



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TE/GE – EO Mandatory Review  
1100 Commerce Street, MC 4920-DAL  
Dallas, TX 75242

Release Number: **200840049**

Release Date: 10/3/08

Date: June 25, 2008

UIL Code: 501.03-01

Legend

ORG = Organization name

ORG

ADDRESS

XX = Date

Address = address

Employer Identification Number:

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer To:

TE/GE Review Staff

**LAST DAY FOR FILING A  
PETITION WITH TAX COURT:**

September 23, 20XX

**Certified Mail – Return Receipt Requested**

Dear

This is a Final Adverse Determination revoking your exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

ORG has failed to provide evidence that you are currently operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). You are not a charitable organization within the meaning of Treasury Regulations 1.501(c)(3)-1(d) in that you have failed to establish that you were operated exclusively for an exempt purpose. You failed to establish that you were engaged in exempt activities, that your expenditures were for exempt purposes, and that your assets did not confer a substantial private benefit to the founder.

Based upon the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code retroactively to January 1, 20XX.

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

You are required to file Federal income tax return Form 1120. These returns should be filed with the appropriate Internal Revenue Campus for the year ending December 31, 20XX 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 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax exempt status was determined by calling, faxing or writing to: Internal Revenue Service, Taxpayer Advocates Office.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals process, 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,

Marsha A. Ramirez  
Director, EO Examinations

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b>		<b>Year/Period Ended</b>
ORG EIN		December 31, 20XX December 31, 20XX December 31, 20XX

LEGEND

ORG = Organization name      XX = Date      Address = address      XYZ = State  
City = city      Bank = bank      Founder = founder      ED-1 & ED-2 = 1<sup>st</sup> & 2<sup>nd</sup>  
Executive Director      Trustee-1 & Trustee-2 = 1<sup>st</sup> & 2<sup>nd</sup> Trustee      ESQ-1 =  
Attorney      CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7, CO-8 = 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>,  
4<sup>th</sup>, 5<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup>, & 8<sup>th</sup> COMPANIES

**ISSUE:**

Whether the ORG's tax exempt status as an organization described in section 501(c)(3) of the Code should be retroactively revoked because it is not operated exclusively for tax exempt purposes and because its net earnings inured to the private benefit of Founder, trustee and substantial contributor?

**FACTS**

**Organizing Documents**

On December 17, 20XX, Founder, formed a trust called the ORG (hereinafter called "ORG" or "trust") via a Declaration of Trust. She initially funded the trust with a deposit of \$ on December 18, 20XX. During its initial short tax year, Founder provided additional funding to the ORG in the amount of \$ on December 30, 20XX. Pursuant to the Declaration of Trust, the ORG was created for the purpose of operating "exclusively as a supporting organization within the meaning of section 1.509(a)-4(a)(5) of the Treasury Regulations."

Some of the provisions of the Declaration of Trust are as follows. Article 2.01, mandatory distribution of net income, states the ORG shall distribute 85% of its net income each calendar year as follows: (1) 33 1/3 % to the CO-1 (CO-1) for its general purposes. (2) 51 2/3 % of the net income will be distributed to one or more qualified charities for its or their general charitable purposes. These qualified charities are listed on Schedule A. Schedule A contains 155 named organizations. Article 6.02 (b) defines net income as "income as described in § 643(b) of the Internal Revenue Code, less all reasonable expenses the ORG incurs in administering the trust estate and conducting the ORG's activities."

Article 2.03 states the trustees may distribute the principal to one or more qualified charities for its or their general purposes at such times and in such amounts as determined by the trustees. The ORGs Form 1023, *Application for Recognition of Exemption*, reported its governing body on Part II, Line 4 A as follows: Founder – Trustee, City, XYZ; Trustee-1 – Trustee, City, XYZ; Trustee-2 – Trustee, City, XYZ.

Article 3.01 states there shall at all times be three trustees acting under this agreement.

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3.01(a) appointment of supported organizations – One trustee shall be appointed by CO-1. CO-1 may remove any trustee appointed by it for any or no reason. If any trustee appointed by CO-1 for any reason ceases to act, CO-1 shall appoint a successor trustee. A letter from ED-1, Executive Director of the CO-1 appointed Trustee-1 on December 12, 20XX.

3.01(b) appointment by family – one trustee shall be appointed by the members of a class composed of the grantor and grantor’s adult descendants (Grantor’s Family). Grantor’s Family may remove any trustee appointed by them for any or no reason. If any trustee appointed by the Grantor’s Family for any reason ceases to act, Grantor’s Family shall appoint a successor trustee. The act of majority of the members of the Grantor’s Family shall constitute the act of the class. This trustee is Founder.

3.01(c) appointment by Trustees – one trustee shall be appointed by the trustees appointed by the CO-1 and Grantor’s Family pursuant to the forgoing provisions of this article 3.01. Such trustees may remove any trustee appointed by them for any or no reason. If any trustee appointed by such trustees for any reason ceases to act, such trustees shall appoint a successor trustee. This trustee is Trustee-2.

3.01(d) Limitation – The composition of the trustees at all times shall be such that the ORG is not “controlled directly or indirectly by one or more disqualified persons” within the meaning of § 1.509(a)-4(j) of the Treasury Regulations.

The Declaration of Trust provides that the Trust is irrevocable and the Grantors reserve no right or power, either alone or in conjunction with others, in any capacity, to revoke the trust, in whole or in part, or to designate the persons who shall possess or enjoy the income and principal of the trust estate.

The Dissolution clause of the Declaration of Trust provides that upon termination of the ORG, the trustees shall distribute all property then comprising the trust estate, including all accumulated and undistributed income, to one or more qualified charities, for its or their general purposes.

### **Exemption Application**

The ORG filed Form 1023, Application for Recognition of Exemption, with the Service on April 16, 20XX. The contact person on the Form 1023 was ESQ-1. in City, XYZ. In Part II of the application, the ORG described its past, present and planned operations as follows:

The organization is being formed as a supporting organization which will provide funds to the publicly supported charitable organizations listed on Schedule A to the trust agreement. This organization will not perform independent charitable services other than providing funds to the named public charities.

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The ORG's response to Part II, question 2, (what are or will be the organization's source of financial support?) was the sum of \$ will be contributed by the Grantor.

The Trustees listed on Form 1023 were as follows:

Founder – Trustee, City, XYZ  
Trustee-1 – Trustee, City, XYZ  
Trustee-2 – Trustee, City, XYZ

In Part II, Question 4(d), Founder is identified by the ORG as a disqualified person within the meaning of IRC 4946.

Part IV of the application contained financial information for the initial short year of December 2, 20XX, through December 31, 20XX, and proposed budgets for the two subsequent years 20XX and 20XX. Part IV Financial Data stated:

	<u>12/XX -</u> <u>12/XX</u>	<u>1/XX -</u> <u>12/XX</u>	<u>1/XX - 12/XX</u>	<u>Total</u>
1. Gifts, Grants, and Contributions				
3. Gross Investment Income				
8. Total				
<hr/>				
15. Contributions, Gifts, Grants				
23. Total expenses				

The ORG did not clarify if the gifts, grants and contributions in line 1 of the above proposed budget would be from the general public or Founder.

Part IV, Section B listed the assets owned by the ORG during the short year of December 2, 20XX, through December 31, 20XX. The ORG reported total assets of \$, which consisted solely of cash. No liabilities were reported for 20XX.

On Schedule D of the Form 1023, question 3 (Does your organization's governing document indicate that the majority of its governing board is elected or appointed by the supported organizations?) the ORG responded negatively "No".

The ORG's response to question 4 on Schedule D (Does your organization's governing document indicate the common supervision or control that it and the supported organization?) was "Yes".

The ORG's response to Part II, line 5 (To what extent do the supported organizations have a significant voice in your organization's investment policies, in the making and timing of grants,



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and in otherwise directing the use of your organizations income or assets?) was “the primary supported organization appoints one of the three trustees, and that trustee in turn has a voice in the appointment of the third trustee. In addition, the primary supported organization must receive one third of the net income of the organization.”

The ORG’s response to Schedule D, Line 7, (what percentage of your organization’s income does it pay to each supported organization?) stated “The organization must pay a minimum of 33 1/3 of its annual income to the primary supported organization and an additional 51 2/3 percent to one of the named charities.

The application did not contain any information revealing the ORG’s December 31, 20XX, \$ loan to Founder, or any information that the proposed contributions in 20XX and 20XX would be almost immediately transferred back either in the form of a loan or as an outright distribution to Founder.

The Service recognized the ORG as an organization exempt from tax under section 501(a) as an organization described in section 501(c)(3), and classified it as a supporting organization described in section 509(a)(3), in a determination letter dated September 03, 20XX.

### **Primary Supported Organization**

The Declaration of Trust provides that the primary supported organization is the CO-1. Trustee-1 was the only trustee appointed by the primary supported organization.

### **ORG’s Deposits and Transfers**

Summoned bank records reveal that Bank account number was opened on December 18, 20XX, by Founder for the ORG with an initial deposit of \$. The bank records confirmed that the authorized signer on account number is one individual, Founder.

On December 30, 20XX, \$ was deposited into The ORG account # number with Bank. The \$ deposit was in the form of a wire transfer from Bank by CO-2 a for-profit entity owned by Founder and ED-2 (Founder is a co-founder and President of CO-2).

Subsequently, on December 31, 20XX, funds totaling \$ transferred to the ORG were distributed to Founder. Founder wrote a check to herself from the ORG’s Bank account number. The authorizing signature was Founder. After the transaction, on December 31, 20XX the Bank account had a balance of \$. The ORG provided a promissory note dated January 2, 20XX, for the loan. The note called for interest payments of 6% per year and for payments of interest only for five years. The promissory note included a short form Deed of Trust declaring property located at Address City, XYZ, parcel number as security. The Deed of Trust provided by the

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ORG was not recorded with the Assessor's County in City. Additionally, public records confirm the deed of trust was not recorded against the title of the borrower's property. The \$ loan was unsecured during all years under audit.

On October 14, 20XX, a wire transfer was made into the ORG's Bank account totaling \$ from CO-2 number. The wire transfer represents 9 months of interest at 6% on the initial \$ loan.

On December 30, 20XX, a sum of \$ was transferred into The ORG's bank account. The \$ deposit was also in the form of a wire transfer from CO-2.

On February 10, 20XX, the funds totaling \$ were distributed to Founder when she wrote a check to herself from the ORG's Bank account number. The authorizing signature was Founder. The ORG was unable to supply a loan document for this transfer. Minutes dated November 15, 20XX, reveal that "a motion was made by Trustee-1, trustee, to make a loan to Founder with terms similar to the loan made in January of 20XX."

On December 28, 20XX, \$ was transferred to the ORG via a wire transfer from CO-2. The funds were subsequently distributed to Founder. On December 29, 20XX, check number for \$, was written by Founder on behalf of the ORG to Founder. The funds were deposited into her personal Bank account number. On January 31, 20XX, Founder transferred \$ to the ORG. Check number totaling \$ was paid to the ORG from Founder's personal bank account with the memo on the check reading "Repayment of loan - error". On February 1, 20XX, the \$ was distributed to CO-2. Check # was written by Founder on behalf of the ORG to CO-2. As previously noted, Founder is the co-owner of CO-2/CO-2. CO-2 and CO-2 have the same EIN. The funds were deposited by CO-2 in Bank of XYZ.

The ORG gave the following explanation regarding the above \$ transfers:

CO-2 had a brand new CFO at that time, who made a gift to the ORG by mistake. When Founder returned from vacation on January 31, 20XX, she discovered the error and tried to rectify the situation. She was not sure how to correct the error so the transactions were reversed.

The ORG's representative did not provide a response to the Service when asked 1) how the \$ that was mistakenly transferred to the ORG ended up in Founder's personal bank account? 2) Was the \$ transfer to Founder a loan?

The ORG informed the Service that neither Founder nor CO-2 took a charitable contribution deduction for any of the \$ transfers.

Based on the bank records reviewed since its inception, the ORG received deposits from the following sources:

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<u>Date</u>	<u>Amount</u>	<u>Payer</u>			
12/18/20XX	\$.				
12/30/20XX	\$.	CO-2	Wire		
10/14/20XX	\$.	CO-2	Wire	9 mos. Interest	
12/19/20XX		CO-3	Check	erroneous	
12/23/20XX		Return item			
12/30/20XX		CO-2	Wire		
1/8/20XX		CO-3	Check	Oct - December ORG Interest	
8/16/20XX		CO-3	Check	ORG Interest Jan - June 20XX	
8/27/20XX		CO-3	Check	ORG Interest Jan - Aug XX	
8/27/20XX		CO-3	Check	ORG Interest July & Aug	
9/30/20XX		CO-3	Check	ORG Interest	
10/28/20XX		CO-3	Check	ORG Interest	
12/9/20XX		CO-3	Check	ORG Interest	
1/28/20XX		CO-2	Wire		
1/10/20XX		CO-3	Check	ORG Interest	
					Repayment of loan - error
1/31/20XX		CO-4/Founder		Check	
2/1/20XX		CO-3	Check	ORG Interest	
4/5/20XX		CO-3	Check	ORG Interest	
4/5/20XX		CO-3	Check	ORG Interest	
5/3/20XX		CO-3	Check	ORG Interest	
6/3/20XX		CO-3	Check	ORG Interest	
6/11/20XX		CO-3	Check	ORG Interest	
10/7/20XX		CO-3	Check	ORG Interest	
10/7/20XX		CO-3	Check	ORG Interest	
10/7/20XX		CO-3	Check	ORG Interest	
11/10/20XX		CO-3	Check	ORG Interest	
11/30/20XX		CO-3	Check	ORG Interest	
12/28/20XX		CO-3	Check	ORG Interest	

Bank statements for the period January 1, 20XX – January 31, 20XX were not provided by the ORG as requested by the Service (Forms 4564 Information Document Request #3 and #4, dated December 8, 20XX, and March 1, 20XX, respectively). The following information was obtained through a third party summons issued to Bank, N.A.: Bank statements for the period January 1, 20XX, through December 31, 20XX, and January 1, 20XX, through January 31, 20XX, front and back of cancelled checks, signature cards, deposits, and wire transfers for January 1, 20XX, through January 31, 20XX.



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The ORG received all of its funding from a single donor and her related entities since its inception. The donor was the founder, Founder, and her related entities, CO-2 and CO-3.<sup>1</sup> Subsequently, Founder was the recipient of the ORG's assets totaling \$ in the form of two loans to Founder.

**Annual Information Returns Form 990**

For the three year period, the ORG reported revenue and expenses on Form 990 as follows:

Year	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
Contributions				
Interest on Savings				
Dividends & Interest				
Plus:				
<i>Gross Amount of Sale (Sec)</i>				
<i>Less Cost/Expense</i>				
Gain (Loss) on Securities				
Other investment income				
<b>Total Revenue</b>				
Program Services				
Other Expenses				
<b>Total Expenses</b>				
Excess (Deficit) for Year				
Net Assets BOY				
<i>Increase in Net Assets</i>				
Net Assets EOY				

The 20XX Form 990 revealed an increase in receivables on Line 50 (receivables from officers, directors, trustees, and key employees) from \$0 at the beginning of the year to \$ at the end of the year. No schedule was attached to the return giving the terms of the loan as required. This amount constituted the loan made to Founder on December 31, 20XX, with the effective date of January 2, 20XX according to the promissory note.

The 20XX Form 990 revealed a \$ increase in receivables from officers, directors, trustees and key employees. Again, no loan terms are provided. Total assets reported at the end of the year was \$ (\$ in cash and \$ in receivables from officers, line 50). The Form 990 for the year ending

<sup>1</sup> Founder is the Agent for Service of Process and a Limited Partner of CO-3.

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December 31, 20XX does not include the \$ received by the ORG on 12/28/20XX from CO-2 via a wire transfer, and is not mentioned in the minutes for that year.

The Form 990 for the year ending December 31, 20XX, inexplicably reports beginning and end of the year receivables from officer/trustees as totaling \$. A total of \$ "disappeared" from the receivables between the end of 20XX and the beginning of 20XX.

Bank statements confirm that the ORG received check number \_\_\_\_\_ on 1/31/20XX totaling \$. However, on 2/1/20XX, the \$ was transferred to CO-2 by check \_\_\_\_\_ written by Founder on behalf of the ORG. CO-2 transferred funds to the ORG on 12/28/20XX and received the funds back from the ORG on 2/1/20XX. This transaction is not mentioned in the minutes and is not reported on the Form 990. In response to Form 4564, IDR #4, received on May 14, 20XX, the ORG provided an amended copy of the Form 990 for tax year ending December 31, 20XX. The amended Form 990 does not report the \$ as a contribution.

**Per Examination**

The correct end of the year net assets on the 20XX Form 990 should total \$ (all in the form of receivables from officers, directors, trustees, and key employees). Corrected Form 990 Reporting:

Year	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
Contributions				
Interest on Savings				
Dividends & Interest				
Plus:				
<i>Gross Amount of Sale (Sec)</i>				
<i>Less Cost/Expense</i>				
Gain (Loss) on Securities				
Other investment income				
<i>Total Revenue</i>				
Program Services				
Other Expenses				
<i>Total Expenses</i>				
Excess (Deficit) for Year				
Net Assets BOY				
<i>Increase in Net Assets</i>				
Net Assets EOY				

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Part III, a of the Form 990, Statement of Program Service Accomplishments, stated "The purpose of this entity is to distribute substantially all of its income to benefit other qualified 501(c)(3) organizations."

The ORG disbursed substantially all of the interest income it received in the form of grants to charities.

	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
Interest Income			
Program Service			
% paid to charity	87.5%	82.9%	100%

The Forms 990 for 20XX, 20XX and 20XX listed the grants<sup>2</sup> as follows:

	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
CO-1			
CO-4			
Other Qualified Charities			
CO-5			
CO-6			
CO-7			
CO-8			

The ORG's net assets totaled \$ for the year ending December 31, 20XX; \$\$ for the year ending December 31, 20XX; and \$ for December 31, 20XX. Consequently, only 2.61% of the ORG's net assets, or \$ was distributed to qualified charities in 20XX, while 5.25% of net assets or \$, and 7.7% of net assets or \$ were distributed to charities in 20XX and 20XX, respectively. The ORG made insubstantial grants in 20XX in relation to its net assets, while substantially all of its net assets were used by the substantial contributor. To illustrate, in 20XX, 97.4% of the ORG's assets were not used (or available for use) for charitable purposes, but used for Founder's benefit in the form of personal loans. Additionally, 94.8% and 92.3% of the ORG's assets were not used for charitable purposes, but used by Founder in the form of loans in 20XX and 20XX, respectively.

<b>Net Assets</b>	<b>\$ .00</b>	<b>\$\$ .00</b>	<b>\$ .00</b>
<b>Grants to Charity</b>	<b>\$ .00</b>	<b>\$ .00</b>	<b>\$ .00</b>
<b>% of net assets distributed to charity</b>	<b>2.61%</b>	<b>5.25%</b>	<b>7.7%</b>

<sup>2</sup> All of these supported charities are included in Schedule A

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### Loans to Founder

The loan for \$ was made prior to board approval. Founder wrote a check to herself from the ORG's bank account on December 31, 20XX, without a loan document and before board discussion and approval. The first board minutes discussing the loan issuance was dated January 15, 20XX, in which a trustee motioned that a loan to Founder be made for \$ for 10 yrs at 6% annually, interest only payable, effective date: January 2, 20XX, Collateral: Trust deed on property at Address City, XYZ. The property located at Address City, XYZ was owned by CO-3 until June of 20XX when the property was sold/exchanged.

The initial promissory note dated January 2, 20XX, stated the terms at five years, whereas minutes dated January 15, 20XX, state the term as being 10 years. Also, the note provided by the ORG was not signed. The note states the interest rate at 6% and the loan is interest only payable in annual installments of \$. Public records show that the deed of trust placing a lien on property located at Address City, XYZ was never recorded. The loan for \$ was unsecured during the years under audit.

The ORG provided another note for the same loan to the Service on 5/17/20XX. The note was purportedly dated January 2, 20XX. The terms include 6% rate of interest to be paid monthly, quarterly, or annually. The principal sum is due on January 2, 20XX. The note also states it is secured by the address property.

The ORG did not provide a contemporaneous loan document for the \$ loan when initially asked by the Service in IDR 03, dated December 8, 20XX, with a due date of December 28, 20XX. Five months later (May 14, 20XX), the ORG provided a Mortgage note to the Service. The note was purportedly dated February 10, 20XX. The terms include 6% rate of interest to be paid monthly, quarterly, or annually. The principal sum is due on February 10, 20XX. The note states it is secured by property located at address, City XYZ. Minutes dated February 5, 20XX (which were provided to the Service on May 14, 20XX), also state the loan terms: 10 years at 6% interest only payable effective February 10, 20XX. Collateral: Property located at address, City XYZ. Furthermore, the note for this loan and the February 5<sup>th</sup> minutes were signed by Founder only indicating no board involvement. Similar to the \$ loan, the \$ was made without board approval. Public records reveal the loan was not secured by property located at Address City, XYZ, parcel number nor property located at address, City XYZ parcel number.

The ORG provided minutes dated March 15, 20XX, stating that the two loans were rolled into one loan and the interest rate was reduced from 6% to 5.5%. The minutes claim the new loan (\$) is collateralized by address, City XYZ. Public records confirm that the \$ was not secured during all three years under audit. The Deed of Trust for the \$ loan was recorded on December 20, 20XX, while the ORG was under audit.

### Requests for Information

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In response to Form 4564 Information Document Requests (IDR) #001, the following documents were provided:

- Organizing documents - Form 1023, Federal Exemption Letter, Trust Document
- Minutes dated December 30, 20XX, January 15, 20XX, November 15, 20XX including letter from ED-1 and ED-2 of the CO-1 dated December 12, 20XX
- Copies of the Bank account number monthly statements. Front copies of cancelled checks (excluding check # for \$ to the CO-1), Balance sheet and general ledger
- Promissory Note Dated January 2, 20XX for the \$ loan. The interest rate is 6% for five years or \$ annually, the promissory note is purportedly secured by property located at Address City, XYZ.
- A copy of Deed of Trust
- Schedule B for the 20XX Form 990 indicating that Founder was the sole contributor for that year.
- Letter from Founder to the CO-1 designating grants from the ORG go to “ ” program.

Form 4564 IDR #002 was prepared and mailed to the ORG on November 1, 20XX, and requested the following information:

- Address and Federal Tax ID Number for the supported charities.
- Front and back copies of the cancelled checks, including check # which was omitted from the first IDR response.

No response was submitted by the due date of November 15, 20XX. A follow up letter was mailed on November 22, 20XX giving the ORG ten days to respond. No response to the follow up letter was provided.

On December 8, 20XX a letter was mailed to the ORG notifying it that the subsequent year's return (12/31/20XX) was being opened. As a result, a document request was prepared with a due date of December 21, 20XX.

Form 4564 IDR #03 was prepared and mailed to the ORG requesting the following information:

- Regarding the \$ loan to Founder:
  - a) Copies (front and back) of the cancelled check for the loan to Founder.
  - b) How did the loan to Founder further the organization's exempt activities?  
Please provide supporting documents with your explanation.
  - c) Loan contract.
  - d) Supporting documentation showing payment on the loan



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e) Is this loan secured? If so was the Deed of Trust recorded? Provide documentation

f) Are there any other encumbrances on the property?

g) Explain why you feel this is not an excess benefit transaction?

