

**Internal Revenue Service**

Appeals Office  
San Jose Appeals, MS-7100  
55 S. Market St., Suite 440  
San Jose, CA 95113

**Department of the Treasury**

**Employer Identification Number:**

**Number: 201548025**  
**Release Date: 11/27/2015**

**Date: August 25, 2015**

**Person to Contact:**

Name:  
Employee number:  
Telephone:  
Fax:  
Contact hours:

**UIL:**

501.32-00  
501.32-01  
501.33-00

**Certified Mail**

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code.

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

1. You are not operated exclusively for exempt purposes within the meaning of Code § 501(c)(3) and Treasury Regulation § 1.501(c)(3)-1(d). You do not engage primarily in activities that accomplish one or more of the exempt purposes specified in Code § 501(c)(3). More than an insubstantial part of your activities are in furtherance of a non-exempt purpose.
2. You are not operated primarily for a public purpose as is required by Code § 501(c)(3) and Treasury Regulation § 1.501(c)(3)-1(d)(ii). Your operations result in substantial benefit to private interests.

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

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit [www.irs.gov](http://www.irs.gov).

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

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

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

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

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

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

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892 and/or 556

cc:



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: JUL 24 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

B = date  
C = state  
D = curriculum  
F = individual  
G = individual  
H = individual  
K = LLC  
m = number  
n = number  
P = date  
Q = company

**UIL:**

501.32-00  
501-32-01  
501.33-00

Dear

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

**Issues**

Are you operating exclusively for charitable purposes within the meaning of Section 501(c)(3)? No, for the reasons described below.

**Facts**

You were incorporated on B in the state of C. You were formed to educate and inspire teachers, whole school communities, and organizations that serve children and youth to strengthen social and educational learning through the implementation of D and other intervention strategies.

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D is a comprehensive program for promoting emotional and social competencies and reducing aggression and behavior problems in elementary school-aged children (Pre-K – Grade 6), while simultaneously enhancing the educational process in the classroom and school. D is taught two or three times per week, providing lessons and materials to facilitate instruction on emotional literacy, social competence, interpersonal problem-solving skills. D leads to improvements in student behavior resulting in academic gains.

D has been recognized as a highly effective evidence-based program by numerous agencies. A new version of D was released in P, which now provides units separately by grade level in grades Pre-K/Kindergarten through Grade 5/6. The original multi-year version is also available from the publisher.

You will provide workshops for educators and other child servicing professionals throughout the world for schools and other agencies to help facilitate the use of D. Workshops are led by certified D trainers. Training sessions are two days long. Certified D trainers will usually travel to school or agency sites to provide workshops, but may also provide workshops at centralized locations. Workshops are held for staff and administration in order to build fidelity and sustainability with D. D workshops will also provide separate trainings for principals and administrators of schools, school psychologists and counselors, specialized teachers, and clinicians working with children and parents. Consulting services through email, phone, or Skype will also be offered.

F and G co-developed D and were co-owners of K before your incorporation. K continues operations as a for-profit company that also provides training to schools to support D. G attempted to convince F to forgo profit and become a non-profit organization, however, F did not agree with this approach. As a result, G relinquished his ownership in K described in a settlement agreement reached between F and G. This agreement stated that both F and G may use the intellectual property of D, and they both receive royalties on the sale of D. You indicate this royalty agreement with F cannot be changed and the royalties are required to be paid. The agreement also states that K's trainers are independent contractors and may work for either F or G.

D is published and distributed by Q, a for profit publishing agency. Links to Q are included on the web site of K, where visitors are instructed to click to find comprehensive media guides for D. Q's web site includes materials on D, how D works, evaluation kits for D, and support resources for current users of D. The logo for D and K are also trademarked by Q, and Q grants you the rights to use this mark. Q has the exclusive right to license and publish D and materials related to D. In return, Q pays F, G, H and another author royalties for units of D that are sold.

