



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

501.03-00

Date: September 17, 2010

Release Number: 201101027

Release Date: 1/7/11

LEGEND

ORG - Organization name

XX - Date Address - address

ORG

ADDRESS

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Employee Telephone Number:

(Phone)

(Fax)

CERTIFIED MAIL – RETURN RECEIPT

Dear

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

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

Organizations described in IRC 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You have failed to establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals. You did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in your activities thus serving private interest.

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20XX.

You are required to file income tax returns on Form 1041. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

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

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

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

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

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
1244 Speer Blvd. Suite 442
Denver, CO 80204

February 19, 2010

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Nanette M Downing
Acting Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule Number or exhibit
Name of taxpayer ORG	Taxpayer Identification Number EIN	Year/Period ended December 31, 20XX through 20XX

LEGEND

ORG - Organization name XX - Date Address - address City - city State - state
 POA - POA LAND - LAND NEWS-1 - 1st News ATTNY, ATTNY-1 & ATTNY-2 - 1st, 2nd & 3rd ATTNY RIS-1, DIR-2, DIR-3, DIR-4, DIR-5 & DIR-6 - 1st, 2nd, 3rd, 4th, 5th, & 6th DIR RA-1, RA-2, RA-3, RA-4 & RA-5 - 1st, 2nd, 3rd, 4th, & 5th RA CO-1 THROUGH CO-21 - 1st THROUGH 21st COMPANIES

ISSUE:

Should the Determination Letter for ORG, granting federal tax exemption pursuant to Section 501(c)(3), be revoked for not operating exclusively for tax exempt purposes?

FACTS:

ORG (ORG) was created with a Declaration of Trust by DIR-1 and DIR-2 (husband and wife) as founders and trustees on November 20, 19XX. The Trust was created for the purpose of establishing an organization which is described in sections 501(c)(3) and 509(a)(3) of the Internal Revenue Code (Code).

The Declaration of Trust provides in relevant part:

The Settlers intend that the Supporting Organization established by this Trust Agreement shall qualify as a supporting organization under section 509(a)(3) of the Code... shall not engage in any activities which are not in furtherance of the purposes referred to in Section 509(a)(3)(A) of the Code.

No part of the net earnings of this Supporting Organization shall inure or be payable to or for the benefit of any private individual...

There shall be five Trustees of the Supporting Organization, comprised of two Family Trustees and three Independent Trustees. The initial Family Trustees shall be DIR-1 and DIR-2. The initial Independent Trustees shall be DIR-3, DIR-4 and DIR-5. Each Family Trustee may designate a successor Family Trustee. The Family Trustees, acting together, may designate successor Independent Trustees, provided that no Independent Trustee shall be a disqualified person as defined in section 4946 of the Code other than a foundation manager or a publicly supported charitable organization. No successor Independent Trustee shall be appointed which would cause this Supporting Organization to be controlled by disqualified persons under Treasury Regulation section 1.509(a)-4(j)(1).

On termination, the Trust Estate as then constituted shall be distributed to or for the benefit of one or more Supported Charities for one or more exempt purposes within the meaning of section 501(c)(3) of the Code.

ORG was initially funded by a contribution by DIR-1 & DIR-2 in the amount of approximately \$\$ in 19XX. Since the funding of ORG the Trustees engaged in various investments that eventually led to the liquidation of ORG's assets in the year 20XX. A brief chronology of these transactions are listed below which will be followed with further detail.

