**Internal Revenue Service**
**Appeals**

Release Number: **200930055**
Release Date: 7/24/09
Date: April 27, 2009

Uniform Issue List:

9300.99-04

**A**
**B**

**Department of the Treasury**

**Address any reply to:**

**Employer Identification Number:**
**C**
**Form Number:**

**Person to Contact:**

**Contact Telephone Number:**

**Fax Number:**

## Certified Mail

Dear Taxpayer:

This is our final adverse determination with respect to your exempt status under section 501(a) of the Internal Revenue Code ("Code"). Recognition of your exemption under Code section 501(c)(3) is revoked effective **D**.

Our adverse determination was made for the following reasons:

**A** is not operated exclusively for exempt purposes. Under Treasury Reg. § 1.501(c)(3)-1(d)(1)(ii), an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. **A** was operated for the benefit of **E** and a for-profit company **E** owns, impermissibly serving private interests. Furthermore, you have agreed to revocation of recognition of your exempt status under section 501(c)(3).

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on Form **F** for any years which are still open under the statute of limitations. Based on the information you furnished, it appears that returns should be filed starting with the year beginning **D**.

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance, or you can contact the nearest Taxpayer Advocate office by calling **G** or writing to Local Taxpayer Advocate, **H**. Taxpayer

Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations. 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 IRC section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

Sincerely yours,

Charles F. Fisher
Appeals Team Manager

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
30 East 7th Street, #1130-B
St. Paul, MN 55101

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 SIR/MADAM:

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

LEGEND
ORG = Organization name XX = Date Founder = Founder Founder
Parents = Founder Parents BM-1, BM-2, BM-3 & BM-4 = 1ST, 2ND, 3RD & 4TH
BOARD MEMBERS CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7 & CO-8 = 1ST, 2MD, 3RD, 4TH, 5TH, 6TH, 7TH, & 8TH COMPANIES

**PRIMARY ISSUE:** Whether the IRC § 501(c)(3) tax exempt status of ORG should be revoked effective January 1, 20XX, because it is not operated exclusively for tax exempt purposes?

**FACTS:**

**Organizing Document**

ORG (the "ORG") was created with a Declaration of Trust (Declaration) by Founder, "Founder" and "Trustee" on December 1, 20XX.

The Declaration provides that ORG was created for the purpose of establishing an organization which is described in IRC § 501(c)(3) and IRC § 509(a)(3). The Declaration provides that the Founder renounces any power to determine or control, by alteration, amendment, revocation, termination or otherwise, the income or principal of ORG estate and that the Founder renounces any interest, either vested or contingent, including any reversionary interest or possibility of reverter, in the income or principal of ORG estate.

The Declaration requires each year the Trustee to distribute 35% of the adjusted net income of CO-1, the named Primary Charity. Per its Form 990, CO-1's sole or primary operation is making grants. In addition to this distribution, each year the Trustee shall distribute a total of 50% of the adjusted net income to one or more organizations listed on Schedule A.

There are 115 organizations listed on Schedule A. Some of the organizations are identified as "and affiliated organizations" such as CO-2 and affiliated organizations.

Some of the organizations listed on Schedule A, including CO-3 and affiliated organizations, are not listed in Pub. 78 and have not otherwise been established to be publicly supported charities described in 509(a)(1) or 509(a)(2).

The Declaration provides that the Board shall be the governing body of ORG and that the members of the Board shall consist of five members determined as follows:

- Four members shall be appointed by CO-1
- One member shall be from the class Founder and descendents of her parents.

In 20XX and 20XX and 20XX, per the minutes[1], the board consisted of the following:

1. Founder,
2. BM-1 (Founder'sister),
3. BM-2,
4. BM-3, and
5. BM-4

The Organization stated that BM-4, BM-2 and BM-3 were appointed by CO-1. The Organization also stated, "We believe that BM-4 and BM-2 are both board members of CO-1." BM-4 is listed on the Form 990 for the year 20XX filed by CO-1 on Part V where officers, directors and key employees are named. BM-2 is not named on that form.

The Declaration provides that upon winding up and dissolution of the Foundation, the assets shall be distributed to a non-profit fund, foundation or corporation, which is organized and operated exclusively for charitable, educational, religious, and/or scientific purposes and which has established its tax exempt status under section 501(c)(3).

