



DEPARTMENT OF THE TREASURY
Internal Revenue Service

July 27, 2006

Release Number: 200709064
Release Date: 3/2/07
UHL Code: 501.03-01

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN:

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: _____

Dear

This is a final revocation letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. The Internal Revenue Service's recognition of your organization described in section 501(c)(3) is hereby revoked effective April 1, 2002.

We have made this determination for the following reasons:

You have not operated exclusively for exempt purposes as required by section 501(c)(3) of the Internal Revenue Code. Your primary activity of producing the magazine, more than insubstantially furthers non-exempt commercial purposes. In addition, your accruing of significant accounts payable to your founder and principle officer furthers our determination that you have not established your organization serves a public rather than a private interest as required by Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii). This practice also leads to our finding that some of your net earnings inured to the benefit of private shareholders or individuals of your organization. You are not operated exclusively for exempt purposes as required for organizations to be recognized as described in section 501(c)(3).

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending March 31, and for all years thereafter.

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

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 Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

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 Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or writing to: Internal Revenue Service, Taxpayer Advocates

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

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Marsha A. Ramirez
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
300 N. Los Angeles St., MS 7300
Los Angeles, CA 90012

August 29, 2005

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

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, take no further action. 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.

Letter 3618 (04-2002)
Catalog Number 34809F

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. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

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:

**Taxpayer Advocate
LOCAL OFFICE**

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,

**R.C. Johnson
Director, E.O. Examinations**

**Enclosures:
Form 6018
Form 886-A
Publications 892 & 3498**

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

LEGEND:

ORG=Name of Organization
ADDRESS= Address of Organization
PUBLICATION=Name of Publication
FOUNDER=Founder of Organization

ISSUE #1:

Should ORG.'s tax exemption under section 501(c)(3) of the Internal Revenue Code be revoked because their activities have not met the requirements of section 501(c)(3) of the Internal Revenue Code?

FACTS:

ORG. was recognized as a tax exempt organization under 501(c)(3) of the Internal Revenue Code in June.. The organization currently leases a hangar at the ADDRESS for approximately \$382.56 per month. Some of the operations are also conducted in the personal residence of FOUNDER. The agent conducted a field audit on _____ at the hangar leased by the organization. The hangar was about 800 square feet and was able to house a small airplane. The hangar was used more as a storage area and an office. Per FOUNDER, Board meetings were sometimes conducted there.

The primary activity of the organization is to produce a quarterly magazine titled "PUBLICATION". Per discussion with FOUNDER the main purpose of these magazines are to educate and to teach flying safety and to provide specific guidelines for travel to specific destinations. However upon review of the organizations Publications, the publications contained numerous advertisements and articles about various travel destinations. There was a minimal amount of articles or other information relating to flying safety. Also a disclaimer was noticed in the magazine that says, "*We gotta tell you: This publication is NOT for navigational use. Pilots must make their own determination regarding safety. We are not responsible for data about advertisers, sponsors, reviews, editorial, airports, or safety messages. This publication is strictly for your entertainment value*".

These publications are mailed to various aviators across the country. These magazines are also mailed in bulk to various airports across the country to be passed out to the public. Aviator names and addresses are obtained through the FAA. Per discussion with FOUNDER, these publications are free of charge. However upon review of the organization's website, there was a section in the website which provided an application to subscribe for the magazine. Costs were either 1 year for \$25 or 2 years for \$40.

A review of the revenue received for the organization showed the following income which corresponds with the subscription price:

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Explanation of Items		Year/Period Ended
Name of Taxpayer ORG		

Name:

Amount:

\$

- A
- B
- C
- D
- E
- F
- G
- H
- I
- J
- K
- L
- M
- N
- O
- P
- Q
- R
- S
- T
- U
- V
- H
- L
- P
- P
- R
- S
- S
- S
- S
- T
- V
- W
- X

Total

\$

This amount was not reported as subscription income on Form 990.

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FOUNDER is in charge of putting together the magazine. Outside writers are paid to write articles in the magazine. Form 1096/1099s were properly filed for these writers. These magazines are distributed quarterly.

Review of the organization's website revealed that the organization's activities were more related to travel and entertainment than they were of educational purposes. In the history section of the website, FOUNDER describes his duties in visiting various travel destinations and reports back in the publications about his "adventures" in the places that he visits. The website also offers the ordering of past subscriptions to PUBLICATION. Photographs of scenic travel destinations are also sold on the website. There is also a section on the website offering safety tips and stories relating to flying.