- On January 2, 20XX, DIR-1 and DIR-5, Trustees, approved a secured loan to DIR-1 & DIR-2 in the amount of \$\$ which would be repaid in 20XX. The note was disclosed on the Form 990 on the Form 990 for the year 20XX.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule Number or exhibit
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- On May 10, 20XX, DIR-1, Trustee, approved the purchase of land located in City, State in the amount of \$\$ from CO-1 (CO-1). CO-1 is an organization owned by DIR-6, son of DIR-1. CO-1 had originally purchased the land from CO-2, an organization also owned by DIR-6. Pursuant to an appraisal performed on March 10, 20XX the value of the land was recorded at \$\$.
- On or around June 14, 20XX, DIR-1 and DIR-5, Trustees, approved an un-secured loan to CO-3 (CO-3) in the amount of \$\$.
- Both DIR-1 and DIR-5 were shareholders in CO-3 and were board members as well.
- During the year 20XX DIR-1 and DIR-5, Trustees, approved the purchase of CO-5 stock in the amount of \$.
- On December 6, 20XX DIR-1 and DIR-5, Trustees, approved a loan to CO-4 in the amount of \$.
- DIR-5 is also the manager for CO-4.
- ORG was also a partner in several partnerships one of which was CO-6 who encountered significant losses due to investments. The losses in large part were related to the CO-5 stock noted earlier.
- In a signed statement by DIR-1, he states that DIR-5 held positions in "CO-5," "CO-5," "CO-3," and "CO-4."

A more detailed description of each transaction is as follows:

CITY LAND PURCHASE:

The balance sheet indicated a purchase of land in 20XX, which is _____ acres in City, State (land). The land is part of the LAND Park Addition. The land was purchased for \$\$ as indicated on the Settlement Statement dated May 10, 20XX. Also reported on the balance sheet is the significant decrease in value to the land in 20XX to \$.

A document request was issued on October 28, 20XX requesting further detail regarding this asset.

An appraisal was provided that indicated the appraisal was performed on March 10, 20XX which revalued the land at \$.

A second document request was issued on January 30, 20XX requesting a certified appraisal on around the time the land was purchased from CO-1 on May 10, 20XX.

An email dated March 16, 20XX was received from POA, where he stated:

Our office handled the acquisition by the Foundation of the City property. I don't see an appraisal from that time in our files.

A second email dated March, 20XX was received from POA, where he stated in part:

The files from the attorney indicate that there was no appraisal when the City property was purchased. The trustees relied on the familiarity of the FAMILY with property values in the area of the purchased property, which they gained from prior business involvement in the immediate vicinity.

County Appraisal Records:

County (county) records indicated the following:

- The current land value is \$\$, which has not changed since 19XX. The county faxed documents to the IRS confirming the property value;

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule Number or exhibit
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- Records also indicated that the sale of the land was originally owned by CO-7 in City, State;
- CO-7 sold the property to CO-2 on January 30, 19XX who held the property of 8 months;
- CO-2 sold the property to CO-1, on September 2, 19XX who held the property for 8 months;
- CO-1 sold the property to ORG, who continues to own the property.

County Clerk Records:

County (county) records reviewed on the county website at ([website](#)) indicated the following:

- VOLUME 620 PAGE 348:
Special Warranty Deed dated January 29, 19XX that states in essence: the Grantor CO-7. sells to Grantee, CO-2 the stated property. The document was executed by RA-1 for CO-7 and DIR-6, President of CO-2.
- VOLUME 731 PAGE 81:
Warranty Deed dated August 31, 19XX that states in essence: the Grantor, CO-2 sells to the Grantee, CO-1 the stated property. The document was executed by DIR-6, President for CO-2.
- VOLUME 771 PAGE 848:
Affidavit regarding right of first refusal agreement dated May 17, 20XX that states in essence: "My name is ATTNY... attorney for CO-1... wherein CO-8. was given a right of first refusal from CO-1 to purchase the property... Written notice was given by me to CO-8 on March 8, 20XX that CO-1 had received an offer to purchase the property... from ORG. Subsequently, on April 16, 20XX and on May 3, 20XX CO-8 in writing elected not to exercise its option to purchase the property. The document was executed by ATTNY, Affiant.
- VOLUME 771 PAGE 841:
Certificate of Corporate Resolution dated May 17, 20XX that states in essence: DIR-6, President and Secretary, of CO-1 resolved to sell the stated property to ORG. The document was executed by DIR-6, President and Secretary for CO-1
- VOLUME 771 PAGE 858:
Warranty Deed dated May 17, 20XX that states in essence: Grantor, CO-1 sells to the Grantee, ORG the stated property. The document was executed by DIR-6, President for CO-1

City Secretary of State:

The website for the City Secretary of State provided additional information regarding CO-1. as well as CO-2. The following was noted:

- DIR-6 is president of both organizations;
- CO-2 was dissolved in July 7, 20XX;
- CO-1 was permanently revoked on January 1, 20XX. The secretary of state's office also provided that regarding this organization that CO-1 was permanently revoked due to not submitting the required documents to remain in good standing. The organization had not submitted anything since January 21, 20XX. CO-1 was basically abandoned.

Accurint:

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A search on Accurint was conducted to gain further information regarding, DIR-6; DIR-1; CO-8. The following relevant facts were noted:

- DIR-6:
 - ✓ Age
 - ✓ Address: Address, City, State
 - ✓ Director of CO-2.: Address, City, State
 - ✓ Director of CO-9: Address, City, State
 - ✓ Relatives: DIR-1; DIR-2

- DIR-1:
 - ✓ Director ORG
 - ✓ Relatives: DIR-6

- CO-8:
 - ✓ Also known as: CO-2
 - ✓ Address: Address, City, State
 - ✓ Officer: DIR-6

IDR August 27, 20XX:

A document request was issued to ORG dated 8/27/20XX, that requested the following information with regard to the property which stated in part:

In order to substantiate the organization's overall compliance as an organization described in Section 501(c)(3), PLEASE PROVIDE THE FOLLOWING:

- A. *Regarding the purchase of the _____ acres (LAND) in City, State:*
1. *A statement detailing the relationship DIR-1 has with DIR-6.*
 2. *Copies of the settlement statement and HUD statement of when CO-2 (CO-2) purchased the property from CO-7.*
 3. *Copies of the settlement statement and HUD statement of when CO-2 sold the property to CO-1. (CO-1).*
 4. *Copies of certified appraisals for the transactions noted in 2 and 3 above.*
 5. *Given the facts that: CO-2 dissolved July 7, 20XX; CO-1 was permanently revoked by the State of City due to inactivity (last communication was January 21, 20XX); DIR-6 was president and/or an officer of these two organizations; and each organization held the property for less than a year. Explain in great detail the chronology of events for this sale and purchasing of this property beginning with LAND.*

In a response that was emailed to the IRS from POA, dated September 18, 20XX, he states:

DIR-6 is the son of DIR-1.

In a follow-up response that was also emailed to the IRS from POA, dated October 2, 20XX, he states in reference to the document request:

Here is what I have learned to date:

1. *A.2. - No copies available. CO-2 and CO-1 are no longer in business and these records do not exist.*
2. *A.3. - Same as A.2.*

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3. A.4. - There are no certified appraisals.
4. A.5. - Waiting for detailed explanation.
5. Do not have name, address and phone # of title company.

In an email dated December 8, 20XX, POA provided a newspaper article in support of the decrease in land value. The article states:

Families say toxins scuttled planned community

January 19XX

NEWS-1

CITY, State – Two families have filed suit against CO-12 and a subsidiary claiming deadly toxins dumped for 17 years by a chemical plant ruined their hopes to build and develop a planned community on the banks of the RIVER.

The suit was filed by RA-2 and other family members after negotiations with the CO-10 brought no resolution according to their attorney, ATTNY-1 of City.

RA-2 moved to City from State, agreeing with the city's Chamber of Commerce that the West State city would be an ideal place to build a planned master community and golf course. The families built the golf course but ATTNY-1 said that just before they began to develop the community, the families discovered something about their land.

Testing had revealed that toxins had polluted the water and soil under two tracts they planned to develop. An investigation traced the source of the pollution to an CO-11 plant located across the street from their planned community. CO-11 is a subsidiary of CO-12.

ATTNY-2, of the firm CO-13, said that as early as 19XX CO-11 had begun dumping industrial and solid wastes into open, unlined pits on 10 acres of their property. In the next 17 years, some 750 tons of pollutants had gone into the pits.

ATTNY-2 said the chemicals leached through the soil and into the groundwater, then began to migrate toward the Linder's property. The lawsuit charges that CO-11 had concealed from the state and city authorities that the pollutants had escaped their property.

