



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
1100 Commerce Street  
Dallas, TX 75242

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: **201039044**  
Release Date: 10/1/10  
Date: June 13, 2007

**A=Name of organization**

UIL:501.03-01

**Last Date for Filing a Petition  
With the Tax Court - Date 1**

**Certified Mail Return - Receipt Requested**

Dear :

This is a Final Adverse Determination Letter as to **A Organization's** exempt status under IRC §501(c)(3).

Our adverse determination was made for the following reasons:

The organization has not been operating exclusively for exempt purposes within the meaning of IRC §501(c)(3) and Treas. Reg. §1.501(c)(3)-1(d). It is not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. It has been operating substantially for a non-exempt purpose and its earnings inure to the benefit of private individuals.

Based upon these reasons, we are retroactively revoking the organization's IRC §501(c)(3) tax exempt status for all years beginning on or after **Date 2**

Contributions to your organization are no longer deductible under IRC §170.

**A Organization** is required to file federal income tax returns on Form 1120, U.S. Corporation Income Tax Return, with the appropriate Service Center immediately and by the due date of Form 1120 for all subsequent years.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under IRC §7428.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or writing to:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate state officials of this action, as required by IRC §6104(c).

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

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosure:  
Publication 892



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
300 N. Los Angeles Street, MS7300  
Los Angeles, CA 90012

October 10, 2006

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)  
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

300 North Los Angeles Street  
Room 5109, Stop 6710  
Los Angeles, CA 90012  
(213) 576-3140

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 886-A, Parts I & II

Form 886-A	EXPLANATION OF ITEMS	Schedule of Exhibit No. Part 1
Name of Taxpayer A (B)		Year Ended Year of Exam

A=Supporting Organization  
B=Employer Identification Number  
C=Founder and Trustee of A and spouse of D  
D=Founder of A and spouse of C  
E=City and State where C and D reside  
F=Organization 1  
G=Board member of A  
H=Board member of A  
I=Organization 2  
J=Organization 3

K=Organization 4  
L=Organization 5  
M=Organization 6  
N=Board member of A  
O=Board member of A  
P=Investment advisory firm of C  
Q=law firm in which C is partner  
R=Board member of A  
S=Board member of A  
T=Law firm partner of C  
U=Organization  
V=Name of financial plan sold by P

W=Organization 7  
X=Organization 8  
Y=Organization 9  
Z=Organization 10  
AA=notation of check  
BB=Investment firm 1  
CC=Investment firm 2  
DD=Investment firm 3  
EE=Grandson of board member N  
\*\*\*\*=Dates  
X=Amounts

### ISSUE #1

Should the **A's** tax exempt status under Internal Revenue Code 501(c)(3) be revoked because it has not established that it is operated exclusively for tax exempt purposes and because the funds of the organization have inured to **C**?

### ISSUE #2

Should the **A** be reclassified as a private foundation?

### FACTS:

#### **Organizing Documents**

The **A's** Declaration of Trust was entered into in the State of \_\_\_\_\_ on \*\*\*\* by **C** and **D** (as Founder or Donor) and **C** (as Trustee) both of whom resided in **E** when the Trust was formed. According to the Declaration, the Trust's purpose is the establishment of an organization which is described in Section 501(c)(3) and Section 509(a)(3) of the Internal Revenue Code of 1986. The Declaration provides that it will be "organized and at all times thereafter will be operated exclusively to support or benefit, as defined by Treasury Regulation Section 1.509(a)-4(b)(1), one or more publicly supported organizations and shall comply with all other requirements of Section 509(a)(3) of the Code. No part of the net earnings of this Trust shall inure to the benefit of any individual... Notwithstanding any other provision hereof, this Trust shall not conduct or carry on any activities not permitted to be conducted or carried on by an organization which is tax exempt or by an organization that receives donations which are deductible from taxable income to the extent allowed by the provisions of the Code and other applicable legislation and regulations as they now exist or may hereafter be amended."

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No. Part 1
Name of Taxpayer A (B)		Year Ended Year of Exam

The Declaration of Trust states that the Trust is irrevocable and the Founder “waives the right and power to alter, amend, revoke, or terminate the Trust or any of the terms of this Declaration” and also “Founder hereby renounces any power to determine or control, by alteration, amendment, revocation, termination, or otherwise, and the Founder renounces any interest in, either vested or contingent, including reversionary interest or possibility or reverter, the income or principal of the trust estate.”

The Declaration of Trust also states that, “All donations so received, together with the income therefrom (hereinafter referred to as the “Trust Fund”) shall be held, managed administered and paid out by the Trustee pursuant to the terms and conditions of this Agreement.”

The Declaration of Trust provides that each year the “Trustee shall distribute percent ( %) of the net income of this Trust to F (hereinafter referred to as the “Primary Charity”), a charitable organization qualified under section 501(c)(3) of the Code”. The Declaration of Trust also provides, “It is intended that the distributions to the Primary Charity will help such charitable organization perform its functions and carry out its purposes. In order to insure that this happens, the Board shall meet with a representative of the Primary Charity to determine the use of such distributions. It is intended that the distributions will be used in a similar fashion each year.” (Note: Amendments were made to the primary charity, see below)

The Declaration of Trust goes on to state, “In addition to the distribution to be made pursuant to Section 2.2.1 above, each year the Trustee shall distribute a total of percent ( %) of the net income of this Trust to one or more of the organizations listed on Schedule A, which by this reference is made a part hereof, or to the Primary Charity as directed by a majority of the Board in writing...Each such distribution shall be made on or before the end of the fourth (4<sup>th</sup>) month immediately following the year in which the income was earned. If, seven (7) business days before the expiration of the above-referred-to time to make such distribution for a particular taxable year, the Trustee has not received directions from the Board to make such distribution, then the Trustee shall distribute such of the above amount as has not been distributed to such of the organizations listed on Schedule A as the Trustee, in Trustee’s sole and absolute discretion, shall determine, provided that each such distribution shall be a distribution which can be made by an organization described in section 509(a)(3) of the Code.”

Section 2.11 of the Declaration provides that the Trustee shall render at least annually an account of income and principal, including statement of receipts, disbursements and capital changes to the Board and to F. (Note: Amendments made to the primary charity, see below)

The Declaration provides that the Board may consist of up to five (5) members and no less than three (3) members. One Board member shall be appointed by the Primary Charity

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No. Part 1
Name of Taxpayer A (B)		Year Ended Year of Exam

or its designated agent. Two Board members shall be from the class consisting of C and D their descendants (the "C/D Family"). The other members of the Board shall be G and H.

The Declaration provides that the membership of the Board shall at all times be such that the original Founder, Donor, or other Disqualified Persons, as defined in section 4946 of the Code, do not control the Board.

Schedule A of the Declaration of Trust listed four (4) organizations that may receive payments as follows: 1) I, 2) J, 3) K, 4) L.

The Declaration of Trust was signed (undated) by C and D as Founder/Donor and C as Trustee. The witnesses section was

#### Amendments to the Declaration of Trust

Amendments made were as follows:

- \*\*\*\* - Amended Purpose clause
- \*\*\*\* - Changed primary charity to K; amended Purpose clause
- \*\*\*\* - Amended Dissolution clause to delete last sentence
- \*\*\*\* - Changed primary charity to M.

All Amendments were signed by C.

#### Application for Recognition of Exemption (Form 1023)

The A filed Form 1023, Application for Recognition of Exemption, with the IRS on or around \*\*\*\*. Based on the application, the IRS recognized A as exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) and Letter number 947 from the IRS, dated \*\*\*\*, was issued to the organization. The letter also stated that the organization was not a private foundation within the meaning of section 509(a) because it was an organization described in section 509(a)(3).

#### Primary Supported Organization

The Declaration of Trust provided that the primary supported organization was initially F. Subsequent amendments changed the primary supported organization to K and finally to M.

#### Activities

The current Governing Board members listed on the Form 990 were as follows:

- C, State 1
- D, State 1
- G, State 1
- H, State 1
- N, State 2 (the Form 1023 listed O, F, State 1)

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G from State 1 is the investment advisor for the C and D.

The grandson of N, received \$ . as a scholarship from M during 2003, based on the Form 990 of M.

As part of the examination, the IRS requested information on Form 4564 (Information Document Request #2 & #2a) from the A regarding its activities to determine if the organization was qualified for tax exemption under IRC section 501(c)(3). The following information was requested:

- 1) Biography and relationships (including business) of all board members
- 2) Information on the supported organizations (primary charities)
- 3) Minutes of all Board/Trustee meetings
- 4) All correspondence and communications with the supported organizations
- 5) Contracts & agreements with P (see discussion below)
- 6) Explanation of the discrepancies between reported payments on the Form 990 and the organizations accounting records (see Financial Information section below)
- 7) Evidence that payments made were exclusively for tax exempt purposes (see Financial Information section below)
- 8) Evidence that the assets of the organization exists (see Financial Information section below)

To date, the A has not provided any response or documents to the items requested on Information Document Request #2 and 2a.

C, a lawyer by trade and has the law firm Q, was expecting a large sum of money from settlements on lawsuit against pharmaceutical companies. Based on the information, an amount up to \$ was estimated to be received from these pharmaceutical company lawsuit settlements.

Information obtained by the IRS indicates that C and D's intent for creating A was not exclusively for charitable purposes but rather for tax avoidance purposes under the direction of P. Documents obtained by the IRS include an application completed by C and D that provides personal information required by P. The application to P includes Personal History, Goals & Objectives, Personal Assets, Personal Liabilities, Personal Annual Income Statement, Personal Expenses, Business History, Advisors. In the Goals & Objectives section, question number II. 2. asks:

*"What was your objective in contacting P?"*



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C and D's written response was, "Reduce Taxes".

Question number VI asks:

*"Are there worthy causes or objectives that you feel strongly about?"*

C and D's response was "Any interests that my wife or girls have are my interests"

Question VII asks:

*"Are there any significant economic events going to take place in the next few years?"*

C and D responded with, "Many cases that we have that could be settling bringing in tremendous amount in fees"

This answer pertains to the pharmaceutical company lawsuits that C's law partnership were involved in. In the Advisor section of the application, C listed R as his investment advisor.

Documents obtained by the IRS also include an **Agreement for Implementation of Master Financial Plan** dated **Date 4**. The agreement is between **S**, an entity related to **P**, and **Q** a C-Corporation law practice with 30 employees. The agreement was signed by **C** (\*\*\*\*), **T** (\*\*\*\*), and the **U** (\*\*\*\*). The agreement includes a "secrecy" clause that states, "You agree not to disclose any information or documents obtained from us, including but not limited to all information and documents contained in your Plan as well as all contracts, entity, organizational and/or other legal documents necessary to implement and maintain your Plan."

Schedule A of the master financial plan agreement lists the products and services to be provided as follows:

#### Domestic

- Two Support Organizations – Preparation of documents to complete the organization, filing with governmental agencies for approval, and preparation of documents as needed for the transfer of assets & filing
- One Loss of Income Policy
- One VEBA
- Equity Management Mortgage
- Two Limited Liability Companies (LLC)
- Two Estate Planning/Living Trusts
- Two Irrevocable Life Insurance Trusts

#### Foreign

- Two Foreign Variable Annuities
- Two Hybrid Guarantee Companies

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- Two International Business Corporations (IBC)

The "Two Support Organizations" listed in Schedule A are presumably for the creation of a tax exempt organization for **C & D (A)** and one for **T**, the law firm partner of **C**. Schedule A was signed by **C (\*\*\*\*)** and **T (\*\*\*\*)** affirming to the implementation of the master financial plan. Schedule B, Implementation and Maintenance Fees and Expenses, is also an attachment to the agreement to implement the master financial plan.

Documents obtained by the IRS also include a **V Development Agreement** between **P** and **Q**. This document was signed by **C (\*\*\*\*)** and **T (\*\*\*\*)**, **P (\*\*\*\*)**, and **U (\*\*\*\*)**.

### **P and Related Entities**

**P** is a \_\_\_\_\_ corporation and **P** is the \_\_\_\_\_ parent company. **P** offers services to clients that are designed to reduce taxes and protect assets through creation of offshore and use of "offshore" entities.

The Securities and Exchange Commission (SEC) filed a complaint against **P** and other related entities on \*\*\*\*. The SEC complaint states that **P** is engaged in an ongoing scheme in which it has obtained investments from clients to whom it provides offshore tax planning and asset protection services. The complaint describes **P** as follows:

*"P provides its services in the form of a "V" it sells to clients and implements on their behalf. The implementation of the plan involves the establishment of offshore entities and the execution of transactions through which its clients invest funds, securities and other assets P promises its clients that, through the implementation of the V, the clients will reduce their taxes by significant percentages, have their investments grow offshore in a tax free environment, and will be able to protect their assets from unwanted liabilities and encumbrances."*

The SEC complaint describes the use of supporting organizations (SO) by **P** as follows:

*"P describes SO's as charitable organizations established for the benefit of an individual client. Among the stated benefits of an investor establishing an SO over using a domestic charitable organization is the investment funds transferred to the investor's personal SO can grow tax free. These investments gains are available to the donor/investor through access to the offshore corporations that manage the investment of the SO."*

Offered the **Vs** to clients and in promoting these plans makes claims to clients that **P** utilizes "loopholes" in the Internal Revenue Code to enable clients to minimize tax obligations and protect assets. **P** also provided a means to repatriate clients assets through transactions that

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hide actual ownership of the assets, thereby enabling the clients to utilize the untaxed funds without paying tax obligations.

### Financial Information

Form 990 for the years ending December 20 through 20 reported revenue and expenses as follows:

<b>Revenue:</b>	<b>200</b>	<b>200</b>	<b>200</b>	<b>200</b>
Contributions	\$XXX,000	\$ XX,XXX	\$ XX,XXX	\$ XX,XXX
<b>Expenses:</b>				
Grants & Allocations				
<b>K</b>	\$ X,XXX	\$ XX,XXX	\$ XX,XXX	-
<b>F</b>	\$ X,XXX	-	-	-
<b>W</b>	-	\$ XX,XXX	-	-
<b>M</b>	-	\$ XX,XXX	\$ XX,XXX	-
<b>X</b>	-	\$ XX,XXX	-	-
<b>L</b>	-	-	-	\$ XX,XXX
<b>Y</b>	-	-	-	\$ XX,XXX
<b>Z</b>	-	-	-	\$ XX,XXX
Miscll	\$ X,XXX	-	-	-
GSI	\$ X,XXX	-	-	-
Accounting Fees	-	-	-	\$ XXX
Bank Charges	-	\$ XX	-	\$ XX
<b>Excess or Deficit:</b>	\$ XXX,XXX	(\$ XXX)	\$ X,XXX	(\$ XXX)

### Year 2000 Transactions

During the year 20 the **C and D** opened an account at **Bank** (#XXXXXXXX) for the **A**. The following transactions occurred in the bank account as follows:

- \*\*\*\* – Deposit of \$X,XXX (not reported on Form 990)
- \*\*\*\* – Check in the amount of \$X,XXX payable to **K** (not reported on Form 990)
- \*\*\*\* – Deposit (transfer) of \$X,XXX
- \*\*\*\* - A miscellaneous debit of \$X,XXX from the account
  
- \*\*\*\* – Deposit (transfer) of \$XXX,XXX
- \*\*\*\* – Check #X for \$XXX,XXX payable to **Bank**. Noted on check is "Investment Contract"
- Check #X for \$ payable to **Bank**. Noted on check is "AA"
  
- \*\*\*\* – Deposit (transfer) of \$X,XXX
- \*\*\*\* – Check #XXX for \$X,XXX payable to **K**

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The **A** has not provided documentation supporting the purpose and disposition of payments made during 20 . Specifically, no supporting documentation has been provided to substantiate the reported payment, purportedly for investment purposes, of the \$XXX,XXX (reported as Savings & Temp Cash Investments on Form 990). Based on the information provided by the **A** to date, the asset is described as located at " . The CSO has not provided evidence that this asset exists and is being used to serve charitable purposes. This asset was contributed to the CSO by the **C and D** who may have claimed a charitable tax deduction on their Form 1040 in connection with this contribution. The **A** has not reported any interest or earnings from the investment of the \$XXX,XXX. It is possible that these funds were returned to the **C and D** via **BB, CC**, and ultimately to **Q**.

**Year Transactions**

The general ledger provided by the **A** for the year 20 did not support the reported expenses on the 2001 Form 990. The **A** general ledger showed the following expenses for the year 20

<b>K</b> (2 payments)	\$ X,XXX
<b>DD</b> (5 payments)	\$ X,XXX
<b>Individual 1</b> (wire transfer)	\$ XX,XXX
<b>Individual 2 &amp; 3</b> (wire transfer)	\$ XX,XXX
Bank Service Charge	\$ XX
Total	\$ XX,XXX

The payees who received payments per the general ledger did not support the reported payees on the Form 990. Also, the reported expense/payment of \$X,XXX to the **F** was never made. **A** voided this payment (check) during \*\*\*\*.

In addition, the **A** has not proven that all payments were made exclusively for charitable purposes. The documents provided to the IRS indicate that payments made by the **A** served private purposes rather than for public or charitable purposes as discussed below:

1) Two (2) payments were made to **K** totaling \$X,XXX during 20 which included a payment of \$X,XXX during September. The description of this \$X,XXX payment in the **A**'s records was, "Full & Final Settlement for and behalf of **K**" and the check was made payable to **Individual 4 and 3 Ltr acronym**. This payment appears to be a payment in settlement of an obligation (possible legal matter) rather than for an exclusive charitable purpose. This payment to **K** occurred on or around \*\*\*\* and on or around \*\*\*\* the **A**'s Declaration of Trust was amended to change the primary charity from **K** to **M**

In addition, the IRS does not have any evidence that the organization, **K**, is recognized by the IRS as an organization that is tax exempt under section 501(c)(3) of the Internal

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Revenue Code.

2) Five (5) payments were made to **DD** totaling \$ during 20 **A's** general ledger describes the payments to **DD** as " " It cannot be determined if these expenditures served exclusively charitable purposes because the **A** has not provided supporting information for these payments.

3) A wire transfer of \$ was made to **Individual 1** on or around \*\*\*\*. The **A's** general ledger describes the wire transfer to **Individual 1** as "Dance Instruction". This payment appears to have not been made exclusively for charitable purposes but rather for the dance instruction of an individual, a purpose that serves a personal and private benefit.

4) A wire transfer of \$. was made to **Individuals 2 and 3** on or around \*\*\*\*. **A's** general ledger describes the wire transfer to **Individuals 2 and 3** as "Dance Instruction". This payment appears to have not been made exclusively for charitable purposes but rather for the dance instruction of an individual, a purpose that serves a personal and private benefit. A review of **M** Form 990 for the year 20 shows that a scholarship was given to (**Individual 4 having same first and last name as Individual 3 with middle name added**) in the amount of \$.

### Year 2002 Transactions

The **A** has not provided books and records for the year 20 however the IRS has obtained bank statements for the **Bank** account (#XXXXXXXX) and used this information in its examination of the payments made from the **A** and are as follows:

- \*\*\*\* - Check XXX for \$ payable to "**W**". Noted on the check was "Trip
- \*\*\*\* - Check XXX for \$. payable to **DD**. Noted on the check was "Nov, Dec, Jan"
- \*\*\*\* - Check XXX for \$ payable to **M**.  
Noted on the check was (Dec, Jan, Feb)
- \*\*\*\* - Check XXX for \$ payable to **C**.
- \*\*\*\* - Check XXX for \$. payable to **DD**. Noted on the check is
- \*\*\*\* - Check XXX for \$. payable to **A**. Noted on the check is "close acct"

The reported payments on Form 990 did not reconcile with payments from the **Bank** account. In addition, the reported income on the Form 990 did not reconcile with the deposits in the **Bank** account.

As with the payments during 20 there are payments to **DD** which have not been explained to the IRS as to the purposes served and there are payments to the dance

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organization which may be for payments for individual dance instruction. In addition, there are direct payments to the C & D (\$ and \$ ) which indicate that funds from the A inured to the benefit of the C and D.

**Year 20 Transactions**

The A did not provide books and records for the year 20 . However a review of the Form 990 shows reported payments were made to organizations other than the supported organization (i.e. M). Payments to organizations included: 1) K (the CSO changed their primary charity to M on \*\*\*\*); 2) W; 3) X; 4) L; 5) Y.; and 6) ZI.

The A has not provided an explanation of why payments to other than the supported organization were made nor to the charitable purposes for these payments. Based on the names of the organizations to which payments were made it appears that some of the entities are not tax exempt organizations such as X, Y, and Z.

The grandson of N (Board Member), EE, received \$ . as a scholarship from M during 20 based on the Form 990 of M

**ISSUE**

Should A's tax exempt status under Internal Revenue Code 501(c)(3) be revoked because it has not established that it qualifies for tax exempt status and has not established that it is operated exclusively for tax exempt purposes.

**LAW:**

IRC § 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

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

Regulation section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities

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which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Regulation section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization. The term "private shareholder or individual" is defined in regulation section 1.501(a)-1(c).

Regulation section 1.501(c)(3)-1(d)(1)(ii) provides an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Better Business Bureau v. United States, 326 U.S. 279 (1945) the court held that regardless of the number of truly exempt purposes, the presence of a single substantial non exempt purpose will preclude exemption under section 501(c)(3) of the Code. See also American Campaign Academy v. Commissioner, 92 T.C. 1053, 1065-66 (1989) (when an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes); Old Dominion Box Co., Inc. v. United States, 477 F2d 340 (4<sup>th</sup> Cir. 1973) (operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose).

In Church of World Peace, Inc. v. Commissioner, T.C. Memo. 1994-87, aff'd, 75 A.F.T.R.2d (RIA) 2082 (10<sup>th</sup> Cir. 1995), the Tax Court held that a church did not operate exclusively for religious purposes because the church facilitated a circular tax-avoidance scheme. The facts showed that individuals made contributions to the church and claimed charitable contribution deductions. The court found that the church then returned the money to the individuals claiming that the payments were for housing allowances and reimbursement of expenses. The court further found that such payments were in fact unrelated to the church's operations.

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

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In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under section 501(c)(3).

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

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

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

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

**GOVERNMENT POSITION:**

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

Funds of the A have inured to the benefit C during the year 20     when a payment of \$  
 \$.                    (check XXXX) was made directly to C. Also during 20     a payment of \$



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(check ) was made to **C** when the **Bank** was closed and the remaining funds in the account were distributed to **C**. In addition, the **A** has not provided evidence as to the disposition of the \$ reportedly invested during the year 20. (check #XXXX) and reported on the Forms 990 as such. The **A** has not established that the asset still exists and if such asset is being used for tax exempt purposes. It is possible that these funds were returned to the **C and D** via **BB, CC**, and ultimately to **Q**.

During 20 payments of and \$ were made for the dance instruction of **Individuals 2 and 3** and **Individual 1** which serves private interests rather than for charitable purposes. Payments to **K** appear to be payments for dance instruction and/or obligations connected with the providing of dance instruction.

The listed **A** board member, **N**, purportedly from the supported organization, **M**, received a private benefit indirectly from the **A** when her grandson received a \$ payment from **M** during 20. **M** was apparently used also to facilitate the wire transfer during 20 to **Individuals 2 and 3** for dance instruction, a transaction that served private interests. Subsequent to the wire transfer of \$ intended for the benefit of **Individuals 2 and 3**, the **M** provided a \$ scholarship to **Individual 4** during 20.

Payments made during the years 20 and 20 were made to organizations that are either not named supported organizations and/or not tax exempt organizations. These payments include \$ to **K**; \$ to **X.**, \$ to **Y.**, and \$ to **Z**.

The payments to "**DD**" have not been explained by the **A** and appear to be payments for the rental of a warehouse. The IRS does not see the need for renting a warehouse since the **A** does not have any reported inventory, furniture, equipment, or supplies belonging the **A**.

Tax exemption is a matter of legislative grace and not a right. Taxpayers have the burden of establishing entitlement to tax exemption. As required per Regulation section 1.6033-2(i)(2) and Revenue Ruling 59-95 it is incumbent upon an organization to submit information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status. **A** has failed to provide all information requested during the examination.

An organization is described in section 501(c)(3) only if no part of its net earnings inures to the benefit of any private shareholder or if it serves a public rather than a private interest. The inurement and private benefit prohibition is designed to insure that charitable assets are dedicated to exclusively furthering public purposes. An organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders and individuals or serves a private interest.

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A charity's assets are required to be irrevocably dedicated to charitable purposes. Treas. Reg. § 1.501(c)(3)-1(b)(4). The inurement and private benefit prohibition serves to prevent the individuals who operate the charity from siphoning off any of a charity's income or assets for personal use. If a charity's investments are decided in part by the needs of private interests, this may indicate the charity may not be operated exclusively for exempt purposes. Western Catholic Church v. Commissioner, 73 T.C. 196, 214 (1979).

A has not established that it primarily engages in activities that accomplish exempt purposes. Moreover, a substantial part, if not all, of its activities appear to serve private interests. A is operated as part of a tax avoidance scheme. Tax avoidance schemes do not further an exempt purpose. Freedom Church of Revelation, 588 F. Supp 693, 696 (D.D.C. 1984).

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

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

**CONCLUSION:**

Accordingly, the A's recognition as an organization described under section 501(c)(3) should be revoked, effective September 28, 20\_\_ because it did not operate exclusively for exempt purposes. Form 1041 U.S. Income Tax Return for Estates and Trusts should be filed for tax years ending December 31, 20\_\_, 20\_\_, 20\_\_, 20\_\_ and December 20\_\_. Subsequent returns are due no later than the 15<sup>th</sup> day of the 4<sup>th</sup> month following the close of the trusts accounting period.

Returns should be sent to the following mailing address:

**ISSUE #2**

Should the A be reclassified as a private foundation?

**LAW:**

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Income Tax Regulations section 1.509(a)-4(c) regarding the organizational test a 509(a)(3) organization must meet provides:

(1) *In general.* —An organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization (as defined in §1.501(c)(3)-1(b)(2)):

- (i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);
- (ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;
- (iii) State the specified publicly supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and
- (iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

Income Tax Regulations section 1.509(a)-4(e) regarding the operational test a 509(a)(3) organization must meet provides:

(1) *Permissible beneficiaries.* —A supporting organization will be regarded as "operated exclusively" to support one or more specified publicly supported organizations (hereinafter referred to as the "operational test") only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by a specified publicly supported organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in §53.4945-4(a)(4) of this chapter. Similarly, an organization will be regarded as "operated exclusively" to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

(2) *Permissible activities.* —A supporting organization is not required to pay over its income to the publicly supported organizations in order to meet the operational test. It may satisfy the test by using its income to carry on an independent activity or program which supports or benefits the specified publicly supported organizations. All such support must, however, be limited to permissible beneficiaries in accordance with subparagraph (1) of this paragraph. The supporting organization may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations, or for the permissible beneficiaries.

Income Tax Regulations section 1.509(a)-4(f) regarding the nature of relationships required for section 509(a)(3) organizations provides:

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(1) *In general.* —Section 509(a)(3)(B) describes the nature of the relationship required between a section 501(c)(3) organization and one or more publicly supported organizations in order for such section 501(c)(3) organization to qualify under the provisions of section 509(a)(3). To meet the requirements of section 509(a)(3), an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. If an organization does not stand in one of such relationships (as provided in this paragraph) to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

(2) *Types of relationships.* —Section 509(a)(3)(B) sets forth three different types of relationships, one of which must be met in order to meet the requirements of subparagraph (1) of this paragraph. Thus, a supporting organization may be:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with, one or more publicly supported organizations.

(3) *Requirements of relationships.* —Although more than one type of relationship may exist in any one case, any relationship described in section 509(a)(3)(B) must insure that:

(i) The supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and

(ii) The supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported organizations.

(4) *General description of relationships.* —In the case of supporting organizations which are “operated, supervised, or controlled by” one or more publicly supported organizations, the distinguishing feature of this type of relationship is the presence of a substantial degree of direction by the publicly supported organizations over the conduct of the supporting organization, as described in paragraph (g) of this section. In the case of supporting organizations which are “supervised or controlled in connection with” one or more publicly supported organizations, the distinguishing feature is the presence of common supervision or control among the governing bodies of all organizations involved, such as the presence of common directors, as described in paragraph (h) of this section. In the case of a supporting organization which is “operated in connection with” one or more publicly supported organizations, the distinguishing feature is that the supporting organization is responsive to, and significantly involved in the operations of, the publicly supported organization, as described in paragraph (i) of this section.

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

(1)

(i) Each of the items “operated by”, “supervised by”, and “controlled by”, as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any one of these terms is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed

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or elected by the governing body, members of the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations.

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

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

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

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

Income Tax Regulations section 1.509(a)-4(i) provides guidance on the meaning of "operated in connection with" as follows:

(1) *General rule*

(i) Except as provided in subdivisions (ii) and (iii) of this subparagraph and subparagraph (4) of this paragraph, a supporting organization will be considered as being operated in connection with one or more publicly supported organizations only if it meets the "responsiveness test" which is defined in subparagraph (2) of this paragraph and the "integral part test" which is defined in subparagraph (3) of this paragraph.

(2) *Responsiveness test*

(i) For purposes of this paragraph, a supporting organization will be considered to meet the "responsiveness test" if the organization is responsive to the needs or demands of the publicly supported organizations within the meaning of this subparagraph. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii)

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(a) One or more officers, directors, or trustees of the supporting organization are elected or appointed by the officers, directors, trustees, or membership of the publicly supported organizations;

(b) One or more members of the governing bodies of the publicly supported organizations are also officers, directors or trustees of, or hold other important offices in, the supporting organizations; or

(c) The officers, directors or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors or trustees of the publicly supported organizations; and

(d) By reason of (a), (b), or (c) of this subdivision, the officers, directors or trustees of the publicly supported organizations have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and the selection of recipients of such supporting organization, and in otherwise directing the use of the income or assets of such supporting organization.

(iii)

(a) The supporting organization is a charitable trust under State law;

(b) Each specified publicly supported organization is a named beneficiary under such charitable trust's governing instrument; and

(c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

**(3) Integral part test; general rule**

(i) For purposes of this paragraph, a supporting organization will be considered to meet the "integral part test" if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii) The activities engaged in for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves.

(iii)

(a) The supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations is sufficient to insure the attentiveness of such organizations to the operations of the supporting organization. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations which meet the attentiveness requirement of this subdivision with respect to such supporting organization. Except as provided in (b) of this subdivision, the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. In applying the preceding sentence, if such supporting organization makes payments to, or for the use of, a particular department or school of a university, hospital or church, the total support of the department or school shall be substituted for the total support of the beneficiary organization.

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(b) Even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary organization's total support, the amount of support received from a supporting organization may be sufficient to meet the requirements of this subdivision if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks the support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization's primary program or activity so long as such program or activity is a substantial one.

(d) All pertinent factors, including the number of beneficiaries, the length and nature of the relationship between the beneficiary and supporting organization and the purpose to which the funds are put (as illustrated by subdivision (iii)(b) and (c) of this subparagraph), will be considered in determining whether the amount of support received by a publicly supported beneficiary organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization. Normally the attentiveness of a beneficiary organization is motivated by reason of the amounts received from the supporting organization. Thus, the more substantial the amount involved, in terms of a percentage of the publicly supported organization's total support the greater the likelihood that the required degree of attentiveness will be present. However, in determining whether the amount received from the supporting organization is sufficient to insure the attentiveness of the beneficiary organization to the operations of the supporting organization (including attentiveness to the nature and yield of such supporting organization's investments), evidence of actual attentiveness by the beneficiary organization is of almost equal importance. An example of acceptable evidence of actual attentiveness is the imposition of a requirement that the supporting organization furnish reports at least annually for taxable years beginning after December 31, 1971, to the beneficiary organization to assist such beneficiary organization in insuring that the supporting organization has invested its endowment in assets productive of a reasonable rate of return (taking appreciation into account) and has not engaged in any activity which would give rise to liability for a tax imposed under sections 4941, 4943, 4944, or 4945 if such organization were a private foundation. The imposition of such requirement within 120 days after October 16, 1972, will be deemed to have retroactive effect to January 1, 1970, for purposes of determining whether a supporting organization has met the requirements of this subdivision for its first two taxable years beginning after December 31, 1969. The imposition of such requirement is, however, merely one of the factors in determining whether a supporting organization is complying with this subdivision and the absence of such requirement will not preclude an organization from classification as a supporting organization based on other factors.

(e) However, where none of the beneficiary organizations is dependent upon the supporting organization for a sufficient amount of the beneficiary organization's support within the meaning of this subdivision, the requirements of this subparagraph will not be satisfied, even though such beneficiary organizations have enforceable rights against such organization under State law.

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

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requirement of the integral part test of section 1.509(a)-4(i)(3)(iii). Rather, in order to satisfy that requirement, all of the factors mentioned in the regulations must be taken into consideration.

Income Tax Regulations section 1.509(a)-4(j) regarding control by disqualified persons provides:

(1) *In general.* —Under the provisions of section 509(a)(3)(C) a supporting organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more publicly supported organizations. If a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a foundation manager of the supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly supported organization, then for purposes of this paragraph such person will be regarded as a disqualified person, rather than as a representative of the publicly supported organization. An organization will be considered "controlled", for purposes of section 509(a)(3)(C), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of any substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization. Except as provided in subparagraph (2) of this paragraph, a supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization. Thus, if the governing body of a foundation is composed of five trustees, none of whom has a veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered to be controlled directly or indirectly by one or more disqualified persons by reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting rights with respect to stocks in which members of its governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

### GOVERNMENT POSITION:

It is the government's position that the **A's** tax exempt status should be revoked (Issue #1). In addition, it should be reclassified as a private foundation.

Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private foundation was intentionally inclusive so that all organizations exempted from tax by section 501(c)(3) are private foundations except for those specified in section 509(a)(1) through(4), Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566, 58 T.C.M. (CCH) 402, 404 (1989); Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7<sup>th</sup> Cir. 1979). **A** seeks to escape private foundation status and its associated controls of Chapter 42 by fitting under section 509(a)(3) which defines supporting organizations.



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Publicly supported organizations as defined in sections 509(a)(1) and (2) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations are similarly excepted from private foundation status. Supporting organizations are excepted because Congress believed the public charities which they support would provide sufficient oversight and keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie Charitable Fund, 603 F.2d at 1277-78.

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

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

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons. None of these tests were met by the **A**.

### Organizational and Operational Test

**A** is not organized to benefit one or more specified publicly supported organizations. Pursuant to Treas. Reg. § 1.509(a)-4(c)(1)(iii) and (iv), an organization's governing instrument must state the specified publicly supported organization(s) on whose behalf the organization is to be operated and cannot expressly empower the organization to support or benefit any organizations other than the specified publicly supported organizations(s). **A** dissolutionment clause allows distributions to organizations other than the specified publicly supported organizations upon termination of the **A**. The possible beneficiaries are not limited to the **M** or to the organizations specified on Schedule A. Therefore, the organizational test is not met. See Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274 (7<sup>th</sup> Cir. 1979) (the court held the organizational test was not satisfied where the trustee had the power to determine the charitable use was unnecessary or impracticable and to distribute the income to any charitable corporation he selected).

In addition, the operational test set forth in Treas. Reg. § 1.509(a)-4(e)(1) is not satisfied. A supporting organization will be regarded as "operated exclusively" to support a specified publicly supported organization(s) only if it engages in activities which support or benefit the specified publicly supported organizations(s). As was discussed under Issue number 1 above, the **A** has served private interests by making expenditures for dance lessons

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of specific individuals and other expenditures that have not been shown to serve charitable interests. In addition, the funds of the **A** has inured to the benefit of **C** via the payment of \$ ( (check XXX) and \$ (check XXX) during 20 . Also, the **A** has not provided evidence that the reported asset of \$. still exists for charitable purposes. Therefore, the **A** has not established that it operates exclusively for the benefit of the publicly supported organization(s).

**Relationship Test**

As set forth in Treas. Reg. § 1.509(a)-4(f)(2), there are three permissible relationships: (a) operated, supervised, or controlled by; (b) supervised or controlled in connection with; and (c) operated in connection with one or more publicly supported organizations.

The relationships “operated, supervised or controlled by” and “supervised or controlled in connection with” presuppose a substantial degree of direction over the policies, programs and activities of the supporting organization by a publicly supported organization. The “operated, supervised or controlled by” relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity or the membership of the publicly supported organization. The “supervised or controlled in connection with” relationship is established by the fact that there is common supervision or control by the persons supervising or controlling both the supporting and the publicly supported organizations, i.e., that control or management of the supporting organization is vested in the same persons that control or manage the publicly supported organization.

In the present case, the majority of the **A**'s governance was not appointed or elected by the specified publicly supported organization. Furthermore, there was no common supervision or control by the same persons over the **A** and the specified publicly supported charity. Accordingly, the facts indicate that there was no substantial control or direction over the policies or activities of the **A** by the supported organization. In fact, the majority of the members of the governing body (Board or Trustees) consisted of the **C and D** and their financial advisor **R**. **A** has not shown that the purported board member(s) from the primary charity (supported organization) attended any board meetings or participated in the investment decisions of the **A**.

Thus, the requirements to be one of the first two types of relationships; i.e. supervised or controlled by and supervised and controlled in connection with relationships, are not met.

The 3<sup>rd</sup> and final relationship possible for section 509(a)(3) organizations is the “operated in connection with” relationship which requires that the supporting organization be responsive to the needs or demands of the publicly supported organization and constitute an integral part of, or maintain a significant involvement in the affairs of the publicly supported

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organization. This relationship is satisfied where the supporting organization meets both the "responsiveness" and "integral part" tests. The integral part test has not been met in this case.

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

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

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

In the present situation, the first requirement is not met. There was -0- reported income (not including contributions from the **C and D**) so, technically, there was -0- required distributions (Note, the **A** did not report any interest income earned despite the reported \$\_\_\_\_\_ in Savings & Temporary Cash Investments). Therefore, there was no requirement per the **A's** Declaration of Trust to distribute any income to any named supported organizations, however the **A** did make payments to **K and M** during 20\_\_\_\_ 20\_\_\_\_ and 20\_\_\_\_ but it appears these payments were made for the dance instruction of specific individuals which serves a private and personal purpose rather than a charitable purpose. In addition, the **A** made distributions to organizations during 20\_\_\_\_ that are not specifically named supported organizations in the **A** Declaration of Trust. Some of these organizations that received

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distributions do not appear to be organizations described in IRC 509(a)(3) nor IRC 501(c)(3). Therefore, requirement number 1 of the Attentiveness test is not met. **A** has not provided any evidence to show that the supported organization(s) were attentive or involved with the operations and investment decisions of the **A** and, therefore, it has not proven that it has met the second and third requirement of the Attentiveness test.

Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a) provides that the amount of support received by a publicly supported organization must represent a sufficient part of the organizations total support so as to insure such attentiveness. As a rule of thumb, an organization that supplies less than 10 percent of the publicly supported organization's total support would, in the usual case, be insufficient to insure the publicly supported organization's attentiveness. Treas. Reg. § 1.509(a)-4(i)(3)(iii)(b) provides that a supporting organization can meet the attentiveness requirement, even where the amount of support received by the publicly supported organization does not represent a sufficient part of the publicly supported organization's total support, if it can be demonstrated that support is earmarked for a substantial program of the publicly supported organization that would be interrupted without the supporting organization's support. And finally, Treas. Reg. § 1.509(a)-4(i)(3)(d) provides that "all pertinent factors. . . will be considered in determining whether the amount of support received by a publicly supported organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization. It goes on to note the importance of the percentage of the income received from the supporting organization is in determining if the publicly supported organization will have the requisite degree of attentiveness and concludes that evidence of actual attentiveness is almost as important.

### Control Test

Internal Revenue Code § 509(a)(3)(C) and Treas. Reg. § 1.509(a)-4(j)(1) provides that a supporting organization may not be controlled, directly or indirectly by disqualified persons. Treas. Reg. § 1.509(a)-4(j)(1) provides that for purposes of section 509(a)(3)(C), an organization will be considered "controlled" if the person, by reason of his position or authority, may require the organization to perform any act which significantly affects its operations or prevents such organization from performing such act. All facts and circumstances are taken into consideration in determining whether a disqualified person controls an organization. Id. As founders, substantial contributors, and officers of the **A, C and D** are disqualified persons. Although three other individuals were listed as board members, there is no evidence indicating that these other board members were involved in any way with the investment policies and activities of the **A**. In addition, if the board consists of four members, **C and D** would have veto power over actions proposed by the board because they would have % of the votes.

### CONCLUSION:

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Therefore, **A** should be reclassified as an organization that is a private foundation defined in section 509(a). **A** cannot be classified as a supporting organization because it has not established that it has met the requirements set forth in Treas. Reg. § 1.509(a)-4(c) through (j). This determination is effective beginning January 1, 2000. Form 990 PF Return of Private Foundation should be filed for tax years ending December 20, 20, 20, 20, and December 20. Subsequent returns are due no later than the 15<sup>th</sup> day of the 5<sup>th</sup> month following the close of the foundation's accounting period.

Send your returns to the following mailing address:

**Note:**

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