



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TEGE EO Examinations Mail Stop 4920 DAL
1100 Commerce St.
Dallas, Texas 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

501.03-00

Date: April 23, 2010

Release Number: 201032048
Release Date: 8/13/2010

LEGEND

ORG = Organization name
XX = Date Address = Address

ORG
ADDRESS

Taxpayer Identification Number:
Person to Contact:
Employee Identification Number:
Employee Telephone Number:
(Phone)
(Fax)

LAST DATE TO FILE A PETITION
IN TAX COURT: July 22, 20XX

CERTIFIED MAIL – RETURN RECEIPT

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated February 19XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

Organizations described in section 501(c)(3) of the Code and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You are not operated exclusively for exempt purposes because you engaged in the illegal diversion of prizes and proceeds from raffle ticket sales for the personal use of your officers, employees, and/or other private individuals. Your net income inured to the benefit of your founder and President. Moreover, you failed to respond to repeated reasonable requests to allow the Internal Revenue Service to examine your records regarding your receipts, expenditures, or activities as required by sections 6001 and 6033(a)(1) of the Code and Rev. Rul. 59-95, 1959-1 C.B. 627.

Contributions to your organization are no longer deductible under section 170 of the Code after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years

thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

You also 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, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

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

Sincerely,

**Nanette M. Downing
Acting Director, EO Examinations**

**Enclosures:
Publication 892**

**Internal Revenue Service
Tax Exempt and Government Entities Division
1100 Commerce Street, MC4915:DAL**

Department of the Treasury

Dallas, TX 75242

Date: December 26, 2008

LEGEND

ORG - Organization name XX = Date
Address = address

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Telephone Number:
Contact Fax Number:

**ORG
ADDRESS**

**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 501(c)(3) 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,

Larry Clevenger
EO, Revenue Agent

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 December 31, 20XX

LEGEND

ORG = Organization name XX = Date CO-1 = 1st Company Secretary =
secretary President = President BM-1, BM-2 & BM-3 = 1st, 2nd & 3rd BOARD
MEMBERS

Issue:

Should the exempt status of ORG, under Section 501(a) of the Internal Revenue Code (IRC) as an organization described in IRC Section 501(c)(3) be revoked for the year beginning on January 1, 20XX, due to inurement, private benefit and violations of state and local law?

Facts:

A State certificate of incorporation was issued to CO-1. on January 10, 19XX (name was changed to ORG in 19XX). According to State records, the address of ORG is Address, City, State.

The last Registered Agent of ORG was BM-1 (deceased). Only officers listed are Secretary as Secretary and director and President as President. All addresses on the annual report are the same as the organization. BM-2 and BM-3 are also listed as directors of ORG.

The State of State terminated the certificate of incorporation on December 19, 20XX for failure to maintain a registered agent.

Based on records from the Internal Revenue Service, ORG, received its non-profit determination letter (Internal Revenue Code Section 501(c)(3) ruling) in 19XX as a 509(a)(2) entity.

In March, 20XX, the United States Attorney's Office of Eastern District of State, indicted President founder, President and Director of ORG on charges of fraud in connection with four raffles conducted by President under the name of ORG. According to the indictment, from January 1, 20XX through May 20XX, President, operated and managed ORG. The raffles were promoted as charitable contributions with substantial prizes for the winners and substantial monies to charities.

The first raffle was the Grand Giveaway in City State. The raffle started in 20XX and the drawing was held on February 14, 20XX. Approximately 1,409 tickets were sold resulting in \$ in proceeds. The winner of the raffle (a house) accepted a substantial cash prize instead of the house.

A second raffle started in October 20XX and yielded proceeds of \$. The drawing was never held, and prizes were not awarded.

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Third raffle started in May 20XX and had ticket sales of \$. Again the drawing was never held and no prizes awarded.

Fourth raffle was located in City, State. The raffle started May 20XX. Tickets sales resulted in proceeds of \$\$ and a drawing was never held and none of the prizes were awarded.

