



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce Street
Dallas, TX 75242

501.03-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: May 28, 2010

Person to Contact:

Release Number: **201035034**
Release Date: 9/3/10
LEGEND
ORG = Organization name
XX = Date Address = address

ORG
ADDRESS

Badge Number:
Contact Telephone Number:
Contact Address:
Employer Identification Number:
Deadline to Petition Tax Court:
August 26, 20XX

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 February 1, 20XX the following reason(s):

You are not organized and operated exclusively for an exempt purpose as required by Internal Revenue Code section 501(c)(3). You are not and have not been engaged primarily in activities which accomplish one or more exempt purposes. You are not a charitable organization within the meaning of Treasury Regulation 1.501(c)(3)-1(d); rather, your activities further a substantial nonexempt commercial purpose and serve private rather than public interests.

Contributions to your organization are no longer deductible effective February 1, 20XX.

Since your exempt status has been revoked, you are required to file Form 1120, U.S. Corporation Income Tax Return, for all years beginning on or after February 1, 20XX.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

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.

The last day for filing a petition for declaratory judgment is August 26, 20XX.

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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE EO Examinations
Examiner's Address
Examiner's Address

Date: March 8, 2010

ORG
ADDRESS

Form Number:
Tax Year Ended:
Taxpayer Identification Number:
Person to Contact:
Employee Identification Number:
Employee Telephone Number:
(Phone)
(Fax)

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Action - Section 7428. If you have already given us a signed Form 6018, you need not repeat this process. We will issue a final revocation letter.

If you do not agree with our proposed revocation, 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. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

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, The Examination Process, and Publication 892, Exempt Organizations Appeal Procedures for Unagreed Issues, 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.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter.

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
Acting Director, EO Examinations

Enclosures:
Form 6018
Publication 892
Publication 3498
Report of Examination

in lieu of Letter 3618

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended January 31, 20XX

LEGEND

ORG = Organization name XX = Date Address = address City = city
 State = state DIR-1 = 1st Director CO-1 & CO-2 = 1st & 2nd COMPANIES

Issue:

Whether ORG is operated exclusively for exempt purposes within the scope of Internal Revenue Code §501(c)(3).

Facts:

ORG was incorporated on January 13, 19XX, as a non-profit corporation in the State of State. ORG is a booster club for CO-1 (also known as CO-1), a for-profit entity. On January 25, 20XX, ORG was issued a determination letter advising the organization of recognition of exempt status under section 501 (c)(3) of the internal revenue code (IRC), and an advance ruling on the foundation status under IRC section 509 (a)(2). A final determination letter issued on April 06, 20XX provided classification as a public charity status under code section 170 (b)(1)(A)(vi).

The Articles of Incorporation purpose clause as stated reads: “To raise funds to promote competitive athletic activities for children ages 5-18 in the field of dance and cheerleading”. The organizing document was amended during the application process to include the following 3 clauses:

- a) The organization is organized exclusively for charitable, religious, educational, and/or scientific purpose under sec 501 (c)(3) of the IRC.
- b) No part of the net earnings of the organization shall inure to the benefit of, or be distributable to, its members, trustees, officers or other private persons, except that the organization shall be authorized and empowered to pay reasonable compensation for the services rendered and to make payments and distributions in furtherance of the purposes set forth in the purpose clause hereof...
- c) Upon dissolution of the organization, assets shall be distributed for one or more exempt purposes within the meaning of section 501 (c)(3) of the IRC.

During the application process for exemption, the IRS Determination Specialist inquired regarding the relationship with CO-1, the organization answered was, “The organization conducts its practice at the CO-1 located at Address, City, State.

In its description to the department for recognition of exemption, the following details are provided: The organization is not a member organization; all fundraising dollars are to be used for the benefit of all athletes; it is not mandatory for all athletes to participate in fundraising activities, it is voluntary; the organization will provide financial assistance for those children that their parents cannot provide; it is determined based on the need of the individual athlete on a case by case approach. (See Exhibit-1)

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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The organization's sources of financial support are fundraising activities through individual or business members and corporate donations as stated on its application for exemption form 1023, part 11, Q2. (Exhibit-2).

Fund raising activities are conducted entirely by the athletes and volunteers from the membership, and include car washes , sales of concessions, yard sales, and oral solicitation of community business support (Form 1023, part II, Q3). (Exhibit-2).

ORG filed form 990 return for the year ending January 31, 20XX. Within Part III, of form 990, the organization stated that their primary exempt purpose is to "provide with cheerleading instructions paid for by grants".

