

**Internal Revenue Service**

Appeals Office  
1000 S. Pine Island Rd.  
Suite 350  
Plantation, FL 33324

Release Number: **201039043**  
Release Date: 10/1/10  
Date: June 29, 2010  
UIL Code: 7428.00-00  
A = Org. Name

B = Org. Address

**Department of the Treasury****Person to Contact:**

Employee ID Number:  
Tel:  
Fax:

**Refer Reply to:**  
AP:FE:FTL:GRP

**In Re:****EIN:**

C = EIN

**Form Required to be Filed:**

1120

**Tax Period(s) Ended:**

19XX12, 19XX12, 20XX12, 20XX12

**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, 1998.

Our adverse determination was made for the following reason(s): Based on a review of your activities for the period 19XX-20XX, we have determined that you did not operate exclusively for charitable, educational or other exempt purposes within the meaning of IRC 501(c)(3). Our determination is based on our findings that: (1) you did not demonstrate that you primarily engaged in activities accomplishing exempt purposes in that your activities serve substantial non-exempt purposes; (2) your net earnings inured to the benefit of private individuals; (3) more than an insubstantial part of your activities were not in furtherance of an exempt purpose within the meaning of Treas. Reg. § 1.501(c)(3)-1(c); (4) you operated for the benefit of private interests within the meaning of Treas. Reg. § 1.501(c)(3)-1d(ii); and (5) you operated for the primary purpose of carrying on an unrelated trade or business within the meaning of Treas. Reg. § 1.501(c)(3)-1(e)(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.

A = Org. Name  
B = Org. Address

C = EIN

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

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Sincerely,

CHARLES FISHER  
TEAM MANAGER



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
4330 Watt Avenue, SA:1111:MT  
Sacramento, CA 95821

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: March 5, 2004

LEGEND

ORG = Organization name      xx = date      address = address      POA = POA  
President = president

ORG  
ADDRESS

Taxpayer Identification Number:  
Form: 990  
Tax Year(s) Ended:  
Person to Contact/ID Number  
Contact Numbers:  
Telephone  
Fax:

Via UPS 2<sup>nd</sup> Day Delivery

Dear :

As you know, since the time our technical advice request was returned to our office without the issuance of a technical advice memorandum, we have requested additional information from you. We have made these requests by means of Information Document Requests and the issuance of a Summons on December 22, 20XX. The purpose of our requests have been to secure the information necessary to make a fully informed determination regarding whether the Foundation operated exclusively for exempt purposes. To date, you have not complied with our requests. Please be advised that our office has made a referral to our Area Counsel (TE/GE) to commence the process of enforcing the summons issued to you on December 22, 20XX.

We have also advised you that we believe the statute of limitations on assessment for the earliest years under examination is set to expire on or about April 7, 20XX. As such, we have requested you to agree to an extension of the statute of limitations so that all of the facts can be developed and that we can make a fully informed determination regarding tax exempt status. To accommodate your concerns, we offered to meet your request to add a new revenue agent to the case to work directly with you and your staff. Despite our best efforts, we have not reached agreement on these matters and we have not received the statute extension. Under these circumstances where the statute of limitations on assessment is about to imminently expire, the Service must act based upon the information available. As such, please find 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 is necessary. Because we believe revocation is necessary, we are also enclosing a copy of Form 4549A reflecting our proposed tax liability once the Foundation's exempt status is revoked.

As noted above, we are coming to the conclusion that your exempt status should be revoked base upon the information available to us. Some of that information includes documents the IRS received from individual donors/members to the Foundation and other sources. At various times throughout our report we reference such documents. So that the administrative record is complete as possible and as support for our report, we have enclosed copies of these documents. For convenience, an index to these document is also attached. These Additional Documents are in addition to the information and documents gathered by Revenue Agent during the examination of the Foundation.

If you accept our findings, take no further action. We will issue a final adverse determination letter revoking your section 501(c)(3) exempt status and a notice of deficiency for corporate income taxes. As such, 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 and 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. In conjunction, if we issue the final revocation notice, we will issue a Statutory Notice of Deficiency to protect the government's interests. Corporations which are not exempt from Federal income tax are obligated to pay Federal income tax on their taxable income. We are enclosing a Form 4549A, Income Tax Examinations Changes for the tax years ending December 31, 19XX through December 31, 20XX. The calculation on taxable income and tax liability is based on all information available to us at this time.

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. Please be advised, however, we can not process a case to the Appeals office unless there exists a minimum of 240 days (plus our processing time of 60 days) remaining on the statute. A Consent to Extend the Time to Assess Tax (Form 872) through March 31, 20XX has been enclosed for your signature. In a letter dated February 14, 20XX from your POA, P.S., received by us on March 2, 20XX, you indicate that you may prefer Form 872A (Special Consent to Extend the Time to Assess Tax). Both forms have been enclosed along with Letter 3600 and Publication 1035.

If we are able to forward your case to Appeals, 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. However, Appeals has procedures for (a) returning cases that are not ready for Appeals consideration, (b) raising certain new issues, and (c) seeking review and comments from the originating IRS function with respect to new information or evidence furnished by the taxpayer or representative.

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 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 the Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate Office. Their phone number.

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,

R.C. Johnson  
Director, EO Examinations

Enclosures:

CC:

LEGEND

ORG = Organization name      XX = Date      Address = address      City =  
city      State = state      Country = country      CORP = CORP      ATTN-1  
& ATTN-2 = 1<sup>st</sup> & 2<sup>nd</sup> Attorneys      BM-1, BM-2, BM-3, BM-4 & BM-5 = 1<sup>st</sup>,  
2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup> & 5<sup>th</sup> BM      CO-1 THRU CO-38 = 1<sup>st</sup> THRU 38<sup>th</sup> COMPANIES  
RA-1 THRY RA-49 = 1<sup>st</sup> THRY 49<sup>th</sup> RA

**ISSUE:**

Whether ORG operated exclusively for exempt purposes during the 19XX-20XX period under examination.

**FACTS:**

**Incorporation of ORG**

The ORG ("Foundation") was incorporated on December 18, 19XX in the State of State. The incorporators and the Board of Directors were BM-1, BM-2, and BM-3. These individuals listed the address of Address, City, State. The Foundation's Articles of Incorporation provide that its purposes are to be exclusively charitable and educational, specifically to

- (1) raise and distribute funds to other nonprofit charitable organizations and
- (2) to initiate, fund and administer a wide variety of charitable, educational, religious, scientific and literary projects.

**Application for Exemption**

The Foundation applied for tax-exemption on Form 1023 dated December 20, 19XX as an organization described under 501(c)(3) of the Internal Revenue Code (IRC). The Form 1023 states its activities are:

"to (1) raise and distribute funds to other nonprofit charitable organizations; and (2) to initiate funds and administer a wide variety of charitable educational, religious, scientific and literary projects."

"The Foundation plans to operate a "donor advised fund" whereby individual donors can request that the donated funds be directed to a specific charitable cause or activity. In some instances, the ultimate suggested donee is another nonprofit organization. In other instances, the suggested beneficiary of the donation is a local charitable activity well known to the donor. In such instances, the Foundation Board of Directors require the submission of detailed background material prior to approving the requests so that the Foundation is satisfied that all expenditures are for bona fide charitable organizations or purposes. As is specified in the certificate of Incorporation, the Board of Directors has the ultimate decision making authority for the disposition of the funds. Some of the donations will be operated as endowment funds for a particular charity and others



will make distributions from corpus. Administrative expenses will be kept to a bare minimum."

"The Foundation is aware of the requirements for operating a donor advised fund and will adhere to rules which permit the Foundation to freely and effectively employ the assets or the income derived therefrom in furtherance of its exempt purposes."

The Form 1023 also states that the funds of the Foundation will be managed by CORP and two of the Directors of the Foundation also serve as Directors of CORP. The CORP is described as a financial planning company. The Foundation represented in its proposed budget that % of amounts contributed by donors in a given year would be distributed by the Foundation for charitable purposes in that same year.

Based upon this application, the IRS recognized tax-exemption for IRC 501(c)(3) status on March 20, 19XX. Since the organization was a newly formed organization, the Foundation was granted public support status under 509(a)(1) and 170(b)(1)(A)(vi) during an advance ruling period ending December 31, 20XX. Upon the completion of the advance ruling period, the Service recognized the Foundation as an organization described in section 509(a)(1) and 170(b)(1)(A)(vi) by letter dated May 6, 20XX.

#### **Foundation's Role within the ORG Family of Companies**

The Foundation is just one corporation associated with ORG, The Economic Association of Health Professionals. BM-1, DMD, is the Founder and Chairman of ORG. As noted earlier, BM-1 is also the incorporator of the Foundation and serves as the President of the Foundation and on its Board of Directors. In general, ORG is a financial counseling and investment service begun by BM-1 in 19XX. Doctors who choose to avail themselves of ORG's services, generally have the option of two types of memberships: (1) a basic membership which allows doctors access to ORG materials for self study and access to ORG promoted financial products (\$\$ to join & \$\$ annual renewal); and (2) an integrated planning membership available to doctors that meet certain income and asset thresholds which provides a greater level of financial services than the basic membership (\$\$ to join & \$\$ annual renewal).

The ORG organizations as a whole, are a group of membership organizations generally restricted to serving health care professionals, notably doctors and dentists. ORG provides financial information, products, and services tailored to the individual needs of its health care professional clients. ORG emphasizes the federal income tax, and to a lesser extent, federal estate tax, savings achieved through ORG products and techniques to reduce federal tax liability. For example, there is a CORP that provides retirement plan design and administration; a CORP providing insurance benefits such as life, disability, and long-term care benefits; a CORP providing investment services as a registered investment advisor; a CORP providing administrative services to the group; and ORG corporation providing written financial plans for its members.

The emphasis on reducing Federal income taxes stems from BM-1's study of the Internal Revenue Code from which he has concluded that doctors should only pay Federal income taxes on earnings needed to maintain a doctor's current lifestyle costs.

BM-1 promotes that earnings in excess of lifestyle costs (food, housing, etc...) should be placed in deductible savings vehicles. BM-1 promotes that the Foundation is one such vehicle.

ORG, the Economic Association of Health Professionals produces a document entitled "Program Summary, Capital Accumulation and Capital Distribution Planning for Doctors." (K2-59)<sup>1</sup> This program summary describes virtually all of the programs sponsored by ORG. The program describes the Foundation as follows:

The ORG is a public charity that enables doctors to contribute pre-tax earnings to their own family public charities that are subaccounts of the "umbrella" ORG charity. Flexible, deductible annual contributions of 0% to 50% of a donor's adjusted gross income can be allocated each year to a doctor's Family Public Charity/ ORG. Growth on contributions within the Family Public Charity accounts accrue tax deferred. Doctor donors may direct the use of funds accumulated within their family public charity accounts to finance charitable projects including personal teaching, research, pro bono works, college and graduate school scholarship programs, and deferred compensation programs.

Donors and their family members may work for and be compensated by their family public charities for good works (teaching, research, or providing pro bono services) they perform on behalf of their family public charities. Compensation levels from the family public charities to doctor donors and their family members are based on usual and customary compensation levels and actual time involvement on projects. Good works projects and expense reimbursement and compensation levels for services performed by doctors, their family members, and others on good works projects of the Family Public Charity are approved for distribution from individual Family Public Charity accounts by the independent board of directors of the parent ORG.

Contributions to doctors' Family Public Charity/ORG accounts may be invested, at the direction of donors, in guaranteed principal and non-guaranteed principal vehicles. Growth on undistributed funds accrues with no losses to current income or capital gains taxes. Family Public Charity accounts are not includable in the donor's family's estate and the accumulated assets within the Family Public Charity account are exempt from the claims of creditors.

Another use of the doctor's Family Public Charity/ORG is for doctors to contribute appreciated personal investment assets to the Family Public Charity before their sale and eliminate the loss of sales proceeds to capital gains taxes. The Family Public Charity then sells the assets transferred, and pays a life income to the donor. Through this approach there is no loss of investment asset value and earnings on investment asset

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<sup>1</sup> References such as this one refer to the Additional Documents accompanying this report.



value to capital gains taxes. Doctors who donate appreciated personal assets to their Family Public Charity/ORGs receive an income tax deduction equal to approximately 30% of the market value of the gift, and an annual income for life of approximately 8% of the total market value of the gift. This life income can be received from the doctor's Family Public Charity without any requirement for the doctor donor to do "good works" (research, teach, provide pro bono services). Any surplus undistributed assets remaining in the Family Public Charity at the doctor-donor's death can be used to compensate surviving family members to do good works personally, or to administer the gifting of Family Public Charity assets to charitable and educational institutions and professional associations selected by the doctor donors during their lives.

The Family Public Charity/ORG makes it possible for doctors to receive expense reimbursement and annual compensation for their time devoted to good works projects of their Family Public Charity. The Family Public Charity/ORG can also establish a deferred compensation plan to provide future reimbursement to doctors for current medical and dental indigent care services and other current charitable pro bono services.

Members who subscribe to the integrated planning membership are entitled to receive a "Tax Reduction Plan: ACCUMULATION". This document is a comprehensive financial planning analysis. It is organized into the following sections:

1. Financial Education
2. Business Structure
3. Income Protection
4. Income Tax Reduction
5. Investment Management
6. Asset Protection
7. Value System Endowment

Accompanying the "Tax Reduction Plan: ACCUMULATION" is normally a letter from BM-1 that includes a discussion of the Foundation in the Income Tax Reduction and Asset Protection sections of the tax reduction plan. In the Income Tax Reduction section BM-1 describes ORG's various tax reduction programs. The Foundation is identified as one such program, along with ORG's 419 Plan, Leveraged Split Dollar Plan, Disability Equity Trust, Malpractice Equity Trust, and various qualified retirement plans.<sup>2</sup> The recurrent theme is that members should not pay taxes on earnings exceeding their lifestyle needs. (K2-18, May 28, 19XX letter to RA-1 from BM-1)

In the Asset Protection section, BM-1 describes the ORG Charitable Foundation Program as follows:

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<sup>2</sup> For further context regarding ORG's operations and the operations of some of the ORG promotions, see \_\_\_\_\_, 20XX WL 250545, United States District Court for the Eastern District of State, Memorandum opinion, Dalzell, J., February 10, 20XX. The opinion supports an order enforcing a summons and describes the plaintiff's participation in ORG's disability equity trust as "tax benefits ... aggressively claimed."