CO-3:

A review of the Forms 990 beginning in 20XX indicated that ORG loaned CO-3, a for-profit company, \$\$\$. The Forms 990 reported the following relevant facts:

20XX Form 990:

- The balance sheet shows an ending balance for "Other notes and loans receivable" in the amount of \$\$.
- Although ORG provided an attached schedule it did NOT give any statement or any other type of information or even mention the name "CO-3" that would indicate a loan to had been conducted.

20XX; 20XX & 20XX Forms 990:

- The balance sheet shows a beginning and ending balance for "Other notes and loans receivable" in the amount of \$\$.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule Number or exhibit
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- On an attached schedule for the Form 990 ORG indicates that ORG entered into a 2-year, 6% note with CO-3 that was issued on April 20XX – although the 20XX Form 990 had already indicated that the loan actually occurred in 20XX.

20XX Form 990:

- On an attached schedule for the Form 990 ORG indicates that the \$\$ loan is now an uncollectible note.

ORG provided two documents in support of the loan: 1. a Promissory Note dated April 30, 20XX from CO-3; and 2. an Agreement between CO-3, dated April 25, 20XX. The documents state in relevant part:

Unsecured Promissory Note:

CO-3, a City corporation (the Issuer), hereby promises to pay to ORG (the Payee)... the principal sum of \$\$, plus accrued interest thereon at the rate of six percent per annum... which shall be due and payable, as follows: (i) \$\$ shall be due... on each of June 15, 20XX, July 15, 20XX and August 15, 20XX, (ii) all accrued and unpaid interest on this unsecured promissory note shall be due... on the first anniversary of this Note, and (iii) all unpaid principal, with accrued and unpaid interest thereon, shall be due... on the second anniversary....

- The note was executed by RA-3, Senior Vice President for CO-3, Address, City, State
- Date executed was April 30, 20XX
- Un-cancelled check # issued to CO-3 in the amount of \$\$, dated 6/14/20XX was provided.

Agreement:

Subject: Agreement for conversion of Notes to Equity of CO-3, and payment of the balance. The following confirms the agreement between the CO-14 (CO-14) and ORG (ORG), (together DIR Parties) and CO-3

1. *Effective April 29, 20XX CO-3 is indebted to CO-14 in the amount of \$\$ as evidenced by a promissory note dated April 30, 20XX with a principal balance of \$\$ and accrued interest of \$\$.*
2. *Effective April 29, 20XX CO-3 is indebted to ORG in the amount of \$\$ as evidenced by a promissory note dated April 30, 20XX with a principal balance of \$\$ and accrued interest of \$\$.*
3. *CO-3 has requested the subordination of the above referenced promissory notes which is a prerequisite for the consummation of a new debt financing of CO-3 which has been agreed to by CO-15 (CO-15). The DIR Parties are unwilling to subordinate their position and therefore have agreed to convert fifty percent of their balance into CO-3 common stock at the rate of \$\$ per share and the balance of the indebtedness is to be paid in full after funding of CO-3 by CO-15 which is expected to occur during the first two weeks of May 20XX.*
4. *It is understood that ORG has agreed to accept CO-3 common stock as full payment of their note at the rate of \$\$ per share.... CO-3 agrees to issue 170.120 shares of CO-3 common stock to ORG and ORG agrees to accept that as full payment of their note.*

- The agreement was executed April 25, 20XX by RA-4, CEO, CO-3; DIR-1, Trustee, DIR-2, for the ORG Fnd.

Call with CO-3:

Contact was made with RA-5, (#) former treasurer with CO-3. He stated that he joined CO-3 in July 20XX and retired as an officer in April 20XX. CO-3 ceased its operation in 20XX. CO-3 had several hundred investors.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule Number or exhibit
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He did state that DIR-5 and DIR-1 were in fact shareholders of CO-3. He stated that DIR-5 was very active prior to 20XX with CO-3 but had stopped after 20XX; same with DIR-1.

To gain further clarification of the nature of this loan and to determine the relationships ORG and its trustees have/had with CO-3 several document requests were issued in addition to internet and internal research was conducted.