The Declaration also states that in the event that ORG does not obtain tax exempt status under Sections 501(c)(3) and 509(a)(3) of the Code, the assets of ORG shall go to the Founder family, as a contingent remainder.

The Declaration also states that in the event the Trustee determines, in Trustee's sole and complete discretion, that the Trust Fund is too small to economically administer, then in such event the Trustee shall distribute the Trust Fund in its entirety outright and free of trust to such organization or organizations as described in Section 170(c)(2) of the Code as the Trustee, in Trustee's total and complete discretion, shall determine.

Based on the information supplied in its exemption application, in June 20XX, ORG was recognized by the Service as exempt from Federal income tax under section 501(a) as an organization described in section 501(c)(3) and classified as a supporting organization described in section 509(a)(3).

**Minutes**

ORG has minutes of its meetings. The minutes of every meeting include the same language repeating that the primary focus of the foundation's investments has been to preserve the

* * * *

[1] On the Form 990 for the years under examination, Founder is the only person identified on Part V as an officer, director and trustee of the Foundation.

principle and get a cash return between 4.5 and 6-10 % return, so ORG will continue to invest in private placement of secured debt instruments . The minutes have a list of all board members and a place to mark if present. Most members are marked present for most meetings. The minutes are also signed by all board members.

ORG provided two versions of minutes for the meeting of January 15, 20XX. They are the same, except that one states the sale of land to Founder was authorized by BM-2, Founder and BM-1. The other does not mention the sale of land. Both of these versions have all board members marked as present and are signed by all members.

The Foundation's representative reported that it was discovered in preparation for the examination that the land reported as an asset of the organization on Form 990 for 20XX and the beginning of 20XX was sold on February 6, 20XX to Founder, the person who contributed the land to the foundation. She paid cash of $$ for the land. Per the Foundation, this was the same amount that she deducted on her 20XX Form 1040 for the contribution. ORG did not establish that this was the fair market value of the land on February 6, 20XX.

**Form 990**

**Income.**

| | | | |
|---|---|---|---|
| **Reported** | **20XX** | **20XX** | **20XX** |
| accrued interest | | | |
| contributions | | | |
| dividends | | | |
| capital gains | | | |
| **Total** | | | |
| **Corrected** | | | |
| dividends | | | |
| sale of land | | | |
| accrued interest * | | | |
| **Total** | | | |

**Grants**

| **Grants to charity** | **20XX** | | **20XX** | | **20XX** |
|---|---|---|---|---|---|
| CO-4 | | CO-4 | | CO-4 | |
| CO-5 | | | | CO-5 | |
| **Total** | | | | | |

**Balance sheets** (end of year)

| | 20XX | 20XX | 20XX | 20XX |
|---|---|---|---|---|
| Savings & Temp cash inv. | $$ | $$ | $$ | $$ |
| Other notes & Loans rec. | | | | $$ $$ |
| Land, bldg. Equip | $$ | $$ | | |
| Other liabilities | | | $$[2] | $$[3] |

The books and records of ORG do not reconcile to the return. This is because

- The sale of the land and the proceeds from the sale of the land were not reported on the Form 990 for 20XX (or 20XX).
- Dividends from Fidelity were not reported in 20XX and were overstated in 20XX
- Accruals of interest were not reported for 20XX.

ORG made grants to an organization not identified in the Declaration, CO-5. CO-5 on is found on the list of organizations to which contributions are deductible, Publication 78.

ORG also made a grant to CO-6 in 20XX. CO-6 is not an organization described in 501(c)(3) and ORG did not list this grant with its charitable grants on Form 990. It listed it as a $$ expense related to Conferences, conventions and meetings. The memo line of the check reads: $$ contribution and $ dinner.

* * * *

[2] ORG explained this as monies it was holding for Founders parents, the parents of Founder. Founders parents purportedly received an unexpected sum of cash. They entrusted this money to ORG while they determined the amount if any to contribute to the Foundation. ORG alleges it discovered it incorrectly reported the amount while preparing its response to the Service about this item. Founders parents decided to contribute $$ to ORG so the payable to Founders parents was overstated and the contribution income was understated per the Foundation. An analysis of the bank records of ORG shows that Founders parents transferred the following funds into the Foundation's account:

9/18/XX $$
9/24/XX $
11/12/XX $

ORG paid out $$ and $$ on 9/16/XX and 9/25/XX, respectively, on behalf of the Founders parents. ORG lent Founders parents $$ on 9/1/XX.

