



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: 200712045
Release Date: 3/23/07
Date: August 15, 2006

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Uniform Issue List:

501.03-00

509.01-01

Legend:

A =

M =

N =

Dear :

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

You were formed by a declaration of trust pursuant to the laws of the state in which you are located.

In your application, you indicate that you were formed to provide financial support to the organizations identified in your trust document. You are requesting classification as an organization described in section 509(a)(3) of the Code based on your relationship with A. You assert that A is an organization recognized as exempt from federal income tax under section 501(c)(3) and is classified as a publicly supported organization. Schedule A of the Trust Agreement specifies additional publicly supported organizations you may support.

You are funded by contributions from your founders, M and N, along with interest and investment income.

~~You are governed by five directors. M and N serve as directors. M also serves as your sole trustee. A appoints the remaining three directors. Two of the directors appointed by A are joint owners with M and N of a limited liability corporation ("LLC").~~

Section 2.3 of the Trust Agreement provides that if A is no longer a qualified charity, your governing board will select an alternate. Further it provides that M and N reserve the right to change the supported 501(c)(3) tax exempt organization to another 501(c)(3) tax exempt organization, at any time and for any reason, if they deem it, in their sole and absolute discretion, to be in your best interest.

Section 2.4 of the Trust Agreement provides that in the event of termination, your assets will be distributed to "such organization or organizations as described in Section 170(c)(2) of the Code" as the Trustee, in his total and complete discretion, shall determine.

Section 2.5 of the Trust Agreement provides that upon dissolution, your remaining assets shall be "distributed to a non-profit fund, foundation, or corporation which is" tax exempt under section 501(c)(3) of the Code. Further, it provides, that in the event you are not recognized as described in sections 501(c)(3) and 509(a)(3), your assets shall be distributed to M and N.

Section 2.6 of the Trust Agreement provides, in pertinent part that M, as your Trustee, is authorized to:

- a. Retain any asset originally or later contributed whether or not such asset is of a character permissible for investment by fiduciaries;
- b. Retain and purchase assets notwithstanding the lack of diversification of the trust assets;
- c. Retain, purchase, sell or exchange any and all stocks, bonds, notes or other securities or any variety of real or personal property including stocks or interest in investments or mutual funds (including any of said items of or maintained by the Trustee);

- d. ~~Change the situs of the trust and of any property which is~~ part of the trust to any place in the United States or any other country, and,
- e. Make distributions of principal or income in kind.

Section 2.7 of the Trust Agreement provides that the Trustee may be removed by written notice signed by at least two board members, one of whom must be M or N.

Your application states that your founders contributed _____ to you in _____. In that same year, you earned interest income, had a net gain from an unidentified sale and a loss from an unspecified activity.

You provided a copy of an unsigned and undated Promissory Note indicating that you loaned M and N _____. Based on information you submitted, it appears that the loan was made in _____. The Promissory Note does not indicate when periodic payments are due, when the loan must be paid in full, or the collateral used to secure the loan. Although you represent that "real estate" was used as collateral, you did not provide a description of the property used as collateral, a valuation of the property, or documents indicating that such collateral was provided. Further, you have failed to produce documents indicating the property you claim was used as collateral is encumbered as a result of the loan.

The amount you loaned to M and N constituted _____ of your total assets.

In _____, you distributed _____ to A. In response to our request for information regarding your _____ and _____ distributions, you referred to documents which do not contain that information. Accordingly, we are assuming that you did not make any distributions in _____ and _____. The funds you distributed to A in _____, were not earmarked for any particular activity or program.

Although requested, you did not provide financial information regarding A for any year other than _____ and _____. A's income was _____ in _____ and _____ in _____. Accordingly, we are assuming that A's income in _____ was at least _____.

You state that you were formed to support A. All of your distributions to date, other than the loan to your founders, have been to A. In a letter dated October 12, 2005, regarding another supporting organization which he represents, your attorney indicates, "In regards to your request for information for the cases that I am handing (*sic*) for clients I think that you should be aware that A is no longer going to be the supported organization and that before the end of this calendar year A will be closed." However, in his undated response with respect to you which was received in this office on November 18, 2005, your attorney makes no mention of the fact that A will be dissolved and continues to refer to it as the organization you will support.

