

Internal Revenue Service
Appeals Office
1000 South Pine Island Road
Suite 350
Plantation, FL 33324

Number: 200935051
Release Date: 8/28/2009

Date: May 29, 2009

UIL: 7428.02-00

A

B

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

AP;FE:FTL:GRP

In Re:

EO Revocation

EIN:

C

Form Required to be Filed:

1120

Tax Period(s) Ended:

20 , 20 , 20

Last Day to File a Petition with the

United States Tax Court: AUG 27 2009

Certified Mail

Dear :

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January 1, 2002.

Our adverse determination was made for the following reason(s):

1. You are not operated exclusively for charitable, educational, scientific, or any other exempt purpose, as is required by IRC section 501(c)(3).
2. Your net earnings inure to the benefit of private shareholders and individuals, which is prohibited by IRC section 501(c)(3).
3. You are operated for a substantial private purpose, you serve private rather than public interests, and your activities result in substantial private benefit, which is not an exempt purpose.

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

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment

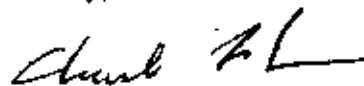
of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

We will notify the appropriate State officials of this action, as required by Code 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.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



CHARLES FISHER
TEAM MANAGER



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

Legend
ORG= Name of organization
NUM= EIN number

Taxpayer Identification Number:
Num
Form:

Tax Year(s) Ended:
December 31, 200X, 200X and 200X
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.

Letter 3818 (04-2002)
Catalog Number 34809F

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 1-877-777-4776 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

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Period Ended
CC		12/xx/200X
		12/xx/200X
		12/xx/200X

Legend

CC= Name of organization

NN= Name of individuals

AA= Affiliated organization

PC= Party organization

AD= City, and State

RR= Related party

PRIMARY ISSUE: Should the IRC § 501(c)(3) tax exempt status of CC be revoked because it is not operated exclusively for tax exempt purposes and because net earnings of the Organization have inured to the benefit of insiders?

FACTS:

CC (the "Organization") was created with a Declaration of Trust by and between NN and NN, "Founder" and NN, "Trustee" on December x, 200X.

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

The Declaration of Trust further provides that each year the Trustee shall distribute XX% of the adjusted net income of the Trust to the RR, the named PC. RR does not carry out any activities of its own. It makes grants to other charities. In addition to this distribution, each year the Trustee shall distribute a total of XX% of the adjusted net income to one or more organizations listed on Schedule A.

There are xxx organizations listed on Schedule A and some of them say "and affiliated organizations" such as AA and affiliated organizations or AA and affiliated organizations. Some of the organizations listed on Schedule A, including AA and AA have not been shown to be publicly supported charities described in 509(a)(1) or 509(a)(2).

The Declaration of Trust provides that the Board shall be the governing body of the Trust and that the members of the Board shall consist of x members. X members shall be appointed by RR or its designated agent. Two members of the board shall be from the class consisting of NN and NN and their descendants.

The initial board members were NN, NN, NN, NN and NN. The same address is reported for NN, NN and NN on Forms --- for 200X through 200X. When it supplied answers to questions, the organization stated that the board members appointed by RR are NN, NN and NN.

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Explanation of Items		
Name of Taxpayer CC		Year/Period Ended 12/xx/200X 12/xx/200X 12/xx/200X

The Trust Document provides that upon winding up and dissolution of the Trust, 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 Trust Document also states that in the event the that the Trust does not obtain tax exempt status under Sections 501(c)(3) and 509(a)(3) of the Code, the assets of the Trust shall go to the NN, as a contingent remainder.

On May xx, 200X, the Organization was recognized by the Service as exempt from Federal income tax under section 501(a) because it is described in section 501(c)(3) and classified as an organization that is not a private foundation because it is described in section 509(a)(3).

All of the contributions of the Organization were given to the RR, a charity that does not carry on any activities of its own, but makes grants to other organizations.

Minutes

The organization has minutes only for the first meeting of the board, held on December x, 200X. These minutes describe how the trust is to operate. There are no other minutes of meetings.

Property Transactions

The initial gift to the organization in 200X was property valued by the founder at \$xxx,xxx. This property was five lots. The addresses are:

AD	(Parcel xx-xx-xxx-xxx)
AD	(Parcel xx-xx-xxx-xxx)
AD	(Parcel xx-xx-xxx-xxx)
AD	(Parcel xx-xx-xxx-xxx)
AD	(Parcel xx-xx-xxx-xxx)

The deed transferring the property at AD from the donor to the organization is for x/x interest. The deed for the property at AD is for a xx% interest. . The remaining interests were held by CC, a company controlled by NN. According to the organization, these xxx lots were also subject to mortgages and had model homes on them. The other parcels were building lots.

It appears that the organization reported the value of the lots as if they had xxx% interest in all

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Explanation of Items		
Name of Taxpayer CC		Year/Period Ended 12/xx/200X 12/xx/200X 12/xx/200X

of them, less the mortgages, as a contribution and also made a math error. This is how the books of the organization showed its assets at the beginning of 200X:

Parcel xx-xx-xxx-xxx			
appraisal	xxx,xx		
	x		
loan amount	xxx,xx		
	x		
	xxx,xx		
	x		
one third interest		xxx,xxx	
Parcel xx-xx-xxx-xxx			
appraisal	xxx,xx		
	x		
loan amount	xxx,xx		
	x		
xx% interest	xxx,xx		
	x		
		xxx,xxx	
Parcel xx-xx-xxx-xxx			
		xxx,xxx	
Parcel xx-xx-xxx-xxx			
		xxx,xxx	
Parcel xx-xx-xxx-xxx			
	xxx,xxx		
	xxx,xxx	xxx,xxx	xxx,xxx

That is, taking into consideration the mortgages and the fractional interests, the organization had property worth \$ xxx,xxx, but reported \$ xxx,xxx on its balance sheet. However, the founders also used \$ xxx,xxx as the price when they tried to re-acquire the lots from the Foundation.

The Foundation states that its interest in these lots was transferred to CC on June x, 200X. In exchange, the Foundation received the promise to pay \$ xxx,xxx from the CC. This note is a credit line promissory note. The ending dates on the note are inconsistent. It is dated June x, 200X, giving CC, the right to borrow and repay up to \$ xxx,xxx any time prior to December xx, 20XX. This note also says that the entire principal and unpaid interest shall be paid on or before December xx, 20XX. The note states, "The entire principal and unpaid interest shall be paid on or before December xx, 20XX. The undersigned has the right to borrow and repay the amount of up to xxxxxx (\$xxx,xxx any time prior to December xx, 20XX)."

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Name of Taxpayer CC		Year/Period Ended 12/xx/200X 12/xx/200X 12/xx/200X

This note also says that monthly payments equal to the interest shall be paid on or before the xth of each month. Interest is at the rate of x percent per annum. Interest has been paid, but not monthly.

This note states that the note is secured by Trust Deeds of Trust, although the representative said that there are no Trust Deeds of Trust. This promissory note is signed by NN manager of CC.

The organization was asked if there were any arrangements for the sale or redemption of the property prior to the time it was given to the Foundation. The organization's representative replied that there was no previous arrangement to transfer the property back to the NN.

The Foundation supplied an amortization schedule for this note which started December xx, 200X. They cannot explain why this beginning date differs from the date of the note. The quit claim deeds transferring the property to the Foundation were executed on December xx, 200X.

AD

xxx,xxx

An appraisal dated xx/xx/200X gives the value of this parcel as \$ xxx,xxx , including \$ xxx,xxx for the site. Public information reports that it was transferred to an unrelated third party by CC and CC on x/xx/200X. The sales price is not known.

AD

xxx,xxx

An appraisal dated xx/xx/200X gives the value of this parcel as \$ xxx,xxx , including \$ xxx,xxx for the site. It was transferred to an unrelated third party

Loans

On June xx, 200X, CC made a payment of \$ xxx,xxx on the note. On July x, 200X, the Foundation made a loan of \$ xxx,xxx to CC.

On November x, 200X, the founder deposited a contribution of \$xxx,xxx into the bank account of the foundation. On November x, 200X, the organization transferred \$xxx,xxx to the founder's business, CC, and recorded it as a loan.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer CC		Year/Period Ended 12/xx/200X 12/xx/200X 12/xx/200X

Forms

Forms -- filed by the foundation reflect the following income and contributions:

	200X	200X	200X
Income per ---			
contributions	xxx,xxx		
interest income	xxx,xxx	xxx,xxx	xxx,xxx
charitable grants	xxx,xxx	xxx,xxx	xxx,xxx

Balance Sheet

The balance sheet for the year ending December xx, 200X reports land with a value of \$ xxx,xxx . The balance sheets for the years ending December xx, 200X and December x 200X report land with a value of \$ xxx,xxx . However, as noted above, during the examination, the organization stated that the land was transferred to CC in exchange for the Promissory note in the amount of \$ xxx,xxx of June x, 200X. Additionally, during the examination, the organization supplied a deed that showed xxx parcel was transferred to NN on May xx, 200X and another deed showing a parcel was transferred to CC in February, xx 2002, prior to the date of the promissory note.

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.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		Year/Period Ended
Name of Taxpayer		12/xx/200X
CC		12/xx/200X
		12/xx/200X

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 words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the 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 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).

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).

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."

Facts that show a charity's investments that 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).

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

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(1978). Loans to disqualified persons promote private rather than charitable purposes. Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959).

A substantial part of the Organization's activities appear to serve private interests. It appears that the Organization is 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)

GOVERNMENT'S POSITION:

The IRC § 501(c)(3) tax exempt status of CC (the "Organization") should be revoked because it is not operated exclusively for tax exempt charitable purposes. More than an insubstantial purpose of the organization is to serve the needs of its founders, NN and their businesses. Additionally, the net earnings of the Organization have inured to the benefit of insiders.

As substantial contributors, NN and NN are disqualified persons and insiders. They have operated the Organization for personal benefit. There is no indication that the terms of the loans to CC, a business controlled by disqualified persons, were considered by the entire board, that alternative investments for the Foundation were considered, or that the Promissory Notes were reviewed by anyone acting in the interests of charity.

On June xx, 200X, the organization received \$xx,xxx as a payment on the note. On July x, 200X, the organization made a loan of \$ xx,xxx to CC. A contribution of \$ xx,xxx was received on November x, 200X and a loan of \$ xx,xxx was made to CC on November x, 200X. The fact that a loan was made the same day that a contribution was received suggests that the intent of the contribution was to make funds available for a loan. The fact that a loan was made within a few days of a loan payment suggests that the purpose of the payment was to make funds available.

It does not appear that any attempt is made to ensure the Foundation's assets are protected. The Foundation made a substantial loan with no verifiable security and although the note calls for monthly payments, there have been no adverse consequences for months without payment.

The organization also transferred land to the business of the founder with no down payment or recording of the promissory note.

There is no evidence that any of the supported organizations are attentive to the operations of the Foundation. There is no assurance that the Foundation will attempt to enforce collection should the loans become delinquent.

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Explanation of Items		
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Gifts to charity by the Foundation are insignificant compared to the loans made to the business interests of the Founder.

A substantial part of the Organization's activities appear to serve private interests. It appears that the Organization is 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 is controlled by NN and NN. There is no indication that the other board members exercise any oversight on the financial activities of the Foundation. There is no indication that any representatives of any of the organizations named in the Trust Document have any input to the operations of the Organization.

The Organization, which is controlled by the NN, is operated to enable the NN to engage in financial activities which are beneficial to them and/or entities with whom they are transacting business, but detrimental to the Organization. Accordingly, it is operated for a substantial non-exempt purpose. See Revenue Ruling 67-5.

The organization's primary activity has been to act as a source of funds for the founder and his business. Although charitable contributions have been made to the supported organization, gifts to charity by the Foundation are insignificant compared to the loans made to the business interests of the Founder.

The Organization's net earnings have inured to the benefit of insiders, and the organization is not operated exclusively for charitable purposes, so it does not qualify as a 501(c)(3) organization.

Facts that show a charity's investments that 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).

The facts show that NN and NN are able to use the Foundation's funds as if they were their own.

The initial gift to the organization was property valued by the founder at \$ xx,xxx. These lots were subject to mortgages and less than xxx% interest was given to the Foundation. Within x months, the lots were transferred to the founder's business, in exchange for a promissory note. Thus, the founder got a charitable deduction and got the lots back without paying out any cash.

On November x, 200X, the founder deposited \$ xx,xxx into the bank account of the

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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foundation. On November x, 200X, the organization transferred \$ xx,xxx to the founder's business, CC. Again the founder got a charitable deduction without actually losing control of the donated assets.

These transactions show that the organization is used to further the business interests of the founder more than to advance charitable purposes.

The foundation provided funds to the business of the founder under terms not available to others.

The Organization'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).

Accordingly, the Organization's status as an organization described under section 501(c)(3) should be revoked, effective January x, 200X because it did not operate exclusively for exempt purposes because its assets inured to, and it served the private interests of, its creator.

ALTERNATIVE ISSUE #1: Should CC be reclassified as a private foundation?

FACTS:

The facts concerning the organizing document and the financial activities of the Foundation are described above.

There is no evidence that representatives of any of the supported organizations ever attended or participated in any meetings of the Board of the Organization, or had any input or oversight on the investments of the Foundation. There is no evidence that any financial reporting were made to any of the supported organizations or requested by any supporting organizations.

LAW:

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

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Name of Taxpayer OC		Year/Period Ended 12/xx/200X 12/xx/200X 12/xx/200X

(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.

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Explanation of Items		
Name of Taxpayer OC		Year/Period Ended 12/xx/200X 12/xx/200X 12/xx/200X

(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.

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Name of Taxpayer CC		Year/Period Ended 12/xx/200X 12/xx/200X 12/xx/200X

(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:

(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.

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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:

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As set forth above, it is the government's primary position that the tax exempt status of CC (the "Organization") should be revoked. Alternatively, the Organization should be reclassified as a private foundation.

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 1969. 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). The Organization claims it is excepted from private foundation status and not subject to the rules of Chapter 42 applicable to private foundations because it meets the requirements of 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 on the theory that the public charities that they support, rather than the public, will provide the scrutiny to keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie, 603 F.2d at 1277-78.

Section 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) 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 Organization 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

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benefit any organizations other than the specified publicly supported organization(s). The Organization's dissolution clause allows distributions to organizations other than the specified publicly supported organizations upon termination of the Organization. The possible beneficiaries are not limited to the RR or to the organizations specified on Schedule A of the Organization's Declaration of Trust. 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, the Organization apparently has served private interests and has made payments for the benefit of NN and NN.

Also, the Schedule A attached to the organization's trust document permits it to benefit AA, not a publicly supported organization.

Therefore, it has not established that it operated exclusively for the benefit of the publicly supported organizations.

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

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control or management of the supporting organization is vested in the same persons that control or manage the publicly supported organization).

In the present case, the organizing document provides that a majority of the board members would be appointed by the primary supported organization, RR. However, there is no indication that any board members appointed by RR participated in the decision making process of CC. There is no indication that they approved a loan made on the same day a contribution was received.

Disqualified Person Control Test

As noted above, NN and NN are disqualified persons because they are substantial contributors to the Foundation. All the checks written are signed by NN. There is no indication that any representatives of any of the organizations named in the Trust Document have any input to the operations of the Organization.

In this case, the largest asset of the organization is the founder's liability to it. A person in control of the organization's largest asset can reasonably be assumed to have significant influence over the organization.

As noted above, the Foundation did not require the monthly payments required by the loan document, although it did receive interest annually. The Foundation did not ensure that its assets were properly recorded on its books. These are indications that the Founders, the borrowers, are in control of the financial arrangements of the Foundation.

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:

For the reasons set forth above, we have determined that CC (the "Organization") is not an organization described in section 501(c)(3). Alternatively, the Organization should be reclassified as an organization that is a private foundation defined in section 509(a) and it should be held liable for the excise taxes under section 4944(a)(1) and (b)(1).

This determination is effective beginning January x, 200X.