

**Internal Revenue Service
Appeals**

Department of the Treasury

Release Number: **200946065**
Release Date: 11/13/09
Date: 8/17/09

Address any reply to:

Employer Identification Number:

Person to Contact:

Contact Telephone Number:

Fax Number:

Uniform Issue List

501.03-00

**Last Day to File a Petition with the United
States Tax Court NOV 16 2009**

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 January 1, 20XX.

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 Federal 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 from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

Our adverse determination was made because **** is not operated exclusively for exempt purposes. Under Treasury Reg. § 1.501(c)(3)-1(c)(1), 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 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. **** does not operate exclusively for exempt purposes; it does not engage primarily in activities which accomplish one or more such exempt purposes specified in I.R.C. § 501(c)(3).

In addition, Under Treasury Reg. § 1.501(c)(3)-1(d)(1)(ii), an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. **** operates for the benefit of private individuals and shareholders

rather than public interests. The organization's assets are used primarily to benefit its founders,
****.

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

You are required to file Federal income tax returns on Form 1041 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 beginning with the year ending December 31, 20XX. You should file any returns due for these years or later years with the Department of the Treasury, Internal Revenue Service Center, Ogden, UT 84201 (as applicable for Form 1041). Processing of income tax returns will not be delayed because you have filed a petition for a declaratory judgment under Code section 7428.

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 **** or writing to Local Taxpayer Advocate, ****. 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, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

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

/s/
Appeals Team Manager



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

Legend
ORG= Name of organization
EIN= EIN of organization
NN= Name of individual

Taxpayer Identification Number:
EIN
Form:

Tax Year(s) Ended:
December xx, 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.

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

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 200X12

Legend

ORG = Name of organization	x = Amount
RR = Related organization	X = Year
UR = Unrelated organization	B = Board Member
ST = State	BK = Bank
NN = Foundation Creator(s)	CY = City
OI = Other Individual	

ISSUES

Whether the ORG's tax exempt status under § 501(c)(3) of the Internal Revenue Code should be revoked

ALTERNATIVE ISSUE

Should the ORG be reclassified as a private foundation?

FACTS

Organizational Documents

The ORG received recognition for tax exempt status under IRC § 501(c)(3) from the Internal Revenue Service on June x, 200X. The organization was also recognized as not being a private foundation because it was described in § 509(a)(3) of the Code.

The foundation's Form 1023 *Application for Recognition of Exemption* provides that the foundation has a special relationship with the Primary Charity, RR (hereon referred to as "the RR"), because one of its Board Members is appointed by the Primary Charity. The Board controls the investment policy, the making of grants and all other activities of the foundation. The foundation is required to provide the Primary Charity with periodic accounting (at least annually).

The foundation's stated primary purpose is to distribute substantially all of its income to and for the use of various public charities. The foundation's governing instruments declare its intent to distribute at least x percent of its net income every year to various charities, of which at least x percent would be donated to its Primary Charity. The remaining funds would be donated to other qualifying organizations as provided in the foundation's governing instruments.

Activities

The ORG was created in ST in December of 199X. The foundation is a supporting organization that seeks donations, invests these funds and distributes them to other charities. The primary donors are the members of the NN family (mainly NN). Although distributions could go to other charities listed in the foundation's Declaration of Trust, donations have been limited to the RR.

At the time that the foundation was created, NN intended to make continuous donations each year to fund the foundation. When NN became unemployed in the year 200X, the foundation moved with him from ST to ST.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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Because his ability to contribute to the foundation had changed, NN decided to perform fundraising services for the charities that the foundation supported in lieu of making cash distributions to support them. He purchased equipment that would allow the foundation to create flyers and other promotional items. The fundraising plans were cut short in 200X when NN was reemployed and returned to ST. Accordingly, the foundation's original plans were restored.

There exists no evidence of such fundraising activities. The foundation has not provided any examples of fundraising work completed, nor do the foundation's minutes suggest that there was any discussion regarding fundraising activities to be performed for the RR.

Minutes

In the minutes from the meeting held on February 16, 200X, NN discussed the financial results of the foundation for the prior year and explained that there was no net income to donate. He also discussed the sale and reinvestment of the foundation's resources, as well as future contributions. Donations were expected to begin within the next year or two.

In the minutes from the meeting held on May 30, 200X, NN discussed that the property owned by the foundation was sold, and proceeds from the sale were reinvested in mortgages. Profits were expected within the next year. NN explained that the foundation was now anticipating about \$x-\$x of annual income. Additionally, a transfer of the foundation to CY was approved by the Board.

In the minutes from the meeting held on July 10, 200X, new board members (B and B from CY) abstained from voting because they did not attend the prior meeting. NN explained that the present loans (when paid off) will be reinvested in mortgages as seen fit. A separate sheet of paper was added (unmarked and unsigned) behind the minutes that provided for the unanimous approval of the purchase of equipment for the use of the trustee and the foundation.

Minutes from the annual meeting on September 9, 200X revealed that NN were the only attendees. During this meeting, gift of the old wireless network in lieu of cash was approved by NN. Rather than make a documented distribution of the equipment through the offices of the RR, they simply dropped the network off at one of the charity's "good will locations" and recorded the donation as a non-cash distribution on the Form 990. According to NN, the foundation decided to drop off the network rather than make an official donation because they were in the process of moving back to ST and did not have enough time.

Additionally, minutes from the annual meeting on December 15, 200X revealed that B, B and B were all participants who were from RR in CY. During the meeting, NN discussed that the foundation had secured interests in real estate properties and car loans. Minutes from the last meeting were read and approved by NN. NN also provided the return for 200X showing that \$x in donations had already been distributed, and it was established that the 200X distribution had already been made.

Books and records

Since inception, NN has personally maintained the foundation's books and records. He posts all of the transactions, and the accountant prepares the tax returns. However, since there were often months in transition when NN did not tend to the foundation's accounting duties, the books do not accurately reflect when payments were made and when income was received.

Assets/Equipment

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 200X12

When the foundation was created, efforts were made to keep the foundation's resources separate from the NN personal assets. Accordingly, the foundation maintains its own computer and printer, which it uses to perform all of its office functions. Phone and internet services are donated by the NN family. However, the computer that they invested in for the foundation could not connect to the internet in the home that they were living in at the time. Therefore, they decided to set up a wireless network. Because investments needed to be tracked, books needed to be balanced and contributions had to be sought (from various family members), the foundation needed to be able to get online in order to obtain the necessary information.

In May of 200X, the foundation purchased a wireless network from UR that proved far too difficult to operate with NN's limited expertise and did not perform the necessary functions. Internet research shows that the UR Pro/Wireless 5000 LAN Family of Products won product of the year honors from UR in 200X. The UR Pro/Wireless 5000 products were described as "leading the computing industry's transition to 802.11a Wireless LAN." It offered speeds up to 54 Mbps, network capacity for more users and the 5GHz, clean spectrum for optimal wireless performance. Users received the highest throughput available in any wireless network technology—enough to handle data intensive applications, large files and true multimedia streaming video.

In 200X, the foundation purchased a new wireless network made by UR. At the time of the replacement, the foundation donated the old wireless network to RR by leaving the equipment at one of the charity's "drop-off locations." RR would have the option of putting the old network to use or selling it for cash. This made up the non-cash contributions of \$x reported on the 200X Form 990. However, there is no record of this distribution. NN explained that because the foundation was in transition from ST to ST at the time, they did not have the time to make a proper distribution.

Equipment purchased as of May 25, 200X totaled \$x. Such equipment includes, in part, the UR Pro 5000 Wireless Network, a UR Router, a UR GRX-590 laptop complete with a CD burner, a UR PDA, a UR video camera complete with accessories, a UR digital camera complete with accessories, a flat panel speaker system, Sohware plugs for printer sharing, multiple surge protectors, an auto adapter, a zip drive, a floppy drive, software for Palm, an USB extender, a travel bag, a label kit, jumper cables, and a hair dryer.

Investments (Loans Receivable)

Aside from savings and other bank accounts, investments are made primarily in the form of loans to family members. For the period ending December 31, 200X, the Foundation reported that it had two outstanding loans as follows:

1) On July 7, 200X, a promissory note was signed by NN for \$x. Interest was based on the prime rate plus x% per annum, simple interest rate. The note was due in x installments, payable on the first day of each month in the amount of \$x. Collateral was not established.