~~You have failed to provide information evidencing that the funds you distributed to A~~
were used for a charitable purpose.

501(c)(3):

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) provides in pertinent part, that an organization must be organized and operated exclusively for religious, charitable, or educational purposes and no part of its net earnings may inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order for an organization to be exempt under section 501(c)(3) of the Code it 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 or operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. Further, it provides that an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

Section 1.501(c)(3)-1(c)(1) of the 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 such exempt purposes specified in section 501(c)(3) of the Code. 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 the regulations 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(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization must be organized and operated to serve a public rather than a private interest and specifically 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. 67-5, 1967-1 C.B. 123, the Service found that an organization controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the organization. The organization owned common stock of a corporation controlled by the organization's creator and his family. The corporation paid no dividends. The Service held that the foundation was operated for a substantial non-exempt purpose and served the private interest of the creator and therefore, was not entitled to exemption under section 501(c)(3) of the Code.

The "not more than an insubstantial part of its activities" standard of section 1.501(c)(3)-1(c)(1) of the regulations can be understood by reference to Better Business Bureau v. United States, 316 U.S. 279 (1945) which held that an organization which engaged in some educational activity but pursued nonprofit goals outside the scope of the statute was not exempt under section 501(c)(3) of the Code. The Court stated that an organization is not operated exclusively for charitable purposes if it has a single noncharitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. Thus, the operational test standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations which further goals outside the scope of section 501(c)(3).

In Best Lock Corporation v. Commissioner, 31 T.C. 620 (1959), the court upheld the denial of recognition of section 501(c)(3) status of an organization that loaned funds to members of the founder's family, even though the loans were repaid. The court determined that loans to family members and unsecured loans to friends of the founder and his family promoted private rather than charitable purposes.

In Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969) and in Church in Boston v. Commissioner, 71 T.C. 102 (1978), the courts found that the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement.

-Rationale-

Section 2.5 of your Trust Agreement provides that if you are not recognized as an organization described in section 501(c)(3) and 509(a)(3) of the Code, upon dissolution your assets will be distributed to the family of M and N. Thus, if you were recognized as an organization described in section 501(c)(3) but were classified as an organization described in other than 509(a)(3), your assets could be distributed to the your founders or their family. Accordingly, you do not meet the requirements of section 1.501(c)(3)-1(b) of the regulations since you fail to satisfy the requirements of section 1.501(c)(3)-1(b)(4).

M and N serve as two of your five directors. M and N indirectly control you by virtue of their substantial influence over the two directors who are their business partners. Thus, M and N have indirect control of your assets and operations. M and N's control is evidenced by the fact that they caused you to make a unsecured loan to them. You have failed to show that M and N qualified for the loan, that they have made timely payments regarding the loan, that there is a due date on the loan, and that there was adequate collateral. Further, you have failed to establish that this loan furthers your charitable purpose.

Like the organization described in Rev. Rul. 67-5, supra, through their indirect control over you, M and N caused you to engage in financial activities that were beneficial to them but detrimental to you. See also Best Lock Corporation, supra, loans to family members might be considered made for personal purposes regardless of whether they are repaid; Founding Church of Scientology v. United States, supra, and Church in Boston v. Commissioner, supra, the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement.

An organization must establish that it operates exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3) if it has a single non-charitable purpose that is substantial in nature. An organization is not operated exclusively for exempt purposes if its net earnings inure in whole or in part to the benefit of private individuals. See Better Business Bureau v. United States, supra.

You were formed to operate for the benefit of M and N. Thus, your primary purpose results in private benefit and inurement to M and N. Accordingly, you serve a private rather than public purpose.

Based on the information provided in your Form 1023 and supporting documentation, we conclude that you are not operated exclusively for purposes described in section 501(c)(3) of the Code. You have not shown that your assets do not inure to any private individual. In fact, your application demonstrates you operate for the benefit of M and N.

Section 509(a)(3):

Law

Section 509(a) of the Code defines the term "private foundation" as an organization described in section 501(c)(3) other than organizations described in section 509(a)(1), (2), (3), or (4). Section 509(a)(3) provides that the term "private foundation" does not include an organization that:

(A) is organized and operated exclusively for the benefit of, to perform the function of, or to carry out the purposes of one or more organizations described in section 509(a)(1) or (2);

(B) is operated, supervised or controlled by, or in connection with, one or more organizations described in section 509(a)(1) or (2);

(C) is not be controlled, directly or indirectly, by one or more persons who would be disqualified persons as defined in section 4946 if the organization were a private foundation, other than foundation managers as defined in section 4946(a)(1)(B) and organizations described in section 509(a)(1) and (2).

Section 1.509(a)-4(c)(1) of the regulations provides that an organization is organized exclusively for one or more purposes specified in section 509(a)(3)(A) of the Code only if its articles of organizations: (i) limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A); (ii) do not expressly empower the organization to engage in activities which are not in furtherance of purposes set forth in section 509(a)(3)(A); (iii) state the specified publicly supported organizations; and (iv) do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations stated in its articles of organization.

Section 1.509(a)-4(e)(1) of the regulations provides that a supporting organization must engage solely in activities that support or benefit the specified publicly supported organizations. These activities may include making payments to or for the use of, providing services or facilities for, individual members of a charitable class benefited by the publicly supported organizations. With respect to permissible beneficiaries, that section of the regulations provides, in pertinent part, that an organization will be regarded as "operated exclusively" to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations.

Section 1.509(a)-4(j)(1) of the regulations provides that an organization will be considered "controlled," for purposes of section 509(a)(3), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of a substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization. Thus, if the governing body of a foundation is composed of five trustees, none of whom has veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered controlled, directly or indirectly, by one or more disqualified persons by reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting right with respect to stocks in which members of the governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

Rev. Rul. 80-207, 1980-2 C.B. 193, held that an organization with a 4-person-board consisting of a substantial contributor and two employees of a corporation owned (over 35 percent) by the substantial contributor was indirectly controlled by disqualified persons and was not a supporting organization under section 509(a)(3) of the Code. The Service stated that because one of the organization's directors was a disqualified person and neither the disqualified person nor any other director had a veto power over the organization's actions, the organization was not directly controlled by a disqualified person under section 1.509(a)-4(j) of the regulations. However, in determining whether an organization is indirectly controlled by one or more disqualified persons, one circumstance to be considered is whether a disqualified person is in a position to influence the decisions of members of the organization's governing body who are not themselves disqualified persons.

Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274 (7th Circuit, August 15, 1979), affirming the Tax Court at 70 T.C. 182 (May 8, 1978), holding that the organizational test was not satisfied where the trustee had the power to substitute beneficiaries when, in the judgment of the trustee, the uses of the named beneficiaries became unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public.

Rationale:

ORGANIZATIONAL TEST

Section 2.3 of your Trust Agreement grants M, as Trustee, the right to substitute "another 501(c)(3) tax exempt organization" for the specified publicly supported organization. Section 2.4 and 2.5 of your Trust Agreement provide that upon dissolution your assets may be disbursed to organizations other than the specified publicly supported organizations.

You are not organized to benefit one or more specified publicly supported organizations. Pursuant to sections 1.509(a)-4(c)(1)(iii) and (iv), an organization's governing instrument must state the specified publicly supported organization(s) on whose behalf the organization is to be operated and cannot expressly empower the organization to support or benefit any organizations other than the specified publicly supported organization(s).

M may, in his sole discretion, change the specified publicly supported organization to another organization described in section 501(c)(3) at any time and for any reason. The substituted organization is not required to be one of the organizations specified in the Trust Agreement nor is it required to be a publicly supported organization. Further, your dissolution clause allows distributions to organizations other than the specified publicly supported organizations upon termination. Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274 (7th Cir. 1979) (holding that the organizational test was not satisfied where the trustee had the power to substitute beneficiaries when, in the judgment of the trustee, the uses of the named beneficiaries became unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public).

Accordingly, you do not meet the organizational test.

OPERATIONAL TEST

The Trust Agreement permits you to operate for other than permissible beneficiaries. It allows you to support organizations other than those specified in the Trust Agreement. The organizations are not required to be other than private foundations which are operated, supervised, or controlled directly by or in connection with the specified publicly supported organizations.

In _____ you expended more than _____ % of your assets to satisfy M and N's need for a loan. You did not meet the operational test in that year since you do not engage solely in activities that support or benefit A. In _____ and _____ you failed to meet the operational test since you have not established that distributions were made to A in those years.

Thus, you failed to meet the operational test. Furthermore, in accordance with your attorney's letter, A, the organization you claim to support, no longer exists. See section 1.509(a)-4(e)(1) and (2) of the regulations.

CONTROL TEST

M and N, who serve as your directors, are substantial contributors and disqualified persons with respect to you as defined by section 4946 of the Code. Two of your five directors are joint owners of an LLC with M and N. As a result of this business relationship, M and N have substantial influence over those directors. Accordingly, M and N indirectly control you. See Rev. Rul. 80-207 regarding the disqualified person's ability to influence the decisions of members of the governing board who are not disqualified persons.

In addition to M and N's influence over two of your directors, M, acting as your sole Trustee, indirectly controls you through the powers granted to him in your Trust Agreement. M, as your sole Trustee and in his sole discretion, has the authority to:

1. Change the publicly supported organization at anytime and for any reason.
2. Determine which organizations will receive your assets in the event you dissolve.

- ~~3. Control your investments since he determines which of your assets will be retained, sold or exchanged and whether assets will be purchased.~~
4. Determine when distributions of principal or income will be made.

Further, M can only be removed as Trustee if he or N agrees.

Based on the following analysis of the information provided in your Form 1023 and supporting documentation, we conclude that you are not a supporting organization. You have not established that you meet the requirements of section 509(a)(3). You have not established that you are organized and operated exclusively for the benefit of specified publicly supported organizations. You have failed to establish that you have a sufficient relationship with specified publicly supported organizations. Finally, you have not established that disqualified persons do not control you.

Conclusion:

Based on our analysis of your activities and, in light of the applicable law, we have determined you do not qualify for tax exemption as an organization described in section 501(c)(3) of the Code. Even if we determined that you were described in section 501(c)(3), you would be a private foundation and not a supporting organization under section 509(a)(3) of the Code. You must file federal income tax returns.

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

You have the right to protest this ruling if you believe it is incorrect. To protest, you should 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.

Your protest statement should be accompanied by the following declaration:

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

~~You also have a right to request a conference to discuss your protest. This request~~ should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see 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 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 this address:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:x)

1111 Constitution Ave, N.W.
Washington, DC 20224

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,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: December 26, 2006

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Form 1065

Tax Years:

All

Dear _____ :

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(3).

We make our ruling for the following reason(s):

You have failed to establish that you are organized and operated exclusively for purposes described in section 501(c)(3) of the Code. Furthermore, you have failed to establish that you will not serve private interests. Your earnings inured to the benefit of private persons and shareholders.

Donors may not deduct contributions to your organization under section 170 of the Code.

We also rule that, even if you did qualify under section 501(c)(3) of the Code, you would be classified as a private foundation. This ruling is made for the following reasons:

You are not a supporting organization described in section 509(a)(3) of the Code because you have failed to establish that you meet the requirements under section 509(a)(3)(A), (B), and (C) of the Code and Treas. Reg. section 1.509-4(d)(j).

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. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia before the

91st day after the date that we mailed this letter to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Filing a declaratory judgment suit under Code section 7428 does not stay the requirement to file returns and pay taxes.

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.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

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 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,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

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