- Bank statements for January 1, 20XX through January 31, 20XX.
- Front and back copies of the cancelled checks for the grants totaling \$.
- Who has signature authority on the organizations checking account number?
- Any other information that explains your activities and shows how you accomplish your exempt purpose.
- Front and back copies of the cancelled checks, including check # which was omitted from the first IDR response.

Form 4564 IDR #4 was mailed on March 1, 20XX to the ORG requesting:

- Front and back copies of cancelled checks for 20XX, 20XX, and 20XX
- Bank statements for January 1, 20XX through December 31, 20XX and January 1, 20XX through January 31, 20XX.

For 12/31/20XX:

- Notes outstanding
- All minutes
- The 20XX Form 990 reports an ending balance of \$ in receivables. The 20XX Form 990 reports beginning net assets as \$. Please explain this discrepancy.
- Please provide the following information regarding the loans to Founder:
  - a) Copies (front and back) of the cancelled check for the \$ loan and \$ loan to Founder.
  - b) How did the loans to Founder further the organization's exempt activities? Please provide supporting documents with your explanation.
  - c) Loan contracts
  - d) Supporting documentation showing repayment on the loans
  - e) Was the Deed of Trust recorded? Provide documentation
  - f) Are there any other encumbrances on the property located at Address City, XYZ?
- Who has signature authority on account number?
- Please provide any other information that explains your activities and shows how you accomplish your exempt purpose.

On December 20, 20XX, the ORG consented to extend the statute of limitations expiration date, for the 20XX tax year, to October 24, 20XX, by signing Form 872, Consent to Extend the Time to Assess Tax. The due date of IDR 03 was extended to a flexible date any day between January 2 – 5 of 20XX.

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The Service contacted the representative for the ORG on January 10, 20XX, concerning the outstanding IDR. The representative stated that he was preparing the requested information. Another due date was given to the ORG. The due date was flexible - the beginning of February 20XX. Form 2039, Third Party Summons, was issued to Bank for the missing bank information on March 21, 20XX. The summonsed bank information was received on April 31, 20XX.

A response to Form 4564 #4 was received from the ORG on May 14, 20XX. The response included an amended copy of the Form 990 for the year ending December 31, 20XX, documents stating that the \$ loan is secured by property located at address City, XYZ, minutes dated February 5, 20XX, November 15, 20XX, November 15, 20XX, March 15, 20XX, December 18, 20XX, and written responses to the questions.

### Minutes

- December 5, 20XX letter from ED-1 Executive Director, CO-1 stating appointment of Trustee-1 to the Board of the ORG.
- December 30, 20XX minutes discuss the ORG's gift from Founder or related party for \$. Minutes contained signatures of each of the three trustees.
- January 15, 20XX stating that Trustee-1 motioned that a loan to Founder be made for \$ for 10 yrs at 6% annually, interest only payable, effective date: January 2, 20XX, Collateral: Trust deed on property Address City, XYZ. Minutes contained signatures of each of the three trustees.

The minutes state the discussion about the loan to Founder of \$ was held on January 15, 20XX. On December 31, 20XX, Founder wrote a check payable to herself from the ORG's account. Founder was already in possession of the funds 15 days before the board discussed lending her the funds. The promissory note is dated January 2, 20XX.

November 15, 20XX – Stated the ORG anticipated receiving \$ from the founder. Motion was made by Trustee-1 to loan the \$ with similar terms to the loan made in January.

February 5, 20XX – Loan of \$ for 10 years at 6%, interest only payable (monthly payments of \$ effective February 10, 20XX. Collateral: Property located at address, City XYZ. Minutes signed by Founder only. The funds were transferred to Founder on February 10, 20XX

November 15, 20XX summarizing the year's activities. Minutes signed by Founder only.

March 15, 20XX – Motion was made to roll the two loans to Founder into one loan, redraft the loan documentation to clarify that the loan is collateralized by real estate at address, XYZ. The

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total amount of the loan is \$. A motion was made to reduce the interest rate to 5.5% from 6%. Minutes signed by Founder only.

November 15, 20XX - summarizing the year's activities. Minutes signed by Founder only.

December 18, 20XX – Board made aware of audit underway.

### LAW

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

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 of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of 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. 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).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. An organization does not serve a public rather than a private interest within the meaning of Reg. 1.501(c)(3)-1(d)(1) if any of its assets or earnings inure to the benefit of any insiders (or disqualified persons). Inurement is any transfer of charitable assets to the organization's insiders for which the organization does not receive adequate consideration. Inurement can take many forms.

It is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

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The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes.

When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. American Campaign Academy v. Commissioner, *supra* at 1065-66.

Section 1.6033-2(i)(2) of the regulations provides that "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 in inquiring into its exempt status and administering the provisions of subchapter F (section 501 and following), chapter 1 of subtitle A of the Code...."

In Church of World Peace, Inc. v. Commissioner, T.C. Memo. 1994-87, *aff'd*, 75 A.F.T.R.2d (RIA) 2082 (10<sup>th</sup> Cir. 1995), the Tax Court held that a church did not operate exclusively for religious purposes because the church facilitated a circular tax-avoidance scheme. The facts showed that individuals made tax-deductible contributions to the church. The court found that the church then returned the money to the individuals claiming that the payments were for housing allowances and reimbursement of expenses. The court further found that such payments were in fact unrelated to the church's operations.

In Founding Church of Scientology v. U.S., 412 F. 2d 1197 (Ct. Cl. 1969) the court stated that loans to an organization's founder or substantial contributor can constitute inurement that is prohibited under section 501(c)(3). In that case, the church made loans to its founder and his family and failed to produce documentation that demonstrated that the loans were advantageous to the church. The church also failed to produce documentation to show that the loans were repaid. Significantly, the court stated that "the very existence of private source of loan credit from an organization's earnings may itself amount to inurement of benefit."

In Help the Children, Inc. v. Commissioner, 28 T.C. 1128 (1957), an organization operated bingo games. Its charitable function consisted of contributions to charitable institutions of amounts that were insubstantial when compared to gross receipts from the bingo games. The court held that the organization did not qualify for exemption under IRC 501(c)(3) because it did not operate any charitable institutions and its principal activity was the profitable operation of bingo games on a business or commercial basis.

In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a ORG controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the ORG. It was further held that the ORG did not operate a charitable program commensurate in scope with its financial resources, rather the ORG was only able to carry out minimal charitable activities. The ruling stated that the ORG was



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operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the ORG was not entitled to exemption from Federal income tax under section 501(c)(3).

In Revenue Ruling 64-182, 1967 CB 186, A corporation organized exclusively for charitable purposes derives its income principally from the rental of space in a large commercial office building which it owns, maintains and operates. The charitable purposes of the corporation are carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such organizations for charitable purposes. *Held*, the corporation is deemed to meet the primary purpose test of section 1.501(c)(3)-1(e)(1) of the Income Tax Regulations, and to be entitled to exemption from Federal income tax as a corporation organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1954, where it is shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources.

#### Effective date of revocation

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, §14.01 (cross-referencing §13.01 *et seq.*), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Rev. Proc. 2007-52, 20078-30, IRB 222.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Rev. Proc. 2007-52, 2007-30 IRB 222.

### GOVERNMENT POSITION

#### 1. Analysis

The ORG was not operating exclusively for charitable purposes within the meaning of IRC section 501(c)(3) during 20XX, 20XX, and 20XX. The ORG is in violation of regulation 1.501(c)(3)-1(c)(2) and regulation 1.501(c)(3)-1(d)(1)(ii) by allowing Founder the personal use of the ORG's assets in the form of below market loans.



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Even though the ORG made grants which furthered its exempt purpose, the amounts were insubstantial in comparison to the private use of the ORG's funds. The ORG was operated primarily to serve the private interests of Founder by allowing her to use all its assets for non-exempt purposes. The ORG provided non-incidental benefits to Founder that served her private interests as opposed to charity. Its assets inured to her benefit. Founder is the principal beneficiary of the ORG, and not the general public or charity.