Question 3a, Part III, ask if the organization make grants for scholarship... the answer provided was checked as "No".

Questions 22b, Part II, form 990, Grants and allocations, list \$ on cash contributions for program expenses.

ORG primary income source is derived from fundraising events, public contributions, donations (individual and corporate). The organization expenses are primarily cash contributions to CO-1 (for-profit entity) and CO-1 related expenses. (See Exhibit-3).

The examination revealed that a substantial part of its total income came from corporate and individual donations (75%). Donation forms give Donors the option to write how they would like to applied their donations. A reviewed of copies of donated checks and bank deposit slips show individual names as the recipients of the donations; in some instances, family owned business donations to their sons or daughters. (see Exhibit-4). This has raised concerns and complaints from students' parents who believe they are raising funds for their sons or daughters but do not receive a scholarship. These allegations are supported based on copies of CO-1 website comments asking parents that they can make or request a tax deductible donation from family and friends even the company they work for to their child's account. (see Pg-11 Exhibit-4).

During the year under audit, ORG, was closely associated with a privately owned for-profit, CO-1 (CO-1), Fully owned by DIR-1 who is also a controlling Officer and Register Agent for ORG (non-for-profit). CO-2 students participate in various state and national competitions. The competitive teams (or individuals) that ORG claims to sponsor are members/students of the all-star program at CO-2. The All-Stars competitive teams compete at various skill levels and they are selected for scholarships based on their talent and financial needs. When Revenue Agent requested information on selection criteria and documentation, there was only a list of individual names provided who supposedly received the funds.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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A reviewed of ORG's bank statements, cancel checks, and General Ledger (Program Expenses), show that 85% of total expenses were checks written to CO-1 (for-profit). When DIR-1 (Director of EO and owner of CO-1) was asked about how ORG exempt purpose is accomplished through cash donations to CO-1? She responded that program expenses and grants to CO-1 include training, uniforms, shoes, travel expenses to regional and national competitions for the all-stars teams. But again, there was no substantiation for individual scholarships received and criteria used (See exhibit-5).

Additionally, some fund raising activities like the "domino's Fundraiser" required Athletes to sell a certain quota to received a prize and a minimum for an entire team to receive free camp outfits and free cards for everyone; contrary to information submitted to Determination Specialist (see Pg-4 of Exhibit-1).

Article III of the Articles of Incorporation, state that Directors will be appointed initially from the community followed by yearly elections. There were no meeting minutes of Officers available to determine if elections have ever taken place. But, documents from the initial application for exemption, and State Division of Corporations Website show DIR-1 as the Director and Register Agent since March, 20XX to present. (exhibit-6).

Government Position:

Based on the facts of the examination, it is our position that your organization is not operated exclusively for purposes within the scope of §501(c)(3) and as a result, your organization does not qualify for exemption under §501(c)(3) of the Internal Revenue Code.

Section 501(c)(3) of the Code provides exemption from federal income tax for organization's organized and operated exclusively for educational, charitable or religious 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), no part of the net earnings of which inures to the benefit of any private shareholder or individual.

In addition, Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

It is the government's position that DIR-1, owner of CO-2 (For-profit entity), controls the booster club, as the primary Officer. Fund raising event flyers urge parent-members to participate in the various fundraising activities for the benefit of all Athlete members on the competitive teams. ORG serves as a tool to raised funds for individual team members and for parents to pay for their own child fees at CO-1 with tax free dollars.

ORG is not supporting the promotion of youth athletic competition but is primarily supporting the children and parents based upon their participation in the organizations fundraising events.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended January 31, 20XX

ORG requires parents-team members to participate in some fundraising activities (Classic Coolie Dough, Domino's Pizza Card) for the benefit of all team members. Donors can make tax free donations to their own child accounts at CO-1 through ORG, and corporate sponsors can designate their donations to specific individual or to a general fund account. Child Accounts are proportionally credited based upon participation and donations received.

The parent-athletes and DIR-1, EO Officer, are considered insiders of the organization because they are in position to have control or influence over the activities of the exempt organization and the for-profit. The requirement that team members participate in the fundraising activities and the call to parents to make tax free donations to their child's training at CO-1 causes a direct benefit to athlete parents and to DIR-1 who controls both organizations. Consequently, the earnings of the exempt organization are being used directly by CO-2 to pay for benefits to specific individuals and for CO-2 expenses rather than to a class of competitive athletes who cannot afford to pay. The organization is allowing the earnings of the exempt organization to inure to the benefit of specific insiders (Parents and Officer/Owner).

