



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **200846039**

Release Date: 11/14/08

Date: August 19, 2008

UIL Code: 501.03-23

501.07-00

501.07-06

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(7) or 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

Letter 4040(CG)(11-2005)
Catalog Number 47635Z

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

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



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

TAX EXEMPT AND
GOVERNMENT ENTITIES

Date: August 19, 2008

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

a = State

b = Date

M = Applicant organization

N = Director

O = For-profit entity

P = Director

Q = Director

R = Director

S = Director

UIL Codes: 501.03.23

501.07-00

501.07-06

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)(7). We have also considered whether you would qualify for exemption under IRC 501(c)(3). We have concluded that you do not. The basis for our conclusion is set forth below.

Issues

1. Does M qualify for tax-exemption under IRC 501(c)(7)?
2. Does M qualify for tax-exemption under IRC 501(c)(3) as an organization that supports the educational activities of a school?

Facts

M filed Articles of Incorporation with the State of a on date b. The incorporator is N, and the initial directors were N and Q. The current directors are N, P, R and S.

Article III of the Articles of Incorporation states that M is organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes no part of the net earnings of which inures to the benefit of any private shareholders. The primary purpose of the Corporation is dance performances in various locations. It further states that "Notwithstanding any other provisions of these Articles, the corporation shall not conduct or carry on any activities not permitted to be conducted or carried on by any organization exempt under Section 501(c)(7) of the Internal Revenue Code of 1986, as amended, or by any organization, contributions to which are deductible under Section 170(c)(2) of the Internal Revenue Code of 1986, as amended."

Section 3.10 of the Bylaws states the following: "Limitations of Power of the Board of Directors. A majority of the members at any regular meeting can nullify or overturn actions of the Board of Directors provided that a quorum is present. The Directors are always responsible to the full membership."

Section 4.1 of the Bylaws states that all officers "must be members in good standing".

M submitted Form 1024, Application for Recognition of Exemption under Section 501(a). M requested classification under IRC section 501(c)(7). There is no postmark date, or date receipt stamp on the application form; however, the original receipt date recorded on the IRS computer system is February 20, 2007.

Form 1024, Part II (Activities and Operational Information) states that M's sole purpose is to provide fundraising opportunities for the families involved in O. Any funds raised can only be used for the following:

1. Individual family accounts at the school (to offset tuition & fees)
2. Board - approved scholarships for the school
3. Organization approved improvements for the school.

All activities are ongoing and organized by a fundraising chairperson.

Part II states that financial support is "solely provided by the fundraising efforts of the families involved with O."

Part II further states that membership in the organization is voluntary, and that "all assets are transferred out to the families at fiscal year- end, July."

Officers and Board Members:

3b, Part II, of the Form 1024 application indicates that none of the Officers are compensated.

The current Director, N, is the owner of O.

Supplemental schedules submitted with the Form 1023 application contained the following gross receipt and scholarship figures.

Gross receipts \$	Scholarships \$
Gross receipts \$	Scholarships \$
Gross receipts \$	Scholarships \$-
Gross receipts \$	Scholarships \$

Correspondence:

In a correspondence signed by Treasurer, P, dated June 26, 2007, the following statements are made:

In item 4, it is stated "There were students enrolled in the school for the - year.", and in item 10. it is stated "we currently have 111 families involved in our organization."

In item 2, it is stated "O is a for-profit entity. It is owned by N."

In item 7, it is stated "The expenses listed on Form 1024, Part III, A, Line 9 are amounts which were transferred out to individual family accounts (please refer to answer #6 above). These funds were passed through our TPO account and closed out for the fiscal year end (July 31st). All funds were used and can only be used to pay fees and costs associated with O."

In item 8, it is stated "For the year - , specifically, our Team Parent Organization raised enough funds to purchase 12 new tumbling mats for the studio. We raised these funds through car washes, can collections, volunteering at the in concession stands, working at Community Days at store, and through individual families transferring their fundraising balances, or portions thereof, towards this cause as a donation. In years prior, similar activities took place to help pay for trophy cases, a large picture frame for the dance team photos, seasonal decorations and new chair upholstery."

In item 11, it is stated "Membership due and assessments are \$0. That being said, however all fundraising income between the family that raises the money and the general fund of the organization. Most fundraising activities have a 95/5 split with the family retaining 95% of their profit in their fundraising account and the General fund receiving 5% to cover any costs associated with the activity and to put towards school donations of school improvements and scholarships. One activity, our Scrip program, has a 90/10 split due to shipping costs associated with this ongoing activity. There are no other membership 'dues' or assessments for this organization."

In item 13, it is stated "Our organization does not specifically raise money for the for-profit studio entity. Our goal is to assist the dancer's families in finding ways to afford and pay for the costs and fees associated with receiving education at this school."

In item 16, it is stated "A. A fundraising letter is given to families as they register for new classes at the beginning of the year. This letter describes the opportunity to raise money to offset costs and fees associated with the dancer's education at the studio. This letter is attached as well. New members are not necessarily solicited, rather they are informed of the opportunity that is being provided by our Team Parent Organization."

Revenues: The applicant's revenues are realized from various fundraising activities conducted by parents of children who attend O. The revenues received from these fundraising activities are not broken down as coming from parents who are members of M or the parents who are not members of M.

ISSUE 1

Law

IRC 501(c)(7) provides that clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Regulation 1.501(c)(7)-1(a) states that the exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Regulation 1.501(a)-1(c) defines "*Private shareholders or individuals*" as persons having a personal and private interest in the activities of the organization.