Based on the exam, the educational, advertising, and entertainment proportions of the periodicals were as follows:

Education	%
Advertisement	%
Entertainment	%

A significant portion of the periodicals were dedicated to advertisements. Per discussion with FOUNDER, he stated the organization does not charge for advertising but is given to certain contributors as a way of showing gratitude toward them for their donations. Upon review of the publications and the organization's website it appears that the organization does solicit advertisement and receives substantially all of its income (approximately \$ from the sales of advertising space in the periodicals (see discussion in Alternative Issue #2).

The assets and liabilities were reported on Form 990 as follows:

	<u>FY</u>	
Cash	\$	
Accounts payable and accrued expenses	\$	
Accounts Payable and accrued expenses of \$		consist of:
Development/Creation Fee expenses (Including % interest)	\$	
Loans (Including % interest)	\$	
Royalties (. % of Gross Revenues)	\$	
Automobile mileage reimbursement (\$. /mile)	\$	
Lease of personal aircraft (\$. hour)	\$	
Lease of equipment (\$. month)	\$	
Salary	\$	

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Commissions (10% of Gross Revenue) \$
 Total \$

Accounts Payable and accrued expenses of \$ are all payable to FOUNDER. Per discussion with FOUNDER, none of this amount has been paid back to him. He stated that amounts will be paid back to him when the organization is more financially stable. IDR-03 requesting documentation to verify Accounts Payable and accrued expenses of \$ was sent to the organization on April.. The organization has not provided the requested documentation to substantiate this balance.

The following is a detail of each accrued expense:

1. **Development/Creation Fee Expenses** - Development/Creation Fee expenses of \$ have been accrued to FOUNDER for the start up of the organization. FOUNDER is also accruing 10% interest on these Development/Creation Fee Expenses. Requested documentation relating to these expenses has not been received to substantiate these expenses.
2. **Loans (Including 10% interest)** - FOUNDER is accruing 10% interest on loans he has made to the organization. FOUNDER has been unable to provide any documentation regarding the amount he has loaned to the organization or approval by the board for the organization to pay FOUNDER 10% interest on these loans.
3. **Royalties and Commissions** - FOUNDER is accruing Royalties of 5% and Commissions of 10% from the gross revenue of the organization. Requested documentation relating to approval by the board of directors or approval in the organization's minutes has not been provided to substantiate FOUNDER in accruing these amounts.
4. **Automobile Mileage Reimbursement** - FOUNDER is accruing mileage reimbursement expenses at \$.50 per mile. Currently the mileage reimbursement that is approved by the Internal Revenue Service is \$.405. Requested documentation has not been provided to substantiate these mileage reimbursement expenses nor for the purposes of claiming it.
5. **Lease of personal aircraft** - FOUNDER is leasing his personal aircraft to the organization at the rate of \$ per hour. Requested flight logs have not been provided to substantiate this amount nor for the purposes of claiming it.
6. **Lease of equipment** - FOUNDER is leasing equipment to the organization at the rate of \$630 per month. Requested detail and use of equipment being leased have not been provided to substantiate this amount nor for the purposes of claiming it.
7. **Salary** - FOUNDER is accruing himself a salary of \$ a year. Documentation relating to the following facts has not been obtained from FOUNDER:
 - The compensation was approved by an authorized body of the organization.
 - The authorized body obtained and relied upon appropriate data as to comparability prior to making its determination.
 - The authorized body adequately documented the basis for its determination

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After numerous requests for records and documentation relating IDR-03 to verify balances in the Accounts Payable and Accrued Liabilities account, the organization does not appear to have any records to support amounts reported as Accounts Payable and Accrued Liabilities.

LAW:

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

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

Income Tax Regulation 1.501(c)(3)-1(c)(1) states, "Primary Activities. 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 section 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. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization. The term "private shareholder or individual" is defined in regulation section 1.501(a)-1(c).

Regulation section 1.501(c)(3)-1(d)(1)(ii) provides 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 subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests

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such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Income Tax Regulation 1.501(c)(3)-1(d)(3) defines Educational as, "In general. The term 'educational', as used in section 501(c)(3), relates to: (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) The instruction of the public on subjects useful to the individual and beneficial to the community. An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion".

Revenue Ruling 67-4 holds that an organization engaged in publishing may qualify for exemption under section 501(c)(3) of the Code if (1) the content of the publication is educational, (2) the preparation of the material follows methods generally accepted as educational in character, (3) the distribution of the materials is necessary or valuable in achieving the organization's exempt purposes, and (4) the manner in which the distribution is accomplished is distinguishable from ordinary commercial publishing practices.