Family Public Charity/ORGs are used by ORG doctors to remove assets from the claims of creditors and to prevent losses of equity to capital gains taxes on sales of appreciated property. Family Public Charity/ORGs are used by ORG doctors to prevent losses to estate taxes and creditors by transferring ownership of appreciated personal assets and high value personal residences out of their taxable estates to these legal entities that are outside the reach of creditors. Doctors and their spouses transferring their primary residences to Family Public Charity/ORGs may retain the right to occupy the gifted residence or a successor residence during their life expectancies.

Family Public Charity/ORGs can be utilized by ORG doctors to transfer assets and growth on these assets outside the taxable estate and away from the claims of creditors. Income tax deductions generated by personal asset transfers into Family Public Charity/ORGs are also used to reduce income tax losses on annual distribution from qualified retirement plans and other investment or earned income. In addition losses to capital gains tax on sales of appreciated assets can be eliminated.

As members advance in their accumulation plan, the ORG Financial Analysis department updates their plan. (K2-49; W-12; V1-V18) Included with the updated plan is a financial data sheet entitled "Summary of Assets." The Summary of Assets identifies the member by name and identifies all assets owned by the member, including assets in ORG promoted products. At the bottom of the sheet is a line identified as "Grand Total." Included as a line item adding up to a member's Grand Total is the net asset value of the member's "Family Public Charity/ORG." (W-11).

### **Members Establish Accounts at ORG**

ORG members<sup>3</sup> who desire to participate in the ORG program submit an "Application to Participate in the ORG". The Application provides for the member to input his or her name, SSN, address and other identifying information. The application requests the member to identify the individual who will be the fund advisor, successor advisor in the event of the death of the fund advisor, and alternate fund advisor in the event the successor advisor can not be the fund advisor. Typically, members select themselves to the fund advisor and family members to the successor and alternate advisors.

This option of selecting successor advisors to the account allows the member's funds to remain under family advisement or control for perpetuity.  
(RA-2, Letter dated 12/5/XX from financial counselor to RA-2)

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<sup>3</sup> This report generally refers to individual doctors who establish accounts with the Foundation as members. While other terms could have been selected such as participant, client, or donor, the term member is consistent with Foundation's Board of Directors characterization of such individuals. "Pro bono work can be done for a Foundation and reimbursed by the Foundation to an individual other than the foundation member." (Emphasis added. December 7, 19XX minutes of the Foundation Board of Directors, page 2.)

The application also requests the member to select a name for their donor advised fund. Typically, members select a name for their fund that uses their last name to be combined with a combination of words such as "foundation," "family," "fund," etc. For example, RA-3 selected the name "CO-1." In some of the correspondence, the account is also referred to as the "CO-1." There does not appear to be any limitations on the name a member may select for their account. The Foundation Board of Directors encourages members to use the designation "Family Public Charity." (December 7, 19XX Board of Directors meeting minutes.)

The application includes a section entitled "Proposed Charitable Purpose." Members may select from two pre-printed choices, either "General Purpose: To provide for charitable religious, educational, scientific or health objectives." or "Other." While the application form allows for members to elaborate on these purposes and advises that additional pages may be attached, typically, members select the General Purpose and do not elaborate.

A third page to the application is a document entitled "Fund Advisor Statement." This statement includes the following language and is then signed by the member as an "applicant" to the Foundation:

By completing and signing this application, I hereby apply to participate in the ORG Program. I understand that the full amount of my initial contribution is tax deductible unless the deferred gift annuity election has been selected. Also, I understand that the contribution amount less fees (set-up fee, annual administration fee and marketing fee) will be deposited and maintained in a separate investment account. I certify that I understand the nature of donor advised funds and will conduct activities which satisfy the requirements of the Internal Revenue Code. I understand that in order to qualify as a deductible contribution for income tax purposes, the ownership and custody of my donated funds and property will be fully relinquished to \*\*. These statements accurately reflect my desires for my charitable fund at the ORG.

\*\* On some Fund Advisor Statements the form is pre-printed to read "ORG." On other Fund Advisor Statements, the form includes a blank line, wherein, typically, members write in the name of their account, i.e., "CO-1."

There is no indication that any materials are provided to prospective members at the time they execute the Fund Advisor Statement to educate them regarding the nature of donor advised funds thereby putting perspective donors in a position to make the certification in the Fund Advisor Statement. Likewise, at the execution of the Fund Advisor Statement, there is no indication that prospective members are provided materials to educate them regarding activities which will satisfy the requirements of the Internal Revenue Code.

As part of the application, members also submit an "Investment Election Form" directing the Foundation where to invest the contributed monies. The Foundation modified this Investment Election Form over the course of the examination years 19XX-

20XX. The form includes a number of options. Members are requested to allocate a percentage of contributed assets to the listed choices. At one time, the options of investments available to the member included the following:

- Money Market Funds
- Bank CDs
- Treasury Bills
- U.S. Stock Index Mutual Funds
- U.S. Corporate Bond Mutual Funds
- U.S. "Balanced" Mutual Funds
- Modern Portfolio Theory (low risk)
- Modern Portfolio Theory (medium risk)
- Modern Portfolio Theory (aggressive growth)
- Individual Listed Securities (as listed)
- Annuities
- Life Insurance

In comparison to larger tax exempt donor advised funds, the relatively simple application/agreement does not elaborate or detail the rights and agreements of the member as well as the rights of the Foundation.

In addition to submitting the application, members must pay a fee of \$\$ for the privilege of opening an account with the Foundation. Upon receiving this fee, the Foundation transmits \$\$ to the law firm of CO-2 and \$\$ to ORG. In addition to this \$\$ fee, members are charged a fee equal to 6% of the amount contributed. The Foundation pays this fee to ORG. This fee is reflected as a "research and marketing" fee.<sup>4</sup> Once an account is established, there are other fees. There is an annual administration fee charged to members of \$\$ . There is also an annual investment management fee of 1.1% of a member's funds in the account.

The Foundation pays various fees to ORG. BM-1 is the sole shareholder of ORG. Per the Foundation's Form 990, the Foundation paid Marketing Fees of \$ \$ ; \$ \$ \$ \$ ; and \$ \$ to ORG. during taxable years 19XX, 19XX, 20XX and 20XX, respectively. In 20XX, it also paid \$\$ in administrative fees to ORG.

Beginning in 20XX, the Foundation also paid Investment Fees to ORG. or ORG Investment Services, Inc. According to the Foundation's Form 990, the Foundation paid \$\$ to ORG and \$ \$ to ORG Investment Services, Inc. for investment fees during taxable years 20XX and 20XX, respectively.

Through August 21, 20XX, the Foundation had 357 member accounts. The Foundation's promotional material does not indicate that it imposes a minimum

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<sup>4</sup> ORG Financial Counselors serve as the principal link between members and the ORG family of companies and programs. BM-1 personally trains all Financial Counselors. The Financial Counselors work exclusively for ORG. (K2-94) "ORG Financial Counselors are highly trained professionals who implement the annual ORG Tax Reduction Plan recommendations for doctors ..." (K2-88) In effect, the ORG Financial Counselors are the agents of ORG. ORG. pays 70% of the research and marketing fee it receives from the Foundation to its financial counselors.

contribution amount to open or maintain an account. In at least 15 of the accounts the member contributed only the initial \$\$ fee and a total of 45 accounts had less than \$\$ contributed to it. At the July 7, 20XX meeting of the Foundation Board of Directors it was resolved that accounts needed to have a minimum cash balance of \$ \$ in addition to the \$\$ set up fee.

In most instances, members also forward assets, either cash or non-cash, to the Foundation at the time they set up their account. Members are encouraged to donate appreciated property, whether that property be marketable securities, real property, or other appreciated assets. In this connection, members are advised of the tax benefits of donating appreciated property. The Foundation does not have any restrictions on the types of property it will accept. The Foundation has accepted partial interests of limited liability companies and other non-liquid and/or non-marketable assets. Members that contribute real estate complete an "Indemnification and Hold Harmless Agreement".

Upon receiving contributions, the Foundation issues a receipt. The receipt identifies the "donor" and the amount contributed. The receipt also indicates that the Foundation's "records indicate that you prefer your gift to be directed toward" the member's particularly named account. The receipt also provides that the member's "contribution is a completed and unrestricted gift to The ORG. It is tax deductible." Finally, receipts include a statement that "no goods or services were provided to the donor unless otherwise stated." (E-15)

Once a members account is established, cash and the proceeds from the sale of property transferred to the Foundation are invested with CO-3 (CO-3), an investment and brokerage firm located in City, State. The Foundation arranges for CO-3 to open for each member an investment account into which earnings are deposited and from which funds are withdrawn. Members receive regular statements setting forth the assets in their Foundation account and reporting transactions during the period, *i.e.* transfers, distributions, and fee payments.

While the great majority of member accounts have their assets invested through CO-3, this is not the exclusive vehicle for investments of member accounts. Some accounts appear to be invested in life insurance contracts, viaticals, accounts at CO-4, or in other investments.

In seeking to understand how the Foundation solicits contributions, IDR 002, question 10 asked, "Please describe how you solicit donors to contribute to the Foundation?" The Foundation responded, as follows:

Typically contributions are not solicited by the Foundation. The Foundation is introduced to ORG member doctors when they express the desire or need to give back to the community via charitable gifts and projects. Participation in the Foundation is also suggested to ORG members as an appropriate method to achieve philanthropic, estate planning or other financial goals. Occasionally, once a donor has established an account, the donor solicits contributions from friends, family or others to support giving for specific charitable purposes.



Financial counselors recommend to members which programs in the ORG family of programs members should participate. The tax savings appears to be the preeminent purpose. For example, in a letter dated October 11, 20XX from ORG Financial Counselor, RA-4, to RA-1, RA-4 wrote:

The establishment of the CO-5 can obtain additional tax and investment diversification. It can be funded up to December 31 to obtain tax help this year and does not require permission of your corporation to be a participant. I requested that the ORG home office supply you with a tape on the family public charity to go along with the enclosed brochure. Please pay particular attention to the comment on page 2 by RA-5 of City.

The ORG home office will send you the information you requested on the children's endowment program and Modern Portfolio Theory.

As we previously discussed, you paid for and are eligible to receive an updated ORG Tax Reduction Plan. As you are [sic] heard on the tapes, the ORG program continues to utilize leading law and investment management firms to design programs specifically of our doctor members.

Please keep in mind that you are [sic] your wife are only legally obligated to pay income taxes on what you spend, not on what you earn. (K5-1)

In a follow-up letter dated December 12, 20XX to RA-1, RA-4 begins his letter by stating, "The adoption of the ORG structure eliminates the loss of your of your [sic] practice earnings and retirement savings to unnecessary taxes. Here is what you need to do to enroll in the program." (K1-31). RA-4's letter concludes, "RA-1, I am sure the ORG structure can help you. The first step is to complete this paperwork so that we can get started. How does that sound?" (K1-32).

Financial counselors continue to be involved with members and serve as the primary contact with ORG. and the Foundation. For example, after RA-1 opened an account, RA-4 wrote to RA-1 on January 9, 20XX advising that the CO-5 "is yet another of the tax reduction tools available to you to prevent the unnecessary loss of your practice earnings. Thank you for your contribution." (K1-33) This letter also shows the involvement of the Financial Counselor in selecting charitable projects. Such continued involvement by Financial Counselors is routine in the operations of the Foundation. (See, response to IDR 0002, question 2, "In the event the Foundation does not receive a copy of the tax determination letter, the request is denied and donor's financial counselor is notified, who in turn will notify the client directly.")

Approximately 4-6 six weeks after establishing an account, members receive a package from the Foundation, including a cover letter from BM-1. Included in the package are a number of items, including the following:

1. An opinion letter from the law firm of CO-2. BM-1 describes the law firm as

(U-30) The opinion letter is general in nature. ("Although we are unable to render advice as to the tax effect of actions taken by any individual donor, at the request of and as legal counsel to the Foundation we have set forth herein general rules regarding public charities." (E-3); "... we have not examined documents with respect to any specific program and do not hereby render an opinion as to the tax effect with respect to any such program ..." (E-6.) The letter repeatedly advises members that they should consult with their individual tax advisors and concludes that "there can be no assurance that the discussions of tax matters set forth in this letter will not be subject to different interpretations. (E-8)

2. A binder that includes the documents executed by the member and sample forms, including:

- a. Charitable Project Expense Reimbursement and Compensation;
- b. Charitable Project Time Allocation Log;
- c. Distribution Request.

#### **Foundation Promotional Material**

In addition to the existence of summary descriptions of the Foundation program in various publications, a more comprehensive page brochure dedicated exclusively to describing the Foundation was provided during the examination. The program is entitled, "ORG, The Economic Association of Health Professionals, Foundation Program, Providing Significance to a Productive Life." The program is not dated, but it appears that it was used during the examination years of 19XX-20XX. It appears that the purpose of the program is to provide information for members considering establishing an account with the Foundation. The full program is transcribed verbatim below. This verbatim transcription ends on page of this report.

#### **ORG, The Economic Association of Health Professionals, Foundation Program, Providing Significance to a Productive Life**

The ORG is an IRS-recognized, donor advised, 501(c)(3) public charity that enables philanthropic and community service oriented doctor-members of ORG to establish their own Family Public Charity donor advised funds within the ORG to receive deductible gifts of earnings and savings. The doctor's Family Public Charity is set up under the "umbrella" of the ORG, thereby eliminating individual administrative duties and costs for doctors and their families. Significant income and capital gains tax benefits exist that are usually superior to private foundations or charitable remainder trusts."

The assets in the Family Public Charity ORG will reduce income, capital gains, and estate taxes and can be used to endow doctors' value systems. Operating within the IRS guidelines, the Family Public Charity can be used for any valid charitable purpose including the tax benefits provided by present or future fundings for pro bono work, teaching, research and religious purposes. This includes scholarships, research grants, direct

funding of current charitable activities and deferred compensation programs for currently provided pro bono services."

In addition to the advantages that the Family Public Charity ORG provides over other charitable structures, the ORG offers many important benefits, including:

- No geographical, ideological or other limitations on bona fide charitable activities of the Family Public Charity.
- No loss of family of control. Often, community and other public foundations require that control of your money will revert to the foundation's Board of Directors after several generations. The Family Public Charity ORG enables generations of doctors' family members to continue to determine the charitable projects to be funded by the Family Public Charity donor advised fund.
- An IRS Determination Letter and a tax opinion letter verifying that the Family Public Charity ORG is a public foundation.
- Investment flexibility as well as access to Nobel Prize winning Modern Portfolio Theory money management. Through a special arrangement, the ORG has access to institutional money managers that advise many of the largest pension, university, and charitable endowment funds in the country.
- Constant monitoring of all foundation activities and law changes by one of the nation's finest philanthropic planning law firms."

