

Number: 200736031  
Release Date: 9/7/2007

Legend:

Org = Name of Organization  
Num = EIN Number  
Date1 = Effective Date

December 7, 2006

UIL: 501.03-01

Org

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

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT: \_\_\_\_\_

Dear \_\_\_\_\_ :

This is a Final Adverse Determination Letter as to the Org's exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

Org. has not been operating exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). \_\_\_\_\_ also is not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. You operate substantially for a non-exempt purpose, for private benefit, and its earnings inure to the benefit of private individuals.

Based upon these reasons, we are retroactively revoking your IRC section 501(c)(3) tax exempt status to Date1.

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 December 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 91<sup>st</sup> 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 writing to: Internal Revenue Service, Taxpayer Advocates Office, Local Office. 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

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.

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:

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,

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

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

**Legend:**

Org = Name of Organization  
State = State of Incorporation  
Date1 = Date of Incorporation  
Date2= Effective Date  
Founder = Name of Founder

**ISSUES**

The primary issue is the continuation of ORG as an exempt 501©(3) organization. The basis for revocation would be ORG.'s failure to meet the requirement of this subdivision due to its inability 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.

**FACTS**

ORG. Was Incorporated in the State in Date1. It applied for and received recognition as a 501© (3) not for profit organization. It has operated as such since that time. Org was founded as an educational organization. The stated purpose of this organization is as follows:

"The purpose for which this corporation is formed is for educational and literary purposes as a non-profit organization; and its plan of operation is to develop, organize and conduct training and professional development courses, seminars and other type meetings in a variety of topics and areas."

The Articles of Incorporation state in Article IV that "The initial Board of Directors shall consist of three persons. Thereafter, the number of directors constituting the entire Board shall be no less than three." Currently, the organization has only two Board members. The organization is controlled by Founder. The Founder are the only Board members and officers of this organization. The Founders are husband and wife.

This organization does not have a conflict of interest policy. The Board and Officers are made up of only the Founders. The Founders have not recused themselves from any decisions where a conflict of interest has existed.

Mr. Founder is the sole shareholder of a for profit corporation. The name of this corporation is Org Inc. A contract exists between ORG. and Org, Inc. This contract calls for % of the net profits of ORG. to be paid to Org, Inc. for facilitating and managing the operations of ORG. Orgs most significant source of revenue ( %) is that which is received form ORG.

The Founders are the only employees of ORG. and the only employees of Founder. The Founders were the only parties to the negotiation of this arrangement. This arrangement was not negotiated at arms length.

**LAW**

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
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Organizations described in section 501(c)(3) are exempt from federal income taxation under section 501(a). Included among the organizations described in section 501(c)(3) are those organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation and which do not participate or intervene in any political campaign on behalf of any candidate for public office.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for charitable purposes unless it serves a public rather than a private interest. Accordingly, the Regulations provide, "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 organizations, or persons controlled, directly or indirectly, by such private interests." See Final Reg. and IRC below.

**FINAL-REG, 2005FED ¶22,608, §1.501(c)(3)-1., Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals**

(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

**IRC, 2005-CODE-VOL, SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.**

**501(c)(3)** 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 provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

In addition to the Regulations and Code, there are numerous court cases where this principle has been upheld. See below.

In *Gemological Institute of America, Inc.*, 17 TC 1604, Dec. 18, 1968. *Aff'd per curiam*, CA-9, 54-1 USTC ¶9339, 212 F2d 205, a nonprofit school that conducted courses in gemology was held not to be tax exempt where it paid a director, who was one of the founders and the most important employee, a yearly salary and an amount equal to 50% of the school's profits. It was held that, regardless of whether these amounts were called salary or compensation based on earnings, it was obvious that half of the net earnings inured to the benefit of an individual, the director.

In *John Marshall Law School*, CtCl, 81-2 USTC ¶9745, an organization that operated a law school and university did not qualify as an exempt organization because a portion of the organization's net earnings inured to the benefit of the private individuals who operated the organization and to their families.

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In *International Postgraduate Medical Foundation*, 56 TCM 1140, Dec. 45,443(M), TC Memo. 1989-36, an organization which sponsored medical education seminars for physicians did not qualify as a tax-exempt organization because it was mainly operated for a non-exempt purpose. The organization's founder exercised his control over the operations to benefit a for-profit travel agency, of which he was president and shareholder, through his exclusive use of the agency for all seminar travel arrangements.

In *Bill Wildt's Motorsport Advancement Crusade*, 56 TCM 1401, Dec. 45,520(M), TC Memo. 1989-93, a motorsport organization's request for exemption from taxation was properly denied, since it failed to carry its burden of showing that it was operated exclusively for exempt purposes or that its net earnings did not inure to the benefit of private individuals.

In *Church by Mail v. Commissioner*, 765 F. 2d 1387 (9<sup>th</sup> Cir. 1985), *aff'g* TCM 1984-349 (1984), the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated:

*"The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."*

## **TAXPAYER POSITION**

The Service's position was presented to the Director's of ORG. and their counsel. The Director's of ORG. and their counsel accept the Service's position.

## **SERVICE POSITION**

The Service's position is that this organization does not operate for a public benefit, but rather for private benefit. IRC 501©(3) states that no part of the net earnings of a 501©(3) organization can inure to the benefit of any private shareholder or individual.

The Service's position is that the payment of % of the earnings of ORG. to a corporation closely held by the Director, establishes that ORG. operates for a substantial non exempt purpose. This is especially true since this arrangement was not an arms length negotiation.

## **CONCLUSION**

ORG does not operate for public benefit. Classification as a 501(c)(3) organization should be revoked as of .Date2