Revenue Procedure 71-17 describes the record keeping requirements of social clubs exempt under IRC 501(c)(7) with respect to nonmember use of their facilities, sets forth guidelines for determining the effect of gross receipts derived from public use of the club's facilities on exemption and liability for unrelated business income tax.

Application of Law

Although the Articles of Incorporation indicate that the applicant is organized exclusively for "pleasure, recreation and other non-profitable purposes", Part II of the Form 1024 application states that "Our sole purpose is to provide fundraising opportunities for the families involved in O." Further, evidence outlined in the Facts section confirms that the organization's primary activities consist of fundraising by the parents of students attending the school to assist in paying for their children's school tuition. Considering the above, it is determined that the applicant is not organized and operated for social and recreation purposes as described under IRC 501(c)(7) of the Code.

The inurement of funds for the benefit of any private shareholder is prohibited for organizations described under either IRC 501(c)(7) or IRC 501(c)(3). Since N, the applicant's Executive Director, owns and operates the for-profit school, she meets the definition of a private shareholder in Regulation 1.501(a)-1. Therefore, both the purchase of equipment for the school, and the fact that the applicant's primary activity is to raise funds for the payment of tuition to the school constitutes prohibited inurement as described in both Regulation 1.501(c)(7)-1 and Regulation 1.501(c)(3)-1(c)(2). Further, even if N now vacated the Executive Director position she would still be considered a "private shareholder" under the Regulation cited above by virtue of her former position.

The inurement of funds extends to the parents of the children who attend O, when they receive their shares of the funds raised at the end of the fiscal year.

The fact that the both the funds raised through fundraising activities and the and distribution of those funds are not separated between parents who are members of M and parents who are not members of M also makes it impossible to determine if the applicant would meet the IRC 501(c)(7) operation guidelines set forth in Revenue Procedure 71-17. Therefore, all of the fundraising activities and the distributions of proceeds from the fundraising activities are deemed to be attributable to non-member activities.

Applicant's Position

The applicant also believes that through its functions the school provides social and recreations activities for both the child students and their parents.

Service Response to Applicant's Position

The operation of a school is not a social or recreational activity. The fundraising activities and the distribution of funds raised are the result of non-member activities, and the benefits of the fund-raising inure to the owner of the for-profit school, and to the parents themselves.

Conclusion

The applicant organization does not qualify for tax-exempt status under section 501(c)(7) of the Code.

ISSUE 2

Law

Section 501(a) of the Code provides, in part, that organizations described in section 501(c) are exempt from federal income tax. Section 501(c)(3) of the Code describes, in part, an organization that is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Regulation 1.501(c)(3)-1(a)(1) provides that in order for an organization to be exempt under section 501(c)(3), it must be both organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Regulation 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 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.

Regulation 1.501(c)(3)-1(c)(2) 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(q)-1(c) defines the word "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Regulation 1.501(c)(2)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph 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 Ruling 69-175 held that a nonprofit organization formed by parents of pupils attending a private school, that provided 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.

Application of Law

The applicant is providing a cooperative funding mechanism to assist the parent–members in paying for their children’s tuition. Those circumstances are similar to those described for the organization discussed in Revenue Ruling 69-175, in which it was determined that parents who were providing a cooperative service for themselves were serving their own interests. Also, the applicant’s membership controls the applicant organization because it occupies all of the Officers positions, and because a membership vote can override any Board decisions.

The applicant’s fundraising activity is its primary activity, which serves the private interests of both the members and the owner of the for-profit school, O. Because of this private benefit, it does not meet the requirements of Regulation 1.501(c)(3)-1(d)(1)(ii). The applicant organization does not meet the requirements of Regulation of Regulation 1.501(c)(3)-1(c)(1), because a substantial part of its activities are not in furtherance of an exempt purpose. Because the Regulation requirements have not been met, the applicant cannot qualify for tax-exempt status under IRC 501(c)(3).

The applicant’s Articles of Incorporation document does not restrict its activities to those described under IRC 501(c)(3) as required by Regulation sections 1.501(c)(3)-1(a) and (b). Further, if the applicant did amend its Articles of Incorporation to comply with the Regulation requirements, it would still not qualify for IRC 501(c)(3) status because it is not operated exclusively for 501(c)(3) purposes.

Applicant’s Position

The applicant states that it provides scholarships based upon need and merit to students, which is an educational activity.

The applicant believes that its fund raising activities enable it to provide dance instruction to children who may not otherwise be able to afford the tuition.

Service Response to Applicant’s Position

A recap of the scholarships distributed as compared to the total assets distributed for years through presented in the Facts section, demonstrate that scholarship distributions were not a significant part of the applicant’s total distributions for years , and . The figures demonstrated that a more significant percentage of receipts were devoted to scholarship activities [Gross receipts \$, compared to scholarships of \$], but also that the vast majority of the organizations receipts were not dedicated to scholarships for the year either.

Information submitted by the applicant organization indicates that with the exception of a few purchases for the school, and some limited scholarship activity, the applicant organization’s activities have been confined to fundraising. All funds raised are split with the member–parents raising the funds, and at the end of the year the remaining funds are distributed to the member-parents at the end of the year. The fundraising activity described serves the private interests of the parents, and is not an exempt activity.

Conclusion

The applicant is not an organization that exclusively supports the educational activities of a tax exempt school, and therefore does not qualify for tax-exempt status under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. 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". 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. If you want representation 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. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

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

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

Please send your protest statement, Form 2848, and any supporting documents to 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.

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

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements