



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
MC:4957:DAL:OS
1100 Commerce St.
Dallas, TX 75242

501.03-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: 201039034

May 06, 2010

Release Date: 10/1/10

LEGEND

ORG = Organization name XX = Date Address = address

ORG
ADDRESS

Form Number:
Tax Year Ended: December 31, 20XX
Taxpayer Identification Number:
Person to Contact:
Employee Identification Number:
Contact Telephone Number:
(PHONE)
(FAX)
In Reply Refer to: TE/GE Review Staff

LAST DATE FOR FILING A PETITION WITH TAX
COURT, THE UNITED STATES COURT OF FEDERAL
CLAIMS OR THE DISTRICT COURT OF THE UNITED
STATES FOR THE DISTRICT OF COLUMBIA: _____
August 04, 20XX

Dear

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

- 1. You have failed to demonstrate that you are operated exclusively for an exempt purpose and that your net income did not inure to the private benefit of individuals.
2. Your operations of the CO constitutes engaging in an activity not in furtherance of an exempt purpose to an extent that is more than insubstantial.

Based upon these reasons, we are retroactively revoking your IRC §501(c)(3) tax exempt status effective for all years beginning on or after January 1, 20XX.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file federal income tax returns on Form 1120, U.S. Corporation Income Tax Return, for the years ended December 31, 20XX, and for all years thereafter with the appropriate Service Center immediately and by the due date of Form 1120 for all subsequent years.

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

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in 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 before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

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 the Taxpayer Advocate from the site where the tax deficiency was determined by calling (214) 413-6500 or writing to:

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 the United States 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.

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

Sincerely yours,

Nanette M. Downing
Director, EO Examinations

Attachment:
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

January 8, 2010

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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,

Nanette M. Downing
Acting Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG		Years Ended December 31, 20XX December 31, 20XX

LEGEND

ORG = Organization name City = city State = stat RA-1 = 1st RA
 DIR-1 = 1st DIRECTOR CO-1, CO-2, CO-3 & CO-4 = 1st, 2nd, 3rd & 4th COMPANIES

ISSUES

Whether the tax-exempt status of ORG under 501(c)(3) be revoked?

BRIEF EXPLANATION OF FACTS

ORG (hereafter "ORG") is a State non-profit corporation domiciled at City, State. ORG organized exclusively for charitable purposes within the meaning of IRC 501(c)(3). ORG was recognized as exempt from Federal income tax under IRC 501(a) as an organization described in IRC 501(c)(3) by the Internal Revenue Service in a letter dated July 17, 19XX. In that same letter, the Service also ruled ORG was reasonably expected to be a publicly supported organization described in IRC section 509(a)(1) & 170(b)(1)(A)(vi).

ORG's primary activity is to own and operate CO-1 located in City. The airports website states CO-1 is "the largest privately owned airport home to over 550 aircraft. State. CO-1 is located three miles Northwest of City. The airport is a small airfield, with two runways. ORG owns 22 rental hangers, which are combined together in two separate building, and are owned and maintained by ORG. All other hangers, planes, and buildings on the premises are individually owned, and are not part of the organization. ORG is under any obligation to maintain the privately owned hangers. In a conversation with RA-1 of the CO-1 the Secretary/Treasurer of ORG stated "the airport is used almost exclusively for general aviation purposes by aircraft based at the airport". The airport operators estimated less than 1% of the traffic was from transient aircraft.

In 20XX and 20XX, the Internal Revenue Service (herein referred to as "Service") conducted an examination of EO's Form 990 for the tax period ending December 31, 20XX, but expanded the examination to include 20XX. The examination also expanded to Forms 990-T for the same tax years. EO is either unable to or refuses to completely respond to the following document requests which raise questions arising from responses from previous document requests, and which are relevant to EO's exempt status: EO-05, 28, 35, 37, 39, 43, 44, 45, 46, 47, and 48.

DIR-1 is one of the founders of ORG. DIR-1 and his Wife, RA-1 operate and control ORG. DIR-1 is listed as Director, and RA-1 DIR-1 is the Secretary/Treasurer. DIR-1 also controls CO-2 a taxable entity. CO-2 is a related organization with respect to ORG by common officers and directors. CO-2 received payments from ORG for loans lent ORG to purchase the Airport assets.

CO-1 is privately owned and operated by ORG. The organization has two board members DIR-1 and RA-1 who control ORG. DIR-1 and RA-1 are related individuals.

No governmental body was found to have any relation with ORG or its management, and ORG receives no governmental support. Income received by ORG is primarily from rental revenue from the hangers, license fees from airport property owners. The organization also receives a small amount of revenue from interest and contributions. Income is expended for permanent improvements to the airport, maintenance, daily operations and payment on debt.

Forms 990 for the period ending December 31, 20XX indicated the following:

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG		Years Ended December 31, 20XX December 31, 20XX

- *There was \$ of Mortgages and Notes Payable according to Parts IV of the Form 990*
- *There was \$ of Other Liabilities reported as Long Term Interest Payable (Accrued Negative Amort) according to Part IV, Balance Sheet.*
- There was \$ of Interest Expense according to Part II Statement of Function Expenses Line 41.

Forms 990 for the period ending December 31, 20XX indicated the following:

- *There was \$ of Mortgages and Notes Payable according to Parts IV of the Form 990*
- *There was \$ of Other Liabilities reported as Long Term Interest Payable (Accrued Negative Amort) according to Part IV, Balance Sheet.*
- There was \$ of Interest Expense according to Part II Statement of Function Expenses Line 41.

The following information/ documents were provided for our examination of this issue:

1. Promissory Note for loan payable to CO-2.dated 12/31/XX. The Principal amount was for \$, had an interest rate of 12%. Principal will be paid in total on demand at the end of a period of time when the interest paid + principal equals the stated \$ or on December 31, 20XX, as may be elected at the discretion of ORG, Inc.

At the end of the 3-year period, the 12% interest rate will be adjusted to offset any negative amortization and a new interest rate schedule will be established.

DIR-1 signed the promissory note.

2. Promissory Note for loan payable to CO-2.dated 12/31/XX. The Principal amount was for \$, had an interest rate of 12%. Principal will be paid in total on demand at the end of a period of time when the interest paid + principal equals the stated \$ or on December 31, 20XX, as may be elected at the discretion of ORG, Inc.

At the end of the 3-year period, the 12% interest rate will be adjusted to offset any negative amortization and a new interest rate schedule will be established.

DIR-1 signed the promissory note.

3. Promissory Note for loan payable to CO-2.dated 12/31/XX. The Principal amount was for \$, had an interest rate of 12%. Principal will be paid in total on demand at the end of a period of time when the interest paid + principal equals the stated \$ or on December 31, 20XX, as may be elected at the discretion of ORG, Inc.

At the end of the 3-year period, the 12% interest rate will be adjusted to offset any negative amortization and a new interest rate schedule will be established.

DIR-1 signed the promissory note

ORG's Form 990, included an attachment schedule (Mortgages Schedule, Page 4, Part IV, Line 64b:listed the amounts of loans outstanding of the following:

Notes Payable O/S Parties		(1)Total Payable to Related Parties	
<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG		Years Ended December 31, 20XX December 31, 20XX

CO-2		
CO-2	\$	
CO-2	\$	
DIR-1	\$	
Total		<u>\$ \$ \$</u>

Note (1): Total Payable to Related Parties include Notes Payable outstanding plus accrued negative amortization on interest on the Notes Payable. The unpaid interest is added to the notes payable balance.

Loan Payments Made by ORG
Per review of CO-3 (Account #) records, the following was paid to CO-2.

<u>CHECK #</u>	<u>DATE</u>	<u>AMOUNT</u>	<u>CHECK #</u>	<u>DATE</u>	<u>AMOUNT</u>
675	01/26/XX	\$	746	01/31/20XX	\$
678	01/24/XX	\$	754	02/28/20XX	\$
676	01/31/XX	\$	765	03/31/20XX	\$
682	02/28/XX	\$	772	04/30/20XX	\$
689	03/31/XX	\$	778	04/30/20XX	\$
693	04/30/XX	\$	789	05/31/20XX	\$
700	05/31/XX	\$	798	06/19/20XX	\$
704	06/30/XX	\$	800	06/30/20XX	\$
709	07/31/XX	\$	806	07/10/20XX	\$
715	08/31/XX	\$	810	07/19/20XX	\$
719	09/30/XX	\$	811	07/20/20XX	\$
724	10/11/XX	\$	812	07/31/20XX	\$
726	10/31/XX	\$	817	08/31/20XX	\$
731	11/30/XX	\$	825	09/11/20XX	\$
741	12/31/XX	\$	826	09/17/20XX	\$
			828	09/26/20XX	\$
			829	09/30/20XX	\$
			839	10/31/20XX	\$
			846	11/30/20XX	\$
			850	12/19/20XX	\$
			853	12/31/20XX	\$
Sub Total:		\$	Sub Total:		\$

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG		Years Ended December 31, 20XX December 31, 20XX

TOTAL 20XX & 20XX CO-2: \$

Per review of CO-3 (Account #) records, the following was paid to DIR-1

677	01/31/XX	\$	744	01/05/XX	\$
683	02/28/XX	\$	747	01/31/XX	\$
690	03/31/XX	\$	752	02/28/XX	\$
694	04/30/XX	\$	755	02/28/XX	\$
701	05/31/XX	\$	760	03/14/XX	\$
705	06/30/XX	\$	758	03/12/XX	\$
710	07/31/XX	\$	766	03/30/XX	\$
716	08/02/XX	\$	770	04/05/XX	\$
720	09/30/XX	\$	771	04/09/XX	\$
727	10/31/XX	\$	773	04/10/XX	\$
732	11/30/XX	\$	777	04/19/XX	\$
742	12/31/XX	\$	779	04/30/XX	\$
			782	05/09/XX	\$
			787	05/21/XX	\$
			788	05/24/XX	\$
			790	05/31/XX	\$
			793	06/11/XX	\$
			798	06/19/XX	\$
			799	06/22/XX	\$
			802	06/30/XX	\$
			804	07/03/XX	\$
			807	07/10/XX	\$
			809	07/16/XX	\$
			819	08/31/XX	\$
			820	08/31/XX	\$
			822	09/27/XX	\$
			824	09/11/XX	\$
			827	09/25/XX	\$
			830	09/30/XX	\$
			831	10/05/XX	\$
			832	10/XX/XX	\$
			834	10/09/XX	\$
			835	10/23/XX	\$
			840	10/31/XX	\$
			847	11/30/XX	\$
			851	12/19/XX	\$
			852	12/22/XX	\$
				12/31/XX	\$
			Sub Total:	Sub Total:	

TOTAL 20XX: \$U.S.

LAW

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG		Years Ended December 31, 20XX December 31, 20XX

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 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 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 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 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 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 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.

Primary Purpose; Substantial Nonexempt Purpose

In *Better Business Bureau of Washington, D.C. v. United States*, 326 U.S. 279, 283 (1945), the United States Supreme Court stated that "the presence of a single . . . [non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

In making the appropriate analysis, it is necessary to focus on the purpose rather than the nature of the organization's activities. *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979); *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978); *Golden Rule Church Association v. Commissioner*, 41 T.C. 719 (1964); see *Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578 (1924); *San Francisco Infant School v. Commissioner*, 69 T.C. 957 (1978). An organization whose activities constitute a trade or business or generate a profit may still be exempt, provided that those activities accomplish an exempt purpose. Sec. 1.501(c)(3)-1(e)(1), Income Tax Regs.; *B.S.W. Group, Inc. v. Commissioner*, *supra*. Compare *Randall Foundation v. Riddell*, 244 F.2d 803 (9th Cir. 1957), [****11**] with *Passaic United Hebrew Burial Association v. United States*, 216 F. Supp. 500 (D. N.J. 1963).

However, in *Living Faith Inc. v. Commissioner*, 950 F.2d 365, 372 (7th Cir. 19XX), *affg.* T.C. Memo. 1990-484, an organization's purposes may be inferred from its manner of operations; its "activities provide a useful indicia of the organization's purpose or purposes."

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 358 (1978), the Court states that "Factors such as the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits are relevant evidence of a forbidden predominant purpose."

KJ's Fund Raisers v. Commissioner, T.C. Memo 19XX-424, *aff'd* 166 F.3d 1200 (2nd Cir. 19XX), petitioner also operated for the substantial private benefit of KJ's Place and its owners. A substantial nonexempt purpose thus characterizes its operation, disqualifying it from exemption under sections

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
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501(a) and 501(c)(3). Citing *Better Business Bureau v. United States*, 326 U.S. at 283; *Copyright Clearance Center, Inc. v. Commissioner*, 79 T.C. at 803.

In *Church by Mail v. Commissioner*, 765 F.2d 1387 (9th Cir. 1985) aff'g TCM 1984-349 (1984), the Court noted that Church by Mail, Inc. ('Church') paid Twentieth Century Advertising Agency ('Twentieth') for services provided. Twentieth was owned and controlled by the two individuals who ran Church. The Tax Court had found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. In addressing whether Church operated for a substantial non-exempt purpose the 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated: "... The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church. *est of Hawaii v. Commissioner*, 71 T.C. at 1080-81; see also *Presbyterian & Reformed Publishing Co. v. Commissioner*, 743 F.2d 148, 155 (3d Cir. 1984) (courts must look to all objective indicia from which a corporate actor's intent may be discerned); *United States v. Dykema*, 666 F.2d 1096, 1100 (7th Cir. 1981), cert. denied, 456 U.S. 983, 72 L. Ed. 2d 861, 102 S. Ct. 2257 (1982) (it is necessary and proper for the I.R.S. to survey all of the activities of an organization to determine whether a non-exempt purpose is furthered).

In *American Campaign Academy v. Commissioner*, 92 T.C. 1053, 1065-1066 (1989), the court stated that when an organization operates for the benefit of private interests...the organization by definition does not operate exclusively for exempt purposes. Prohibited private benefits may include an "advantage; profit, fruit; privilege; gain; [or] interest." Occasional economic benefits flowing to persons, as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefits. Thus, should [the organization] be shown to benefit private interests, it will be *deemed* to further a nonexempt purpose under section 1.501(c)(3)-1(d)(1)(ii)... This nonexempt purpose will prevent [the organization] from operating primarily for exempt purposes absent a showing that no more than insubstantial part of its activities further private interests or any other nonexempt purposes.

In *Housing Pioneers v. Commissioner*, 65 T.C.M. (CCH) 2191 (19 XX), aff'd, 49 F.3d 1395 (9th Cir. 19XX), amended 58 F.3d 401 (9th Cir. 1985) ("*Housing Pioneers*"), the Tax Court concluded that an organization did not qualify as a section 501(c)(3) organization. The organization could describe only a vague charitable function of surveying tenant needs.

Inurement and Private Benefit

In *American Campaign Academy v. Commissioner*, 92 T.C. 1053, (1989), the Court addressed the operational test and illuminates the difference between private benefit, derived by private interests where such private benefit is adverse to exemption under Section 501(c)(3), from inurement, derived by insiders, which also is adverse to exemption under Section 501(c)(3). It states:

... To establish that it operates primarily in activities which accomplish exempt purposes, petitioner must establish that no more than an insubstantial part of its activities does not further an exempt purpose. Sec. 1.501(c)(3)-1(c)(1), Income Tax Regs. The presence of a single substantial nonexempt purpose destroys the exemption regardless of the number or importance of the exempt purposes. *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945); *Copyright Clearance Center v. Commissioner*, 79 T.C. 793, 804 (1982).

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... We have consistently recognized that while the prohibitions against private inurement and private benefits share common and often overlapping elements, Church of Ethereal Joy v. Commissioner, 83 T.C. 20, 21 (1984), Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337, 345 n. 10 (19XX), the two are distinct requirements which must independently be satisfied. Canada v. Commissioner, 82 T.C. 973, 981 (1984); Aid to Artisans, Inc. v. Commissioner, 71 T.C. at 215. Nonetheless, we have often observed that the prohibition against private inurement of net earnings appears redundant, since the inurement of earnings to an interested person or insider would constitute the conferral of a benefit inconsistent with operating exclusively for an exempt purpose. Western Catholic Church v. Commissioner, 73 T.C. 196, 209 n. 27 (1979), *affd. in an unpublished opinion* 631 F.2d 736 (7th Cir. 1980). See also sec. 1.501(c)(3)-1(c)(2), *Income Tax Regs.* In other words, when an organization permits its net earnings to inure to the benefit of a private shareholder or individual, it transgresses the private inurement prohibition and operates for a nonexempt private purpose.

... The absence of private inurement of earnings to the benefit of a private shareholder or individual does not, however, establish that the organization is operated exclusively for exempt purposes. Therefore, while the private inurement prohibition may arguably be subsumed within the private benefit analysis of the operational test, the reverse is not true. Accordingly, when the Court concludes that no prohibited inurement of earnings exists, it cannot stop there but must inquire further and determine whether a prohibited private benefit is conferred. See Aid to Artisans, Inc. v. Commissioner, 71 T.C. at 215; Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 287 (1982).

In People of God Community v. Commissioner, 75 T.C. 127 (1980) the Court, in examining the compensation arrangement of an insider, noted that it is an established principle that the organization is entitled to pay reasonable compensation to an insider but the burden of establishing the reasonableness of the compensation fell upon the organization.

In Founding Church of Scientology v. United States, 412 F. 2d 1197 (Ct. Cl. 1969), *cert. den.*, 397 U.S. 1009 (1970). The Court determined that the different arrangements between the organization and its founder, such as payment of ten percent of gross revenues, lending of money to him and his family, payment of expenses on their behalf, rental of property at inflated prices, resulted in inurement. The Court rejected the reasonable compensation defense. It stated: If in fact a loan or other payment in addition to salary is a disguised distribution or benefit from the net earnings, the character of the payment is not changed by the fact that the recipient's salary, if increased by the amount of the distribution or benefit, would still have been reasonable.

Section 4958 of the Code, effective September 14, 1995, was added to the Internal Revenue Code by the Taxpayer Bill of Rights 2 bill in 1996 (P.L. 104-168, enacted July 30, 19XX). In Caracci v. Commissioner, 118 T.C. No. 25 (2002), the Court noted: "With the enactment of section 4958, however, the issue whether the tax-exempt status of ... tax-exempt entities should be revoked now must be considered in the context of the 'intermediate sanction' provisions. ... the intermediate sanction regime was enacted in order to provide a less drastic deterrent to the misuse of a charity than revocation of that charity's exempt status. The legislative history explains that 'the intermediate sanctions for 'excess benefit transactions' may be imposed by the IRS in lieu of (or in addition to) revocation of an organization's tax-exempt status.' *H. Rept. 104-506, supra at 59, 19XX-3 C.B. at 107.* A footnote to this statement explains: 'In general, the intermediate sanctions are the sole sanction imposed in those cases in which the excess benefit does not rise to a level where it calls into question whether, on the whole, the organization functions as a charitable or other tax-exempt organization'. *Id. n. 15, 19XX-3 C.B. at 107.* Although the imposition of section 4958 excise taxes as a

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer ORG		Years Ended December 31, 20XX December 31, 20XX

result of an excess benefit transaction does not preclude revocation of the organization's tax- exempt status, the legislative history indicates that both a revocation and the imposition of intermediate sanctions will be an unusual case." (emphasis added)

Net earnings may inure to the benefit of private individuals in ways other than by the actual distribution of dividends or payment of excessive salaries. General Contractors' Ass'n v. United States, 202 F. 2d 633 (7th Cir. 1953) - reports and surveys furnished to members; Chattanooga Auto. Club v. Commissioner, 182 F. 2d 551 (6th Cir. 1950) - services to members; Underwriters' Laboratories, Inc. v. Commissioner, 135 F. 2d 371 (7th Cir.), cert. denied, 320 U.S. 756 (1943) - reports and studies furnished; Spokane Motorcycle Club v. United States, 222 F. Supp. 151 (E.D. Wash. 1963) - goods, services, and refreshments given. That the benefit conveyed may be relatively small does not change the basic fact of inurement. Spokane Motorcycle Club v. United States, supra.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd in unpublished opinion 647 F.2d 170 (9th Cir. 1981) ("est of Hawaii"), several for-profit est organizations exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. The fact that amounts paid to the for-profit organizations under the contracts were reasonable did not affect the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in section 501(c)(3).

Section 501(c)(4) of the Code provides for exemption from federal income tax of civic leagues or organizations nor organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the primarily engaged in welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Section 1.501(c)(4)-1(a)(2)(ii) of the regulations provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

TAXPAYER'S POSITION

Unknown at this time

GOVERNMENT'S POSITION

The government's position is that ORG does not qualify for exemption under section 501(c) (3) of the Internal Revenue Code, as it does not meet the operational test. The operational test outlined in section 1.501(c)(3)-1(c) of the Regulations states that an organization will not meet the operational test if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

ORG activities does not appear to meet the definition of social welfare under section 501(c)(4) of the Internal Revenue Code. Social welfare can also be considered a charitable activity under Treasury Regulation 1.501(c)(3)-1(d)(2).

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Pertinent to this case, we are specifically concerned whether the organization meets the compliance tests listed below:

- Operational Test: Charitable Activity
- Operational Test: Primary Purpose, Substantial Nonexempt Purpose
- Operational Test: Inurement (Private Benefit)
- Effect on Section 4958 of the Code

Primary Purpose, Substantial Nonexempt Purpose

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945).

ORG's primary activity is to own and operate CO-1 located in City. The airports website states CO-1 is " . State. CO-1 is located three miles Northwest of City. The airport is a small airfield, with two runways. ORG owns 22 rental hangers, which are combined together in two separate building, and are owned and maintained by ORG. All other hangers, planes, and buildings on the premises are individually owned, and are not part of the organization. ORG is under any obligation to maintain the privately owned hangers.

DIR-1 is one of the founders of ORG. DIR-1 and his Wife, RA-1 operate and control ORG. DIR-1 is listed as Director, and RA-1 DIR-1 is the Secretary/Treasurer. DIR-1 also controls CO-2 a taxable entity. CO-2 is a related organization with respect to ORG by common officers and directors. CO-2 received payments from ORG for loans lent ORG to purchase the Airport assets.

No governmental body was found to have any relation with ORG or its management, and ORG receives no governmental support. Income received by ORG is primarily from rental revenue from the hangers, license fees from airport property owners. The organization also receives a small amount of revenue from interest and contributions. Income is expended for permanent improvements to the airport, maintenance, daily operations and payment on debt. The organization is carrying on a business with the general public in a manner similar to organizations operated for profit. Operating an airport in a commercial manner is inherently an exempt activity. An organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code. Whether an organization has satisfied the operational test is a question of fact; See *Harding Hospital Inc.*, supra. The main reason why the organization does not qualify for exemption under 501(c)(3) is it fails to operate for a charitable non-exempt purpose.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes. The requirement an organization operate exclusively for charitable purposes is further amplified in section 1.501(c)(3)-1(c)(1) of the regulations. This section provides 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. In the fundamental case or *Better Business Bureau of Washington, D.C., Inc. v. United States*, supra, the Court concluded the presence of a single nonexempt purpose, if substantial in nature, would preclude exemption regardless of the number of important of statutorily exempt purposes.

Inurement (and Private Benefit)

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DIR-1 controls ORG's operations and financial affairs. He was a founding member of the organization, and he makes decisions for ORG. He also exerts substantial influence over the organization for purposes of the excess benefits tax under section 4958 of the Code.

We have determined that the interest rate on the loans payable by ORG to DIR-1 and CO-2 a for-profit controlled by DIR-1 were above market rate. During 20XX and 20XX the interest rate paid by ORG for the loans originated in 19XX was 8.0%, 7.0% for the loan originated in 19XX (which paid off in 20XX) and 8.0% for the loan originated in 20XX. The interest rate on the loans originated in 19XX and 19XX both were originally 12% and were adjusted yearly ranging between 7% and 12%.

Year	19XX Loans	19XX Loan
19XX	12%	7%
19XX	12%	7%
19XX	12%	7%
19XX	7%	7%
19XX	7%	7%
19XX	7%	7%
19XX	12%	7%
20XX	12%	7%
20XX	12%	7%
20XX	7%	7%
20XX	7%	7%
20XX	7%	7%
20XX	8%	7%
20XX	8%	7%

The application federal rate for long term loans originated in 19XX was 7.07%, originated in 19XX 6.36, and originated in 20XX was 4.64%. Since the rate were above market DIR-1 is treated as having received an economic benefit form the organization equal to the amount of interest received that exceeded market value. See schedule below for a comparison of actual interest payments with those using the applicable federal rate.

CO-4

Note Payable to CO-2/DIR-1

Cost - Actual vs current applicable federal rate (AFR)

CO-2	(Origination Date	19XX)					
	Days	Actual	AFT %	Int @ 8%	Int @ Act%	Difference	
	o/s						
December-XX		8.000%	7.070%				
January-XX		8.000%	7.070%				
February-XX		8.000%	7.070%				
March-XX		8.000%	7.070%				
April-XX		8.000%	7.070%				
May-XX		8.000%	7.070%				
June-XX		8.000%	7.070%				
July-XX		8.000%	7.070%				
August-XX		8.000%	7.070%				
September-		8.000%	7.070%				

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XX			
October-XX		8.000%	7.070%
November-XX		8.000%	7.070%
December-XX		8.000%	7.070%

CO-2	(Origination	Date	19XX)				
		Days					
		o/s	Actual	AFT %	Int @ 8%	Int @ Act%	Difference
December-XX							
January-XX		31.00	8.000%	7.070%			
February-XX		28.00	8.000%	7.070%			
March-XX		31.00	8.000%	7.070%			
April-XX		30.00	8.000%	7.070%			
May-XX		31.00	8.000%	7.070%			
June-XX		30.00	8.000%	7.070%			
July-XX		31.00	8.000%	7.070%			
August-XX		31.00	8.000%	7.070%			
September-XX		30.00	8.000%	7.070%			
October-XX		31.00	8.000%	7.070%			
November-XX		30.00	8.000%	7.070%			
December-XX		31.00	8.000%	7.070%			

CO-2	(Origination	Date	19XX)				
		Days					
		o/s	Actual	AFT %	Int @ 8%	Int @ Act%	Difference
December-XX							
January-XX		31.00	7.000%	6.360%			
February-XX		28.00	7.000%	6.360%			
March-XX		31.00	7.000%	6.360%			
April-XX		30.00	7.000%	6.360%			
May-XX		31.00	7.000%	6.360%			
June-XX		30.00	7.000%	6.360%			
July-XX		31.00	7.000%	6.360%			
August-XX		31.00	7.000%	6.360%			
September-XX		30.00	7.000%	6.360%			
October-XX		31.00	7.000%	6.360%			
November-XX		30.00	7.000%	6.360%			
December-XX		31.00	7.000%	6.360%			

Total CO-2 (20XX)

DIR-1	(Origination	Date	19XX)				
		Days					
		o/s	Actual	AFT %	Int @ 8%	Int @ Act%	Difference
December-XX							
January-XX		31.00	8.000%	7.070%			
February-XX		28.00	8.000%	7.070%			

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March-XX	31.00	8.000%	7.070%
April-XX	30.00	8.000%	7.070%
May-XX	31.00	8.000%	7.070%
June-XX	30.00	8.000%	7.070%
July-XX	31.00	8.000%	7.070%
August-XX	31.00	8.000%	7.070%
September-XX	30.00	8.000%	7.070%
October-XX	31.00	8.000%	7.070%
November-XX	30.00	8.000%	7.070%
December-XX	31.00	8.000%	7.070%

Total DIR-1 (20XX)

Total

CO-4

Note Payable to CO-2

Cost - Actual vs current applicable federal rate (AFR)

CO-2	(Origination Date 19XX)						
	Days	Actual	AFT %	Int @ 8%	Int @ Act%	Difference	
December-XX	o/s						
January-XX	31.00	8.000%	7.070%				
February-XX	28.00	8.000%	7.070%				
March-XX	31.00	8.000%	7.070%				
April-XX	30.00	8.000%	7.070%				
May-XX	31.00	8.000%	7.070%				
June-XX	30.00	8.000%	7.070%				
July-XX	31.00	8.000%	7.070%				
August-XX	31.00	8.000%	7.070%				
September-XX	30.00	8.000%	7.070%				
October-XX	31.00	8.000%	7.070%				
November-XX	30.00	8.000%	7.070%				
December-XX	31.00	8.000%	7.070%				

CO-2	(Origination Date 19XX)						
	Days	Actual	AFT %	Int @ 8%	Int @ Act%	Difference	
December-XX	o/s						
January-XX	31.00	8.000%	7.070%				
February-XX	28.00	8.000%	7.070%				
March-XX	31.00	8.000%	7.070%				
April-XX	30.00	8.000%	7.070%				
May-XX	31.00	8.000%	7.070%				
June-XX	30.00	8.000%	7.070%				

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
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July-XX	31.00	8.000%	7.070%
August-XX	31.00	8.000%	7.070%
September-XX	30.00	8.000%	7.070%
October-XX	31.00	8.000%	7.070%
November-XX	30.00	8.000%	7.070%
December-XX	31.00	8.000%	7.070%

CO-2	(Origination Date Days o/s)	20XX)	Actual	AFT %	Int @ 8%	Int @ Act%	Difference
December-XX	31.00	8.000%	4.640%				
January-XX	28.00	8.000%	4.640%				
February-XX	31.00	8.000%	4.640%				
March-XX	30.00	8.000%	4.640%				
April-XX	31.00	8.000%	4.640%				
May-XX	30.00	8.000%	4.640%				
June-XX	31.00	8.000%	4.640%				
July-XX	31.00	8.000%	4.640%				
August-XX	30.00	8.000%	4.640%				
September-XX	31.00	8.000%	4.640%				
October-XX	30.00	8.000%	4.640%				
November-XX	31.00	8.000%	4.640%				
December-XX							
Total CO-2 (20XX)							

DIR-1	(Origination Date Days o/s)	19XX)	Actual	AFT %	Int @ 8%	Int @ Act%	Difference
December-XX	31.00	8.000%	7.070%				
January-XX	28.00	8.000%	7.070%				
February-XX	31.00	8.000%	7.070%				
March-XX	30.00	8.000%	7.070%				
April-XX	31.00	8.000%	7.070%				
May-XX	30.00	8.000%	7.070%				
June-XX	31.00	8.000%	7.070%				
July-XX	31.00	8.000%	7.070%				
August-XX	30.00	8.000%	7.070%				
September-XX	31.00	8.000%	7.070%				
October-XX	30.00	8.000%	7.070%				
November-XX	31.00	8.000%	7.070%				
December-XX							
Total DIR-1 (20XX)							
Total							

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The Service has sufficient information to establish a pattern of control on the part of some insiders has resulted in continuing inurement to the insiders. Apart from the inurement concerns, there continues to be primary purpose, substantial nonexempt purpose, and primary activity concerns which disqualify ORG from exemption.

GOVERNMENT’S POSITION:

Based on the above, we propose to revoke CO-4 tax-exempt status. This proposed revocation would become effective January 1, 20XX. Any contributions to CO-4 are no longer deductible as charitable contributions. Any contributions to this organization by those who were in part responsible for, or were aware of, the activities or deficiencies on the part of the organization that gave rise to loss of exempt status will not be allowed as a deduction effective the date of revocation. ORG will be required to file Form 1120 for all tax years since 20XX, inclusive.

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 as of the fiscal year ended December 31, 20XX,

Forms 1120, U.S. Corporation Income Tax Return should be obtained for the fiscal years December 31, 20XX to the present.

If this proposed revocation becomes final, appropriate State officials will be advised of the action in accordance with Internal Revenue Code Section 6104(c) and applicable regulations.

The organization may re-apply for tax exemption under 501(c)(3) or 501(c)(4), as long as it can be determined their activities further their exempt purpose.