[3] This was explained in a Schedule attached to the Form 990 as $$ NP – BS and $ Rounding. If this was the amount due back to Founder parents, it should have been $ ($$ reported in 20XX less $$ that should have been a contribution from Founders parents in 20XX = $).

On the Form 990 for the years under examination, Founder is the only person identified on Part V as an officer, director, and trustee of the Foundation.

**"Loan" Transactions**

ORG made the following "loans" in 20XX and 20XX:

| | | |
|---|---|---|
| Promissory notes | | |
| 4/15/20XX | CO-7 | $ |
| Replaced with<br>12/31/20XX | CO-7 | $ |
| also<br>9/1/20XX | Founder Parents | $ |

- On April 15, 20XX, ORG transferred $$ to the CO-7, in exchange for a promissory note. Founder is the president and sole shareholder of CO-7. According to the terms of the promissory note, no payments of interest or principal are due until April 15, 20XX. The stated interest rate is 4.25%.[4]

- On September 1, 20XX, ORG made a "loan" to Founder Parents, the parents of Founder, for $$ at a rate of 5% with interest and principal due on September 1, 20XX.[5]

- On December 31, 20XX, ORG received a second promissory note from CO-7 in the amount of $$. The document states that this note replaces the note dated April 15, 20XX. The terms include interest at 4.25% with principal and interest due on April 15, 20XX.[6]

- ORG representative stated that new note documents were put in place in July 20XX. This note is dated July 18, 20XX. The principal amount is $$. It says the borrower will pay this loan in one payment of all outstanding principal plus all accrued unpaid interest within 120 days from written notice of demand from lender. This note says that until such time as borrower has invested the proceeds from this note in an interest-bearing loan, the interest rate on this Note shall be tied to the Index Rate, and may change from time to time. At such time as Borrower has invested the proceeds from this note in an interest bearing loan, the interest rate on this Note shall be computed at a fixed rate and tied to the interest charged to the Borrower on its interest-bearing loan. The fixed rate on this note

* * * *

[4] Per the minutes, the full board approved this loan.
[5] Per the minutes, the board did not consider or approve the loan.
[6] Per the minutes, the board did not consider or approve the loan replacement.

shall be two percent below the interest rate charged by borrower.

- No payments of interest have been received by the Foundation. The interest reported on Forms 990 is interest that has accrued on the loans made by the Foundation.

**Fund Transfers made by the Founder Parents**

According to the ORG, Founder Parents, the parents of Founder, received an unexpected sum of money and desired to donate all or a portion of it to the ORG. Founder Parents requested that ORG hold the money until they made a final decision as to how much they were going to contribute. ORG did not describe the receipt of these funds or the expenses for which these funds were used on its Form 990. See footnotes 2 and 3 (the net monies were reported as Other liabilities on the Form 990 for 20XX but the Statement that should have described them did not and the Statement on the Form 990 for 20XX described them as $$ NP – BS).

Founder Parents transferred the following funds into the account of ORG at Bank:

- $$ was transferred on September 18, 20XX.
- $$ was transferred on September 24, 20XX.
- $$ was transferred on November 12, 20XX.

ORG made the following payments on behalf of Founder Parents:

$ $ on 9/16/20XX paid to CO-8
$ $ on 9/25/20XX paid to CO-8

ORG was asked the purpose of the payments to CO-8. In reply, the Foundation's representative stated, in a letter dated February 24, 20XX, that ORG made various disbursements at the request of the Founder Parents from the funds held on their behalf and ORG did not inquire of the Founder Parents as to the purpose of these disbursements. Internet research finds more than one company called CO-8.

**LAW:**

IRC § 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in

(including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Regulation section 1.501(c)(3)-1(c)(1) 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.

Regulation section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The term "private shareholder or individual" is defined in regulation section 1.501(a)-1(c) as persons having a personal and private interest in the activities of an organization.

Regulation section 1.501(c)(3)-1(d)(1)(ii) provides an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under section 501(c)(3). See also American Campaign Academy v. Commissioner, 92 T.C. 1053, 1065-66 (1989) (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); Old Dominion Box Co., Inc. v. United States, 477 F2d 340 (4th Cir. 1973) (operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose).

In Founding Church of Scientology v. United States, 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 Church of World Peace, Inc. v. Commissioner, T.C. Memo. 1994-87, aff'd, 75 A.F.T.R.2d (RIA) 2082 (10th 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 contributions to the church and claimed charitable contribution deductions. 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 Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation 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 foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under section 501(c)(3).

Criteria to determine if there is a bona fide loan: Patrick v. Commissioner, T.C. Memo. 1998-30, aff'd, 181 F.3d 103 (6th Cir. 1999); Berthold v. Commissioner, 404 F.2d 119 (6th Cir. 1968); Smith v. Commissioner, 370 F.2d 178 (6th Cir. 1996); John Kelley Co. v. Commissioner, 326 U.S. 521 (1946); Litton Business Systems, Inc. v. Commissioner, 61 T.C. 367; Geftman v. Commissioner, T.C. Memo. 1996-447.

**GOVERNMENT'S POSITION:**

The IRC § 501(c)(3) tax exempt status of ORG (the "ORG") should be revoked because it is not operated exclusively for tax exempt charitable purposes. Rather, it was operated for the benefit of its founder, Founder, and her family and business.

**"Loans"**

A substantial portion of the ORG funds were "loaned" for private interests. While the transactions are being referred to herein as "loans, they were not commercially reasonable. ORG has not established that it could have procured similar "loans" from an independent party on the same terms.

In 20XX, funds in the amount of $$ were transferred to a business owned and operated by Founder, CO-7. The loan amount was later increased to $$ in the following year. Per the ORG, the amount was increased again in 20XX and the loan terms were substantially changed as well. The loan was unsecured, and the terms of the promissory note did not require payments of interest and/or principal until April 15, 20XX. Among the 20XX changes was a change to make the "loan" payable 120 days after demand. In 20XX, funds in the amount of $$ were loaned to

Founder' parents. Again, the loan was unsecured and did not require payments of interest and /or principal until September 1, 20XX. ORG did not establish that the interest rate was reasonable.

There is no indication that the loan to Founder' parents and the loan replacement in 20XX to CO-7 were considered by the entire board. Furthermore, there is no indication that alternative investments and diversification of investments for ORG were considered.

While the transfers were referred to as loans, they do not meet the criteria to be a bona fide loan. A transfer of money will be characterized as a loan for Federal income tax purposes where, "'at the time the funds were transferred, [there was] an unconditional intention on the part of the transferee to repay the money, and an unconditional intention on the part of the transferor to secure payment.'" Patrick v. Commissioner, T.C. Memo. 1998-30, affd, 181 F.3d 103 (6th Cir. 1999). In cases where there is no unconditional intention on the part of the transferee to repay the "borrowed" money, and no unconditional intention on the part of the transferor to secure payment, there is no genuine debt. The parties must intend to create bona fide debt, and the intention of the parties "relates not so much to what the transaction is called, or even what form it takes as it does to an actual intent that money advanced will be repaid." Berthold v. Commissioner, 404 F.2d 119, 122 (6th Cir.1968), affg. T.C. Memo.1967-102.

Because direct evidence of a taxpayer's state of mind is not available, courts have focused on certain objective factors to determine whether a bona fide loan exists:

(1) The existence or nonexistence of a debt instrument;
(2) provisions for security, interest payments, and a fixed repayment date;
(3) whether the parties' records, if any, reflect the transaction as a loan;
(4) the source of repayment and the ability to repay;
(5) the relationship of the parties;
(6) whether any repayments have been made;
(7) whether a demand for repayment has been made; and
(8) failure to pay on the due date or to seek a postponement.

See Smith v. Commissioner, 370 F.2d 178, 180 (6th Cir.1966), affg. T.C. Memo.1964-278. The above factors are not exclusive, and no one factor is dispositive. See John Kelley Co. v. Commissioner, 326 U.S. 521, 530 (1946). The factors are simply objective criteria helpful to the Court in analyzing all relevant facts and circumstances. The ultimate question remains whether "there [was] a genuine intention to create a debt, with a reasonable expectation of repayment, and did that intention comport with the economic reality of creating a debtor-creditor relationship". Litton Business. Systems Inc. v. Commissioner, 61 T.C. 367, 377. This is a factual issue, to be decided upon all the facts and circumstances in each case. See Geftman v. Commissioner, T.C. Memo. 1996-447.

Where the same individuals control both the transferor and the transferee, the transaction must be scrutinized according to "an objective test of economic reality" to determine its true economic nature. Fin Hay Realty Co. v. United States, 398 F.2d 694 (3rd Cir. 1968) (where "the same persons occupy both sides of the bargaining table," the form of a transaction "does not necessarily correspond to the intrinsic economic nature of the transaction, for the parties may mold it at their will" in order "to create whatever appearance would be of ... benefit to them despite the economic reality of the transaction."). Accordingly, some courts have refused to characterize transfers as debts where the purported debtor conveyed its funds to another entity over which it retained a degree of control only to "borrow" the same funds back a short time later. See, e.g., Wilken v. Commissioner, T.C. Memo. 1987-272 (transfers from trusts to taxpayers who had funded the trusts were not bona fide loans, despite promissory notes bearing interest and mortgage securing repayment, since taxpayers had retained control over trust assets and thus were 'borrowing' their own assets in order to generate deductible interest payments); Ribisi v. United States, 1983 WL 1581 (N.D.Cal.1983) (transfers from trust to taxpayer were not a valid loan, despite promissory note, because taxpayer had used trust as "conduit" through which it cycled the funds purportedly borrowed), aff'd, 746 F.2d 1487 (9th Cir. 1984).

As previously stated, the transfers were not loans. While there were debt instruments, there was no security, the loan terms were constantly altered, there was no verification of the borrower's ability to repay the loans, the parties are related, there have been no demands for repayment and the loans were not paid when due. The disqualified persons used the Organization's assets as if they were their own. Even if these were valid loans, there would be inurement because the Organization was used as the disqualified persons own private lender and the organization failed to establish that the terms of the "loan" were reasonable.

An organization is described in section 501(c)(3) only if no part of its net earnings inures to the benefit of any private shareholder. The inurement prohibition is designed to insure that charitable assets are dedicated to exclusively furthering public purposes. An organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders or individuals.

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 (6th Cir. 1974). The lending of funds to Founder business and to her parents unsecured without the obligation to pay interest and/or principal for ten years was financially unreasonable and served the personal and private interests of Founder and/or other disqualified persons. 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, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980). Even if the lending of the funds were for investment purposes, 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 v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980).

The ORG, which is controlled by Founder, is operated to enable her to engage in financial activities which are beneficial to her, but detrimental to the ORG. Accordingly, it is operated for a substantial non-exempt purpose. See Revenue Ruling 67-5.

The ORG's net earnings have inured to the benefit of insiders. Treas. Reg. § 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966). 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); Church in Boston v. Commissioner, 71 T.C. 102 (1978). Loans to disqualified persons promote private rather than charitable purposes. Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959).

**Fund Transfers made by the Founder Parents**

Founder' parents, the Founder Parents, parked funds in the ORG's bank account. The Founder Parents transferred a total of $$ into ORG in 20XX. In the same year, ORG made payments as directed by the Founder Parents totaling $$. ORG has offered no reasonable explanation for the funds being put into its account at three different times and expenses of Founder' parents being paid therefrom. The explanation was that the parents received an unexpected sum of money. This runs counter to there being three deposits of money at three different times. It also runs counter to the loan of monies to the Founder Parents in 20XX. One of the payments on behalf of the parents was prior to any transfer of money into the Foundation's account from the Founder Parents. Another payment followed two of the deposits very closely and could have been easily paid by the Founder Parents rather than there being this flow of monies. The funds were allegedly deposited while the Founder Parents made up their minds how much, if any, to contribute to the ORG. ORG alleged the Founder Parents contributed $$ to ORG in 20XX. This is not reflected on the Form 990 for 20XX which shows the net amount after the payment of the Schroeder's expenses as an Other Liabilities without explanation. The Form 990 for 20XX shows the $$ as the amount of Other liabilities.

A gift to a charitable organization must be a voluntary transfer of money or property without the receipt of adequate consideration, made with charitable intent. Hernandez v. Commissioner, 490 U.S. 680, 690 (1980). To claim a deduction under section 170, a donor must surrender dominion and control over the gift. United States v. Estate Preservation Services, 202 F.3d 1093, 1101 (9th Cir. 20XX). A charity's assets are required to be irrevocably dedicated to charitable purposes. Treas. Reg. § 1.501(c)(3)-1(b)(4). By using its funds to make payments on behalf of the Founder Parents, ORGbreached the dedication requirement and its net earnings have inured to the benefit of private interests. Furthermore, the Founder Parents used ORGto facilitate a circular tax avoidance scheme. Church of World Peace v. Commissioner, T.C. Memo. 1994-87. The ORG's

assets served private interests and ORG was operated as part of a tax avoidance scheme. Tax avoidance schemes do not further an exempt purpose. Freedom Church of Revelation v. United States, 588 F. Supp 693, 696 (D.D.C.1984)

The Organization was used by the Founder Parents as their own personal holding company and they used the assets held by the Organization to conduct personal transactions. These transactions furthered a substantial nonexempt purpose because they furthered the Founder Parents' personal interests.

**Land**

In addition, in October 20XX, Founder transferred land to the ORG. Per the ORG, she originally acquired the land and intended to build a commercial building on the land. She decided to locate her business elsewhere and transferred the land to the ORG. Subsequently, she decided to follow her original plan and re-acquired the land from the ORG. ORG stated Founder took a charitable contribution deduction for $$. To support the value of the land, ORG provided the Service with a one page summary which included sales comparisons, neighborhood and sales information. The one page summary estimated the fair market value of the land as of May 1, 20XX, at $$. ORG did not establish the fair market value of the land on February 6, 20XX, when it transferred the land back to Founder.

The Form 990 for 20XX reflected the land as an asset of ORG at the beginning and end of the year. It was no longer reported on the Form 990 as an asset of ORG at the end of 20XX, but neither Form990 reflected that the land had been sold, much less sold to Founder for a sales price of $$.

The parking of monies by the Founder Parents in the ORG's account, the "loans" that were not commercially reasonable, and the sale of the land back to Founder for an amount that was not established to be reasonable (if paid at all because it was not reflected on the Form 990), leads to the conclusion that disqualified persons used ORG as their pocketbook. This is not an exempt purpose. It was substantial in scope and precludes ORG from being exempt from tax. See Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980); Western Catholic Church v. Commissioner, 73 T.C. 196 (1979).

**CONCLUSION:**

Accordingly, the ORG's status as an organization described under section 501(c)(3) should be revoked , effective January 1, 20XX because it did not operate exclusively for exempt purposes because its assets inured to, and it served the private interests of, its creator. ORG transferred $$ to its Trustee's business on April 15, 20XX, more in 20XX and 20XX and it transferred monies to her parents in 20XX. None of these purported "loans" were commercially reasonable. In

addition, its founder transferred land to it in 20XX and took a charitable contribution deduction therefore. She later determined that she wanted the land back and it was purportedly sold back to her for the same amount as the contribution deduction, rather than for its fair market value. This sale, if it occurred, was not reflected on the Foundation's Form 990.

Form 1041 U.S. Income Tax return for Estates and Trusts should be filed for tax years ending December 31, 20XX, December 31, 20XX, December 31, 20XX and December 31, 20XX. Returns should be sent to:

For tax year ending December 31, 20XX, Form 1041 is due April 15, 20XX and should be sent to:

**ALTERNATIVE ISSUE:** If ORG's exempt status is not revoked, it should be reclassified as a private foundation, effective January 1, 20XX.

**FACTS:**

The facts concerning the organizing document of ORG and the loans and other questionable transactions of ORG are described above.

ORG does not conduct any independent charitable activities, it only provides grants. These are the grants made by ORG in the years under examination:

20XX

CO-2
CO-5

20XX

CO-2
CO-2

20XX

CO-2
CO-5

**LAW:**

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);

(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 foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, 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:

(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(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*

(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 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 foundation. 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:

(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 foundation 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 foundation 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 foundation is composed of five trustees, none of whom has a veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered 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:**

As set forth above, it is the government's primary position that the tax exempt status of ORG should be revoked effective January 1, 20XX. Alternatively, if its exempt status is not revoked, ORG should be reclassified as a private foundation effective January 1, 20XX.

Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 19XX. The definition of a private foundation is intentionally inclusive so that all organizations exempted from tax by IRC § 501(c)(3) are private foundations except for those specified in IRC § 509(a)(1) through(4). Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566; Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7th Cir. 1979). ORG currently is excepted from private foundation status because it is currently classified as an organization described in section 509(a)(3), which defines supporting organizations.

Public charities (organizations described in section 501(c)(3) that meet the requirement of sections 509(a)(1) or (2)) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations are similarly excepted from private foundation 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 foundations are prone. Quarrie, 603 F.2d at 1277-78.

To be classified as a Section 509(a)(3) supporting organization, ORG must meet all 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. ORG has not established that it has met the first or third test.

**Organizational and Operational Tests**

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 ORG's dissolution clause allows distributions to organizations other than the specified publicly supported organizations upon termination of the ORG. The possible beneficiaries are not limited to the CO-1 or to the organizations specified on Schedule A of the Foundation's Declaration of Trust. Furthermore, the Trustee has the power to determine the trust corpus is too small to economically administer and distribute the assets to any section 170(c)(2) organization that he chooses.

Therefore, the organizational test is not met. See Quarrie, supra (holding that the organizational test was not satisfied where the trustee had the power to substitute beneficiaries when, in the judgment of the trustee, the uses of the named beneficiaries became unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public).

Moreover, 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, ORG has served private interests and has made payments for the benefit of disqualified persons and their business interests. It has not made any grants to its named primary charity, the CO-1. Therefore, it has not established that it operated exclusively for the benefit of the publicly supported organizations.

In addition, the operational test is not satisfied because ORG made distributions to other organizations that were not specified in the declaration of trust. These distributions are in violation of Treas. Reg. § 1.509(a)-4(e)(1).

ORG made a grant to CO-6 in 20XX. CO-6 is not an organization described in 501(c)(3). ORG did not list this grant with its charitable grants on the Form 990. However, its books and records demonstrate that it did make a donation. The memo line on check to CO-6 says $$ donation, $ dinner.

ORG made payments to an organization not identified in the Declaration, CO-5.

**Relationship Test**

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).

Pursuant to the Declaration, CO-1 has the power to appoint four of the five board members. It appoints three of the five board members per the ORG. Thus, the "supervised or controlled in connection with" relationship is established. However, see the discussion under Control.

**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 in determining whether a disqualified person controls an organization. Id. As founder, substantial contributor, and Trustee and member of the board of directors of the ORG, Founder is a disqualified person.

In the present case, the facts indicate that there was no substantial control or direction over the policies or activities of ORG by CO-1, the Primary Charity or any other public charity. Although the representatives appointed by CO-1 appear to have attended or participated in board meetings, the evidence developed thus far indicates that the appointed representatives deferred all financial, operational, and governance decisions to Founder. Accordingly, control and management of ORG was primarily vested with Founder and not with the appointed directors.

All the minutes of meetings state that the primary focus of the ORG's investments has been to preserve the principle and get a cash return between 4.5 and 6-10 % return, so ORG will continue to invest in private placement of secured debt instruments. However, ORG actually made investments which provided that neither principal nor interest payments are required until the year 20XX.

With the other board member's approval in some cases, Founder used the ORG's funds for her personal benefit and for the benefit of other disqualified persons. In other cases, the ORG's assets were used to benefit disqualified persons without any board oversight. These improper uses of the ORG's assets significantly impeded ORG from performing its stated exempt purpose as discussed above.

Accordingly, the Organization should be reclassified as a private foundation because it does not qualify as a supporting organization under the requirements set forth in Treas. Reg. § 1.509(a)-4(c) through (j).

**Conclusion**

Accordingly, if its exempt status is not revoked, ORG should be reclassified as a private foundation, effective January 1, 20XX. This is because it does not qualify as a supporting organization under the requirements set forth in Treas. Reg. § 1.509(a)-4(c) through (j).

The effect of this determination will be that the Organization is required to file Form 990-PF Return of Private Foundation. Form 990-PF should be filed for tax years ending December 31, 20XX, 20XX and 20XX. Subsequent returns are due no later than the 15th day of the 5th month

following the close of the Foundation's accounting period. For tax year ending December 31, 20XX, Form 990 PF is due May 15, 20XX.

Send your returns to the following mailing address:

**Note:**
Form 990-PF is required for each tax year until Private Foundation status is terminated under IRC 507.