Revenue Ruling 60-351 ruled that a corporation organized for the primary purpose of publishing a magazine was not an exempt charitable, scientific, literary or educational organization within the meaning of section 501(c)(3) of the Internal Revenue Code. Although the magazine was printed in a foreign language and may provide some materials unlike those in other magazines, there is no showing that the operations fulfill a corporate role which in and of itself is exclusively charitable, scientific, literary or educational. The mere fact the corporation is not organized for the profit of its members does not remove the necessity for the corporation to bear its burden of proof to a right to exemption.

Revenue Ruling 77-4 ruled that a nonprofit organization, whose only activities are preparing and publishing a newspaper of local, national, and international news articles with an ethnic emphasis, soliciting advertising and selling subscriptions to that newspaper in a manner indistinguishable from ordinary commercial publishing practices, is not operated exclusively for charitable and educational purposes and does not qualify for exemption.

In Better Business Bureau v. United States, 326 U.S. 279 (1945) the court held that regardless of the number of truly exempt purposes, the presence of a single substantial non exempt purpose will preclude exemption under section 501(c)(3) of the Code.

In Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash. 1981), net profits were found to inure to private individuals where refreshments, goods and services amounting to \$ (representing some 8% of gross revenues) were furnished to members.

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Regulation section 1.6001(a) states in part that organizations, "...shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such persons in any return of such tax or information."

Regulation section 1.6033-2(i)(2) states, "Every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (section 501 and following), chapter 1 of subtitle A of the Code, section 6033, and chapter 42 of subtitle D of the Code."

Revenue Ruling 59-95 provides that a failure to file required information return or comply with the provision of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status.

In Church of Gospel Ministry vs. United States, 640 F. Supp 96, the court ruled that a failure to keep and present accurate and adequate records prevented the Church from meeting its burden of showing that its operations were primarily for charitable purposes and did not inure to the private benefit of its officers. The court also stated that, "...the lack of adequate records or receipts...makes it impossible for CGM to establish that it is not being operated for the private benefit of its members and provides independent grounds for rejecting its claim to tax-exempt status."

GOVERNMENT POSITION:

The ORG. is not operated exclusively for 501(c)(3) purposes as defined by the Internal Revenue Code and the Regulations. The organization's primary activity is publishing their quarterly magazine titled "PUBLICATION" which are dedicated more for entertainment and advertising purposes rather than for educational purposes. Based on review of the Publications showed the educational content occupied an average of 5% of the publication compared to advertisements of 25% and entertainment of 70%. The organization's primary activity is to prepare a magazine which is dedicated primarily to travel and entertainment activities, soliciting advertising, and selling subscriptions. Thus the organization does not qualify for exemption since it is operating more in the manner of commercial purposes rather than operating exclusively for charitable and educational purposes.

The organization has not provided any documentation to substantiate the amount of \$ reported in Accounts Payable and Accrued Liabilities. It cannot be determined that the fees charged by FOUNDER to the organization are reasonable because FOUNDER has not provided substantiating documentation for these transactions. In addition, the interest rates FOUNDER is charging, the 10% interest rate on the Development/Creation Fee Expenses, the

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H
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Total

\$.

A review of the periodicals showed that 2 out of 3 companies listed above contained advertisements in the periodicals. The percentage of companies that paid for advertising services in "PUBLICATION" was approximately 62% from the list above.

A significant portion of the periodicals were dedicated to advertisements. Per discussion with FOUNDER, he stated the organization does not charge for advertising but is given to certain contributors as a way of showing gratitude toward them for their donations. Upon review of the publications and the organization's website it appears that the organization does solicit advertisement.

LAW:

Internal Revenue Code Section 512 (a)(1) states, "Except as otherwise provided in this subsection, the term 'unrelated business taxable income' means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b)."

Income Tax Regulation 1.512(a)-1(f) states, "Determination of unrelated business taxable income derived from sale of advertising in exempt organization periodicals. (1) In general. Under section 513 (relating to the definition of unrelated trade or business) and §1.513-1, amounts realized by an exempt organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business activity involving the exploitation of an exempt activity, namely, the circulation and readership of the periodical developed through the production and distribution of the readership content of the periodical."

GOVERNMENT POSITION:

Most, if not all of the income received as reportedly as contributions are actually income from placing ads in the magazine. Advertisements that were noticed during the review of the publications are determined to be Unrelated Business Income per Internal Revenue Code Section 513. Advertisements were solicited by the organization through their publications and website.

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All amounts received by contributors who have advertisement space in the organization's publications will be treated as Unrelated Business Income.

CONCLUSION:

Accordingly, the ORG. should file Form 990-T for the unrelated business income received from the sales of advertising.