-- A promissory note was signed and dated August 7, 200X by NN for the amount of \$x to refinance the initial loan. Interest was based on the prime rate plus x% per annum, simple interest rate. The note was due in x installments, payable every x days in the amount of \$x. An accompanying security agreement established collateral on a 199X Dodge Dakota.

-- A spreadsheet was provided showing that \$x was received each month to cover principal and interest on the loan. The loan was paid off on September 10, 200X. (See spreadsheet below)

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 200X12

Date		Amount	Principal	Interest	Balance
7/7/200X	Open	X	x	x	x
8/5/200X	Payment	X	x	x	x
8/9/200X	Recast	X	x	x	x
8/9/200X	Recast fee	X	x	x	x
9/200X		X	x	x	x
10/200X		X	x	x	x
11/200X		X	x	x	x
12/200X		X	x	x	x
1/200X		X	x	x	x
2/200X		X	x	x	x
3/200X		X	x	x	x
4/200X		X	x	x	x
5/200X		X	x	x	x
6/200X		X	x	x	x
7/200X		X	x	x	x
8/200X		X	x	x	x
9/10/200X		X	x	x	x

2) A one page demand grid note was signed and dated December 26, 200X by NN (and by NN as witness). Interest was based on the prime rate plus x% per annum. A handwritten statement was added to declare that "the annual payment of all accrued interest is allowed." The document did not state the amount of the loan. Collateral was not established.

-- A spreadsheet was provided that showed the grid note as a line of credit offered at an amount that totaled \$x. The credit taken was paid off on April 30, 200X. (See spreadsheet below)

Date	Line of Credit	Interest	Int Pmt	Accr Int	Prin Pmt	Prin Bal	Total Accr Int & Prin
12/31/200X	x					x	x
12/31/200X	x					x	x
1/2/200X	x	x		X		x	x
4/2/200X		x	x	X		x	x
5/6/200X		x	x	X		x	x
12/31/200X		x		X	x	x	x
12/31/200X			x	X		x	x
12/31/200X			x	X		x	x
12/31/200X			x	X		x	x
3/31/200X		x	x	X		x	x
3/31/200X				X	x	x	x
4/30/200X		x	x	X		x	x
4/30/200X				X	x	x	x
10/26/200X		x	x	X		x	x

-- Based on the BK statement provided for May 2, 200X for the Savings account # x, a wire transfer from UR was received in the amount of \$x on April 30, 200X giving the account an ending balance of \$x. \$x was recorded as principal repayment of the NN line of credit on the general ledger, and \$x was recorded as interest paid.

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Financials

200X Form 990 reports \$x in cash contributions received and \$x in interest received.

200X Form 990 reports \$x in non-cash contributions distributed, \$x in (equipment) depreciation expense, \$x in office expenses, and \$x in bank charges.

Office expenses for 200X include, in part, multiple software upgrades, multiple batteries of various types, multiple power strips, various types of labels (i.e. disk, files, and address), a label printer, x stamps, a cordless phone, a multi-lined phone system, a cordless handset, recorders, a Palm, a laser printer, an external USB drive, a PCI card, a USB Serial adapter, a UR notebook adapter, a wireless adapter, and a router, an AC interfere filter, a remote extender, and a REM controller/timer.

200X Form 990 reports \$x in cash at the end of the year, \$x in loans receivable and \$x in equipment after \$x was taken as depreciation.

200X Form 990 balance sheet shows the following:

- | | |
|------------------|------|
| 1) Checking | \$ x |
| 2) Savings | \$ x |
| 3) NN Loan | \$ x |
| 4) NN Trust Loan | \$ x |
| 5) Equipment | \$ x |

Based on the bank statements provided for 200X, transfers were made from the organization's savings account to its checking account each time a reimbursement was due to NN for office expenses. Additionally, transfers were made to provide funds for loans made out to NN and to NNNN. Deposits received, as described in the general ledger, represented payments from the NN loan, payments from the NN truck loan, interest on investment from the NN loan, and donor contributions (\$x from NN and \$x from OI and OI)

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.

Treas. Reg. § 1.501(c)(3)-1(a)(1), *Organizational and operational tests*, provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treas. Reg. § 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

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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.