During the period of the four raffles, ORG raised approximately \$ dollars with \$\$ going to charitable purposes. President spent \$\$, of the money on personal credit cards and \$\$ on mortgage payments and wrote himself \$\$ in checks.

While testifying at the trial, President stated that the had purchased several hundred raffle tickets for two of the raffles and had won the grand prize. He stated that he used fictions name to purchase the tickets. He also admitted to lying to an Internal Revenue Service auditor who asks about the charity's operations.

The charity was audited by a Revenue Agent for the years 20XX through 20XX and resulted in backup withholding taxes due of \$\$.

In November 20XX, President was found dead of an apparent suicide as the jury was deliberating his fate in the federal trial.

In January 20XX, a City County judge ordered the charity to pay more than \$ as restitution to the people who bought raffle tickets and to pay the state more than \$ in penalties.

Law:

All organizations seeking exemption under **Internal Revenue Code Section 501(c)(3)** must conform to certain fundamental legal principles applicable to all charitable organizations. One of these basic charitable principles is that charitable organizations may not engage in behavior that is illegal or violates public policy.

The illegality doctrine derives from English charitable trust law, the legal foundation on which **Internal Revenue Code Section 501(c)(3)** was established. Under charitable trust law, trusts violating law or public policy cannot qualify for charitable status. The law of charity provides no basis for weighing or evaluating the objective merits of specific activities carried on in furtherance of a charitable purpose, if those activities are reasonably related to the accomplishment of the charitable purpose, and are not illegal or contrary to public policy. See Restatement (Second) of Trusts, section 374, comment 1 (1959).

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Internal Revenue Code Section 501(a) allows organizations described in subsection 501(c) to be exempt from taxation.

Internal Revenue Code Section 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 to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (i)), 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.”

Internal Revenue Code Section 6033(a)(1) requires that, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Section 1.501(c)(3)-1(a) of the **Income Tax Regulations** provides that an organization cannot be exempt under section 501(c)(3) of the Code unless it meets both an organizational and operational test. That is, the organization must be both organized and operated exclusively for charitable purposes.

In determining whether an organization meets the operational test, the issue is whether the particular activity undertaken by the organization is appropriately in furtherance of the organization's exempt purpose, not whether that particular activity in and of itself would be considered charitable. Moreover, the fact that the activity reflects a particular viewpoint or opinion on a controversial issue does not preclude the organization from qualifying for exemption under section 501(c)(3) of the Code. See section 1.501(c)(3)- 1(d)(2) of the regulations.

Treas. Reg. § 1.501(c)(3)-1(a)(1) requires 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.”

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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 such exempt purposes specified in IRC § 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) states 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."

Treas. Reg. § 1.501(a)-1(c) defines private shareholder or individual as "persons having a personal and private interest in the activities of the organization."

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that the operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private rather than a public interest.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(i) provides that an organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

- (a) Religious,
- (b) Charitable
- (c) Scientific,
- (d) Testing for public safety,
- (e) Literary
- (f) Educational, or
- (g) Prevention of cruelty to children or animals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more of the purposes specified in IRC 501(c)(3) unless it services a public rather than a private interest.

Treas. Reg. § 1.501(c)(3)-1(d)(2) includes in the definition of "charitable" or "charity", the following:

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- (a) Relief of the poor and distressed or of the underprivileged,
- (b) Advancement of religion,
- (c) Advancement of education or science,
- (d) Erection or maintenance of public buildings, monuments, or works,
- (e) Lessening of the burdens of Government, and
- (f) Promotion of social welfare by organization designed to accomplish any of the above purposes, or
 - (i) To lessen neighborhood tensions,
 - (ii) To eliminate prejudice and discrimination,
 - (iii) To defend human and civil rights secured by law, or
 - (iv) To combat community deterioration and juvenile delinquency.

Therefore, in making the determination of whether an organization's activities are consistent with exemption under section 501(c)(3) of the Code, the Service will rely on a three-part test, as stated in **Revenue Ruling 80-278 (1980-42 I.R.B. 8)**.

Accordingly, the organization's activities will be considered permissible under section 501(c)(3) if:

- (1) The purpose of the organization is charitable;
- (2) **the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions;** and
- (3) the activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.

Revenue Ruling 71-447, (1971-2 C.B. 230), in interpreting section 501(c)(3) of the Code, concluded that an organization is not operated exclusively for charitable purposes if its activities are carried on in a manner that can be reasonably classified as contrary to well-established Federal public policy.

Revenue Ruling 59-95, (1959-1 C.B. 627), concerns an exempt organization that was requested to produce a financial statement and a statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions 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 exempt status.

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In **Arlie Foundation, Inc. v. United States of America, D.D.C., 826 F. Supp. 537**, the District Court upheld the revocation of Arlie Foundation's tax-exempt status. The District court upheld the revocation because Arlie Foundation operated for non-exempt purposes and for private inurement. In 1979, Dr. Murdock Head, the founder and executive director of AFI, was convicted in the Eastern District of Virginia of conspiracy to commit tax fraud and to bribe public officials. The Fourth Circuit reversed the conviction based on an improper jury instruction. *United States v. Head*, 641 F.2d 174 (4th Cir.1981). Dr. Head was retried and again convicted in 1981. The conviction was affirmed in *United States v. Head*, 697 F.2d 1200 (4th Cir.1982), cert. denied, *539 462 U.S. 1132, 103 S.Ct. 3113, 77 L.Ed.2d 1367 (1983). Following the criminal case, the Internal Revenue Service initiated an investigation of Arlie Foundation's tax-exempt status for the years 1976 through 1980. At the conclusion of the investigation, the Internal Revenue Service determined that the Arlie Foundation did not operate exclusively for exempt purposes because it operated for the private benefit of Dr. Head. In 1988, the Internal Revenue Service issued a notice of determination which revoked, effective January 1, 1976, Arlie Foundation's tax-exempt status as a section 501(c)(3) organization.

In **Freedom Church of Revelation v. United States of America, 588 F.Supp. 693**, the court had to determine if the exempt organization (1) "operated exclusively" for tax-exempt purposes, in accordance to IRC section 501(c)(3); (2) that no part of its net earnings inured to the benefit of any private individual., and (3) and if the revocation should be imposed retroactively?

With regard to the first requirement of section 501(c)(3), i.e., that an organization must be operated exclusively for an exempt purpose, the applicable regulations state as follows: (c) *Operational test* --(1) *Primary activities*. 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.*

Based on similar court cases, the Court wrote that if the nonexempt activities of the plaintiff are more than incidental or insubstantial, it is not entitled to continuing qualification as an exempt organization. The presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes. If there is present in [an organization's] operations a single noncharitable purpose substantial in nature, though it may have other truly and important charitable purposes, it is not entitled to be exempt.

The Court examined the documents presented by Freedom Church, and determined that the plaintiff did not operate exclusively for religious, charitable or educational purposes. Plaintiff has failed to provide any financial records to buttress its claims that it is organized primarily for

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exempt purposes under section 501(c)(3). Moreover, the United States has presented evidence, which has not been refuted, that a substantial activity engaged in by plaintiff was the promotion of tax-avoidance schemes.

Section 501(c)(3) clearly states that an organization must be operating *exclusively* for religious, charitable, educational or other exempt purposes. Tax avoidance schemes do not qualify as "other exempt purposes." Because more than an insubstantial part of its activities is not in furtherance of an exempt purpose, plaintiff has not met the "operational test". Therefore, the Court finds that plaintiff has failed to meet the first requirement of section 501(c)(3) that it be "operated exclusively" for one or more exempt purposes.

The Court also concluded that even if the plaintiff did meet its burden of proving that it is "operated exclusively" for an exempt purpose, plaintiff fails to meet the second requirement of section 501(c)(3), *i.e.*, that its assets do not inure to the private benefit of private shareholders or individuals. A "private shareholder or individual" refer [s] to persons having a personal and private interest in the activities of the organization," and includes the creator of the organization and his family. The requirement that there be no private inurement overlaps the requirement that an organization must operate exclusively for exempt purposes. Clearly, if part of an organization's earnings inure to the benefit of private individuals, the organization cannot be operating exclusively for exempt purposes.

The Court was shown documents which substantiated that a total of \$ was disbursed by check from two Freedom Church accounts to various debtors, all personal in nature. In the absence of any evidence submitted by plaintiff to explain how the funds in these church accounts were used for legitimate church purposes, the Court must conclude that the funds in these accounts inured to the founder's personal benefit. Under any standard of proof, plaintiff has not established that its earnings did not inure to private individuals as required under section 501(c)(3) of the Code. Because plaintiff has failed to meet the requirements of section 501(c)(3), the Court finds that it is not entitled to continuing qualification as an exempt organization.

Finally, the Court had to determine whether the revocation should be imposed retroactively. Title 26, Code of Federal Regulations, section 601.201(1)(5), provides in pertinent part: Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the Gateway to a Cure to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such ruling if (i) there has been no misstatement or omission of material facts, (ii) the facts subsequently developed are not materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable law, (iv) the ruling was originally issued with respect to a prospective or proposed transaction, *and* (v) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to his detriment.

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The Court determined that the plaintiff does not meet all of the requirements set forth in this regulation, thus, it cannot avoid retroactive application of this revocation. The facts upon which the revocation is based are materially different from the representations made in plaintiff's original application for exemption upon which an exemption was granted in 1979. It was only after the IRS granted a tax exemption to plaintiff pursuant to section 501(c)(3) that the IRS found out that Freedom Church was actively promoting tax-avoidance methods and that its earnings were inuring to private individuals, including its leaders. Clearly, these facts as subsequently developed differ materially from the facts on which the original ruling was based.. Accordingly, the Court sustained the retroactive application of the revocation of plaintiff's tax-exempt status.

Government's Position

President of ORG had properly incorporated the organization in accordance with State regulations. However, from January 1, 20XX to May of 20XX, President willfully and specifically violated **Internal Revenue Code Section 501(c)(3)** by diverting the proceeds from the raffles for his own personal use. He admitted to using part of the proceeds to repay personal loans, credit cards and other cash items. These willful acts of diversion are clearly inurement that benefited President.

Since the officer of ORG knowingly and willingly carried out activities in a manner that are contrary to State and Federal public policy, the Internal Revenue Service is proposing that the exempt status of the organization be revoked. President admitted their participation in the following acts:

- President admitted to having made payments to individuals who won prizes at raffles and not filing 1099 forms with the Internal Revenue Service and that these prizes were worth substantially more than \$ dollars.
- President admitted that he used monies from ORG to make payments on his personal credit cards, to make his mortgage payments and to write checks to himself.
- President admitted that he purchased several hundred-raffle tickets in false names and "won" the grand prize on two separate occasions.

In consideration of all the previously reported illegalities which occurred during the operation of ORG from January, 20XX to May, 20XX, and which were willfully and purposely incurred by the officers of the organization, the Internal Revenue Service has determined that the organization does not meet the "three-part activities test" as referenced in **Revenue Ruling 80-**

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278 (1980-42 I.R.B. 8), and thus ineligible to be tax exempt under **Internal Revenue Code Section 501(c)(3)**.

Taxpayer's Position:

The Secretary of the organization (per annual report filed with Secretary of State) will not response to telephone calls.

Conclusion:

Due to the determination that ORG has conducted activities that are in violation of **Internal Revenue Code Section 501(c)(3)**, the Internal Revenue Service is proposing that the tax exempt status of this organization be revoked for the year beginning on January 1, 20XX.