G and H are members of your board of directors. H is also one of the trainers who receives m dollars for the planning, coordinating, conducting, and following up on

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training sessions for schools. G and H do not receive compensation for other duties and responsibilities.

You charge n dollars to organizations for the training and pay the certified trainers m dollars to arrange the training times, and coordinate the location and facilities. The difference is used to provide for your operation so it can operate to benefit school systems that can't afford D. You plan to provide free and/or greatly reduced training fees to schools in impoverished communities. K also charges n dollars to organizations and pays certified trainers m dollars. D grade level program kits also vary in price from approximately \$400-\$800. Fees are also charged for follow up training, on-going consultations, certain supplies for students, and an optional D coach.

Your primary source of revenue will come from training income. You will also solicit for supplemental grants and donations. Your largest expense is contract employees. Other significant expenses include consultations, marketing and publications, and compensation for your executive director.

#### Law

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations 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.

Section 1.501(c)(3)-1(c)(2) of regulations states that an organization whose net earnings inure to the benefit of private shareholders or individuals or which is operated for the benefit of private interests is not operated exclusively for exempt purposes.

Section 1.501(c)(3)-1(d)(1)(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, to meet the requirement of this subsection, 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.

In Rev. Rul. 72-369, 1972-2 C.B. 245, an organization was formed to provide managerial and consulting services for section 501(c)(3) organizations to improve the administration of their charitable programs. The organization enters into agreements with unrelated section 501(c)(3) organizations to furnish managerial and consulting

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services on a cost basis. This revenue ruling stated that::

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test,' the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and the applicable regulations.

Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code.

Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

In Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that, in order to fall within the claimed exemption, an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes.

In Spokane Motorcycle Club v. U.S., 222 F.Supp. 151 (E.D. Wash. 1963) - Net profits were found to inure to private individuals where refreshments, goods and services amounting to \$825 (representing some 8 percent of gross revenues) were furnished to members. A small amount of private inurement is fatal to exemption.

In B. S. W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978) the Court stated that free or below cost service is only one of several factors to consider in making a determination. Others include the particular manner in which the organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. All of these must be considered, for no single factor alone is determinative. The record reflected that the corporation would be in competition with commercial enterprises and the Court concluded that the petitioner is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial.

In Easter House v. United States, 12 Cl.Ct. 476, 487 (1987), citing section 1.501(c)(3)-1(d)(1)(ii) of the regulations, aff'd without opinion, 846 F.2d 78 (Fed.Cir.1988) that an organization is not operated exclusively for exempt purposes if it serves a private rather than a public interest.

In Living Faith Inc. v Comm'r, 60 T.C.M., 710, 713(1990), aff'd 950 F.2d 365 (& Cir. 1991) the court wrote that the activities were conducted as a business and the

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organization was in direct competition with other restaurants and health food stores; thus it did not qualify for exemption under Section 501(c)(3). The appellate court stated the factors that the court relied on to find commerciality and thus offered the best contemporary explanation of the commerciality doctrine.

### **Application of Law**

You are not described in section 501(c)(3) of the Code because your operations of selling and providing support services for D are done in a commercial manner and result in substantial private benefit and inurement. Therefore, you are not operated for exclusively charitable purposes as described in Section 1.501(c)(3)-1(c)(1).

As described in section 1.501(c)(3)-1(c)(2) of the Regulations, you are not operated exclusively for exempt purposes because your net earnings inure to the benefit of private shareholders or individuals. Your activities consist of providing support services for the sale of D. Your board members, G and H receive royalty payments as a result of the sale of D. Since you are promoting and facilitating the sale of D, your operations result in financial payments to your board members. Because your board members are receiving financial benefit from these transactions, your operations result in substantial private benefit. As stated in section 1.501(c)(3)-1(d)(1)(ii), you are not operated for exclusively 501(c)(3) purposes because your operations serve the private interests of your board members.