The ORG's grants to charity in 20XX, 20XX, and 20XX totaled \$, \$, and \$, respectively while the ORG provided Founder the use of \$, effective January 2, 20XX, and \$ effective February 10, 20XX, in the form of below market loans. The \$ was transferred to the ORG on December 30, 20XX, and the \$ was transferred on December 30, 20XX, by CO-2, an entity which Founder co-owns.

The ORG had a total of \$ in net assets for the year ending December 31, 20XX, yet the ORG's distributions to charity were negligible in relation to the value of its net assets. Only 2.61% of the ORG's net assets (\$) were distributed for charitable purposes. The ORG's grants constituted only 5.26% of its net assets in 20XX, and only 7.7% of net assets in 20XX. The ORG's grants to charity were insubstantial.

	20XX		20XX	20XX
Net Assets	\$	\$\$	\$	
Grants to Charity				
% of net assets Distributed to charity	2.61%	5.25%	7.7%	

The ORG's failure to make substantial grants to charitable programs is attributable to the ORG serving the private interest of its founder, Founder, by allowing its assets to serve the founder's private interests in the form of below market loans. Donors are not permissible beneficiaries. Essentially, the ORG has engaged in operations which are beneficial to its creator and detrimental to it. It is apparent that the ORG was created to benefit Founder by enabling her related entity to take a charitable contribution deduction, and subsequently return the funds to the founder for personal use.

In the instant case, the loans were made at a below market interest rate. However, even if the interest rate was reasonable, private benefit does not require that payments for goods or services be unreasonable or exceed fair market value. In est of Hawaii v. Commissioner, 71 TC 1067 (1979), the Tax Court stated: "Regardless of whether the payments made by petitioner to International were excessive, International and Est, Inc., benefited substantially from the operations of petitioner."

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Similarly, 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 9<sup>th</sup> 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 operations of the Church."

**Loans:**

The government contends that the decision to loan \$ of the ORG's funds to Founder was not made by the board of trustees, including the representative of the primary supported organization (CO-1). The loans was made without a contemporaneous loan agreement. This is evidenced by the fact that Founder was in possession of the \$ fifteen days before any discussion held by the board (which was purportedly held on January 15, 20XX). As to the \$ loan, the November 13, 20XX minutes state that "Motion was made by Trustee-1 to loan the \$ with similar terms to the loan made in January..." but does not state any actual loan terms. Minutes dated February 5, 20XX, state the terms of the loan, but contain only Founder's signature, which clearly indicates the board was not involved.

The first loan document provided for the \$ transaction, which was not signed, had an effective date of January 2, 20XX, stated terms as "The interest rate is 6% interest only for five years or \$ annually (secured by property located at Address City, XYZ)." The second loan document for this transaction was provided on May 14, 20XX, and contained the following discrepancies: the period in which the note was due changed from five years to 10 years (due on January 2, 20XX) and annual payments to monthly, quarterly, or annually. Public records show that the deed of trust (Address City, XYZ) was never recorded. The loan was unsecured during the years under audit.

A note for the \$ loan was purportedly dated February 10, 20XX. The Service received the note on May 14, 20XX, (five months after it was initially requested). The terms include 6% rate of interest to be paid monthly, quarterly, or annually. The principal sum is due on February 10, 20XX. The note states it is secured by property located at address, City XYZ. This loan was unsecured during the years under audit as no deed of trust was recorded.

The loans were consolidated on March 15, 20XX, and the interest rate was reduced from 6% to 5.5%. Public records confirm that the \$ was not secured during all three years under audit. The Deed of Trust for address, City XYZ securing the \$ loan was recorded on December 20, 20XX, while the ORG was under audit. Only Founder signed the minutes agreeing to the consolidation and reduced interest rate.

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The Service contends that these transactions are not arms-length transactions. In January 20XX, the prime rate was 4.25%, in February 20XX, the prime rate was 4%, and in March 20XX, the prime rate was 5.5%. The prime rate is the base rate on corporate loans posted by at least 75% of the nation's 30 largest banks. A third party lender would not lend such funds for a personal unsecured loan for \$ and \$ with such terms and conditions: 6% interest only payable monthly, quarterly or annually at the borrower's selection. The Service contends the correct interest rate that should be applied to these loans is the standard credit card interest rate, i.e., unsecured loans/lines of credit. The standard credit card interest rate on January 1, 20XX was 13.44% and 13.80% in February 20XX.

Founder controls the ORG and the use of its assets. Substantially all of the ORG's assets are used for the founder's personal and private benefit. Founder has sole signature authority over the ORG's bank account. By having sole signature authority on the ORG's account, Founder transferred monies to herself prior to board approval and without documentation.

A charity's assets are required to be irrevocably dedicated to charitable purposes. Treas. Reg. § 1.501(c)(3)-1(b)(4). The inurement prohibition serves to prevent the individuals who operate the charity from siphoning off any of a charity's income or assets for personal use. By transferring its assets to Founder in unsecured loans at below market interest rates, the ORG breached the dedication requirement and its assets have inured to the benefit of Founder.

Although the inurement prohibition is stated in terms of net earnings, it applies to any of a charity's assets that serve the interests of its private shareholders. Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6<sup>th</sup> Cir. 1974). The transfer of funds to Founder serves her financial interests. Facts that show a charity's investments are decided in part by the needs of private interests indicate the charity may not be operated exclusively for exempt purposes. Western Catholic Church v. Commissioner, 73 T.C. 196 (1979), aff'd, 631 F.2d 736 (7<sup>th</sup> Cir. 1980). Even if the transaction is characterized as an investment, when a charity's investments are decided in part by the needs of private interests, the charity is not operating exclusively for exempt purposes. Western Catholic Church, 73 T.C. at 214.

The ORG's assets have inured to the benefit of Founder. The very presence of a private source of loan credit may amount to inurement. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969). The loans at issue promote private rather than charitable purposes. Id. Accordingly, the exempt status of the ORG should be revoked because it is operated for substantial non-exempt purposes.

## 2. Effective Date of Revocation

While revocation of a determination letter is generally not retroactive, revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or



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operated in a manner materially different from that originally represented. In cases where the organization omitted or misstated a material fact, revocation may be retroactive to all open years under the statute. In cases where revocation is due to a material change, inconsistent with exempt status, in the character, the purpose, or the method of operation, revocation will ordinarily take effect as of the date of the material change. In any event, revocation will ordinarily take effect no later than the time at which the organization received written notice that its exemption ruling or determination letter might be revoked. Rev. Proc. 2007-52, 2007-30 IRB 222.

In this case, the agent recommends retroactive revocation of the determination letter because the ORG operated in a manner inconsistent with its exempt status under IRC 501(c)(3), since its inception. Accordingly, it is recommended that revocation be effective as of December 17, 20XX, the date of its inception. The ORG did not disclose in its application that it had already lent its Founder virtually all of its assets and that it would continue to lend all of its assets to its Founder at below market interest rates.

### CONCLUSION

The ORG's tax exempt status under section 501(a) as an organization described in section 501(c)(3) of the Code should be retroactively revoked to December 17, 20XX, because the ORG was not operated exclusively for charitable purposes. The ORG serves the private interests of Founder. Its assets inured to her benefit.

### ALTERNATIVE ISSUE

In the alternative, if the ORG qualifies for exemption under section 501(c)(3), whether the ORG should be classified as a private ORG?

### LAW - ALTERNATIVE ISSUE

Income Tax Regulations section 1.509(a)-4(c) regarding the organizational test a 509(a)(3) organization must meet provides:

(1) *In general.* —An organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization (as defined in §1.501(c)(3)-1(b)(2)):

(i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);

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- (ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;
- (iii) State the specified publicly supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and
- (iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

Income Tax Regulations section 1.509(a)-4(e) regarding the operational test a 509(a)(3) organization must meet provides:

(1) *Permissible beneficiaries.* —A supporting organization will be regarded as “operated exclusively” to support one or more specified publicly supported organizations (hereinafter referred to as the “operational test”) only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by a specified publicly supported organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in §53.4945-4(a)(4) of this chapter. Similarly, 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 ORG, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

(2) *Permissible activities.* —A supporting organization is not required to pay over its income to the publicly supported organizations in order to meet the operational test. It may satisfy the test by using its income to carry on an independent activity or program which supports or benefits the specified publicly supported organizations. All such support must, however, be limited to permissible beneficiaries in accordance with subparagraph (1) of this paragraph. The supporting organization may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations, or for the permissible beneficiaries.

Income Tax Regulations section 1.509(a)-4(f) regarding the nature of relationships required for section 509(a)(3) organizations provides:



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(1) *In general.* —Section 509(a)(3)(B) describes the nature of the relationship required between a section 501(c)(3) organization and one or more publicly supported organizations in order for such section 501(c)(3) organization to qualify under the provisions of section 509(a)(3). To meet the requirements of section 509(a)(3), an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. If an organization does not stand in one of such relationships (as provided in this paragraph) to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

(2) *Types of relationships.* —Section 509(a)(3)(B) sets forth three different types of relationships, one of which must be met in order to meet the requirements of subparagraph (1) of this paragraph. Thus, a supporting organization may be:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with, one or more publicly supported organizations.

(3) *Requirements of relationships.* —Although more than one type of relationship may exist in any one case, any relationship described in section 509(a)(3)(B) must insure that:

- (i) The supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and
- (ii) The supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported organizations.

(4) *General description of relationships.* —In the case of supporting organizations which are “operated, supervised, or controlled by” one or more publicly supported organizations, the distinguishing feature of this type of relationship is the presence of a substantial degree of direction by the publicly supported organizations over the conduct of the supporting organization, as described in paragraph (g) of this section. In the case of supporting organizations which are “supervised or controlled in connection with” one or more publicly supported organizations, the distinguishing feature is the presence of common supervision or control among the governing bodies of all organizations involved, such as the presence of common directors, as described in paragraph (h) of this section. In the case of a supporting organization which is “operated in connection with” one or more publicly supported organizations, the distinguishing feature is that the supporting organization is responsive to, and significantly involved in the operations of, the publicly supported organization, as described in paragraph (i) of this section.

Income Tax Regulations section 1.509(a)-4(g)(1) provides guidance on the meaning of “operated, supervised, or controlled by” as follows:

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(i) Each of the items “operated by”, “supervised by”, and “controlled by”, as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any one of these terms is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations.

(ii) A supporting organization may be “operated, supervised or controlled by” one or more publicly supported organizations within the meaning of section 509(a)(3)(B) even though its governing body is not comprised of representatives of the specified publicly supported organizations for whose benefit it is operated within the meaning of section 509(a)(3)(A). A supporting organization may be “operated, supervised, or controlled by” one or more publicly supported organizations (within the meaning of section 509(a)(3)(B)) and be operated “for the benefit of” one or more different publicly supported organizations (within the meaning of section 509(a)(3)(A)) only if it can be demonstrated that the purposes of the former organizations are carried out by benefiting the latter organizations.

Income Tax Regulations section 1.509(a)-4(h) provides guidance on the meaning of “supervised or controlled in connection with” as follows:

(1) In order for a supporting organization to be “supervised or controlled in connection with” one or more publicly supported organizations, there must be common supervision or control by the persons supervising or controlling both the supporting organization and the publicly supported organizations to insure that the supporting organization will be responsive to the needs and requirements of the publicly supported organizations. Therefore, in order to meet such requirement, the control or management of the supporting organization must be vested in the same persons that control or manage the publicly supported organizations.

(2) A supporting organization will not be considered to be “supervised or controlled in connection with” one or more publicly supported organizations if such organization merely makes payments (mandatory or discretionary) to one or more named publicly supported organizations, even if the obligation to make payments to the named beneficiaries is enforceable under state law by such beneficiaries and the supporting organization's governing instrument contains provisions whose effect is described in section 508(e)(1)(A) and (B). Such arrangements do not provide a sufficient “connection” between the payor organization and the needs and requirements of the publicly supported organization to constitute supervisions or control in connection with such organizations.

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Income Tax Regulations section 1.509(a)-4(i) provides guidance on the meaning of “operated in connection with” as follows:

(1) *General rule*

(i) Except as provided in subdivisions (ii) and (iii) of this subparagraph and subparagraph (4) of this paragraph, a supporting organization will be considered as being operated in connection with one or more publicly supported organizations only if it meets the “responsiveness test” which is defined in subparagraph (2) of this paragraph and the “integral part test” which is defined in subparagraph (3) of this paragraph.

(2) *Responsiveness test*

(i) For purposes of this paragraph, a supporting organization will be considered to meet the “responsiveness test” if the organization is responsive to the needs or demands of the publicly supported organizations within the meaning of this subparagraph. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii)

(a) One or more officers, directors, or trustees of the supporting organization are elected or appointed by the officers, directors, trustees, or membership of the publicly supported organizations;

(b) One or more members of the governing bodies of the publicly supported organizations are also officers, directors or trustees of, or hold other important offices in, the supporting organizations; or

(c) The officers, directors or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors or trustees of the publicly supported organizations; and

(d) By reason of (a), (b), or (c) of this subdivision, the officers, directors or trustees of the publicly supported organizations have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and the selection of recipients of such supporting organization, and in otherwise directing the use of the income or assets of such supporting organization.

(iii)

(a) The supporting organization is a charitable trust under State law;

(b) Each specified publicly supported organization is a named beneficiary under such charitable trust's governing instrument; and

(c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

(3) *Integral part test; general rule*



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(i) For purposes of this paragraph, a supporting organization will be considered to meet the "integral part test" if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii) The activities engaged in for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves.

(iii)

(a) The supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations is sufficient to insure the attentiveness of such organizations to the operations of the supporting organization. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations which meet the attentiveness requirement of this subdivision with respect to such supporting organization. Except as provided in (b) of this subdivision, the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. In applying the preceding sentence, if such supporting organization makes payments to, or for the use of, a particular department or school of a university, hospital or church, the total support of the department or school shall be substituted for the total support of the beneficiary organization.

(b) Even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary organization's total support, the amount of support received from a supporting organization may be sufficient to meet the requirements of this subdivision if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks the support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization's primary program or activity so long as such program or activity is a substantial one.

....

(d) All pertinent factors, including the number of beneficiaries, the length and nature of the relationship between the beneficiary and supporting organization and the purpose to which the funds are put (as illustrated by subdivision (iii)(b) and (c) of this subparagraph), will be considered in determining whether the amount of support received by a publicly supported beneficiary organization is sufficient to insure the attentiveness of such organization to the

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operations of the supporting organization. Normally the attentiveness of a beneficiary organization is motivated by reason of the amounts received from the supporting organization. Thus, the more substantial the amount involved, in terms of a percentage of the publicly supported organization's total support the greater the likelihood that the required degree of attentiveness will be present. However, in determining whether the amount received from the supporting organization is sufficient to insure the attentiveness of the beneficiary organization to the operations of the supporting organization (including attentiveness to the nature and yield of such supporting organization's investments), evidence of actual attentiveness by the beneficiary organization is of almost equal importance. An example of acceptable evidence of actual attentiveness is the imposition of a requirement that the supporting organization furnish reports at least annually for taxable years beginning after December 31, 1971, to the beneficiary organization to assist such beneficiary organization in insuring that the supporting organization has invested its endowment in assets productive of a reasonable rate of return (taking appreciation into account) and has not engaged in any activity which would give rise to liability for a tax imposed under sections 4941, 4943, 4944, or 4945 if such organization were a private ORG. The imposition of such requirement within 120 days after October 16, 1972, will be deemed to have retroactive effect to January 1, 1970, for purposes of determining whether a supporting organization has met the requirements of this subdivision for its first two taxable years beginning after December 31, 1969. The imposition of such requirement is, however, merely one of the factors in determining whether a supporting organization is complying with this subdivision and the absence of such requirement will not preclude an organization from classification as a supporting organization based on other factors.