Treas. Reg. § 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. The term "private shareholder or individual" is defined in regulation section 1.501(a)-1(c).

Treas. Reg. § 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 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) of the Code. 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 F.2d 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 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 Spokane Motorcycle Club v. U.S., 222 F. Supp. 151, net profits were found to inure to private individuals where refreshments, goods and services amounting to \$825 (representing some 8% of gross revenues) were furnished to members.

In Rev. Rul. 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).

Treas. Reg. § 1.6033-2(i)(2) states, "Every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (section 501 and following), chapter 1 of subtitle A of the Code, section 6033, and chapter 42 of subtitle D of the Code."

Treas. Reg. § 1.6001-1(a) states in part that organizations, ".shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such persons in any return of such tax or information."

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Rev. Rul. 59-95 provides that a failure to file required information return or comply with the provision of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status

In Church of Gospel Ministry v. United States, 640 F. Supp 96, the court ruled that a failure to keep and present accurate and adequate records prevented the Church from meeting its burden of showing that its operations were primarily for charitable purposes and did not inure to the private benefit of its officers. The court also stated that, "...the lack of adequate records or receipts...makes it impossible for CGM to establish that it is not being operated for the private benefit of its members and provides independent grounds for rejecting its claim to tax-exempt status."

Treas. Reg. § 1.6001-1(c) provides, in part, that every organization exempt from tax under IRC § 501(a) shall keep such permanent book of account and records, including inventories, as are sufficient to show specifically the items of gross income, receipts and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by IRC § 6033. IRC § 501(c)(3) provides for the exemption of the organizations described within this section provided, in part, that no part of the net earnings inures to the benefit of any private shareholder or individual.

GOVERNMENT'S POSITION

The ORG has not shown that it has/is operated exclusively for tax exempt purposes and the funds of the ORG has inured to or for the benefit of private individuals in violation of regulation 1.501(c)(3)-1(c)(2) and regulation 1.501(c)(3)-1(d)(1)(ii).

Over the years, the ORG has accumulated equipment that far surpasses the capacity required for an organization of its size. Such equipment appears to serve the personal purposes of the NN family rather than the exempt purposes of the ORG. Additionally, the ORG's funds are continuously invested in loans made out to members of the NN family. The conditions of such loans serve to fund the personal needs of the NN family members and do not serve to benefit the exempt organization.

The Tax Court in Patrick v. Commissioner, T.C. Memo 1998-30, aff'd, 181 F. 3d 103 (6th Cir. 1998), cert. denied, 528 U.S. 878 (1999) listed eight separate factors used to determine whether a bona fide loan exists: the existence of a debt instrument; provisions of security; interest payments and fixed repayment date; the parties' records, the source of repayment and the ability to repay; the relationship of the parties; whether repayments have been made; demand for repayment; and failure to pay or seek a postponement.

Although the contracts drafted between the foundation and the members of the NN family were signed by the borrower, such contracts lacked important characteristics of a legal binding document.

Whereas the refinancing documents for the loan issued to NN were drafted to provide collateral and a reasonable rate of interest to the foundation, it was found that NN did not make payments to the foundation as required by the provisions of the loan document. Actual payments did not yield a reasonable rate of interest. Additionally, review of the bank statements and check registers provided show that payments were not made on schedule. Rather, sporadic payments have been made on a schedule which appears to be dependent on the borrower. The loan was paid off on September 10, 200X.

Likewise, the loan issued to NN was recorded in the organization's records as a line of credit. The loan document, itself, did not establish a credit limit, nor did it establish collateral against this line of credit. Sporadic payments received shows that the borrower maintains discretion over when payments should be

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made. Additionally, the existence of a line of credit allows the borrower access to an amount that was not set by the loan documents but, evidently, amounted to a majority of the foundation's cash assets. Based on the \$x total reported assets on the 200X Form 990 PF, x% of these assets was loaned to NN.

Loans made out to NN and NN did not constitute bona fide loans. Loans were made without adequate security or a reasonable rate of interest. Additionally, such loans were never approved by the Board of Directors. Minutes provide that such loans were described as "secured investments." The loans made up a substantial part of the foundation's corpus, and they were made with the purpose of diverting fund from its declared purpose. The ORG's financial records show that the foundation's funds were donated by the NN family and were loaned back to the NN family in a continuous cycle. The loans do not work to the benefit of the foundation but rather provides for the circulation of charitable funds among the members of the NN family for the purpose of rendering financial aid to family members.

As provided 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), an organization is not operating exclusively for the purposes provided under IRC § 501(c)(3) when funds are circulated among individuals for the private benefit of these individuals who made contributions to the church and claimed charitable deductions.

The ORG operates for the benefit of the disqualified persons in relation to the foundation. Treas. Reg. § 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. The foundation has not provided adequate support to provide that is it not organized and operated for the benefit of private interests such as for the creator or his family.

In addition to loans made out to family members, over the course of its existence, the organization has invested in various types of equipment, reported such equipment as expenses on Form 990, and claimed depreciation for such equipment. As provided by the foundation's Articles of Trust, at least x% of the organization's net income would be devoted to its support organizations. Expenses claimed for the investment in such equipment provided for a deduction in the net income recognized on the foundation's Form 990.

Review of the expenses incurred as of the end of 200X reveals that the organization has invested in equipment that far surpasses the capabilities required for an organization of its size.

NN stated that an effort was made to separate the family's personal assets from the foundation's assets. Thus, the foundation maintains its own equipment for business purposes. As a supporting organization, NN noted that, aside from the claimed fundraising activities, the organization need access to the Internet in order to maintain its bank accounts and investments and to seek donations from family members. However, the organization's equipment appears to support a small business more so than a private foundation operating out of the corner of the founder's personal residence.

Aside from a high capacity network, the ORG invested in multiple power strips, multiple phones (including a multi-lined phone system), a high volume of labels and stamps, multiple surge protectors, and plugs for printer sharing purposes.

Additional equipment purchased included a UR GRX-590 laptop complete with a CD burner, a UR PDA, a UR video camera complete with accessories, a UR digital camera complete with accessories, a flat panel speaker system, an auto adapter, a zip drive, a Palm, software for the Palm, a USB extender, a travel bag, recorders, a laser printer, an external USB drive, a PCI card, a USB Serial adapter, a UR notebook adapter, a wireless adapter, and a second router. Based on the limited operations run by the foundation, such equipment proves to be extravagant and self serving. Aside from the fact that the foundation has not provided any evidence of the fact that it had provided fundraising efforts to RR, purchase of such

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extensive equipment does not appear to serve the purpose of providing basic promotional items and creating flyers for the supported organization. Instead, the equipment purchased appears to serve the private interests of the NN family and inures to the benefit of family members.

Furthermore, equipment included as office expenses include an AC interfere filter, a remote extender, and a REM controller/timer, jumper cables and a hair dryer. Such equipment meets the NN personal needs and does not qualify as an office expense. Such expenses inure to the benefit of the NN family members.

In Spokane Motorcycle Club v. U.S., 222 F. Supp. 151, net profits were found to inure to private individuals where refreshments, goods and services amounting to \$825 (representing some 8% of gross revenues) were furnished to members.

As provided by section 6033 of the Internal Revenue Code, it is the foundation's responsibility to maintain adequate records to substantiate that its activities are serving an exempt purpose. In Church of Gospel Ministry v. United States, 640 F. Supp 96, the court also stated that, "...the lack of adequate records or receipts...makes it impossible to establish that it is not being operated for the private benefit of its members and provides independent grounds for rejecting its claim to tax-exempt status."

Based on the information provided by the ORG, the foundation has failed to show that its existence meets a legitimate charitable purpose. Furthermore, the foundation's operations substantially divert corpus and income from the foundation's exempt purpose by rendering financial aid to members of the NN family in the form of loans and lines of credit and by investing in equipment that far surpass the requirements of a organization of its size. Clearly, funds inure to the benefit of the NN family.

The ORG has not met the burden of showing that it operations and funds were primarily used for charitable purposes and did not inure to private benefit of individuals (see Church of Gospel Ministry v. United States, 640 F. Supp 96 (D DC 1986)).

Therefore, based on the information, the ORG's tax exempt status under section 501(c)(3) of the Code should be revoked because it has not established that is operated exclusively for tax-exempt purposes and or that its net earnings did not inure to the private benefit of the NN family or private individuals.

CONCLUSION

Accordingly, the ORG's recognition as an organization described under section 501(c)(3) should be revoked, effective January 1, 200X because it did not operate exclusively for exempt purposes. Form 1041 U.S. Income Tax Return for Estates and Trusts should be filed for tax years ending December 31, 200X, December 31, 200X, December 31, 200X. Subsequent returns are due no later than the 15th day of the 4th month following the close of the trusts accounting period. For tax year ending December 31, 200X Form 1041 is due April 15, 200X.

Returns should be sent to the following mailing address:

Internal Revenue Service

ALTERNATIVE ISSUE

Should the ORG be reclassified as a private foundation?

LAW

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Internal Revenue Code § 509(a)(3), in part, excludes from the definition of a private foundation, a domestic or foreign organization described in § 501(c)(3) at all times thereafter is operated, exclusively for the benefit of, to perform the function of, or other than an organization that is:

- (A) is organized, and at all times thereafter is operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph (1) or (2),
- (B) is operated, supervised, or controlled by or in connection with one or more organizations described in paragraph (1) or (2) and
- (C) is not controlled directly or indirectly by one or more disqualified persons (as defined in § 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2)

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(b)(1) provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively “for the benefit of, to perform the functions of, or to carry out of the purposes of” one or more specified publicly supported organizations. If the organization fails to meet either the organizational or the operational tests, it cannot qualify as a supporting organization.

Income Tax Regulations section 1.509(a)-4(e) provides that:

(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

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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)(2) provides that section 509(a)(3)(B) sets forth three different types of relationships, one 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
- (iii) Operated in connection with, one or more publicly supported organizations

Income Tax Regulations section 1.509(a)-4(f)(3) provides that 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.

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

(1) (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.

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

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

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

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

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

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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

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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.

Revenue Ruling 76-32, 1976-1 C.B. 160, held, even though the reports are voluntarily submitted, so long as the agreement is observed it will be considered evidence of actual attentiveness within the meaning of section 1.509(a)-4-(i)(3)(iii)(d) of the Regulations for purposes of determining whether the attentiveness requirement of the integral part test of section 1.509(a)-4(i)(3)(iii) is satisfied. However, while the agreement will be considered evidence of actual attentiveness under section 1.509(a)-4(i)(3)(iii)(d), it will not, in itself, satisfy the attentiveness requirement of the integral part test of section 1.509(a)-4(i)(3)(iii). Rather, in order to satisfy that requirement, all of the factors mentioned in the regulations must be taken into consideration.

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

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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

It is the government's position that the ORG's tax exempt status should be revoked (Issue #1). Alternatively, it 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 was intentionally inclusive so that all organizations exempted from tax by section 501(c)(3) are private foundations except for those specified in section 509(a)(1) through(4), Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566, 58 T.C.M. (CCH) 402, 404 (1989); Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7th Cir. 1979). The ORG seeks to escape private foundation status and its associated controls of Chapter 42 by fitting under section 509(a)(3) which defines supporting organizations.

Publicly supported organizations as defined in sections 509(a)(1) and (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 because Congress believed the public charities which they support would provide sufficient oversight and keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie Charitable Fund, 603 F.2d at 1277-78.

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

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

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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. None of these tests are met here.

(A) Organizational and Operational Test

The ORG is not organized to benefit one or more specified publicly supported organizations. Pursuant to Treas. Reg. 1.509(a)-4(c)(1)(iii) and (iv), an organization's governing instrument must state the specified publicly supported organization(s) on whose behalf the organization is to be operated and cannot expressly empower the organization to support or benefit any organizations other than the specified publicly supported organizations(s). Although the ORG's organizing documents specify its publicly supported organization's on Schedule A recognizing RR as its Primary Charity, its dissolution clause allows distributions to organizations other than the specified publicly supported organizations upon termination of ORG. The trust document, also, provides that in the event that the organization does not achieve exempt status under IRC section 501(c)(3), 509(a)(3), assets will go to the members of the NN family upon dissolution. The possible beneficiaries are not limited to RR or to the organizations specified on Schedule A. Therefore, the organizational test is not met. See Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274 (7th Cir. 1979) (the court held the organizational test was not satisfied where the trustee had the power to determine the charitable use was unnecessary or impracticable and to distribute the income to any charitable corporation he selected).

In addition, 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 Issue number 1 above, the ORG has served private interests and has made payments for the benefit of the NN family. Therefore, it has not established that it operates exclusively for the benefit of the publicly supported organizations. Most, if not all, of the distributions and activities have personally benefited the NN family and not specified publicly supported organizations.

Relationship test under IRC Section 509

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.

In the present case, the majority of the ORG's governance was not appointed or elected by the specified publicly supported organization. In fact, per city in which it resided, the ORG requested that members of RR sit on its Board of Directors. Furthermore, there was no common supervision or control by the same persons over ORG and the specified publicly supported charity. The information provided by the ORG

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shows that the representatives from RR attended board meetings but did not participate in the investment decisions of the ORG. Accordingly, the facts indicate that there was no substantial control or direction over the policies or activities of the ORG by RR.

Thus, the requirements to be one of the first two types of relationship are not met.

The third and final relationship possible for section 509(a)(3) organizations is the "operated in connection with" relationship which requires that the supporting organization be responsive to the needs or demands of the publicly supported organization and constitute an integral part of, or maintain a significant involvement in the affairs of the publicly supported organization. This relationship is satisfied where the supporting organization meets both the "responsiveness" and "integral part" tests.

Neither the integral part test nor the responsiveness tests have been met in this case.

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

Treas. Reg. § 1.509(a)-4(i)(3)(ii) provides that the activities engaged in for or on behalf of the publicly supported organizations must be activities to perform the functions of, or to carry out the purposes of, such organizations and, but for, the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves. Thus, this part of the integral part test applies in those situations in which the supporting organization actually engages in activities which benefit the publicly supported organizations as opposed to simply making grants to support the publicly supported organizations. See Roe Foundation, 58 T.C.M. at 408; Cuddeback Foundation v. Commissioner, T.C. Memo. 2002-300. The ORG does not meet this test because it does not perform any activities the publicly supported organization conduct themselves.

Treas. Reg. § 1.509(a)-4(i)(3)(iii) has 3 basic requirements and they are: 1) payment of substantially all of its income to publicly supported organizations; 2) the amount received by one publicly supported organization must be sufficient to motivate it to pay attention to the operations of the supporting organization; and 3) a substantial amount of the total support of the organization must go to those publicly supported organizations that meet the attentiveness requirement.

Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a) provides, in part, that in order to meet the integral part test, the foundation has two options: 1) it could engage in activities normally performed by the supported organization to carry out the functions of the supported organization or 2) it could make payments to substantially all of its income to or for the use of one or more publicly supported organizations and the amount of such support received by one or more of such publicly supported organizations must be sufficient to ensure that attentiveness of such organizations to the operations of the supporting organization. Additionally, 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.

Although the ORG has the option to donate to any charity listed in its Articles of Trust, the foundation reported that it focuses x% of its attention on RR. During the year under examination, the foundation claims to have provided its supported charity with fundraising efforts in lieu of cash contributions. The

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foundation had purchased equipment for the purpose of creating flyers and other promotional items to provide support to its charities; however, the foundation has not provided any evidence that suggests that such equipment was used to create promotional items for the RR.

Furthermore, minutes of the meetings do not suggest that fundraising activities were discussed between the foundation and the RR. Correspondence with RR failed to confirm that the organization performed any services for RR to support those functions normally carried out by the RR. NN, executive director of RR during the period of time in which the foundation operated in CY, has been replaced by NN. NN did not find the ORG memorable and implied that no records existed to substantiate its relationship with the foundation. NN agreed to search the charity's databases to confirm. Subsequent to multiple efforts to contact NN with the last attempt made on March 3, 200X, she has chosen not to respond.

Furthermore, NN stated that he did not devote all of his time to the foundation. He held that the organization's books and records were not properly maintained because he often posted transactions months at a time. Without staff members, it is highly unlikely that that NN would have the time to conduct fundraising activities that would prove significant to the RR's existing resources. Additionally, upon the foundation's return to CY in 200X, "fundraising efforts" were abandoned.

Consequently, in order for the organization to meet the integral part test, it would have to qualify under the second option and distribute enough income to its supported charities to ensure attentiveness.