You are like Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279, in that you are not "operated exclusively" for exempt purposes. Your purposes include promoting and implementing D, and sales of D result in private financial benefit to F, G, and H. Like the organization in Easter House, supra, this nonexempt purpose of serving private interests destroys your claim for exemption under section 501(c)(3) of the Code.

As stated in Spokane Motorcycle Club v. U.S., 222 F.Supp. 151, a small amount of inurement is fatal to exemption. You provide support services for D, which is copyrighted to G. G and H receive royalties from the sale of D. Your operations show that designated board members will receive financial benefit as a result of the sale of D and you facilitate the sale and implementation of D. Therefore, you do not qualify for exemption under section 501(c)(3) because your operations result in inurement to G and H.

You are like the organization described in Rev. Rul. 72-369, 1972-2 C.B. 245 because you are operating in a commercial manner. A substantial portion of your activities consists of marketing and selling support services for a fee. As explained in the ruling, even if services are provided at cost this is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. See B. S. W. Group, Inc. v. Commissioner. You charge rates above cost to offset the cost of providing some

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free/reduced fee services, demonstrating you operate in a commercial manner.

Like the organization described in Living Faith, you are in operation of a business that is in direct competition and providing services similar to K. You and K both promote the same curriculum and charge the same fees for training. In addition, per your settlement agreement, K's trainers are able to provide services for G, which demonstrates the trainers provide similar training. Your main source of revenues is training fees and your largest expense is contract employees. Your operations are substantially the same as for-profit, K, showing you are operating in a commercial manner which precludes you from exemption under section 501(c)(3).

### **Applicant's Position**

You maintain your activities are exclusively charitable and educational within the meaning of section 501(c)(3). You contend there is no excess private benefit since you do not provide compensation to your directors from the activities of the organization and royalties are legally required to be paid. Also, you believe your operations differ from a commercial enterprise because you seek donations and use excess revenues to provide free or reduced cost services to schools.

### **Service Response to Applicant's Position**

Even though you do not pay G or H compensation for services they provide as board members, they still receive a financial benefit from the sale of D. Your operations are to promote and facilitate the use of D; thus, you cannot fulfill your purposes without the sale of D and subsequent royalty payments to G and H. Further, any promotion and sale of D benefits Q as well as F. You do not meet the operational test as described in section 1.501(c)(3)-1(c)(1) of the regulations and therefore do not qualify for exemption under section 501(c)(3) of the Code.

### **Conclusion**

Your operations promote the use and sale of D, which result in financial benefit to copyright holders and authors F, G, and H, in the form of royalty payments. In addition, you are providing support services for D in a substantially commercial manner. Therefore, you are not operating exclusively for charitable purposes within the meaning of Section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of why you disagree. Your protest statement must be filed within 30 days of the date of this letter and should include:

- a. Your organization's name, address, EIN number and a daytime phone number.
- b. A statement that the organization wants to protest the proposed determination.

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- c. A copy of this letter showing the findings that you disagree with (or the date and IRS office symbols from the letter.
- d. An explanation of your reasons for disagreeing including any supporting documents.
- e. The law or authority if any, on which you are relying.

The protest statement may be signed by one of your officers or your representative. 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, *How to Appeal an IRS Decision on Tax-Exempt Status*.

The protest statement should also include the following declaration.

"Under penalties of perjury, I declare that I have examined this protest including accompanying documents and, to the best of my knowledge and belief, the statement contains all relevant facts, and such facts are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your protest will be considered incomplete without this statement.

If an organization's representative signs and submits the protest, a substitute declaration must be included stating that the representative prepared the protest and any accompanying documents; and whether the representative personally knows (or does not know) that the statement of facts in the protest and any accompanying documents are true, correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. In that case you must file a 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](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to seek a declaratory judgment in court at a later date because the court requires that you first exhaust administrative remedies at the IRS. 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

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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 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.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Director, Exempt Organizations

Enclosure: Publication 892

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