

**Internal Revenue Service**  
Appeals Office

Number: **201038020**  
Release Date: 9/24/2010

Date: June 29, 2010

UIL: 7428.00-00

**Legend**

ORG = Name of Organization  
EIN = EIN of Organization  
NN = Name of Individual

ORG

**Certified Mail**

Dear :

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January 1, 2003.

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

Based on the examination of your records, it has been determined that you do not meet the requirements of an organization described under section 501(c)(3). You failed the operational test described in Income Tax Regulations section 1.501(c)(3)-1(c)(1).

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

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

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

**Department of the Treasury**

**Employer Identification No.:**  
EIN

**Person to Contact:**

**Employee ID Number:**

**Tel:**

**Fax:**

**Form Required to be Filed:**

**Tax Years:**

December 31, - December 31,

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance or you can contact your nearest Advocate's office, in this case by calling (904) 665-1000 or writing to:

Internal Revenue Service  
Taxpayer Advocate's Office  
400 W. Bay Street, Room 535A, MS TAS  
Jacksonville, FL 32202

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in 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 Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Sincerely,

Appeals Team Manager



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service

January 12, 2007

Legend

ORG= Name of organization

EIN= EIN of organization

NN= Name of individual

ORG

Taxpayer Identification Number:

EIN

Form:

Tax Year(s) Ended:

December x, 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 <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer  ORG.		Year/Period Ended  200X12

**Legend**

ORG= Name of organization  
 NE-ORG= New entity organization  
 RR= Related organization  
 ST= State  
 CY= City  
 NN= Name of individual

HOS= Hospital  
 UU= Unrelated organization  
 CT= Country  
 TT= Title  
 x= Amount, Number  
 X= Year

**ISSUES**

1. Whether the tax-exempt status of ORG., an organization that was granted exemption as a school but never operated as a school, effective January x, 200X.
2. Whether revocation of the organization's tax-exempt status should be applied retroactively?

**BRIEF EXPLANATION OF FACTS**

Taxpayer was originally organized as ORG. It subsequently changed its name to ORG., (ORG). ORG was granted exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). It was further determined that it was not a private foundation within the meaning of section 509(a) of the Code, because it is an organization described in sections 509(a)(1) and 170(b)(1)(A)(ii).

According to its Form1023, Application for Recognition of Exemption, ORG stated that the primary purpose of the organization was to operate as a school. It had an agreement with RR (RR) to operate in ST as an extension campus of RR. RR is located in CY, ST. ORG has never operated as an extension campus for RR apparently as the cost would have been too expensive for ORG and its students.

Since its original organization thru current the activities of ORG have been performed by or at least under the direction of NN.

ORG primary activity initially was the collection of food from grocery stores and the distribution of the food to various organizations in the CY, ST area that fed the hungry. ORG does not have any records to substantiate the amount of time that spent on this activity. They estimated that it took x to x hours a day to pickup and delivery food. This activity had been outsourced by January 200X with the NN's efforts limited to coordinating.

Sometime after being granted exempt status they added teaching computer techniques to senior citizens and then teaching others how to translate the Bible. This activity continued through 200X and until 200X. Again there are no records to show the number of people taught or the amount of time spent on these activities.

Sometime in 200X/200X, while recovering from kidney surgery, NN wrote x small religious books. NN also served as volunteer TT at HOS. NN kept the accounting records for the ORG and did whatever additional task needed to be done. They estimated they spent x hours a week working for ORG. Again there is no documentation to support the activities or the amount of time.

The gross receipts for ORG for 200X were \$x with \$x coming from its subordinate members and \$x from sale of network marketing products to the UU. Expenditures totaled \$x with \$x going directly to charity type activities. \$x was spent on cell phone and amvox service for seven months, and \$x was spent on x months of electric bills, with \$x spent on various insurance expenses that included auto/pickup (and tag for truck) as well as life and health insurance on the NN's.

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In 200X ORG applied for and received a group exemption ruling. The group ruling was granted March x, 200X under Section 501(c)(3).

ORG allowed other entities to be covered under its group exemption ruling for a fee. ORG charged each organization an initial fee of \$x plus a monthly fee of \$x. This program allowed the other entities to obtain exemption under 501(c)(3) without having to go thru the normal process of each entity applying to the Internal Revenue Service for an exemption. ORG Group number with the Internal Revenue Service is x.

Each year ORG is required to supply to the Internal Revenue Service a listing of;

- (1) a statement of any changes during the year in the purposes, character, or method of operation of its subordinates;
- (2) a listing of names, mailing address and employer identification numbers of subordinates that, since its previous report; (a) Changed names or address; (b) were deleted from its roster; or (c) were added to its roster.
- (3) For each subordinate to be added, attach a:
  - (a) Statement that the information on which its present group exemption letter is based applies to the new subordinates;
  - (b) Statement that each has given it written authorization to add its name to the roster;
  - (c) List of those to which the Service previously issued exemption rulings or determination letters;
  - (d) Statement that none of the subordinates is a private foundation

On October x, 200X ORG reported to the Internal Revenue Service that it had x subordinate entities. The letter indicated that several were new subordinates and that any subordinate that was on prior year's report and not listed on this year's report were no longer subordinates, instead of a listing of subordinates dropped as required by their letter ruling. Of the x entities that were on the original application for the group exemption letter of ORG in 200X only RR, which was founded by the NN's, was on the October x, 200X subordinate listing.

The Internal Revenue Service's listing of subordinates, as of cycle 200XXX, listed x entities as subordinates which included only x of the entities reflected on the ORG October x, 200X listing. Review of the website hosted by Economic Research Institute on January x 200X reflected x entities as subordinates of ORG with x of those different from those on the IRS 200X list.

Included on the website of ORG published on 12/13/200X was the statement "for those who are signing up for a non profit group exemption status for \$x, you will receive a full year free monthly association fee-worth \$x..." In addition, on the same website in 200X was a statement that "NN and I have started x faith-based organizations in CT, and assisted over x groups to acquire 501(c)3 Non-Profit Subordinate Status in CT." This statement was subsequently removed from the website.

At about the same time the group ruling was granted by the IRS, the NN's joined a network marketing group as a means to fund ORG. The network marketing activity was in the NN's name. Network marketing is similar if not the same as Multi-level Marketing. It is a means where products or services are distributed by individual distributors instead of a wholesale/retail system employed by "Normal Businesses." Such as, one distributor getting another person (distributor) involved in using and distribution the product or service. Levels are created and the initial person gets monies based upon the sales, use of products of those they introduced into the program and those in their line below them for a certain number of levels. They may receive actual cash payments or larger discounts on their purchases from the organization or a combination of both.

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On June x, 200X, the NN's transferred their network marketing activity to a new entity that they incorporated called NE-ORG. NE-ORG is owned and controlled by the NN's. NE-ORG was incorporated as a for profit corporation on May x, 200X and elected non-profit status by a Board meeting on December x, 200X and filed articles with the State on February x, 200X for the non-profit election. NE-ORG reported all of its activities on Forms 990 for 200X and 200X.

NE-ORG was not included as a subordinate organization of ORG on the subordinate listing filed with the IRS in October x, 200X.

After initiation of the IRS examination of ORG and NE-ORG, the NN's filed amended returns to remove the network marketing activity from the Form 990 of NE-ORG and add it to the NN's personal 1040 for 200X. For 200X the NN's reported the net working activity on their personal Form 1040, but did not file an amended Form 990 for NE-ORG for 200X to remove the networking activity.

Total receipts reported on the original form 990 for NE-ORG for 200X were \$x, with \$x coming from network marketing activities and the balance of \$x from other than network marketing activity, of which \$x was from the NN's.

On the filed amended return the receipts and the expenditures for 200X were exactly the same amount. Of the \$x listed as spent by NE-ORG; \$x went to ORG; \$x to a mortgage payments on principal residence and \$x to NN (their son). Most of the balance (\$x) was not determined.

The website of ORG has links to the network marketing activity and advises its subordinate organizations on how to use the network marketing activity to fund their exempt organizations activities.

## LAW and Analysis

### Issue 1.

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

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

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an **insubstantial** part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that 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, 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.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the promotion of education.

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The presence of a **single substantial** nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Bus. Bureau v. United States, 326 U.S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F.2d. 340 (4<sup>th</sup> Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). 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. Am Campaign Acad. v. Commissioner, supra at 1065-1066.

In Christian Stewardship Assistance vs. Commission 70 T.C. 1037, an organization was formed as a nonprofit corporation to support and assist religious, educational and/or other nonprofit organizations in their relationships with their contributors and in stimulating proper application of Christian stewardship principles among their contributors. To reimburse its cost of operation, petitioners charge a fee to each subscribing organization.

Respondent determined that the described activities, although helpful to charitable organizations are not exclusively for charitable purposes, but rather serve private interest by advising individuals about methods to decrease Federal income and estate taxes.

In Revenue Ruling 69-545, a hospital did not qualify under section 501(c)(3) of the Code because it must be organized and operated exclusively for one or more of the purposes set forth in that section. Hospital B was initially established as a proprietary institution (same as network marketing) for the benefit of its owners. Although its ownership had been transferred to a nonprofit organization, the hospital continued to be operated for the private benefit of the original owners who exercised control over the EO through the board of trustees. They had used their control to restrict staff (determine amount contributions), to enter into favorable rental agreements (who deducts what expenses), and to limit emergency room care and hospital admission to their own patients. These facts indicated that the hospital was operated for the private benefit of its original owners, rather than for the exclusive benefit of the public.

In Living Faith, Inc vs. Commissioner 950 F.2<sup>nd</sup> 365, a nonprofit organization operated restaurants and food stores in accordance with doctrines of the Seventh-day Adventist Church. Their application was denied because it was not operated exclusively for exempt purposes. Living Faith operated two vegetarian restaurants and health food stores in Illinois. These two facilities-the subject of this litigation-were open to the public. They had several purposes listed to (1) teach restaurant management, (2) teach vegetarian cooking, (3) minister to those...changing their way of life....,(4) learn how to communicate with others. In addition to purveying food and health products, Living Faith disseminated various informational materials which promoted both the healing and message of Jesus Christ and.... Each day before the facilities opened, Living Faith conducted devotional talks....., Bible reading....., Bible Studies.....It occasionally provided meals to the needy..... The nonexempt purpose cannot be substantial. A single activity may be carried on for more than one purpose. The fact that an organization's primary activity may constitute a trade or business does not, of itself, disqualify it from classification under 501(c)(3), provided the trade or business furthers or accomplishes an exempt purpose. If one of the activities purposes, however, is substantial and nonexempt, the organization will be denied exempt status under 501(c)(3), even if its activity also furthers an exempt purpose.

In making its decision, the Tax Court considered the following factors to be critical to its determination: (1) Whether an activity has a substantial nonexempt purpose is a question of fact; (2) Does it conduct its business in an apparently commercial manner? Does the organization use promotional materials and "commercial catch phrases" to enhance sales? (3) Is the organization in competition with commercial firms?



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### TAXPAYER'S POSITION

The organization believes that it is entitled to exemption under section 501(c)(3) because its primary purpose is to lead men and women to a life of Christian Fellowship and relationship with God. It's programs of caregiving through food programs, and aid to seniors, disabled and downtrodden in all aspects of their lives are section 501(c)(3) activities.

### GOVERNMENT'S POSITION

Based on the facts determined during the examination, the organization does not qualify for exemption as a school, its original reason for exemption status, since its operations were never that of a school. It never informed the government even when applying for group ruling that it had never operated as a school and was instead carrying on other charitable activities such as a food bank.

Its activities of operating as a food bank and teaching of Seniors on the use of computers was in prior years and does not have documentation that supports the amount of time or money involved in these activities. The Food Bank activity was outsourced in 199X. The teaching of senior citizens on how to use computers ended sometime in 200X due to lack of funding.

Rather ORG's primary activities have involved promoting a network marketing activity from its website that is more than insubstantial and directly confers a private benefit to its directors and at least one of its purported subordinate organizations which in actuality has been used to conduct for profit marketing on behalf of the NNs.

Although operating the network marketing may have some benefit to the public as a result of educating about water purification, such education would appear quite minimal and not much different from customer education resulting from the sale of any product. Rather, the operating of the network marketing and the sale of the units by NE-ORG (subordinate organization of ORG), its directors or any other of its subordinates is clearly allowing the supposed charity to operated for the private benefit and interests of the NN's. See Rev. Rul. 69-545.

As noted above, an organization that operates for the benefit of private interests, such as designated individuals, by definition does not operate exclusively for exempt purposes. This case is similar to Living Faith, in that network marketing is the means to generate revenues vs. operation of a restaurant and health food store. In the instant case ORG uses its website to advocate its network marketing as a means to secure financing for various exempt activities. However, the primary activity of ORG has never been to operate a school. Since 200X its main activity has been to solicit others to its networking marketing operations that directly benefit the founders of ORG and any of the other Subordinate Exempt Organization Directors' that join the networking marketing. ORG only benefits indirectly from the activity by eventually getting whatever funds the Directors decide to donate to ORG.

### CONCLUSION

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked.

### LAW

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**Issue 2.**

IRC § 7805(b) provides that the Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.

Rev. Proc. 98-1, 1998-1 I.R.B. 7 provides that except in rare or unusual circumstances, the revocation or modification of a letter ruling will not be applied retroactively to the taxpayer for whom the letter ruling was issued or to a taxpayer whose tax liability was directly involved in the letter ruling provided that: (1) there has been no misstatement or omission of material facts; (2) the facts at the time of the transaction are not materially different from the facts on which the letter ruling was based; (3) there has been no change in the applicable law; (4) the letter ruling was originally issued for a proposed transaction; and (5) the taxpayer directly involved in the letter ruling acted in good faith in relying on the letter ruling, and revoking or modifying the letter ruling retroactively would be to the taxpayer's detriment.

**TAXPAYER'S POSITION**

The organization claims that it meets the five criteria to obtain equitable relief under section 7805(b) on the basis that it operated under the good faith belief that it qualified as an educational and charitable organization under section 501(c)(3) of the Code.

**GOVERNMENT'S POSITION**

Section 7805(b) relief should not be granted in this case, since the organization, contrary to its position, does not meet the listed five criteria; the organization failed to conduct the tax-exempt activities that it reflected in its application for exemption. When the organization realized that it would not nor could not operate as authorized and changed its exempt purpose it did not notify the Service of this change as required by regulations. When it applied for group ruling it did not notify that it was conducting network marketing. It also did not mention that it was no longer a school as authorized in the original application. Accordingly, the failure to disclose the information is an omission of a material fact and the organization's tax-exempt status should be revoked retroactively.

**CONCLUSION**

Based on the foregoing, the organization is not entitled to section 7805(b) relief.