(e) However, where none of the beneficiary organizations is dependent upon the supporting organization for a sufficient amount of the beneficiary organization's support within the meaning of this subdivision, the requirements of this subparagraph will not be satisfied, even though such beneficiary organizations have enforceable rights against such organization under State law.

Rev. Rul. 76-208, 1976-1 C.B. 161, held that a charitable trust described in section 501(c)(3) did not satisfy the "substantially all" requirement of the integral part test set forth in section 1.509(a)-4(i)(3)(iii)(A) of the regulations and was therefore not a supporting organization. The trust instrument provided that 75 percent of the trust income was to be distributed annually to a specified church with the remaining 25 percent to accumulate until the original corpus doubled, at which time the entire annual income was to be distributed to the church. The Service also stated that for purposes of the integral part test, the term "substantially all" means 85 percent or more.

Income Tax Regulations section 1.509(a)-4(j) regarding control by disqualified persons provides:



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(1) *In general.* —Under the provisions of section 509(a)(3)(C) a supporting organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than ORG managers and other than one or more publicly supported organizations. If a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a ORG manager of the supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly supported organization, then for purposes of this paragraph such person will be regarded as a disqualified person, rather than as a representative of the publicly supported organization. An organization will be considered “controlled”, for purposes of section 509(a)(3)(C), 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 any 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. Except as provided in subparagraph (2) of this paragraph, a supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization. Thus, if the governing body of a ORG is composed of five trustees, none of whom has a veto power over the actions of the ORG, and no more than two trustees are at any time disqualified persons, such ORG will not be considered to be 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 rights with respect to stocks in which members of its governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

## GOVERNMENT’S POSITION – ALTERNATIVE ISSUE

It is the government’s position that the ORG’s tax exempt status should be revoked retroactive to the date of its creation. Alternatively, the ORG should be reclassified as a private ORG.

Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private ORGs, private ORGs were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private ORG was intentionally inclusive so that all organizations exempted from tax by section 501(c)(3) are private ORGs except for those specified in section 509(a)(1) through (4), Roe ORG Charitable Trust v. Commissioner, T.C. Memo. 1989-566, 58 T.C.M. (CCH) 402, 404 (1989); Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7<sup>th</sup> Cir. 1979). The ORG currently is excepted from private ORG status

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because it is currently classified as a supporting organization which is described in section 509(a)(3)

Publicly supported organizations as defined in sections 509(a)(1) and (2) are excepted from private ORG status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private ORGs are subject. Supporting organizations are similarly excepted from private ORG status. Supporting organizations are excepted if they are subject to the scrutiny of public charities that provide sufficient oversight to keep supporting organizations from the types of abuses to which private ORGs are prone. Quarrie Charitable Fund, 603 F.2d at 1277-78.

IRC 509(a)(3) organizations must meet all three of the following tests:

1. Organizational and Operational Tests under section 509(a)(3)(A).
2. Relationship Test under section 509(a)(3)(B).
3. Lack of Disqualified Person Control Test under section 509(a)(3)(C).

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons.

### **Organizational and Operational Tests**

The ORG is not organized to benefit one or more specified publicly supported organizations. Pursuant to Treas. Reg. § 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). The dissolution clause of the ORG's Declaration of Trust (the "Declaration") allows distributions to organizations other than the specified publicly supported organizations upon termination of the ORG.

The operational test set forth in Treas. Reg. § 1.509(a)-4(e)(1) is not satisfied. A supporting organization will be regarded as "operated exclusively" to support a specified publicly supported organization(s) only if it engages in activities which support or benefit the specified publicly supported organizations(s). As was discussed under the Primary Issue above, the ORG has served the private interests of Founder. Therefore, it has not established that it operated exclusively for the benefit of the specified publicly supported organizations.

### Relationship between organizations

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As set forth in Treas. Reg. § 1.509(a)-4(f)(2), there are three permissible relationships:

(a) operated, supervised, or controlled by; (b) supervised or controlled in connection with; and (c) operated in connection with one or more publicly supported organizations.

The relationships “operated, supervised or controlled by” and “supervised or controlled in connection with” presuppose a substantial degree of direction over the policies, programs and activities of the supporting organization by a publicly supported organization. The “operated, supervised or controlled by” relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity or the membership of the publicly supported organization. The “supervised or controlled in connection with” relationship is established by the fact that there is common supervision or control by the persons supervising or controlling both the supporting and the publicly supported organizations (*i.e.*; that control or management of the supporting organization is vested in the same persons that control or manage the publicly supported organization).

Operated, supervised, or controlled by

The ORG does not meet the requirements under Reg. 1.509(a)-4(g) to be “operated, supervised, or controlled by.” A majority of the ORG’s directors/trustees are not elected/appointed by CO-1.

Supervised or controlled in connection with

The ORG does not meet the requirements under Reg. 1.509(a)-4(h) to be “supervised or controlled in connection with.” The control/management of CO-1 is not the same as the control/management of the ORG.

Operated in connection with

The third and final relationship possible for section 509(a)(3) organizations is the “operated in connection with” relationship which requires that the supporting organization be responsive to the needs or demands of the publicly supported organization and constitute an integral part of, or maintain a significant involvement in the affairs of, the publicly supported organization. This relationship is satisfied where the supporting organization meets both the “responsiveness” and “integral part” tests. Neither test has been met in this case.

**Responsiveness test.** The ORG does not satisfy the responsiveness test. In order to meet the responsiveness test, either Treas. Reg. § 1.509(a)-4(i)(2)(ii) or (iii) must be satisfied. Income Tax Regulations section 1.509(a)-4(i)(2)(ii) requires a supporting organization to demonstrate that one or more of the officers, director or trustees of the supporting organizations either (a) be appointed or elected by specified representatives of the publicly supported organizations or



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(b) be members of the governing body of the publicly supported organizations or (c) maintain a close and continuous working relationship with the officers, directors or trustees of the publicly supported organizations. A trustee was appointed by CO-1. However, by virtue of the relationship the officers, directors or trustees of the publicly supported organizations would have to have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making grants, the selection of recipients by the supporting organization and in otherwise directing the use of the income or assets of the supporting organization. There is no evidence that CO-1 had a significant voice in the ORG's operations. The board did not exercise oversight – it did not oversee the ORG's operations to prevent its income and assets from benefiting disqualified persons. The board considered the first loan fifteen days after the funds were transferred to Founder. The terms of the loan documents supplied were inconsistent. The loans were not secured because the deeds of trust were not recorded. There is no evidence the board considered alternative investments, ensured the terms of the loans were reasonable or determined the amount or the recipients for grants prior to the grants being made. There is no evidence the whole board even met after November 20XX.

If this test is not met, there is a second way to satisfy the responsiveness test that is set forth in Income Tax Regulations section 1.509(a)-4(i)(2)(iii). The second method requires that (a) the supporting organization be a charitable trust under state law; (b) each specific publicly supported organization be a named beneficiary under the trust's governing instrument; and (c) the beneficiary organization have the power to enforce the trust and compel an accounting under state law. The Declaration of Trust requires the trustee to distribute 33 1/3% of the net income to CO-1. The trustee will distribute an additional 51 2/3% of the net income to one or more of the organizations listed on Schedule A. There are 155 organizations listed on Schedule A that the trustee can select as grant recipients. Only the primary charity is entitled to receive a specified portion of the ORG's net income. The ORG is not required to make any specified distributions to any of the other organizations. Therefore, the ORG has not established that any of these organizations are beneficiaries to the trust or that they have the power to enforce the trust under state law. Thus this test is also not satisfied by the ORG.

**Integral Part Test** While the responsiveness test guarantees that the publicly supported organization can influence the activities of the supporting organization, the integral part test ensures that the publicly supported organization will be motivated to attend to the operations of the supporting organization. The integral part test is considered to have been satisfied if the supporting organization maintains a significant involvement in the operations of one or more publicly supported organizations and the publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. Treas. Reg § 1.509(a)-4(i)(3)(i). In order to meet the integral part test, either Treas. Reg. § 1.509-4(i)(3)(ii) or (iii) must be satisfied.



