



**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street  
Dallas, TX 75424**

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

Number: **200749026**  
Release Date: 12/7/2007

September 10, 2007

UIL: 501.03-01

ORG

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

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

Inurement and/or private benefit of an IRC Section 501(c)(3)'s assets in any form or amount is prohibited. ORG has not been operating exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). ORG 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 members of the organization.

You failed to meet the requirements of IRC section 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for the benefit of your members by providing insurance benefits similar to a mutual benefit association which is not a charitable activity.

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, 20XX, and for all years thereafter.

1100 Commerce Street Dallas, TX 75242

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 calling:

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

Attachment:  
Form 886-A

**Internal Revenue Service**

**Department of the Treasury**

TE/GE Division

Date:

Taxpayer Identification Number:

Form:  
990

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, please sign and return the enclosed Form 6018, Consent to Proposed Adverse Action. We will send you a final modification or 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:

Oakland Area Office  
1301 Clay Street, Suite 1540S  
Oakland, CA 94612-5210  
Phone: (510) 637-2703  
Fax: (510) 637-2715

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,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number Num	Year/Period ended 20XX12

**LEGEND:**

ORG = Name of Organization      Translator = Name of Person      Num = EIN  
 ABC Org = Contract Entity      City1 = Name of City      City2 = Name of City  
 People FC = Custom, Traditions of People

**Issue:**

Should the organization's tax exempt status under section 501(c)(3) of the Internal Revenue Code be revoked due to the lack of exempt activity under section 501(c)(3)?

**Facts:**

The ORG received tax exempt status from the Department of the Treasury on August 21, 19AA under section 501(c)(3) of the Internal Revenue Code. The organization's copy of the determination letter was the organization's initial determination letter:

Based on information supplied, and assuming your operations will be as stated in your application for recognition of exemption, we have determined you are exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

Because you are a newly created organization, we are not now making a final determination of your foundation status under section 509(a) of the Code. However, we have determined that you can reasonably be expected to be a publicly supported organization described in section 509(a)(1) – 170(b)(1)(A)(vi). Accordingly, you will be treated as a publicly supported organization, and not as a private foundation, during an advance ruling period.

The initial determination letter included a clause that informed the organization that, "if your sources of support, or your purpose, character, or method of operation change, please let us know so we can consider the effect of the change on your exempt status and foundation status."

A copy of the organization's administrative file was unavailable. Therefore, reliance was made on the determination letter that the organization passed the organizational test as an exempt organization under section 501(c)(3) of the IRC and a public charity under sections 509(a)(1) and 170(b)(1)(A)(vi) of the IRC.

From a review of a copy of the ORG's bylaws that were translated from Chinese to English by Translator on February 7, 19GG it was determined that the organization was formed with the goal of being a non-profit assistance organization:

Our Association is a non-profit, non-political, and non-religious community benevolent organization, its goal is to promote the principle of unity and assistance among ourselves, to develop sincere and cordial hometown friendship among our kinfolds in the United States. Also to help new immigrants to quickly adapt to the new environment and

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lives her, to encourage the preservation of fine Chinese traditions and the long standing morality and customs of the People FC.

The stated purpose in the bylaws is charitable in nature and qualifies it from exempt status under section 501(c)(3) of the Internal Revenue Code. No unusual clauses were noted in the bylaws. The bylaws describe policies and procedures consistent with those of other charitable organizations. It was noted that the bylaws did not contain the powers and dissolution clauses, which are necessary for 501(c)(3) organizations, but since the admin file was unavailable, it could not be determined if they were present in the articles.

During the examination of the 20XX12 tax year, it was determined that the only activity of the organization was to act as a mutual benefit association. This means that the organization charges its members a fee each time a member dies in order to make a death benefit payment to the family of the deceased member. The current process of determining the amount of the benefit and the amount charged to the current members is written out on the organization's contract with the ABC Org.

The contract stipulates that members are not eligible for benefits until they've been a member of the organization over six months if they are between the ages of 55 and 75, twelve months if they are between the ages of 76 and 80, and twenty-four months if they are over the age of 81. The contract only limits its membership by age restrictions. The organization does not limit its membership to class of charitable recipients. The contract also specifies that the association will collect \$8 from all members from both associations when the death certificate of the member is received. The City1 association charges its members that have less than ten years with the organization \$10 per fatality from its local members, but only \$8 for the death of a City2 member. In addition, the City1 association charges a 7% administration fee before paying the benefit to the deceased member's family of its own members, not to the City2 association. The expenses and administration of the two associations are handled separately.

**EXAMPLE 1:**

If the organization had a City1 member die when there were 247 City2 members, of whom 152 members had tenure, and 290 City2 members still present, the death benefit calculation would be as follows:

$(152 + 290) \times \$8$	=	3,536
$95 \times \$10$	=	<u>950</u>
		4,486
Less admin: $(0.07 \times \$4,486)$	=	<u>(314)</u>
Benefit Paid	=	4,172

**EXAMPLE 2:**

If the organization had a City2 member die when there were 247 City2 members, of whom 152 members had tenure, and 290 City2 members still present, the death benefit calculation would be as follows:

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247 x \$8	=	1,976
290 x \$8	=	<u>2,320</u>
Benefit Paid:		4,296

**Law:**

Internal Revenue Code section 501(c)(3) defines organizations exempt under this code section as 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.

Treasury Regulation section 1.501(c)(3)-1(d)(1) states that in general:

(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.

(iii) Since each of the purposes specified in subdivision (i) of this subparagraph is an exempt purpose in itself, an organization may be exempt if it is organized and operated exclusively for any one or more of such purposes. If, in fact, an organization is organized and operated exclusively for an exempt purpose or purposes, exemption will be granted to such an organization regardless of the purpose or purposes specified in its application for exemption. For example, if an organization claims exemption on the ground that it is "educational", exemption will not be denied if, in fact, it is "charitable".

United States Tax Court *102 T.C. 745* Filed June 14, 1994 explains that organizations that provide commercial type insurance activities are not exempt under section 501(c)(3) of the Internal Revenue Code:

Section 501(m), as currently written, was added to the Code by section 1012(a) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, 2390-2391. The House Ways and Means Committee report strongly indicates that Congress intended a broad definition of the term "commercial-type insurance" when it added the current version of section 501(m). See H. Rept. 99-426, at 662-665 (1985), *1986-3 C.B. (Vol. 2) 1, 662-665*. Pertinent portions of the House Report read as follows:

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**2. Taxation of Tax-Exempt Organizations Engaged in Insurance Activities (sec. 1012 of the bill and sec. 501(m) of the Code)**

**Present Law** – The providing of insurance benefits by an organization otherwise described in sec. 501(c)(3) generally is considered a commercial activity that does not meet the requirements for tax-exempt status. For example, *if two or more unrelated tax-exempt organizations pool funds for the purpose accumulating and holding funds to be used to satisfy malpractice claims against the organizations, the organization holding the pooled funds is not entitled to tax exemption because the activity (i.e., the provision of insurance) is inherently commercial in nature.*

**Reasons for Change** – The committee is concerned that exempt charitable and social welfare organizations that engage in insurance activities are engaged in an activity whose nature and scope is so inherently commercial that tax exempt status is inappropriate. The committee believes that *the tax-exempt status of organizations engaged in insurance activities provides an unfair competitive advantage to these organizations.* The committee further believes that the provision of insurance to the general public at a price sufficient to cover the costs of insurance generally constitutes an activity that is commercial.

**Explanation of Provision** – Under the bill, an organization described in sections 501(c)(3) and (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance. For this purpose, no substantial part has the meaning given to it under present law applicable to such organizations.

**Government's Position:**

The government contends that the organization does not qualify for exemption since the operation of its mutual benefit association is not a charitable activity described under section 501(c)(3) of the IRC. As noted above, an organization that operates for the benefit of private interests, such as designated individuals, by definition does not operate exclusively for exempt purposes.

In a member benefit fund supported by the members themselves where benefits are awarded in the event of death, illness, or disability, without regard to financial distress, the organization is a sort of mutual benefit association, not a charity. This form of self-help serves the interests of the members, which is not a public purpose.

A charitable organization must be set up for the benefit of an indefinite class of individuals, not for specific persons. A corporation organized and operated for the benefit of specific individuals is not charitable. Thus, an organization to benefit the members of the ORG is not a charitable organization even though the facts may show that some members are impoverished.

**Taxpayer's Position:**

The organization did not have a stated position as of the time of the draft report.

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**Conclusion:**

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked as of January 1, 20XX.

Please note that this is not a final report. This draft report is subject to review and modification by our review staff. You will receive the final report from review.