As of January 18, 200X, the organization has made the following donations to the RR:

- 1) December 18, 200X
 - Donation: check for \$x
- 2) December 31, 200X
 - Donation: \$x non-cash contribution (wireless network)
- 3) December 1, 200X
 - Donation: check for \$x

NN confirmed that she has been working with the foundation for about a year. She explained that the NN Foundation used to work with RR in ST and that they requested that she sit on the Board of Directors when they moved back to ST. NN has, as of January 18, 200X attended x meetings. When questioned about the depth of her involvement with the foundation, NN simply stated that the foundation is a "very small organization that is made up primarily of family members." Subsequent calls to verify additional information, with the final attempt made on February 9, 200X, were ignored.

Even though the foundation's interaction with RR in CY could not be confirmed, it may be concluded that since RR has not made a conscious effort to confirm its relationship with the ORG, the foundation's interaction with its Primary Charity was evidently not significant enough to cause RR to pay an adequate amount of attention to the foundation's operations. Furthermore, it may also be determined that compared to the millions in assets that RR maintains, the maximum donation made by the ORG to RR of \$x is insignificant.

It is evident that the foundation did not provide RR with enough support to ensure the charity's attentiveness to its activities, nor did the foundation contribute a substantial amount of its total support to the charity. The foundation also fails to meet provisions provided under Treas. Reg. § 1.509(a)-4(i)(3)(iii)(b) that allows the foundation to meet this test by contributing its funds to support a particular program. Instead, the foundation has invested most of its revenue in supplies and equipment that do not appear to serve the foundation's exempt purpose. In addition, a majority of the foundation's assets have been disbursed and continuously reinvested as loans to family members.

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Treas. Reg. § 1.509(a)-4(i)(2)(ii)(d) provides, in part, that in order to meet the responsiveness test, the officers, directors, or trustees of the publicly supported organizations must have a significant voice in the supporting organization's financial decisions.

NN, executive director of RR in CY, stated that during the meetings, the foundation basically ran through the financials and discussed how much was put into the foundation. Upon request, NN provided a copy of a check received from the ORG on December 1, 200X in the amount of \$x that documents the only funds donated to the charity in CY as of January 18, 200X.

It is apparent that the foundation made an effort to meet the responsiveness test by requesting that members of RR sit on its Board of Directors. However, in order to meet the responsiveness test, the supported organization's involvement must surpass that of a receiver.

First, the foundation automatically assumed that RR would find use for an old wireless network. In February of 200X, the discontinuance of the UR Pro 5000 network was announced by UR as they moved on to concentrate on their other products lines. Since the network would no longer be on the market and receive customer support from the maker, it would eventually become obsolete and valueless.

Furthermore, the content of the meetings provide that members of RR merely sit in on the meetings and are informed of the decisions already made by NN. It appears that RR has not been provided with the opportunity to exercise any rights to participate in decision making matters.

Control Test (IRC 509(a)(3)(C))

Internal Revenue Code § 509(a)(3)(C) and Treas. Reg. § 1.509(a)-4(j)(1) provides that a supporting organization may not be controlled, directly or indirectly by disqualified persons. 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. As founders, substantial contributors, and members of the Board of Directors of the ORG, NN (trustee) and NN are disqualified persons. As the son of NN and NN and as an alternative member of the Board of Directors in 2004, NNNN is a disqualified person.

Although individuals from RR were recognized as board members, there is no evidence indicating that these other board members were involved in any way with the investment policies and activities of the ORG. In their sole discretion, the NN family entered into questionable transactions using ORG's funds for their personal benefit which significantly impeded ORG's ability to perform its stated exempt purpose as mentioned above.

CONCLUSION

Therefore, the ORG should be reclassified as an organization that is a private foundation defined in section 509(a). The ORG cannot be classified as a supporting organization because it has not established that it has met the requirements set forth in Treas. Reg. § 1.509(a)-4(c) through (j). This determination is effective beginning January 1, 200X Form 990 PF Return of Private Foundation should be filed for tax years ending December 31, 200X, December 31, 200X, December 31, 200X. 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, 200X Form 990 PF is due May 15, 200X.

Send your returns to the following mailing address:

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Internal Revenue Service

Note:

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