**Compensation for Pro Bono Work Performed Before and During Retirement.** One use of this program is for doctors actually to work for their own Family Public Charity ORG. A doctor can provide free medical or dental attention to patients and be compensated by his or her Family Public Charity from funds generated by deductible contributions of earnings or savings. Examples range from the simple provision of occasional volunteer or pro bono services to the establishment of an actual clinic in the doctor's home town or inner city locations or even Third World countries. Compensation levels from the Family Public Charity ORG to doctor-donors and their family members are based on usual and customary compensation levels for services provided and actual time involvement on patients and projects. All expenses, including travel and supplies can usually be funded by the Family Public Charity ORG.

"Throughout my professional life I have been able to help thousands of patients. Because of my success, my family has been able to live a very comfortable life. My wife and I felt an obligation to give back to those less fortunate than us. Through the CO-6 we will continue to be able to provide cataract and glaucoma

surgery for the poor of Country. It's been a life changing experience. Knowing what a tremendous need there is, we are unable to stop going." RA-5, City, State.

**Deferred Compensation for Pro Bono Services Being Rendered Today.** Another use of the Family Public Charity ORG is the creation of a deferred compensation plan, the ORG Pro Bono Plan, for doctors through their Family Public Charity. Doctors who are providing current medical or dental indigent care services or other pro bono work can be reimbursed by their Family Public Charities during retirement years. Again, usual and customary compensation levels and actual time involvement records in the form of patient billings and pro bono service verification must be kept by the participants and submitted regularly to the ORG's Board of Directors.

**Teaching and Research Programs.** Another goal that many ORG doctors have for their retirement is to teach or perform research work. Because doctors direct the use of funds accumulated within their Family Public Charities, many doctors elect to work on research projects and teach and have their Family Public Charity ORG fund these projects. These charitable projects, including expense reimbursement and compensation for teaching and research, are approved for funding from the doctor's Family Public Charity by the Board of Directors of the ORG based upon IRS approved guidelines.

**Charitable Gift Annuity.** Many ORG doctors elect to receive income from their Family Public Charity ORG without performing pro bono work or any other services. Doctors can contribute appreciated assets to their Family Public Charity before their sale and receive an income tax deduction while eliminating the loss of sales proceeds to capital gains taxes. These assets may be appreciated real estate or securities. The ORG then customarily sells these assets and pays a life income to the doctor or to the doctor and the doctor's spouse. Any assets remaining after the death of the doctor/spouse become available for other charitable or ORG Permanent Endowment Program purposes and may be directed by the doctor's will or surviving family members.

"The deferred gift annuity program is an efficient way to receive income in retirement. Without a charitable foundation, one would probably use traditional savings alternatives and pay additional income, capital gains or estate taxes. By means of a charitable gift annuity, savings are optimized outside of doctors' taxable estates within their Family Public Charity ORG and may be used in the future to support charities, personal charitable work or permanent endowment activities." RA-6, City, State.

**A Conduit for Charitable Giving.** ORG doctors can use their Family Public Charity ORG account as a holding account and eventually as a

conduit for giving to other charitable institutions such as their church, medical school, YMCA or other recognized charitable institution. Use of this conduit structure may have certain significant income tax benefits for doctor-donors when compared to a direct giving program. Also, it enables doctors to avoid unwanted solicitations from numerous organizations who are seeking financial contributions.

### **Perpetually Increasing Permanent Endowment Programs**

One of the most rewarding and long lasting ways doctors can perpetuate their value systems is through the establishment of a ORG Permanent Endowment Program providing perpetually increasing funds to charitable and educational institutions. Doctors can endow an institution, university, church or community organization through the use of a sophisticated investment strategy or through the use of mortality gain contracts. The result is a continuous stream of increasing income to the institutions for generations to come as a result of gifts from the doctor's Family Public Charity ORG. The gifts received by the institutions selected by a doctor multiply a doctor's contributions to his/her Family Public Charity ORG in an exponentially increasing manner for perpetuity.

“The RA-7 Family Foundation's Permanent Endowment Program was established so that long after we are gone, CO-7 can continue to grow and produce the leaders of tomorrow. Anyone who has the means and the inclination to help others should seriously consider creating a Family Public Charity ORG and funding a ORG Permanent Endowment Program.” RA-7, RA-8, City, State.

**Estate Tax Reduction.** No matter how sophisticated an estate plan may be, there are really only four options for the disposition of your accumulated savings:

- spend your surplus savings before death;
- give surplus to your children or others;
- give surplus to charity;
- lose surplus to the government in the form of estate taxes.

The Family Public Charity ORG used in conjunction with a charitable bequest will allow a doctor to eliminate estate tax losses and to direct surplus savings to his or her Family Public Charity ORG to be distributed according to the doctor's wishes. Once doctors meet gift-giving goals to their families, this structure transfers all remaining assets to their Family Public Charity ORG. Regardless of the size of the estate, this planning structure should eliminate all estate tax losses. Following the death of the doctor and doctor's children and eventually their grandchildren, thereby perpetuating the value systems of the original donors and creating a legacy of family involvement in philanthropy.



“I am fortunate to be living a productive life, and I hate the thought of the government receiving a significant amount of my unspent assets at my death. I’ve consulted with many of the so-called ‘experts’ and the ORG Program best fits my needs. It is simple and allows my children to continue the projects which my wife and I have started.” RA-9, City, State.

**ORG Board of Directors.** Ultimate control of all ORG activities rests with the Board of Directors listed below. Properly advised by legal experts in the field of charitable giving, these five individuals act as a "watchdog" for your monies and for safeguarding your income, capital gains, and estate tax deductions and the tax exempt status of your contributions and your projects. Moreover, they are required to establish policies for charitable projects and distributions of funding which are compatible with current IRS policies and guidelines. Within these guidelines, the Board of Directors is obliged to follow and implement the desires of each individual advisor without consideration of any geographical or ideological issues. The five members of the Foundation’s Board of Directors are:

BM-1, DMD – Chairman and Founder of ORG.

BM-4 – General Surgeon Retired, Consultant

BM-5 – Oral Surgeon and Director, Department of Oral and Maxillofacial Surgery CO-8 City, State

RA-9 – Endodontist, Adventurer, Philanthropist

BM-2, MBA – Executive Vice President ORG.

**Legal Advisors**

ATTN-1 – Chairman, CO-2, Law Firm

RA-10, LLM – V.P. and General Counsel ORG.

**KEY QUESTIONS AND ANSWERS Relating to the ORG.**

**What is it?** The Family Public Charity ORG Program enables philanthropic and community service oriented doctors to establish their own personal donor advised funds and contribute earnings and/or savings each year on a deductible and completely discretionary basis.

**Are There Income Tax Benefits?** Yes. All contributions usually are fully deductible on the individual’s personal income tax return. Furthermore, all earnings on these contributions within the Family Public Charity account are exempt from any federal or state income taxes. Since the ORG qualifies as a public rather than a private 501(c)(3) charity, none of the funds within a Family Public Charity account are required to be paid out each year. Furthermore, all monies inside a doctor’s Family

Public Charity account should be exempt from any malpractice claims or judgment creditors.

**Who Ultimately Receives These Funds?** The law requires that all Foundation funds eventually be used to benefit recognized charities, schools, universities, religious organizations and community service organizations performing charitable work. They also may be used to pay for work performed by professional who do research, teach, help the indigent or others not able to afford the professional' s services, or to provide community service. For example, they may be used to pay for a doctor who is willing to spend his time and skills to provide medical services for needy individuals. Funds may also be used for community service and missionary projects outside the United States.

**Can Doctors Who Establish These Foundations Use Contributions To Pay Themselves?** Yes, provided they legitimately perform this type of charitable or pro bono work.

**How Much Can the Foundation Pay the Doctors?** Doctors performing pro bono services or doing research or teaching can be paid normal hourly or daily rates for performing similar medical or dental services subject to standards of reasonable compensation for the services actually provided. In addition, the Foundation can reimburse legitimate out-of-pocket expenses (such as travel, supplies and support personnel) incurred in the process of performing the charitable services.

**Who Acts as Legal Counsel to the Foundation?** The Law firm of CO-2 located in State and State acts as legal counsel to the foundation. CO-2 will issue an individual tax letter to each participant in this program.

**How Much of my Contribution Actually Ends Up in My Foundation?** 94%. The remaining 6% is allocated to finance ORG research and marketing expenses.

**What are the Other Costs to Establish Such a Foundation?** One time set-up Fee: \$

Annual Administration Fee: \$\$\*

Annual Investment Management Fee: 1.1%;

\*During the accumulation and distribution phase, annual administration fees may increase if there are special administrative requirements of an income recipient.

**How are my Foundation Contributions Invested?** All Foundation contributions must be invested in NYSE listed stocks, bonds, broad-based and recognized mutual funds, money market accounts, or viaticals, annuities or legal reserve life insurance contracts. Within these categories, doctors have advisory discretion as to how Foundation monies are

invested. ORG., a registered investment advisor, acts as the investment manager for doctors' Family Public Charity ORG funds.

**How Can I Monitor the Growth on the Funds?** Monies will be held in segregated Family Public Charity ORG accounts at a major discount brokerage firm. Doctors will receive a periodic statement regarding any earnings or losses on these monies.

**For How Many Years do I Have to Contribute?** There is no set minimum number of years.

**How Flexible is my Contribution?** Completely flexible; however, donors are subject to the usual IRS restrictions on deductibility—generally 50% of adjusted gross income during a calendar year; any excess deductions may be carried forward (usually the year of the gift plus 5 future years) and used against future adjusted gross income levels.

**Is it Possible to Defer Taking Income for Pro Bono Work Being Done Currently Until a Later Date?** Yes, provided the service provider keeps a proper record of personal time allocated to pro bono work.

**Are There Minimum Distributions Required Each Year?** No.

**What are the Income Tax Consequences for Payments for Services?** Any funds received by an individual for services rendered will be taxable in the year received. The recipient will receive a 1099 from the Foundation for any compensation received for charitable services.

**Has the IRS Approved This Type of Arrangement?** The ORG operates within the guidelines established for public foundations doing direct charitable work. These guidelines are specifically set forth in the ORG Letter of Determination. This provides guidelines and a "safe harbor" for the operations of the ORG which the Foundation scrupulously observes.

**What Happens in the Event of Death?** The Donor can appoint a family member or friend to act as a successor advisor to the Family Public Charity donor advised account after the Donor's death. The successor advisor could recommend ultimate charitable beneficiaries for the funds.

If your spouse and/or family members and/or other individuals are able to continue to provide services, payments can be made to them. If not, then any remaining Foundation monies must go to a recognized charity which can be identified by you through written instruction prior to your death. These written instructions are subsequently approved by the Board of Directors of the Foundation.

**Can I Name my Own Foundation?** Yes. Most participants use their own name; for example, the CO-9.

**Are there Annual IRS Reporting Requirements?** Yes. All these are provided by the ORG and all costs are included in your annual administration fee.

**Are Assets in the Foundation Considered Part of my Estate and Subject to Estate Taxes?** No.

**Is it Possible to Contribute Appreciated and "In Kind" Assets (such as securities or real estate) into the Foundation?** Yes. You should receive a full deduction for the current fair market value of those assets, subject to AGI limitations.

**Is it Possible to Contribute my House or Vacation Residence into the Foundation and Still Retain the Right to Use it While I am Alive?** Yes. This type of charitable gift structure removes the asset from your estate and provides you with the use of the property for your life expectancy. The deductibility of your contribution is less than the deductibility for a "completed" gift.

**Can I receive Income from the Foundation Without Performing Pro Bono Work?** Yes. You may elect to receive gift annuity life income from donating a specific asset, but this election reduces the deductibility of your contribution of this asset. If this "split interest gift" concept interests you, a ORG representative would be happy to explain more thoroughly the methods used to achieve this objective.

**Can Any of my Contributions be Given to Charities or Other Institutions or Individuals Which I do Not Approve?** No. The ORG will not initiate charitable distributions from your donor advised account, unless it is left with no advisor (you or your successors) to provide guidance in that area. The ORG will make every effort to honor your disbursement requests as long as they are within the limits of the IRS.

**Assuming I want to Proceed, What are the Next Steps?** Simply complete the enclosed application form and investment election form and return them to your ORG Financial Counselor along with a single check made payable to the ORG for \$\$ (the set-up fee plus the first year's annual administration fee) plus the desired amount of your initial contribution.

---- END OF BROCHURE ---

### **BM-1 Video Presentation of ORG, The Economic Association of Health Professionals**

BM-1 himself provides a comprehensive description of what ORG, as a whole, can provide for members in a video taped presentation distributed to prospective members. BM-1 begins the video with a history and the purpose of the ORG organization



when it began in 19XX. He states ORG began as a research project to help doctors get enough money saved by normal retirement age so they could retire with the same standard of living they enjoyed when they were in practice. The result of this research project was that a doctor only has to pay income taxes on what the doctor spends in lifestyle costs (rent, food, etc..) and that a doctor does not need to pay income tax on everything he earned. Therefore, ORG provides vehicles for doctor's to shift earned income for the purposes of reaching a retirement savings amount (critical capital mass) in order to maintain the same lifestyle in retirement as the doctor experienced during the practice years.

BM-1 states in the video that when members join the ORG program they receive an accumulation plan which is detailed in a document entitled, "Tax Reduction Plan: Accumulation" (Red book). Annual updates to this accumulation plan are provided to members to inform the members of their progress in their retirement savings plan. The goal of the accumulation phase is to reach critical capital mass which is the amount of money needed in a retirement savings account today to be able to fund lifestyle needs from retirement to life expectancy or through the life expectancy of the spouse. BM-1 briefly discusses the second phase of the ORG program which is the distribution phase (Green Book) where members are counseled how to spend or give away all of the funds during the member's life expectancy so the member may control the use of all of the money saved in his retirement savings account. BM-1 briefly mentions the Family Public Charity (FPC) and how it can be used by the member in both the accumulation and distribution phases of the ORG program. He states, "The ORG was created to benefit not only the charitable causes but also doctors and their families."

BM-1 goes in to detail on the accumulation phase of the program and presents the vehicles that ORG has available for members to help them lower taxable compensation and increase savings. The vehicles BM-1 presents are: 1) 419 Plan; 2) Leveraged split dollar plan; 3) Disability equity trust; 4) Malpractice equity trust; and 5) Long term care equity trust. As a last resort, BM-1 states that if for some reason or another a member is not able to use the vehicles discussed above, the member may use the "final plan", the Family Public Charity. He goes on to discuss how the FPC can be used to pay themselves for "good works" and concludes this section by stating, "you don't have to pay income tax on earnings you don't need to live on. There are plenty of different programs within the ORG program to allow you to eliminate income taxes on earnings other than necessary for lifestyle costs."

An interesting feature that BM-1 presents as a useful feature of the FPC is the use of the FPC in selling a member's practice at retirement. He states, "ORG got involved in practice sales somewhat by accident you know being a part of the integrated planning for doctors and developed a planning program for practice sale." BM-1 asserts that the FPC can be used to eliminate income tax and capital gains tax on the sales proceeds from a sale of a practice and the way to do this is to "gift" the practice to the FPC. The FPC then sells the practice and the proceeds go in to the FPC account of the member who will maintain control and direction of the FPC account in perpetuity. This feature may explain the reasons why a substantial number of members with accounts don't have any current activities (discussed later).



BM-1 continues on to discuss how a member can use the FPC to give money to their children by having the member's children perform "good works" and receive payment or compensation from the FPC. BM-1 calls this feature "an economic safety net".

And finally, BM-1 states that if a member has his children taken care of, has enough money for himself to pay lifestyle costs for his life expectancy and his spouse's life expectancy, then the member may want to support institutions that perpetuate the members value system via the permanent endowment program.

This video presentation by BM-1 emphasizes the tax savings and retirement savings benefits of the FPCs within the Foundation and is the primary purpose of the Foundation. Charitable intentions and uses of the Foundation appear to be a secondary purpose or byproduct of the Foundation. Even this conclusion is based on the assumption that "the perpetuation of a doctor's value system" is consistent with the meaning of section 501(c)(3).

**Foundation's Information Return Filing History**

The Foundation failed to timely file Form 990, Return of Organization Exempt from Income Tax for 19XX and 19XX. Such returns would have been due on May 15, 19XX and May 15, 20XX, respectively. The Foundation filed its 19XX and 19XX Forms 990 on April 8, 20XX. Pursuant to extensions, the Foundation timely filed its Form 990s for 20XX and 20XX. In summary, the Foundation reported the following:

	19XX	19XX	20XX	20XX
Contributions:				
Cash	\$			
NonCash	\$			
Dividends/Interest	\$			
Rents				
Change in Annuities	\$			
Loss in Securities	\$	0		
<b>Total Revenue</b>	\$			
Program Service Expense:				
Grants	\$			
Legal	\$			
Interest	\$			
Admin	\$			
Bank Fees	\$	\$	0	\$
Taxes	\$	\$	0	\$
Investment Fees	\$	0	\$	\$ \$ \$
Marketing Fees	\$ \$ \$	\$ \$ \$	\$ \$	
<b>Total Expenses</b>	\$			

Excess/Deficit	\$	
Beg Fund Balance	\$	
Other Change in		
Net Assets:		
Transfer from		
National Fdn	\$	
<hr/>		
Net Assets at		
End of Year	\$	

### Records Reviewed During the Examination

The Foundation maintains its records in a computer database. Every transaction of the Foundation is recorded. During the examination, on August 22, 20XX, the Foundation provided its computerized database information to the Service for the period August 1, 19XX through August 21, 20XX. This information was provided in electronic format.

The Foundation also provided answers to certain questions posed by the examining agent, provided a copy of its check register, and copies of selective files maintained by the Foundation with respect to individual member accounts. These individual member files maintained by the Foundation contained records and documentation of transactions, correspondence, and copies of checks related to the member's transactions with the Foundation.

As noted above, the Database provided to the IRS was in an electronic format (i.e. computer file). The examining agent sorted and summarized the information contained in the database. Each transaction by the Foundation was given an accounting code or "contype" by the Foundation as the codes are called by the database. The legend for the codes is as follows:

A	Annuities	FDN Assets	Annuities
B	Brokerage-Sei,SWB,PNC	FDN Assets	Brokerage-CO-3,SWB,PNC
BF	Fees	Payouts	Brokerage-CO-3,SWB,PNC
C	Contribution	Contributions	
CB	Contrib-Brokerage	Contributions	Brokerage-CO-3,SWB,PNC
CG	Contrib-Gift Annuity	Contributions	Gift Annuity
CL	Contrib-Life Insurance	Contributions	Life Insurance
CM	Contrib-Misc	Contributions	Misc
CN	Contrib-Note Rec	Contributions	Note Receivable
CO	Contrib-Other Brokerage	Contributions	All other brokerage
CR	Contrib-Real Estate	Contributions	Real Estate
D	Donations	Payouts	
DC	Deferred Comp	Payouts	
EA	Earnings-Annuities	Earnings	Annuities
EB	Earnings-Brokerage	Earnings	Brokerage-CO-3,SWB,PNC
EL	Earnings-Life Insurance	Earnings	Life Insurance
EN	Earnings-Note Rec	Earnings	Note Receivable

EO	Earnings-Other Brokerage	Earnings	All other brokerage
ER	Earnings- Real Estate	Earnings	Real Estate
EV	Earnings-Viatical	Earnings	Viaticals
F	Fees	Payouts	
G	Gift Annuity	Fdn Assets	Gift Annuity
IG	Interest-Gift Annuity	Payouts	
IR	Income-Real Estate	Earnings	
L	Life Insurance	Fdn Assets	Life Insurance
M	Misc	Fdn Assets	Misc
N	Note Receivable	Fdn Assets	Note Receivable
O	All Other Brokerage	Fdn Asssets	All other brokerage
P	Pro Bono	Payouts	
R	Real Estate	Fdn Assets	Real Estate
S	Student Loans	Fdn Assets	Student Loans
V	Viaticals	Fdn Assets	Viaticals
X	Reimb Expenses	Payouts	
XR	Expenses-Real Estate	Payouts	

The following is a summary of the total amount for each code for each of the four years under examination from the database (Note: 20XX has 8 months).

Assets	19XX	19XX	20XX	20XX(p)
A Annuities	\$			
B Brokerage	\$			
G Gift Annuity	\$			
L Life Insur	\$			
M Misc	\$			
N Note Rec	\$			
O Other Broke	\$			
R Real Estate	\$			
S Student Loan	\$			
V Viaticals	\$			

**Payouts**

D Donations	\$
DC Deferred Comp	\$
F Fees	\$
IG Interest-Gift Annuity	\$
P Pro Bono	\$
X Reimb Expenses	\$
XR Expns-Real Estate	\$

**Contributions**

C Contribution	\$
CB Contrib-Brokerage	\$
CG Contrib-Gift Annuity	\$
CM Contrib-Misc	\$
CN Contrib-Note Rec	\$

CO Contrib-Othr Brok \$  
 CR Contrib-Real Estate \$

**Earnings**

EA Earnings-Annuities \$  
 EB Earnings-Brokerage \$  
 EL Earnings-Life Ins \$0 \$ \$ \$0  
 EN Earnings-Note Rec \$  
 EO Earnings-Othr Brok \$  
 ER Earnings- Real Est \$0 \$0  
 EV Earnings-Viatical \$0 \$  
 IR Income-Real Estate \$

We have placed our reliance in the database despite that fact that we were unable to exactly reconcile the numbers reported on the Form 990 to the database information. The Foundation and its CPA did not provide enough detailed information and documentation to reconcile the Form 990 to the database. Our reliance on the database is based on the sample testing and tracing of transactions contained in the database to the source documents contained in the member files. Transactions in the database such as contributions, donations, student loans, and pro bono projects are, we feel, reliable and provide an accurate accounting of the amounts and transactions for these items.

The following is a summary of the amounts per Form 990 versus the amounts per the Foundation's database:

	<b>Form 990</b>	<b>Foundation Database</b>
19XX Contributions	\$	
19XX Contributions	\$	
20XX Contributions	<u>\$</u>	
Total	\$	
19XX Member Projects (probono, exp, def comp)	\$	
19XX Member Projects (probono, exp, def comp)	\$	
20XX Member Projects (probono, exp, def comp)	<u>\$</u>	
Subtotal		\$
19XX Grants/Donations	\$	\$
19XX Grants/Donations	\$	\$
20XX Grants/Donations	<u>\$</u>	<u>\$</u>
Total	\$	\$
19XX Fees	\$\$	\$
19XX Fees	\$\$	\$
20XX Fees	<u>\$</u>	<u>\$</u>
Total	\$	\$

For the payments made in the Student Loan program, it is not apparent from the Form 990 how it was reported. Presumably, these payments were recorded in the accounts receivables. The payments made for the Student Loan Program were as follows (from database):

19XX	\$
19XX	\$
<u>19XX</u>	<u>\$</u>
Total	\$

### **Distributions from Member's Accounts at the Foundation**

There are a number of means by which funds will be transferred from a member's account. In addition to the fees that must be paid to ORG and ORG Investment Services, Inc., members may select that funds be distributed to (1) other organizations described in section 501(c)(3); (2) "student loans"; or (3) member initiated charitable projects. Each of these three distribution options is discussed below.

The Foundation has a policy that members may not provide advice to the Foundation for distributions in excess of the member's account balance. (Board of Director Minutes, April 20XX, p. ) In addition, the Board will not initiate any distribution's from a member's account unless there is no fund advisor with respect to such account.

#### **(1) Distributions to Other Qualified Charities.**

Members may request the Foundation distribute funds to other organizations described in section 501(c)(3). As of October , 20XX, the Foundation did not have any written procedures or other applicable procedures for approving such requests. (See, response to IDR 0002, question #3.)

Despite the lack of written procedures, the Foundation had a practice of receiving a written "request" from a member on a Foundation form entitled "Distribution Request." The Distribution Request form sets forth the basic identifying information such as the name of the charity to whom the distribution is to be made, their address and telephone number, the amount of the requested distribution, the purpose of the distribution, and whether the distribution is a one time or recurring event. The form notes that "all checks will be sent to you [the member] unless you request otherwise." There is no indication on the Distribution Request form that funds distributed to the charity can not be used for the personal private benefit of the member.

When receiving a Distribution Request, the Foundation has a clerical employee check Publication 78, Cumulative List of Organizations to see if the distributee organization is a qualified donee organization. If the organization is so listed, the clerical employee will note the page number and column in Publication 78 where the distributee organization is listed. Next, the clerical staffer will begin the process of requesting CO-3 to send funds to the Foundation from the member's CO-3 account. Once the funds are received from CO-3, the clerical employee will cut a Foundation check payable to the



distributee organization. The routine practice is to send such checks to the member for presentation to the distributee organization. The Foundation checks include the imprinted name and address of the Foundation. In much larger font appears the name of the member's account above the payee line.

If the distributee organization does not appear in Publication 78, the Foundation staff attempts to contact the organization and requests a copy of their determination letter regarding exempt status. If the organization submits a copy of their determination letter then a distribution is made as above. If the determination letter is not submitted to the Foundation then the distribution will be denied.

During 19XX, 19XX, and 20XX there were 142, 194, and 481 distributions made by check, respectively. The Foundation provided records of denied distributions for the years under exam. They consisted of 2 denied distribution request in 19XX and 5 denied in 20XX. For the years 19XX, 19XX, 20XX, and 8 months of 20XX the number of members that made at least one distribution to another section 501(c)(3) organization was 80 out of the 357 member accounts ( %).

The following are examples of donor requested distributions that were reviewed during the examination and were obtained from the individual member files:

**1. Member – RA-2 (account name – RA-2 Foundation)**

Letter from the Foundation confirming quarterly distributions to numerous organizations in 19XX as directed by RA-2 (no request found in donor file). The letter from the Foundation also states that the Foundation is waiting for a payment from RA-11 from the rental property to fund the next quarter's distributions (RA-2 contributed rental income property to the Foundation and this property was being managed by RA-11 who would send the rental income to the Foundation. RA-11 subsequently purchased the rental property from the Foundation).

During calendar year 19XX a total of \$ (approximately \$ per quarter) was distributed from RA-2's account and distributed to various organizations. Some of the distributions were earmarked for individuals as follows:

CO-10 for RA-12  
CO-11 for RA-13 & 14  
CO-12 for support of RA-15 #  
CO-13 for support of RA-16 & 17  
CO-14 – RA-18 & 19, RA-20 & 21, RA-22 & 23  
CO-15 RA-24 & 25

During calendar year 19XX a total of \$ was distributed from RA-2s account and distributed to various organizations. Some of the distributions were earmarked for individuals as discussed above including:

CO-12 for monthly support of RA-26 #

During calendar year 20XX a total of \$\$ was distributed from RA-2' s account and distributed to various organizations. Some of the distributions were earmarked for individuals as discussed above including:

Hospital Chaplain's CO-16 for the living expenses of RA-27, account

CO-12 for RA-28, account, to support monthly living expenses

CO-17 – RA-29 account

CO-11 for gift to CO-18 account

All of RA-2's requests for distributions were honored by the Foundation. There is no documentation in the file that would indicate the Foundation inquired or investigated into the "earmarking" of distributions to individuals including personal living expenses which are printed on the check prepared by the Foundation. This is an indication of lack of oversight and knowledge regarding the laws relating to tax exemption and contributions.

Distributions from RA-2's account is further detailed in the charitable projects section below.

## **2. Member – RA-30 (account name – CO-19)**

Distribution request form submitted by RA-30 dated 6/26/XX for a distribution to CO-20 for \$ \$. The purpose is identified as "Country." The distribution request form is signed "OK XF" and approved. The Foundation prepares check 2 \$ made payable to the Church dated 7/13/XX.

## **3. Member – RA-31 (account name – CO-21)**

A distribution (no request form in donor file) for \$ to CO-22 of State on 5/21/XX.  
A distribution (no request form in donor file) for \$ to CO-22 of State on 10/26/XX (check).

### **(2) Student Loan Program.**

The CO-2 tax opinion letter states the following:

Educational Loans. The Foundation may support an educational loan program whereby students may borrow college and graduate school tuition and related expenses for education in an area related to the Foundation's charitable purposes. Each student must agree to a loan agreement under which he or she agrees to repay the loan, with interest, or alternatively provide one year of service to a charitable organization or charitable activity for each year of tuition received. Such agreement will be enforced. There can be no private inurement with respect to such a program.

An analysis of the student loan distributions follows:

	19XX	19XX	20XX
Contributions (excluding CG)	\$		
Student Loans \$	\$		
As a Percentage of Contributions	%	%	%

When compared with the percentage of donations to contributions ( % , % , and 8.13% for 19XX, 19XX, and 20XX, respectively) the student loan distributions is a substantial activity the Foundation carries on.

The Database information reveals that there are 38 member accounts with these student loans. The Foundation does not publish any information regarding the eligibility for these loans. Out of the 38 member accounts with student loans, 30 accounts made student loans to parties with the same last name (presumably the sons and daughters of the members based on the information reviewed) and for 7 of the member accounts with student loans we have not yet been able to determine the party(s) who received the student loan.

In addition from the Database information, from the known students who received a student loan (54), 48 of them had the same last name as the member and are presumably the sons and daughters of the member.

In many of the member accounts with student loans, distributions for student loans represent a very significant percentage of the funds contributed into the member's account. In 17 of the 38 accounts, more than % of the amount contributed into the account was dispersed in the form of student loans. For example, member RA-32 established his donor account (#8067) in 19XX. RA-32 contributed \$ \$ \$, and \$ to his donor account during taxable years 19XX, 19XX and 20XX, respectively. These contributions total \$ \$. Student loans were made from RA-32's account to or for the benefit of RA-33 and RA-34 in the amounts of \$ \$ and \$ during taxable years 19XX, 20XX and 20XX, respectively. This amount totals \$. Over % of the amounts contributed by RA-32 to the Foundation were distributed as student loans for his children. RA-32 made no other distributions from his account.

To receive a loan, the children of members are supposed to execute two documents: a Commitment Agreement and Education Expense Repayment Agreement. These documents are supposed to be countersigned by a representative of the Foundation. The Commitment Agreement provides that to receive funding for educational expenses, the student agrees to provide charitable work for the Foundation. The amount of charitable work time shall be not less than 2,000 hours for each year of educational expense advanced by the Foundation. The type of charitable work undertaken by the program participant is to be consistent with the charitable intent of the Foundation. If charitable work is not undertaken by the student to repay the educational expenses advanced, the student agrees to repay the Foundation all educational expense advanced not reduced by charitable services, together with interest according to the terms of an Educational Expense Repayment Agreement. The Commitment Agreement further

provides that charitable work for the Foundation is to commence immediately following the student's originally scheduled graduation. The student's course of study is to have some reasonable relationship to the Foundation's charitable program. Per the Commitment Agreement, the student is required to provide regular reports, at least annually, of his or her progress in the student's course of study and intended work, which is also to include an explanation of how the student intends to meet his or her charitable obligations per the agreement. Finally, the Commitment Agreement provides that when a student begins fulfilling their charitable obligation, the student will be expected to provide regular reports on the hours worked and charitable activities performed. The student is expected to explain how their work relates to the charitable purpose of the Foundation and include a signature from an "appropriate supervisory authority."

Some members may not understand that these distributions are student loans, but rather believe that the distributions are outright scholarships or grants. (AA)

In IDR 0003, question 4, the examining agent asked the Foundation to provide any status reports as required by the Commitment Agreement. The Foundation advised on December 13, 20XX that only one student had submitted any of the status reports and attached some documents relating to student RA-35. RA-35 began receiving student loans in 19XX. In that year, RA-36 contributed \$. Student loans were made for RA-35 in the following amounts: 19XX-\$ 19XX-\$ 20XX-\$ 20XX-\$. Total student loans were \$. The "status report" submitted by the Foundation includes a letter from RA-36 wherein he advises the Foundation that his daughter performed 672 hours of volunteer work at the CO-23 over the past three years. Attached thereto is a letter from CO-23 dated May , 20XX which is consistent with RA-36's representations to the Foundation. The "status report" also includes a December 17, 19XX statement from RA-36 requesting that his daughter be credited for 1,034.5 hours of community service volunteer work at the CO-24. Attached thereto is a summary of hours volunteered by RA-35 for 19XX and 19XX in a CO-24 document. Included on these documents are various hand-written calculations apparently attempting to demonstrate the decrease in repayment obligation.

By December , 19XX, the Foundation had issued student loans to at least 32 students (32 was the number of member accounts with student loans). The Foundation provided no further documents. The Foundation advised in December 20XX that it "does not have information that would indicate that any of the loan obligations are currently due." The Foundation further advised that it was exploring installing software to track the repayment obligations. In 20XX, the Foundation advised that no repayments of loans had commenced. Members have independently advised the Service that the Foundation has sold its student loan interests to a "third party investor." (E-75, Question 10) Other information suggests that in late 20XX the Board terminated the student loan program.

The related Education Expense Repayment Agreement is also supposed to be executed by the student and a Foundation representative. It provides that repayment of principal and interest is to be made either by (a) charitable work performed by the student at the rate of 2,000 hours for each full year of education expenses advanced by the Foundation, proportionately adjusted, or (b) by checks issued to the Foundation. Charitable work is to begin immediately following graduation. No cash payments are required until five years following the students graduation date. At such time any

remaining amounts due to the Foundation shall be repaid at the rate of  $\frac{1}{2}$  % of unpaid principal, together with interest thereon each year for five years. Thereafter, any remaining amounts of unpaid principal and interest will be repaid at the rate of  $\frac{1}{2}$  % of principal, together with interest each year. The entire loan must be repaid by the end of the 15th year following the student's originally scheduled graduation date.

The following are examples of student loans that were reviewed during the examination:

**1. Member – RA-30 (account name – CO-19):**

In 19XX and 19XX a Commitment Agreement for an educational loan was executed with RA-37 and RA-38, respectively. RA-37 & 38 are the daughters of donor RA-30. The agreement was to pay the tuition and books to attend the CO-25 and CO-26, respectively. RA-37's total tuition payments from the Foundation were (based on copies of checks in donor file):

19XX	19XX	19XX	20XX
\$	\$	\$	\$

Payments were made by checks payable to CO-25 except for check 6583 dated 10/ XX in the amount of \$ which was made payable to RA-30 to reimburse him for paying his daughters tuition.

RA-38's total tuition and book payments from the Foundation were (based on copies of checks in donor file):

19XX	19XX
\$	\$

Payments were made by checks payable to CO-26. All payments to the university were made by the Foundation based on requests made by RA-30.

Contributions to the Foundation by RA-30 were as follows:

19XX	19XX	20XX	20XX
\$	\$	\$	\$\$

**2. Member – RA-39 (account name – CO-27):**

In 19XX a Commitment Agreement for an educational loan was executed with the daughter of donor RA-40. The agreement was to pay the tuition, books, room & board to attend CO-28. Another educational loan agreement was executed on the same day with RA-41, the son of RA-39.

Denise's tuition, books, room & board payments from the Foundation were:

19XX	19XX	20XX
\$	\$	\$



Payments were made by checks payable to CO-28 except for check 1020, dated 1/30/XX, for \$ which was made payable to RA-39 who was being reimbursed for paying the tuition for Denise.

RA-41 tuition payments made by the Foundation were:

19XX	19XX	20XX
\$	\$	\$

Payments were made by checks payable to CO-28.

Contributions to the Foundation by RA-39 were as follows:

19XX	19XX	20XX
\$	\$	\$

### **3. Member/Foundation President and Board Member/Founder of ORG. - BM-1**

On July 30, 19XX a Commitment Agreement and Education Expense Repayment Agreement for an educational loan was executed with RA-42. On August 16, 19XX and August , 19XX the same agreements were executed with RA-43 and RA-44, respectively. The agreements were for the payment of tuition, fees, and on campus room & board to attend CO-29 (RA-42), CO-30 (RA-43), and the CO-31 (RA-44).

RA-43's tuition, fees, room & board payments from the Foundation were:

19XX	19XX	20XX
\$	\$	\$

Payments were made by checks payable to CO-30 and also to the CO-32 (CO-32) for study programs in Italy. Total payments to the CO-32 were \$ during the year 20XX. In addition, a payment of \$ was paid to an institution called the CO-33 in the year 20XX. It was noted during the year 19XX that payments to CO-30 included a payment of \$ to the CO-30 bookstore (presumably for books) and \$ in payments for resident phone service. During the year 20XX a payment of \$ was paid to CO-30 and subsequently refunded because RA-43 withdrew from the spring and winter terms. Also for 20XX, the database information in the IRS' possession stops in August of 20XX and paper records provided by the Foundation contain a payment of \$ on 9/ /20XX. Out of the 21 payments made there were only 2 formal distribution requests in the files.

RA-42's tuition, fees, room & board payments from the Foundation were:

19XX	19XX	20XX
\$	\$	\$

Payments were made by checks payable to CO-29. Out of the 7 payments made by the Foundation there were 2 formal distribution requests in the file and one of these formal distribution requests was not signed/approved by the Foundation.

RA-44's tuition, fees, room & board payments from the Foundation were:

19XX	19XX	20XX
\$ \$0		\$0

Payments were made to the CO-31 for tuition and fees and a payment was made to CO-34 for room & board including \$ for chapter dues. No formal distribution requests were in the records.

To recap, BM-1' total student loans from the Foundation during the years under exam were follows:

19XX	19XX	20XX
\$ \$		\$

Contributions to the Foundation by BM-1 were as follows:

19XX	19XX	20XX
\$ \$\$	\$	

(3) Member Initiated Charitable Projects.

In addition to distributions in the form of payments to other charities and student loans, members can initiate their own charitable projects. The Foundation produced a one-page memorandum dated January , 19XX setting forth their written procedures with regard to "Foundation Projects (such as Pro Bono Services) / Deferred Compensation." ("Project Memorandum") The Project Memorandum is addressed to "All ORG Donor-Advisors." It is not clear how this memorandum was distributed. The Foundation did not claim any postage expenses on its 19XX Form 990. It is inconclusive whether the Project Memorandum is actually provided to all members.

In regard to the Foundation's standards for project approvals, the Project Memorandum provides, "All charitable projects need to have prior approval from ORG. Requests should follow the format on the form named 'Charitable Project Approval'." Apparently, this edict was not carefully followed. The Foundation's minutes of its December , 19XX Board of Directors meeting notes that the Foundation has been funding member initiated charitable projects without prior approval from its Board of Directors. The "Charitable Project Approval" form requests members to identify the name, date(s), location and estimated costs of a charitable project. The form does not include a request whereby the member would explain how the project's activities accomplish charitable purposes. There are no instructions to the form.

The Project Memorandum identifies three means by which members can receive payment from their projects: (1) Current reimbursement payment for expenses; (2) current payment for reasonable compensation; or (3) deferred payment for reasonable compensation. The Project Memorandum refers to various Foundation forms for requesting payment for these various types of expenditures. The Project Memorandum advises members that if they have questions they should contact their ORG Financial Counselor or the ORG home office.

Members are not permitted to initiate or request payment for charitable projects in excess of the cash balance in their accounts. See April , 20XX Board of Director Minutes, page 2 stating that there is a general ORG policy of not permitting members to advise distributions in excess of their account balance. See also a letter from Financial Counselor providing, "At no time should the value of services you have rendered exceed the account balance in your Modern Portfolio Theory account as this creates substantial problems. You have given me some indication that you will make periodic additions to the account. Previously, I had provided you the deposit slips to do so." (K1-62).

In addition to these types of member initiated charitable projects, some of the Foundation's internal forms suggest that a member can agree in advance with a patient that the patient will not be billed for the member's medical services. The member then bills his or her Foundation account for the medical services he or she provides to the patient. Perhaps because of this aspect, the Foundation often refers to member initiated charitable projects as "pro-bono."

As noted, the Foundation provides for a deferred compensation arrangement if a member wants to be compensated at a later date for "pro bono" work performed. For this arrangement, a member completes a Participants Election to Defer Compensation form ("Election Form") with ORG. Per the Election Form, a member may elect deferral of up to 100% of any amount earned as compensation for ORG. The deferred amount will be invested and the value of the deferred amount will be paid to the member under the terms of The ORG Deferred Compensation Plan. As summarized in the Election Form, the deferred amount will be deferred until retirement, termination of employment, or death. On the Election Form the member is required to select a lump sum payment, annuity, joint annuity, or installment payments. To participate in the deferred compensation arrangement, the donor also executes an Independent Contractor Agreement with ORG, to perform "pro bono" services. The ORG is a wholly owned subsidiary of ORG.

The Election Form provides "I understand that I do not have the right to revoke my election to defer payment of any incentive compensation earned in the Plan Year and that taxation of any such deferred amounts is subject to the rules and regulations of the Internal Revenue Service." At the April , 20XX Board of Directors meeting, the Board unanimously passed a motion providing that if a member died the amounts designated as deferred would automatically revert back to the member's account instead of to its rightful beneficiaries is because "the utility of such transfers is questionable." The only reason given for the utility of such transfers being questionable is that the beneficiaries would lose 75% of such funds to taxes.

An analysis of the Pro Bono, Expense Reimbursement, and Deferred Compensation follows:

	19XX	19XX	20XX
Pro Bono	\$0	\$\$	\$\$
Exp. Reimb	\$\$	\$\$	\$\$
Def. Comp	\$\$	\$\$	\$\$

Examples of member initiated charitable projects have included: composing church music; tutoring students; performing medical services; and taking trips to foreign countries that include attendance or teaching at seminars or conferences or the provision of services.

During the examination, several Foundation member files were examined and two files in particular were examined in detail, as follows:

**1. Member – RA-45 (account name – CO-35)**

On 12/ /XX, CO-35 contributed a 98% interest in the CO-35 to the Foundation. The CO-35 consists of CO-35 a State Corporation (general partner with 1% interest) and CO-35 (limited partner with 99% interest). Both have the same address and are controlled by RA-45. The value of the 98% contribution to the Foundation was \$. Assets of the partnership consist of numerous investment funds (Charity Limited Family Partnership or Char-Flip). RA-45 requested a change of investment to Balanced Blend on 5/17/XX. On 5/24/XX the Foundation changed the investment from CO-36 to CO-36. RA-45 received back from the Foundation the following:

**6/28/XX** – Check in the amount of \$ payable to RA-45 for CO-37. (for this CO-37, RA-45 is composing and writing CO-37 which she sends to churches in her denomination)

**7/8/99** – Check in the amount of \$ for January, February, and March pro bono work. 271 hours at \$/hour for "Research and preparation of materials for tutoring students in writing, grammar, and ESL issues".

**7/21/XX** – Check in the amount of \$ payable to RA-45. 263 hours for "Research and preparation of materials for tutoring students in writing, grammar, and ESL issues", and 372 hours for CO-37. The Research and preparation were at \$ per hour for the months of April, May, and June and the CO-37 was at \$ per hour for April, May, and June.

**11/3/XX** – Check in the amount of \$ payable to RA-45. 178 hours of CO-37 at \$ per hour and 229 hours of Tutoring and research preparation at \$ per hour for the months of August and September.

**1/31/XX** – Check in the amount of \$ payable to RA-45. 198 hours of tutoring and research at \$ per hour and 306 hours of CO-37 at \$ per hour for the months of October, November, and December.

**5/18/XX** – Check in the amount of \$ payable to RA-45. 228 hours of tutoring and research at \$ per hour and 380 hours of CO-37 at \$ per hour for the months of January, February, and March. Note, RA-45 elected to defer this compensation and paid this amount back to ORG.

After reviewing the above files, the examining agent asked in IDR 003, question 3, "Please explain if there is any further investigation as to the charitable validity for payments made for pro bono work and reimbursement and donations to charitable organizations. For example, donor RA-2's donations to charitable organizations appears to have distributions for the personal living expenses of individuals. Also there is not enough information in the files to determine what donor RA-45 is doing to earn her pro bono compensation." The Foundation provided the following response:

The charitable validity of pro bono work is determined by reviewing the information submitted to the Foundation in the Project Approval form (and accompanying documents, if any). If the Foundation Administrator determines on primary review that the contemplated pro bono work does not further a recognized charitable purpose, the Foundation Administrator will deny approval or request additional information. Pro bono requests that are approved by the Foundation Administrator are ultimately submitted to the Foundation Board for final approval. The Foundation does not generally conduct on-site reviews of approved pro bono projects; however, follow-up documentation such as time allocation journals, patient logs, and patient fee waiver forms are routinely required before pro bono payment requests are honored. Expense reimbursement requests are honored when the payer provides documentation (i.e. receipts) of the actual costs associated with a charitable project. Generally, the Foundation's donations to other charitable organizations occur only after the Foundation determines the receiving organization is an exempt entity qualified to receive the gift. In the case of reimbursement made for RA-2's missionary and orphanage work in Country and elsewhere, please clarify which expense reimbursements you believe are personal. Our records indicate that RA-45 composes religious music for use in churches around the United States and has provided some tutoring for students with weak English skills. Because the music composition is a solitary endeavor, RA-45's journal records of time spent on the project are accepted as evidence of the work performed. Inaccurate records would expose RA-45 to civil and perhaps criminal fraud liability.

## **2. Member – RA-2 (account name – RA-2 Foundation)**

RA-2's file contained documentation for 10 projects for which RA-2 was reimbursed. RA-2 wife accompanied RA-2 during these projects and it is assumed that the reimbursed expenses include RA-2 wife's expenses. The file did not contain any approval of RA-2 wife's participation.

The 10 projects occurred during 19XX, 20XX, and 20XX. Of the 10 projects, pre-approval documents were in the file for 3 of the 10 projects. All 3 pre-approval forms submitted by RA-2 were undated and the information included the estimated dates, project name and/or description, and estimated costs. Those 3 projects were as follows:

- 1) Travel to Country 4/ – 5/ 'XX  
Symposium  
Estimated Costs: \$ to \$ \$

No Foundation approval signature on the form but had the note, "okay same as project last year still check with RA-46 but let RA-46 know similar to Country's." (no documentation in the file for such Country trip or subsequent follow up).

- 2) Travel to Country 7/ 'XX – 7/ 'XX  
Dentistry in Village for 3 weeks, donations to church, toys for children, printing regarding trip



Estimated Costs: \$

The Project Approval form included a handwritten statement, "For RA-2 per verbal order" Foundation approved this project despite the lack of RA-2's signature. RA-2 involved another organization to pay for the lion's share of travel costs for this trip.

3) Travel to Country 10/ 'XX - 11/ 'XX

Dental Symposium; Training & lecturing in clinical techniques & office procedures.

Estimated Costs: \$ to \$ (Transportation, housing, food, in-country travel, supplies (personal), interpreters, equip.)

The file contained a correspondence requesting his presence at the symposium. This request also asked that the Dr. bring new technical equipment to demonstrate new technologies.

RA-2 did bring dental equipment for his trip. The equipment was donated from 3M to RA-2 per his request in a letter to 3M. Also in that letter, RA-2 requests information on how 3M products can be ordered in European sources and that he would "be happy to unofficially represent the quality products during the meeting."

Approval form was approved.

The file contained project expense requests for all three trips and subsequent payments from the Foundation to RA-2. Project #1 was reimbursed in the amount of \$, however no receipts were in the file. RA-2 notes in the project expense request that the purpose of the trip was to introduce free market concepts and business practices, clinical skill, and dentistry to local business & professionals. There was no Foundation approval signature on the project expense request, which was paid. Project #3 reimbursed RA-2 for \$.

A person trained and knowledgeable reviewing and processing the above documents would reasonably question, or at a minimum, inquire on whether the purposes of the above projects are exclusively in furtherance of charitable purposes, within the meaning of 501(c)(3). Project #1 and #3 especially would indicate that RA-2 may have not been performing charitable activities. The documents in the file do indicate that RA-2 did have humanitarian intentions and he indicated that he had intentions of this also. However, the information would indicate that RA-2 may have been performing an activity of a commercial or marketing activity, which a reasonably knowledgeable and trained individual would determine. The monitoring and apparent concern indicated by the evidence is lacking or nonexistent. Payment was made as requested.

Project #3 had receipts for the reimbursed expense, however there were no notes or inquiry regarding the apparent personal expenses claimed by RA-2. There was a claim in the amount of \$ for Business Cards (RA-2 Dentistry Bus Cards), film & processing, and ball bearings for \$, and cash gifts to individuals including \$ given to "interpreters & in-country travel RA-47." In the expense reimbursement request, RA-2 writes;

“It has been our habit the last several years to stop over in a European city for a few days. This time we chose to take a 5 day Greek Island cruise at our personal expense. The airline costs that we have submitted to ORG represent our flight to Country. The return trip costs are from Country – Country and from State We returned from the cruise to State as part of the cruise and are not requesting reimbursement for that part.”

The above language and the supporting documents are not clear if RA-2 did or did not claim all of the personal costs of his trip. There are no documents in the file that would indicate the Foundation did any investigation before it paid RA-2.

The remaining 7 trips that did not have Project Approval forms in the file maintained by the Foundation. Despite the lack of project approvals, the following were reimbursed for claimed project expenses :

- 1) Travel to Country, Country 3/XX to 4/XX  
Help build a church  
Request for \$ and paid (including cash gifts)
- 2) Travel to Country 5/ 'XX – 5/ 'XX  
Request for \$ and paid  
No supporting documents in file
- 3) Trip to Country, Country 6/ 'XX – 7/ 'XX  
Request for \$ and paid  
No supporting documents in file
- 4) Trip to Country 9/ 'XX – 9/ 'XX  
Request for \$ and paid  
RA-2 writes, "Our flight as broken down into segments as noted on our visa bill (not in file). Part of it was considered personal due to post project travel."
- 5) Trip to Country – Country 11/ '20XX – 11/ '20XX  
International School Project  
Request for \$ and paid  
On the request there is a notation, "per BM-1 & RA-46 Buck all expenses are related-Pay what they are asking for even if we do not have all the records."
- 6) Trip to Country 3/ '20XX – 4/ '20XX  
Request for \$ and paid  
No supporting documentation in file
- 7) Trip to Country, Country 5/ '20XX – 5/ '20XX  
Request for \$ and paid  
No supporting documents in file

The only indication found in RA-2's file with any indication of monitoring of the activities of RA-2 was a letter dated 10/ 'XX from RA-48, Administrator. It is a note to the file that states RA-2 has been notified that he will not be reimbursed for gifts RA-2 has made with his own monies. The letter admits that they have made exceptions in the past but that they cannot continue this. Yet, for the trip to Country on 11/ 'XX to 11/ 'XX, after the date of the note to the file, the apparent approval on RA-2's expense

reimbursement request provides, “per BM-1 & RA-46 Buck all expenses are related-Pay what they are asking for even if we do not have all the records.” In summary, after the Foundation advised RA-2 about claiming unreimbursable expenditures, the Foundation completely stop requiring records or receipts from RA-2.

A third member’s file at the Foundation was also examined:

**3. Member – RA-49 (account name – CO-38)**

RA-49’s file contained documents similar to the RA-45 file. The Foundation’s file does contain one Project Approval form for City Free Clinic, however the form is dated March 23, 20XX, which is after the performance date of services and all payments on the project occurred. (RA-49 apparently volunteered his medical services at two free medical clinics. There is no Project Approval form for the second clinic.) The file contains only summary time sheets that only contained time worked and the raw number of patients seen. These forms were not Foundation forms, but rather were on a paper sheet containing the letterhead of City Free Clinic. No specific reports were in the file elaborating on the services performed. The file does contain a letter dated March 15, 20XX from the Greater City Free Clinic to “Whom It May Concern.” This letter advises that RA-49 volunteered at the Greater City Free Clinic for 50 hours during the period September 19XX to March 20XX. The letter is signed by the clinic’s executive director. There is no indication or acknowledgement of the ORG. The following distributions were made from the Foundation to RA-49:

The following were payments were made to RA-49 for claimed medical services provided to City Free Clinic:

- 1/ /XX - \$,\$ on check
- 2/ /XX - \$,\$ on check
- 3/ /XX - \$,\$ on check
- 3/ /XX - \$,\$ on check
- 5/ /XX- \$ on check
- 7/ /XX - \$,\$ on check

Payments to RA-49 also included compensation for medical services provided to City Free Clinic in the amount of \$ on check . Note that \$ was requested by RA-49 but only \$ was paid because that was all that was left in his account.

**Distributions of Fees from the Foundation**

As noted previously in this report, a large percentage distributions goes the payment of fees to ORG and ORG, Investment Services. An analysis of the fees paid to the related ORG entities follows:

	19XX	19XX	20XX
Contributions (990)	\$	\$\$	\$
Fees per Form 990	\$\$	\$	\$\$





## Application of Legal Principles to Operations of the Foundation

### I. THE FOUNDATION HAS NOT ESTABLISHED THAT IT OPERATES EXCLUSIVELY FOR EXEMPT PURPOSES.

#### A. The Foundation has not demonstrated that it primarily engages in activities that accomplish exempt purposes.

Section 501(c)(3) provides that an organization must, to qualify under that section, be organized and operated exclusively for an exempt purpose. Exclusively does not mean solely in this context. It does mean primarily. Treas. Reg. §§ 1.501(c)(3)-1(c)(1), 1.501(c)(3)-1(a)(1). As a general precept, any tax-exempt organization must operate primarily for its tax-exempt purpose to remain exempt. See e.g. Orange County Agricultural Society, Inc. v. Commissioner, T.C. Memo. 1988-380, aff'd, 893 F.2d 647 (2d Cir. 1990).

The general rule, as stated by the Supreme Court, is that the “presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes.” Better Business Bureau v. United States, 326 U.S. 279, 283 (1945). See also Universal Church of Jesus Christ, Inc. v. Commissioner, T.C. Memo. 1988-65. The Eighth Circuit held that nonexempt activity will not result in loss or denial of exemption where it is “only incidental and less than substantial” and that a “slight and comparatively unimportant deviation from the narrow furrow of tax approved activity is not fatal.” St. Louis Union Trust Co. v. United States, 374 F.2d 427, 431-32 (8<sup>th</sup> Cir. 1967); see also Seasongood v. Commissioner, 227 F.2d 227 F.2d 907, 910 (6<sup>th</sup> Cir. 1955).

The existence of one or more truly exempt purposes of an organization will not be productive of tax exemption if there is present in its operations a substantial nonexempt purpose. See, Stevens Brothers Foundation v. Commissioner, 324 F.2d 633 (8<sup>th</sup> Cir. 1963); Scripture Press Foundation v. United States, 285 F.2d 800, 806 (Ct. Cl. 1961). There is no definition of insubstantial in this context. Thus, it is a question of fact to be determined under the facts and circumstances of each case. See e.g., Kentucky Bar Foundation v. Commissioner, 78 T.C. 921 (1982). One court opinion suggests that where a function represents less than 10 percent of total efforts, the primary purpose test will not be contravened. World Family Corporation v. Commissioner, 81 T.C. 958 (1983). Another court opinion held that where an organization received approximately one-third of its revenue from an unrelated trade or business, it could not qualify for tax-exempt status. Orange County Agricultural Society, supra.

If one assumes *arguendo* that an organization has one or more exempt purposes, the focus is then on whether the organization has a commercial or other nonexempt purpose. Upon finding a non-exempt purpose, an inquiry should then be made as to whether it is primary or incidental to the exempt purposes. See American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962); Pulpit Resource v. Commissioner, 70 T.C. 594 (1978). If there is a single nonexempt purpose that is substantial in nature, the exemption would be precluded. See Policemen’s Benevolent



Association v. Commissioner, T.C. Memo. 1981-679 [policemen's benevolent association could not qualify for tax exemption because the payment of retirement benefits to its members was a substantial nonexempt purpose]; Copyright Clearance Center, Inc. v. Commissioner, 79 T.C. 793 (1982) [court agreed organization served tax-exempt purposes and to a substantial degree but held that the founders' interest was to create a device to protect their copyright ownership and to collect license fees and this nonexempt purpose was not incidental so the organization could not qualify for tax exemption]; Local Union 712, I.B./E.W. Scholarship Fund v. Commissioner, T.C. Memo. 1983-76 [a scholarship fund did not qualify for tax exemption where it was established pursuant to a collective bargaining agreement and the only recipients of scholarships were children of the employees so the fund did not confer the requisite "public benefit" and the benefits were compensation]; Church in Boston v. Commissioner, 71 T.C. 102 (1978) [organization did not qualify where one of its purposes was to make grants that had no legal requirement that principal and interest be repaid and where the organization could not demonstrate how the grant recipients were selected or the reason for the specific amounts given or the purpose of the grants].

As amplified further in this report, more than an insubstantial purpose of ORG is to benefit its donors and ORG. Funds from the donor advised accounts were used to provide "scholarships" for the donor's children, were promoted and used as a retirement account for the donors, were used to shelter income of the donors, were used to provide tax benefits for the donors and were used to provide compensation for the donors. In addition, a not insubstantial purpose of ORG was to financially benefit a related entity, ORG by paying it for marketing, fundraising, investment and administration and by creating a market for products that ORG. and its related entities promotions.

While ORG did disburse some funds for charitable purposes, i.e. to section 501(c)(3) organizations, it has not demonstrated that that is its exclusive (primary) activity. Rather the facts show that there are nonexempt purposes which are more than insubstantial. ORG should not be a tax exempt organization.

B. The Foundation has not demonstrated that its activities do not serve substantial nonexempt purpose.

An organization, to qualify as a charitable entity, is regarded as operated exclusively for one or more tax-exempt purposes only if it engages primarily in activities that accomplish one or more of its exempt purposes. Treas. Reg. § 1.501(c)(3)-1(a)(1). An organization will not be so regarded if more than an insubstantial part of its activities are not in furtherance of an exempt purpose. Treas. Reg. § 1.501(c)(3)-1(c)(1); see also, Society of Costa Rica Collectors v. Commissioner, T.C. Memo. 1984-648. An organization is not considered as 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(c)(3)-1(c)(2); Athenagoras I Christian Union of the World, Inc. v. Commissioner, T.C. Memo. 1988-196. The concept of private benefit is to ensure that the organization serves public rather than private interests. Church of Scientology v. Commissioner, 83 T.C. 381, 491 (1984), aff'd, 823 F.2d 1310 (9<sup>th</sup> Cir. 1987).

The critical inquiry is whether an organization's primary purpose for engaging in an activity is an exempt purpose or whether its primary purpose is a nonexempt purpose, such as operating a commercial business to produce net profits. See B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352, 356-57 (1978); Ohio Teamsters Education and Safety Training Fund v. Commissioner, 77 T.C. 189 (1981), aff'd, 692 F.2d 432 (6<sup>th</sup> Cir. 1982).

When an organization operates to confer a private benefit, where the benefit is more than incidental, it cannot satisfy the operational test. In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court concluded that an otherwise qualifying school that trained individuals for careers as political campaign professional did not qualify because of the benefit accruing to entities of a political party and its candidates. Nearly all of the school's graduates became employed by or acted as consultants to these entities and candidates.

As amplified further in this report, ORG engages in activities that do not primarily further its charitable purpose. For instance, it operates "scholarships" that benefit the donor's children, it operates as a retirement account for its donors, it operates to shelter income of the donors, it operates to provide inappropriate tax benefits for the donors and it operates to provide inappropriate compensation for its donors. In addition, a not insubstantial part of ORG's activities financially benefits a related entity, ORG by paying it for marketing, fundraising, investment and administration and ORG also operates to create a market for products that ORG and its related entities promote.

C. The Foundation has not demonstrated that it meets the standards for donor funds set in National Foundation, Inc.

In National Foundation, Inc. v. United States, 13 Cl. Ct. 486 (1987), the Court of Claims concluded that National Foundation, Inc. ("NFI") was organized and operated exclusively for exempt purposes. NFI raised and distributed funds to other nonprofit organizations and initiated, funded, and administered a wide variety of charitable, educational, religious, scientific and literary projects, most of which are recommended by donors. Individual funds or accounts were established under the NFI umbrella when individuals submitted an application with a nonrefundable fee of \$100 and a minimum initial contribution of \$\$ which was designated to a charity which was suggested by the donor and approved by the exempt organization. NFI solicited contributions from potential donors usually through professionals called Charitable Development Officers (CDOs). CDOs are accountants, attorneys, trust officers, stockbrokers, life underwriters, ministers, and representatives of charitable institutions. As compensation for soliciting donors, they were paid a percentage, ranging from three to six percent, of the donations they generated.

Approximately percent of the total amount disbursed was contributed directly to existing 501(c)(3) organizations. NFI claimed that the balance of the donated funds were disbursed to support projects that furthered its exempt purpose.

The Court of Claims held that in deciding whether NFI would approve a specific charitable project initiated by a donor, as opposed to grants to other section 501(c)(3) organizations, the projects met five "stringent" standards, described as follows:

- 1) Projects must be consistent with charitable purposes allowed by the Internal Revenue Code;
- 2) Projects must have a reasonable budget;
- 3) Projects must be adequately funded;
- 4) Projects must be staffed by competent and well trained personnel; and
- 5) Projects must be capable of effective monitoring and supervision by NFI.

The Foundation does not adhere to these stringent standards. For example, member RA-45 was permitted to engage in music composition and tutoring. The entire substance of the Charitable Project Approval form consists of a statement from RA-45 requesting \$ per hour for "Preparation, composition, arrangement, research, and publication of CO-37 for church use." A second form requests approval for \$ per hour for "research and preparation of materials for tutoring students in writing, grammar, and ESL issues." These forms do not reflect any inquiry into whether her projects had a reasonable budget, were adequately funded, the competence of RA-45 to perform the tasks, or whether the Foundation was capable of effectively monitoring and supervising these projects. When asked about the nature of RA-45's projects the Foundation advised that her music composition project was a "solitary endeavor." The Foundation advised that RA-45's journal records of time spent on the projects were accepted as evidence of the work performed, despite the fact the records revealed that RA-45 performed well more than 40 hours of service per week on the combined projects.

RA-45's projects were not capable of effective monitoring and supervision by the Foundation. The Foundation has no policy or expectation that its members will report to it on the progress of any charitable projects. RA-45 did not provide contemporaneous periodic reports to the Foundation the work she was performing. To be sure, she tendered Charitable Project Compensation Request forms, Charitable Project Monthly Time Allocation Logs and Quarterly Summaries. Presumably, all of these services were performed by RA-45 herself. These documents merely list dates, hours and compensation rates. The Foundation's only review of these materials was to be sure that compensation requests corresponded to the hours listed on the logs. The Foundation's supervision consists of a post-hoc statement that if RA-45 were to supply inaccurate records she would be exposed to civil and criminal fraud liability. There is no evidence that the Foundation informed RA-45 of these potential liabilities. Presumably, the Foundation would pursue such claims. The likelihood of the Foundation prosecuting its customer is minimal at best.

ORG has not established that it operates exclusively for section 501(c)(3) purposes. One of its three programs, the student loan program, primarily benefits its donor/account holders and their families. The other two programs, the "Pro Bono Services Program" and the "Charitable Grants Program," are operated with insufficient oversight by ORG, making it unable to establish that disbursements it approves are used exclusively for section 501(c)(3) purposes.

ORG's Board of Directors initiates no activities under any of its purported charitable programs. Although the Foundation stating that its "Statement of General Purposes and Policies," adopted by its Board on December , 19XX, empowers the

Board "to determine the manner by which Foundation assets will be utilized," there is no evidence that the Board initiated any activity during the years in issue. Rather, in all disbursements during the years in issue, the Foundation relied on its members to initiate proposals. In fact, the Board formally ratified this practice by approving procedures limiting disbursements for any proposal to the funds in the account of the donor account holder who submitted the proposal.

Although the Board's reliance on its members to carry out the Foundation's stated purposes does not, in itself, prevent the Foundation from operating for exclusively charitable purposes, it requires the Foundation to exercise sufficient oversight of the activities it authorizes its members to take on its behalf to insure that those activities or disbursements further exclusively charitable purposes. The information in the records examined do not establish that the Foundation exercised sufficient oversight when making disbursements. The documentation for disbursements made under the "Pro Bono Program" is superficial at best, showing only that the activity *might* be charitable. There is no documentation that the activities were carried out in a manner that insured they served public rather than private interests. As noted, the Foundation does not even employ a process suggesting or requiring members to report on the progress of their projects and whether any charitable objectives are being achieved.

D. The Foundation has not demonstrated that it does not allow donors to control investments.

In a memorandum opinion, the District Court for the District of Columbia held that an organization formed to facilitate anonymous donations to charitable organizations by private donors is not entitled to tax-exempt status under IRC 501(c)(3). The Fund for Anonymous Gifts v. Internal Revenue Service, 97-2 U.S. Tax Cases (CCH) P50, 710 (D.D.C. 19XX). In this case, the donor placed a number of restrictions on each donation, such as: who receives the donation; when the donation is received; and how the donation is managed. The only control the trustee exercised over the donation was determining whether the selected recipient was a charitable organization. The court contrasted the Fund with NFI. In National Foundation, the court found that donations to NFI were given without restriction, thereby preventing it from merely acting as a "conduit." It also found that NFI performed charitable work that qualified it as a 501(c)(3) organization. In contrast, the trustee in The Fund for Anonymous Gifts was bound by a number of restrictions attached to each donation. Because of the continuing control the donor exercised over the donation, the court found that the Fund resembled a "conduit" more than it resembled NFI. The court concluded that the donor's control of the investment activity through its numerous restrictions was not an exempt purpose under IRC 501(c)(3). It found that "the manner in which the Fund's investment activity would be conducted makes clear that one of the purposes of the Fund is to allow persons to take a charitable deduction for a donation to the Fund while retaining investment control over the donation." While this case was on appeal, the Fund changed its operation.

Members of the ORG can experience similar control over investments. For example, the Foundation does not appear to have any restrictions over the type of property it will accept as a contribution. RA-45 donated an interest in a limited liability company, but maintained control over the assets. Members are also permitted to have the



Foundation invest their accounts in viatical contracts and other life insurance investments. Moreover, during at least part of the years under examination, members could direct the Foundation to invest their account in any stock or security identified by the member.

E. The Foundation has not demonstrated that it keeps adequate records to demonstrate it exclusively furthers charitable purposes.

For an organization claiming the benefit of section 501(c)(3), tax exemption is a privilege, a matter of grace rather than right. Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849, 857 (10<sup>th</sup> Cir. 1972). The books and records maintained by ORG are inadequate to demonstrate that it made appropriate grants for the "charitable activities" of the donor advised funds.

In Church of Scientology v Commissioner, 823 F.2d 1310, 1318 (9<sup>th</sup> Cir. 1987), the Ninth Circuit noted that it found the taxpayer's arguments unpersuasive in large part because the taxpayer presented little documentation to show that the majority of the money was used for Church purposes and failed to present the documentation necessary to trace the source and use of Church monies.

The Tax Court in Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980) noted that the taxpayer failed to establish that it was not operated for the private benefit of its founders. The taxpayer claimed to have expenditures for maintenance and supplies, office supplies and maintenance and supply inventory. The taxpayer made a general statement that the amounts were for hymnals, church and office equipment, postage, etc. This was found not to be adequate. The taxpayer claimed to follow Protestant forms of ritual but there was no direct information about the services conducted or who attended. No objective facts were provided to explain the purposes of a trip to Germany. Only vague information was provided making it probable that virtually all of the income benefited the founders. Inadequate information was given about how compensation was determined and there was virtually no objective information about the services performed.

In Bubbling Well Church of Universal Love, Inc. v. Commissioner, 670 F.2d 104 (9<sup>th</sup> Cir. 1981), the Ninth Circuit sustained the Tax Court's denial of an application for exempt status holding that there was a possibility of inurement because the taxpayer did not make an open and candid disclosure of facts. The court found that there was no evidence showing that payments were reasonable where there was no evidence in the record of any regular or substantial church activities. The court found that the cost of comparable services is a factor to be considered in determining if salaries are reasonable. [See also Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9<sup>th</sup> Cir. 1985); B.H.W. Anesthesia Foundation, Inc. v. Commissioner, 72 T.C. 681, 686 (1979)] The court noted that the organization refused to itemize expenses for maintenance and supplies and that there were no facts detailed to explain the relationship between the taxpayer and a trip to Europe by the pastor "on Church business, proselytizing new church members."

In The Church in Boston v. Commissioner, 71 T.C. 102 (1978), the court concluded that the operational test was not satisfied where the taxpayer could not



adequately document grants that it made. The taxpayer stated the grants were made in furtherance of a charitable purpose to wit, to assist the poor who were in need of food, clothing, shelter and medical attention. The only documentation for the grants was a list of grants made which included the name of the recipient, the amount of the grant and the "reason" for the grant which was specified as either unemployment, moving expenses, school scholarship or medical expense. Some grants were made to the taxpayer's officers. The court found this was inadequate and that there needed to be documented criteria which would demonstrate the selection process of a deserving recipient, the reason for specific amounts given, or the purpose of the grant.

In New Concordia Bible Church v. Commissioner, T.C. Memo. 1984-619, the court noted that complete information about disbursements was required to insure there is no inurement. There needs to be details about services provided in exchange for support.

There is no objective evidence in the record to show how the Foundation determined that the member or his family was the person best qualified to carry out the "charitable activity" funded, how the amounts paid were determined to be reasonable, how "pro bono" recipients were determined, the criteria for the awarding of scholarships, and a detailed description of the activities performed and when they were performed for which compensation was paid. Furthermore, there is no objective evidence in the record of how the Foundation ensured that monies paid to section 501(c)(3) organizations did not benefit the donors. The checks were routinely issued to the members which made the likelihood of members claiming charitable deductions for the contributions to the Foundation and to the section 501(c)(3) organization more likely. (The Foundation did not have a standard or other cover letter to be transmitted to other section 501(c)(3) organizations advising that the distributed funds were from the Foundation as opposed to being from the individual member.) The Foundation had no mechanism in place to ensure that the monies were not being used to pay for items for which the donor would receive some quid pro quo benefit.

F. The Foundation has not established that it has sufficient control over "contributed" assets to further exempt purposes.

The Foundation has represented that full legal control and custody of contributed property is vested in it (or in some instances in the donor advised fund) and that its Board of Directors has the ultimate decision making authority for the disposition of funds. The Foundation represented in its exemption application that percent of the amounts contributed to it in a given year would be distributed for charitable purposes in that year. Nonetheless, in operation, the Foundation advises its members that they and future generations of their family will determine the charitable projects to be funded; that they can use "their" account as a conduit for charitable giving; that members are subject only to IRS policies and guidelines, the Board of Directors is obliged to follow and implement the desires of each individual advisor; that donors have advisory discretion to determine in which category of investments the monies will be invested, that the Foundation will not initiate charitable distributions from the accounts as long as there is an advisor and that, as long as the disbursement requests are within IRS guidelines, the ORG will make every effort to honor them.

In other words, the Foundation cannot determine that a charity is worthwhile and use the accounts to fund it. The Foundation cannot determine that its assets are not properly distributed between investment vehicles and change the mix. The Foundation cannot refuse to fund a charity on the ground that it does not fit within the Foundation's purposes. The Foundation cannot disburse monies from any account as long as there is an advisor even if that account has made no charitable recommendations for an extended period of time. The evidence, here, indicates that the members maintain continuing control of the assets in the accounts. In enforcing the internal revenue laws, the substance of a transaction rather than its form control. Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945). Facts that indicate that members are allowed to access the accounts for personal benefits is further evidence of the Foundation's lack of control. The Foundation has not supplied an credible information that shows it has the ability to employ the assets in the account for charitable purposes.

In National Foundation, *supra*, the Court found that the taxpayer did not act as a "conduit" for its donors. The donors relinquished all ownership and custody over the funds. The taxpayer could accept or reject any donor suggestion and, if accepted was prohibited by its articles of incorporation, from applying the funds for a non-exempt purpose. The donor had no legal recourse for return of the funds if the taxpayer failed to honor its request.

ORG tells its members it will act as a conduit. It cannot initiate any charitable project, it can only act on its members' recommendations. The Foundation does not have adequate control over contributed amounts. See Section IV. B. below for further explanation of why it is that members have not adequately relinquished and the Foundation has not adequately received control over the purportedly donated assets.

G. ORG has not demonstrated that it has adequate staff to evaluate member distribution requests or that the staff that it does use has any experience with charitable giving

The Foundation does not use its own staff to evaluate member distribution requests. Instead, the Foundation uses employees of ORG., a for-profit organization, to evaluate distribution requests. It appears that the individuals who conduct the activities of the Foundation at ORG.'s headquarters in City do not have any professional background in the charitable sector. Rather, these individuals appear to be in the nature of secretarial or support staff. The Foundation purports to operate a unique charitable program that allows activities of whatever the Internal Revenue Code permits, but has chosen to have secretarial staff make the day to day and other significant decisions. The minutes of the Board of Directors reflects that the Board was not regularly involved in approving charitable projects or other distributions. Given the amount of assets of the Foundation and the amount of fees paid to ORG., an expectation arises that the Foundation should employ an individual with professional experience in the charitable sector who is knowledgeable of the Internal Revenue Code requirements. The decision to use secretarial staff to make these important operational decisions is further evidence that the Foundation does not operate exclusively for exempt purposes.

## II THE FOUNDATION OPERATES FOR THE PRIVATE BENEFIT OF ITS DONORS/MEMBERS.

The ORG does not qualify for tax-exempt status as an organization described in section 501(c)(3) because it has operated for the benefit of designated private individuals. The prohibition against inurement and substantial private benefit ensures that organizations described in section 501(c)(3) are dedicated to furthering public, rather than private, purposes. The Foundation's donors/advisors each have a personal and private interest in a specific segment (the "segregated accounts" or family public charities) of the activities of the Foundation and have used or plan to use the assets in the account for personal gain, such as for providing loans, scholarships or compensation to family members. Treas. Reg. Section 1.501(a)-1(c).

The courts have consistently agreed with the Service in denying exempt status under section 501(c)(3) when organizations have allowed private persons to use organizational funds to enrich themselves. See, e.g., Harding Hospital, Inc. v. United States, 505 F. 2d 1068 (6<sup>th</sup> Cir. 1974); Birmingham Business College v. Commissioner, 276 F. 2d 476 (5<sup>th</sup> Cir. 1960); Parker v. Commissioner, 365 F. 2d 792 (8<sup>th</sup> Cir. 1966)

The Foundation, for fees, allows itself to be exploited by its donor-advisors. Its promotional material, which it provides to the donors, explicitly exclaims that the accounts can be used to provide financial benefits, provide compensation, reimbursement for expenses and loans to family members. While the Foundation has not had a very long operational history, its operations do squarely show that the assets donors "transfer" to their accounts are used for their benefit. Yet the Foundation states that donors are entitled to take a deduction under section 170 for contributions of funds and property to the accounts. While a charitable contribution deduction is being encouraged, donors use their accounts to make suspect loans to support their own family member's education. At least one member believes these "loans" are out right scholarships. This program confers a personal benefit.

Courts have found prohibited inurement when an organization has been used as a private source of loan credit. Easter House v. United States. Moreover, the Foundation lacks adequate procedures to track the loans and the due dates. In addition, the Foundation's operations strongly suggest that most of loans will be forgiven if the debtors perform 20XX hours of work for each year of education the loan covered. The Foundation's records show that the child of one member performed 1,300 hours of work in connection with an educational loan obligation, but the records do not establish what type of work was performed nor do they verify that the work was in fact performed. In fact, the records suggest that these volunteer services were performed while the child was still attending school, not post-graduation as contemplated by the agreements the children are supposed to sign.

In Charleston Chair Company v. United States, 203 F. Supp. 126 (EDSC 1962), a foundation was set up to provide educational scholarships. Most of its distributions were in the form of scholarships to children of the donor's employees. One scholarship went to a child of the Foundation's trustee. The court held that the Foundation was not entitled to section 501(c)(3) status stating "the narrow class of persons who might benefit, the more

restricted group who did benefit and the preference given to the son of the director, stockholder and trustee disclose that the Foundation was not operated exclusively for charitable purposes." Similarly, the Foundation operated its student loan program to benefit, almost universally, members who were currently paying higher education costs for their children. For some members, this purpose appears to be the sole reason for their involvement with the Foundation.

Similarly, the Foundation has allowed its donors to pay themselves compensation for purported "good works" while its records do not adequately establish that the work exclusively furthered a purpose described in section 501(c)(3). The administrative file shows that donors have been allowed to contribute interests in closely held businesses that they control, generate a tax deduction, while the contributed interest lacks any genuine economic substance. These examples in administrative record demonstrate that the Foundation has not established that its donor-advisors, who indisputably have a "personal and private interest in the activities of the organization" (albeit only as it pertains to each account), do not use the assets of the organization for private gain. *Treas. Reg. Section 1.501(a)-1(c)*. The facts in the administrative file strongly suggest that the Foundation furthers private, rather than public, purposes.

While it is acceptable for charities to compensate workers, whether as employees or independent contractors, the compensation must be reasonable for the services rendered and must be properly reported for tax purposes. The organization should have documentation to verify the work that was done on its behalf. For employees the documentation should include: personnel files, job descriptions, employment agreements, supervision information, progress reports, and performance reviews. For independent contractors the documentation should include a record of the actual services performed. In the course of its operations, the Foundation does not collect or request this type of information.

Moreover, the Foundation has failed to demonstrate that these pro bono type services further its exempt purpose. Rather, when a member performs services, for example at a free medical clinic for the poor, the member is serving the exempt services of the organization operating the clinic, not the exempt purposes of the Foundation. In order for these activities to be considered to be activities of the Foundation, the Foundation would need to maintain policies under which the program is administered. The Foundation does not maintain such policies. Likewise, for a charitable endeavor solely conducted by a member and not in affiliation with another charitable organization, the Foundation would need to maintain further policies. These policies would specify criteria for evaluating individual need; documentation of need, including external verification, adequately trained personnel to evaluate requests.

An organization described in section 501(c)(3) may compensate individuals to perform services. The compensation, however, must be reasonable and it must be incurred for services performed. See *World Family Corp. v. Commissioner*, 81 T.C. 958, 968 (1983). In *Senior Citizens of Missouri, Inc. v. Commissioner*, T.C. Memo 1988-493 (1988), the court held the organization was not operated exclusively for exempt purposes when it could not establish that advances it paid solicitors were for services performed. To support its holding, the court stated that an organization must describe in



“detail the criteria and method used to determine the amount of the advances paid to each solicitor.” The court explained that keeping records and establishing standards for the distribution of charitable assets, for charitable and administrative purposes, “may appear onerous to a fledging organization . . . . Compliance with these recordkeeping requirements, however, is necessary to safeguard against the potential abuse of the organization’s funds.” Citing Church in Boston v. Commissioner, 71, T.C. 102, 107 (1978).

As to grants to other section 501(c)(3) organizations, the Foundation lacks any significant grant administration and control procedures. It should exercise some pre-grant due diligence. This would undeniably include documentation about the recipient organization's section 501(c)(3) status, but it would also include: information about the organization's operations and personnel; information about the project or work or other proposed use of the funds; and information about how the proposed grant will further the Foundation’s exempt purposes. The Foundation should determine if the proposed recipient is an organization that makes disbursements to other individuals or entities. Most charities use written grant agreements that include specific terms, expected results, timing of funds, consequences of noncompliance, specifies accountability provisions such as progress reports, accounting and financial statements, a provision that allows audit and inspection of records and on site inspection of programs. The Foundation should supply documentation of the approval process.

While there is not any direct legal authority that requires adoption of these specific provisions, an organization is required to establish its entitlement to exempt status and it is required to keep adequate books and records. The Foundation’s primary purported "charitable" activity is grant-making. It should offer evidence that its grants exclusively further its exempt purposes. It is insufficient to check if an organization is listed in Pub 78. It must take some action that ensures the recipient does not use its funds for an improper purpose. For example, there are virtually no safeguards that would prevent, or even monitor, a recipient from distributing the funds overseas for which a donor may not be entitled to 170 deduction if he or she made the contribution directly to the recipient charity. Granted, ORG.’s general counsel prepared a memorandum dated December , 19XX for distribution to ORG Financial Counselors regarding foreign activities, the memorandum contains legal inaccuracies, which further compounds the problems. For example, memorandum provides that distributions can be made to organizations possessing a section 501(c)(3) determination letter. In fact, foreign entities may obtain a section 501(c)(3) determination letter, but contributions to it are not deductible under section 170. Since the Foundation allows its donors to exercise considerable influence (if not outright control) over the assets contributed the accounts, the operations of each account in some respects resembles a private foundation and it would be appropriate for the Foundation to adhere to the expenditure responsibility provisions of section 4945 as a way to establish that its (donor's) grants further charitable purposes.

In some instances, the Foundation issues grant checks with the names of individuals in the memo line of checks to recipient charities. Generally, gifts that are earmarked for a specific individual are not deductible as charitable contributions. Deductions are not allowed, subject to certain exceptions, whenever the donor has



specified, by name, the person to receive the gift. Through this practice, the Foundation is apparently enabling member's to circumvent this restriction by serving as vehicle to receive gifts from donors who take a 170 deduction and then later direct the gift to charity, but earmarked for a specific individual.

The Foundation does not maintain a consistent message to its members that grants can not be used for the personal benefit of the member. For example, the Distribution Request form, which may be the only communication a member uses, does not advise the member that the requested grant can not be used for personal purposes, such as fulfilling a legally binding personal pledge or paying their children's tuition.

### III THE FOUNDATION OPERATES TO FINANCIALLY BENEFIT ORG. AND OTHER RELATED FOR-PROFIT ENTITIES.

A substantial part of the Foundation's operations serve the private interests of ORG its founder, BM-1 and the other entities in the ORG family. The complexity of the ORG organizational structure and the wide array of financial services it offers its members raise a concern about the appropriateness of the Foundation's section 501(c)(3) status. In this regard, the promotional material in the file shows that the Foundation is just one financial product of many that ORG members can use to shelter their assets from taxes. The members pay management and other administrative fees to maintain accounts with the Foundation and these funds are in turn paid to ORG and the related entities. During the examination period, a considerable amount of the funds leaving the Foundation were paid to another ORG entity. The size of the payments to other ORG entities in conjunction with the promotional material distributed by representatives of the ORG family of entities shows a phenomenal emphasis on financial gains from selling products that exploit "loopholes" in the federal tax system. This arrangement and focus serve to benefit private interests and is not consistent with exempt status under section 501(c)(3). The evidence in the administrative record does not demonstrate that the Foundation does not more than insubstantially serve the private interests of the private individuals and entities that control it. Church of Scientology v. Commissioner, 823 F. 2d. at 1317.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36 (1989), the court upheld revocation of 501(c)(3) exemption of a nonprofit organization that conducted continuing medical education tours abroad. The nonprofit had a substantial non-exempt purpose to benefit a for profit travel agency which the nonprofit used exclusively to arrange tours for its seminars. The nonprofit spent 90% of its revenue on brochures for tours arranged by the for-profit and did not solicit competitive bids from any other travel agency. The nonprofit was formed by the owner of the for-profit to obtain customers for his tour business, he controlled the nonprofit, and he exercised that control for the benefit of the for-profit. The court noted that when a for-profit benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes under section 501(c)(3), even if it furthers other exempt purposes. These principles have direct application to the Foundation's operations.

IV. THE FOUNDATION OPERATES A TRADE OR BUSINESS WHICH DOES NOT PRIMARILY FURTHER AN EXEMPT PURPOSE.

A. The Foundation provides or delivers asset management services to members who pay for the service.

In substance, the Foundation operates a trade or business of providing asset management and other financial services to its members. Members must pay fees in order to avail themselves of these services. ORG Financial Counselors, as agents of ORG., are the first link between members and ORG.

In Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978) an organization whose primary activity was to provide advice on income and estate planning to reduce the individuals liability for income taxes to a minimum was denied exemption under section 501(c)(3) of the Code. The organization's activities of assisting contributors in obtaining tax advantages were a substantial non-exempt activity.

B. Facts in the record infer that members do not relinquish control of assets.

Treasury Regulation 1.507-2(a)(8)(iv)(A), relating to the transfer of assets of terminating private foundations to public charities, contains guidance in determining if material restrictions exist on transferred assets. The regulation sets forth several factors any of which are considered as preventing the transferee from freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of its exempt purposes. Though the regulation applies to terminating private foundations it has relevance in this situation and can be used as guidance:

(2) The presence of some or all of the following factors will indicate that the reservation of such a right does not exist:

(i) There has been an independent investigation by the staff of the public charity evaluating whether the donor's advice is consistent with specific charitable needs most deserving of support by the public charity (as determined by the public charity).

(ii) The public charity has promulgated guidelines enumerating specific charitable needs consistent with the charitable purposes of the public charity and the donor's advice is consistent with such guidelines;

(iii) The public charity has instituted an educational program publicizing to donors and other persons the guidelines enumerating specific charitable needs consistent with the charitable purposes of the public charity;

(iv) The public charity distributes funds in excess of amounts distributed from the donor's fund to the same or similar types of organizations or charitable needs as those recommended by the donor; and

(v) The public charity's solicitations (written or oral) for funds specifically state that such public charity will not be bound by advice offered by the donor.

(3) The presence of some or all of the following factors will indicate the reservation of such a right does exist:

(i) The solicitations (written or oral) of funds the public charity state or imply, or a pattern of conduct on the part of the public charity creates an expectation, that the donor's advice will be followed;

(ii) The advice of a donor (whether or not restricted to a distribution of income or principal from the donor's trust or fund) is limited to distributions of amounts from the donor's fund, and the factors described in paragraph (a)(8)(iv)(A)(2) or (i) or (ii) of this section are not present;

(iii) Only the advice of the donor as to distributions of such donor's fund is solicited by the public charity and no procedure is provided for considering advice from persons other than the donor with respect to such fund; and

(iv) For the taxable year and all prior taxable years the public charity follows the advice of all donors with respect to their funds substantially all of the time.

It appears that all of the adverse factors are present. Foundation members expect that their advice will always be followed. (See, ORG General Counsel Memorandum 99-10, "As with all ORG Programs, we want to support the doctor's desires to the maximum extent possible.") The Foundation makes it clear that members may not make recommendations for amounts in excess of their account balance. There is no evidence that the Foundation seeks to educate its members about any particular charitable needs. In fact, the opposite seems true in that the emphasis is on the lack of geographical restrictions. Only the advice an account's fund advisor is sought and there is no procedure for any others to advise distributions. Finally, the advice is followed substantially all of the time. In only a few instances have requests been made that were not followed and it appears that the only reason for those declinations was that the ultimate beneficiary was not listed in Publication 78.