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**Integral Part Test: Activities.** Treas. Reg. § 1.509(a)-4(i)(3)(ii) provides that the activities engaged in for or on behalf of the publicly supported organizations must be activities to perform the functions of, or to carry out the purposes of, such organizations and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves. Thus, this part of the integral part test applies in those situations in which the supporting organization actually engages in activities which benefit the publicly supported organizations as opposed to simply making grants to the publicly supported organizations. Compare to Treas. Reg. § 1.509(a)-4(i)(3)(iii) (which sets forth the rules of the integral part test applicable to supporting organizations that make payments to or for the use of publicly supported organizations), see also Roe ORG, T.C. Memo. 1989-566; Cuddeback Memorial Fund v. Commissioner, T.C. Memo. 2002-300. The ORG does not meet this test because it does not perform any activities for or on behalf of the publicly supported organizations. The ORG only makes grants to publicly supported organizations.

(1) **Integral Part Test: “Substantially all” requirement.** Because the ORG only makes grants to publicly supported organizations, the applicable rules for satisfying the integral part test are in Treas. Reg. § 1.509(a)-4(i)(3)(iii). This section of the regulation has the following 3 basic requirements: 1) payment of substantially all of its income to publicly supported organizations; 2) the amount received by one publicly supported organization must be sufficient to motivate it to pay attention to the operations of the supporting organization; and 3) a substantial amount of the total support of the organization must go to those publicly supported organizations that meet the attentiveness requirement. The ORG does not meet the second requirement and, therefore, it cannot meet the third requirement.

(2) **Integral part test: Attentiveness requirement.** Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a) provides that the amount of support received by a publicly supported organization must represent a sufficient part of the organization’s total support so as to insure such attentiveness. Treas. Reg. § 1.509(a)-4(i)(3)(iii)(b) provides that a supporting organization can meet the attentiveness requirement, even where the amount of support received by the publicly supported organization does not represent a sufficient part of the publicly supported organization’s total support, if it can be demonstrated that support is earmarked for a substantial program of the publicly supported organization that would be interrupted without the supporting organization’s support. And finally, Treas. Reg. § 1.509(a)-4(i)(3)(d) provides that “[a]ll pertinent factors. . . will be considered in determining whether the amount of support received by a publicly supported organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization.” It goes on to note the importance of the percentage of the income received from the supporting organization is in determining if the publicly supported organization will have the requisite degree of attentiveness and concludes that evidence of actual attentiveness is almost as important.

Income Tax Regulations section 1.509(a)-4(i)(3)(iii)(c) contains examples of organizations that meet the attentiveness test that have the following common factors: 1) the supporting

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organization pays over all its income, 2) the supporting organization provides all funds for the specific project, and 3) the expense of conducting the program is substantial.

The ORG made grants to CO-1 as follows:

20XX	\$
20XX	\$
20XX	\$

The support of CO-1 was as follows:

20XX	\$
20XX	\$
20XX	\$

CO-1's program's support was as follows:

20XX	\$
20XX	\$
20XX	\$

There is no evidence the grants were earmarked, although Founder asked in one year that the grant be used to support the Program. There is no evidence this program is a substantial program that would be discontinued or interrupted without the ORG's support. However, even if the funds were earmarked for a substantial program of CO-1, the amounts granted were insufficient to ensure that CO-1 would be attentive to the ORG's operations.

Further, CO-1 was not attentive to the ORG's operations. After November 20XX, there is no evidence that anyone representing CO-1 attended the board meetings. Even those board meetings where a representative of CO-1 was present, she did not ensure that the assets of the ORG were invested properly and that there was no self-dealing by disqualified persons. CO-1 never requested or received any financial reports from the ORG. Thus, it is apparent that CO-1 was not attentive to the operations of the ORG. Because this requirement was not satisfied, the third requirement, that a substantial amount of the total support of the organization must go to those publicly supported organizations that meet the attentiveness test, cannot be satisfied.

#### Control Test

Treas. Reg. § 1.509(a)-4(j)(1) provides that for purposes of section 509(a)(3)(C), an organization will be considered "controlled" if the person, by reason of his position or authority, may require the organization to perform any act which significantly affects its operations or prevents such organization from performing such act. All facts and circumstances are taken into consideration



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in determining whether a disqualified person controls an organization. Id. As founder, substantial contributors, and/or trustee of the ORG, Founder is a disqualified person. Section 4946. The facts show that Founder controlled the ORG.

This control is evidenced by the fact that the ORG's assets ended up in the possession of Founder. Founder controls the ORG and the use of its assets. Substantially all of the ORG's assets were obtained by the founder as personal loans at below market interest rates.

The minutes state the discussion to loan Founder \$ was held on January 15, 20XX, however, on December 31, 20XX, Founder wrote a check payable to herself from the ORG's account. Founder was already in possession of the funds 15 days before the board discussed lending her the funds. Founder had the freedom to write checks to herself with no objections from the board. Thus, there was no evidence produced that show that independent board members exercised any oversight over the ORG or Founder's actions. Further, Treas. Reg. § 1.509(a)-4(j)(1) requires a consideration of the assets held by the ORG in determining if there is indirect control. All of the ORG's assets are tied up in below market interest rate loans to Founder. Thus, Founder directly and indirectly controlled the ORG.

#### 509(a)(1) and 509(a)(2)

The ORG is currently classified as a supporting organization described under § 509(a)(3). As addressed above, it does not meet the requirements to be classified as a supporting organization that are set forth under § 1.509(a)-4. The ORG also does not meet the requirements to be classified as a publicly supported organization under § 509 (a)(1) and § 170(b)(1)(a)(vi). To qualify under IRC 170(b)(1)(A)(vi) as publicly supported, an organization must "normally" receive at least 33 1/3% of its total "support" from governmental units, direct or indirect contributions from the general public, or a combination of these sources.

Furthermore, the ORG does not maintain a program for soliciting funds from the general public or community, and its activities are not such as to attract support from governmental units or other publicly oriented organizations described in §§ 170(b)(1)(A)(vi) through (vi). Treas. Reg. § 1.170A-9(e)(3)(iv) provides that where an organization's public support is derived from a representative number of persons rather than from members of a single family, this factor indicates a publicly supported nature. In this case the ORG receives support only from the founder. Treas. Reg. § 1.170A-9(e)(3)(v) provides that where an organization's governing body represents the broad interests of the public rather than the private interest of a limited number of donors, this factor indicates a publicly supported nature. 2. In general, the broad interests of the public will be served by a governing body comprised of public officials or their representatives; persons with expertise in the organization's field of operation; community leaders; or persons elected by a broadly based membership.

#### **CONCLUSION - ALTERNATIVE ISSUE**

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If the ORG tax exempt status is not revoked retroactive to December 17, 20XX, it should be reclassified as an organization that is a private ORG defined in section 509(a). The ORG has failed to establish that it is a supporting organization because it has not met the requirements set forth in Regulation section 1.509(a)-4(c) through (j). This determination regarding the ORG's private ORG status would be effective beginning December 17, 20XX. Retroactive reclassification is appropriate because the ORG failed to state in its application that it would operate for the benefit of Founder, that it would not have a sufficient relationship with any public charity and that it would be controlled by Founder. If the ORG is reclassified as private ORG, Form 990 PF Return of Private ORG should be filed for tax years ending December 31, 20XX, December 31, 20XX, December 31, 20XX. Subsequent returns are due no later than the 15<sup>th</sup> day of the 5<sup>th</sup> month following the close of the ORG's accounting period.

Send your returns to the following mailing address:

**Note:**

Form 990-PF is required for each tax year until Private ORG status is terminated under IRC 507.





TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

**DEPARTMENT OF THE TREASURY**

Internal Revenue Service  
Tax Exempt & Government Entities  
450 Golden Gate Avenue, MS 7401  
San Francisco, CA 94102-3412

ORG  
ADDRESS

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,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination