate supported by [redacted] fiscal ability and include executive management and as the [redacted] budget allows, the other services listed above will be added as fiscally appropriate with corresponding increases in the Agreement fees to [redacted] %.

The minutes go on to state that:

The contractual Agreement between [redacted] and [redacted] will be presented to the board for review and approval upon its completion for retroactive initiation date of [redacted].

As of [redacted], [redacted] will assume the title of Executive Director and will continue to perform his duties under the authority and direction of [redacted] per the management Agreement.

[redacted] last day on the payroll of [redacted] was [redacted] to be [redacted]; the pay period ended on [redacted] and [redacted] was inadvertently paid [redacted] extra days on the payroll.

3. The minutes indicate that [redacted], while Executive Director of [redacted], had considerable input into the terms of the Agreement. This is evidenced by his recommendation of an 'incremental transition' into the [redacted] management services Agreement relationship and his statement "The Agreement will begin at a rate supported by [redacted] fiscal ability and include executive management and as the [redacted] budget allows, the other services listed above will be added as fiscally appropriate with corresponding increases in the Agreement fees to [redacted] %".

The Agreement was not an "arm's length" transaction. In Information Document Request #2, Form 4564, dated [redacted], the question was asked:

Question #3 - Did [redacted] put the management services out for competitive bidding before awarding it to [redacted] ?

Question #3 Answer –

[redacted] board of directors did not see a need to solicit bidding as the team brought an extensive knowledge base in executive leadership and the challenges that [redacted] would face in the ever-challenging field of foster care. The board of directors was careful to ensure that the Agreement with [redacted] was within fair market

values. The Agreement was actually established at a lower than market standard fee structure, as evidenced by the reviewed and included in this report.

4. The Agreement gave a substantial amount of control of operations to . The Agreement states that for Agreement purposes is referred to as , an Corporation (**herein " " or Manager or Administrator**). The agreement states that:
- ii. shall recruit, recommend for selection and provide oversight Executive Director who is responsible for the fulfillment of contractual obligations.
 - iii. shall provide, supervise and administer a comprehensive program of quality standards and assurance in compliance with applicable state and referring agency regulations, standards and policies.
 - iv. shall provide, supervise and administer appropriate budgeting processes for to assure fiscal responsibility in accordance with generally accepted accounting practice and shall insure satisfactory completion of an annual independent audit in compliance with state and agency regulatory standards.
 - v. shall provide, supervise administration for program development and strategic planning to accomplish program objectives and to provide for long term growth.
5. The terms of the Agreement give a substantial amount of control over the operations of including in recruiting, recommending for selection, and oversight of the Executive Director; budgeting; involvement in the annual independent audit of ; and program development and strategic planning to, among other things, provide for long-term growth.

According to answers received IDR #2, dated ,

Question #8 - Please provide a narrative description of the typical services performs for in a given week including (c), Who performs those services

Question #8C answers –

- a) also works closely with human resource staff on personnel issues, including hiring and any disciplinary actions that may need to address with personnel.

- b) The primary focus of executive support and consultation to the executive director and management team is “strategic planning around the achievement of economy of scale,” and “ meets daily with management leading the process of metrics based decision-making, coordinating the development of strategic growth plans for each region....”

Question #9 - Please provide a narrative description of the services performed occasionally or on a set schedule e.g., monthly, quarterly, or yearly and the services performed on an ad hoc/as needed basis, including: c.) Who performs these?

Question #9C answer –

also produces financial reports and coordinates audit activities with state contract audits.

focus on strategic planning and growth of operations has the effect of increasing revenues, which in turn increases the fee paid to , as it is based on a percentage of gross revenue

is the founder of . He left when the Agreement was signed. He and his wife have control of and are % shareholders of . As such, & are “Insiders” in and by inference . The larger the fees collected from by , the larger the income to the shareholders of . Thus and meet the definition of private shareholders or individuals referred to in section 501 of the Regulations as persons having a personal and private interest in the activities of the (Regulation 1-501(a)-1(c))

6. pays a substantial amount of money for management services, the vast majority of which pays out to and in the form of salaries and distributions to themselves and their trusts. A review of Forms , for the years under the current contract determined that approximately percent (%) of the management fee paid by was paid out to the and their trusts each year.

This is a similar fact pattern to *People of God Community v. Commissioner*, 75 T.C. 127 (1980). In *People of God*, the salaries of the ministers of the Christian church were based on a predetermined percentage of the gross tithes and offerings received. The court held that part of the church’s net earnings inured to the benefit of private individuals. This finding caused the court to determine that the church was not exempt as an organization described in IRC §501(c)(3).

The major difference between *People of God* and this case is the insertion of

between [redacted] and the [redacted]. In People of God the ministers controlled the church directly. In this case the Agreement gave substantial control of [redacted] to [redacted], with [redacted] & [redacted] controlling [redacted] by being the CEO and Asst. CEO respectively.

As in the People of God case, the Agreement set management fees paid by [redacted] to [redacted] at a predetermined percentage of [redacted] gross income.

In People of God, the court stated that:

“We hold here that paying over a portion of *gross* earnings to those vested with the control of a charitable organization constitutes private inurement as well. All in all, taking a slice off the top should be no less prohibited than a slice out of net”.

The court continued:

What is prohibited is inurement “to the benefit of any private shareholder or individual.” The term “private shareholder or individual” refers to persons who have a personal and private interest in the payor organization. The term does not refer to unrelated third parties. In other words, section 501(c)(3) denies exempt status to an organization whose founders or controlling members have a personal stake in that organization's receipts. Such is the case here, where petitioner's ministers, and Donhowe, in particular, completely control its affairs. Petitioner therefore fails to qualify for exemption under section 501(c)(3). (citations omitted)

In this case the Agreement gives [redacted] a substantial amount of control of [redacted] operations. [redacted] has a stake in [redacted] gross receipts. The better [redacted] performs, the higher the fees received by [redacted].

The operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private benefit rather than public interests. (Regulations §1.501(c)(3)-1(c)(2)) As in People of God, [redacted] fails to qualify for exemption under section 501(c)(3).

7. [redacted] is the main client of [redacted]. [redacted] benefits substantially from the operation of [redacted].

The Agreement's fee structure provides that “Compensation rates are in accordance with general business standards as researched and verified through organization [redacted] filings, ranging from [redacted] % to [redacted] %. Current rate is [redacted] % of gross revenue as adjusted for corrections and refunds less bad debt with adjustments made for annual reconciliation. Compensation may be increased based on current market analysis and mutual Agreement between both parties during the life of the Agreement”.

With these facts in mind, [redacted] does not meet the requirements of Regulations §§1.501(c)(3)-

1(c)(2) and 1.501(c)(3)-1(d)(1)(ii) as earnings serves a private benefit rather than public interests.

Revocation

Regulations §1.501(c)(3)-1(f)(ii) provides that In determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization described in section 501(c)(3) that engages in one or more excess benefit transactions that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and circumstances, including, but not limited to, the following -

- (A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;
- (B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;
- (C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;
- (D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and
- (E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6) and § 53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

The most relevant considerations in this case are C, D, and E of the regulation. has been involved in the excess benefit transactions that violate the prohibition on inurement under section 501(c)(3) since the adoption of the original agreement in of . Since the original agreement was signed, and have been "Insiders" in relation to . They have both been officers of and only shareholders. The signing of the agreement did nothing to modify the agreement in any way that would prohibit the control and fee structure of the agreement from enabling and to receive funds that inured to their private benefit.

The agreement was not an "arms-length" transaction. The organization made no attempt to put the management services out for competitive bidding before awarding it to . In IDR #2, Question #3, stated that:

board of directors did not see a need to solicit bidding as the team brought an extensive knowledge base in executive leadership and the challenges that would face in the ever-challenging field of foster care. The board of directors was careful to ensure that the Agreement with was within fair market values. The Agreement was actually established at a lower than market standard fee

structure, as evidenced by the report. reviewed and included in this

The Agreement gave substantial control of operations to and by inference, and . As discussed above, in People of God v. Commissioner, the court found that:

“We hold here that paying over a portion of *gross* earnings to those vested with the control of a charitable organization constitutes private inurement as well. All in all, taking a slice off the top should be no less prohibited than a slice out of net”.

and its Board have not made good faith efforts to seek correction from and who benefited from the excess benefit transactions. Amendments to the Agreement were made to increase the percentage of gross income paid by as management fee, but no control modification amendments were included.

Considering the above facts and circumstances, should not continue to be recognized as an organization having the tax-exempt status of an applicable tax-exempt organization described in section 501(c)(3). (Regulations §1.501(c)(3)-1(f)(ii), example 3(iii))

Conclusions

The Service has sufficient information / evidence to establish the Agreement between and exhibits a pattern of control over the operations of . is the founder of . He left when the Agreement was signed. and have control of and are % shareholders of . As such, & have a personal and private interest in and by inference (Reg. §1.501(c)(3)-1(c)(2)).

pays a substantial amount of money for management services, the vast majority of which pays out to and in the form of salaries and distributions to themselves and their trusts. A review of Forms for the years under the current contract determined that approximately percent (%) of the management fee paid by was paid out to the and their trusts each year.

We believe that paying the excise taxes and making corrections would not be sufficient to allow to retain its tax-exempt status since would continue to be controlled by the through the Agreement, thus continuing the practice of using substantial assets for the private benefit of the same individuals. As long as the Agreement is in place, it will continue to disqualify from exemption.

should lose its tax-exempt status. In addition, given the fact pattern of abuse, non-profit private foundation status should be terminated pursuant to IRC §507(a)(2) and Regulations §1.501(c)(3)-1(f)(ii), example 3(iii))

The revocation should be effective _____ (the _____ day of the audit period). _____ will be required to file Form 1120 for all tax years since _____, inclusive.

Taxpayer Position