Inurement of income is prohibited under IRC 501(c)(3) without regard to the amount involved. Like the organization in *Better Business Bureau of City State, Inc. v. United States*, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

ORG activities are similar to the organization described in Rev. Rul. 69-175, 1969-1 C.B. 149, in which a group of parents got together and provided bus transportation for their own school children to and from the school their children attended. The organization was found to serve a private rather than a public interest and was not exempt under section 501(c)(3).

The examination revealed that 75% of total ORG expenses are direct cash donations to CO-2. There was no documentation provided that shows how, who, and any criteria used for athletes selection to received scholarship donations. When requested, the exempt organization provided a list of 10 individual athletes who supposed to have received scholarship donations but no documentation as to how they were selected was received. Additionally, some CO-2 expenses show direct payments from the exempt organization account.

ORG' use of CO-2 private facility and direct cash donations resulted in a substantial private benefit to its owner and accordingly benefiting a commercial enterprise. ORG operations are not exclusively charitable within the meaning of section 501 (c)(3).

LAW:

Section 501(c)(3) of the Code describes certain organizations exempt from taxation under section 501(a) of the Code and reads as follows:

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

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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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, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Treasury Regulations

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is 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 or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes. Thus, to qualify for exemption, the organization must show that it engaged "primarily" in activities which accomplished that exempt purpose. The organization will not qualify for exemption if a nonexempt activity is more than an insubstantial part of its activities, or if an activity of the organization has more than an insubstantial nonexempt purpose.

Section 1.501(c)(3)-1 (d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, 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.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education and the promotion of social welfare by organizations designed to combat juvenile delinquency.

Section 1.501(c)-1(d)(3) of the regulations defines the term "educational" as including the instruction or training of the individual for the purpose of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

REVENUE RULINGS

Revenue Ruling 69-175, 1969-1 C.B. 149 states that when a group of individuals associate to provide a cooperative service for themselves, they are serving a private interest. By providing

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended January 31, 20XX

bus transportation for school children the organization is enabling the participating parents to fulfill their individual responsibility of transporting their children to school. Thus, the organization serves a private rather than a public interest. Accordingly, it is not exempt from Federal income tax under section 501(c)(3) of the Code.

Revenue Ruling 65-2, 1965-1 CB 227, (Jan. 01, 1965) describes an organization which is organized and operated exclusively for the purpose of teaching a particular sport to the children of a community by providing free instruction, free equipment, and facilities. The foundation was formed to provide educational and character building programs for the children of the community. Its activities consist of conducting clinics for student players at playgrounds and at parks, coaching clinics for instructors of the student players, provide free instruction in schools, playgrounds, and parks and furnish free equipment to those children who are unable to afford such equipment, stimulates interest in its program through the use of film and other instructional devices. Its program and facilities are available to any child in the community who desires to participate, is physically able, and has reached the qualifying age level.

The ruling concludes that the organization's activities of instructing individuals to develop their capabilities are educational. Further, its furnishing of free instruction, equipment, and facilities to children of the community is accomplishing the charitable purpose of combating juvenile delinquency. Accordingly, the organization qualifies for exemption under IRC 501(c)(3).

Revenue Ruling 9-215, 1980-2 C.B. 174, describes an organization which is organized and operated to develop, promote, and regulate a sport for junior players, and to promote sportsmanlike competition for junior players in a particular state. The organization is comprised of affiliated individual associations, clubs, leagues, and teams. Each club may be comprised of any number of teams. The organization organizes local and state-wide competition for individuals under 18 years of age; promulgates rules; organizes officials; and presents seminars for players, coaches, and referees. The organization provides a framework for protests, appeals, and procedures. It also distributes a newsletter, and otherwise encourages the growth of the sport throughout the state. This ruling holds that the organization's activities combat juvenile delinquency and promote the education of children. Therefore, the organization qualifies for exemption under IRC 501(c)(3).

Court Cases

Better Business Bureau of City State, Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

Taxpayer's Position:

A draft report of examination was provided to the organization. The organization has not provided any information as to their position at this time.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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Conclusion:

Based on the facts presented above, the method in which ORG operates results in the inurement of its income to its parent-members and to the owner of CO-1 (CO-2).

ORG exemption should be revoked effective February 01, 20XX.

Form 1120 returns should be filed for the tax periods after February 01, 20XX.