The information gathered disclosed the following facts:

- CO-3 had been experiencing financial challenges prior to ORG's \$\$ loan in that CO-3 had reported losses over several years prior to 20XX.
- Both DIR-5 and DIR-1, Trustees, were on the advisory board for CO-3.
- Both DIR-5 and DIR-1 were shareholders in CO-3.
- DIR-5 was paid for raising money for CO-3.
- The initial loan was to CO-3 was June 14, 20XX as evidenced by the check #.
- No loan agreement was executed on or around June 14, 20XX.
- The note receivable executed April 30, 20XX was un-secured.
- DIR-1 had invested additional monies through the CO-14 (CO-14) in the amount of \$\$.

CO-5 STOCK:

ORG, at the direction of DIR-5 and DIR-1, Trustees, purchased CO-5 Stock at an amount of \$\$\$. CO-5 was subsequently named CO-5 and which provides on-line services such as movies and television programming for hotels. It was stated in a signed statement by DIR-1 that DIR-5 held a position with CO-5. The company had experienced financial challenges and applied and received a \$\$ loan from CO-14 (CO-15), an unrelated lending institution. The loan was guaranteed by CO-6 of which ORG is a partner.

CO-4:

On December 6, 20XX, ORG, at the direction of DIR-5 and DIR-1, Trustees, wired \$\$ to CO-4, a company managed by DIR-5.

Three (3) documents were provided by ORG in support of the wire transfer: a promissory note; promissory note repayment; and a subscription agreement. They state in relevant part as follows:

Promissory Note:

The promissory note, executed on December 6, 20XX states in relevant part:

For value received, the undersigned CO-4 (maker) promises to pay ORG... \$\$, together with interest at the rate of 5.0% per annum until paid. Principal and all accrued interest shall be due and payable 30 days from the date hereof.

The note was signed by DIR-5, manager, for CO-4

Promissory Note Repayment:

Pursuant to the terms of the promissory note, ORG accepted two units of membership. The UNDATED (subsequent to December 6, 20XX) document states in relevant part:

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule Number or exhibit
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This will confirm our understanding with regard to repayment of the promissory note issued by CO-4 on December 6, 20XX and held by ORG. . . . This is to notify you that your offer, for ORG to accept two units of membership interest in CO-4 and an amount of cash equal to \$\$ as full payment of all principal and interest now outstanding on the FRF Note, is accepted by ORG. Please provide the necessary documents in order for ORG to subscribe to CO-4.

Subscription Agreement:

The Subscription Agreement executed on December 10, 20XX states in relevant part:

The undersigned hereby tenders this Subscription Agreement to CO-4, a State limited liability company (Company) to purchase TWO Units of membership interest in the Company. Payment in full payable to CO-4 is tendered with this subscription. The undersigned acknowledges that this subscription shall not become effective until it has been properly executed by the undersigned and accepted by the Company . . .

The document was executed by DIR-1 & DIR-2 on behalf of ORG and by DIR-5 on behalf of CO-4.

A search on the State Government website indicated that CO-4 voluntarily dissolved as of 4/21/20XX. The State records also indicate that the Registered Agent is CO-16 and the manager is CO-17 a company owned and operated by DIR-5.

In 20XX the DIR-1 created "CO-18" to hold the CO-4. As such the Form 990 reported the following information on the balance sheet:

TABLE DELETED

The 20XX Form 990 indicated the following information on the balance sheet:

TABLE DELETED

In a statement by POA, POA, he stated the following regarding CO-4:

CO-4. This was an entity organized by DIR-5. Again, DIR-5 raised money for CO-4 aka CO-19. This is a large real estate development in State, between City and City. It is my understanding the CO-4 collected money from investors and then loaned that money to CO-4. It is my further understanding that the investors including the Foundation had some kind of option to convert their investment into direct equity in CO-4 and its affiliated corporation CO-20. I think the entity dissolved when the equity interests were distributed to members. . . . in addition to being a trustee, DIR-5 is also the investment advisor to the Foundation. . . . DIR-5 presumably earned a commission for raising money for CO-4, but I don't have details concerning his compensation arrangement.

We created CO-18 to hold the various pieces in CO-4 held by the Foundation. CO-18 is owned 12.5% by the Foundation, 12.5% by the CO-14 (of which the Foundation is a beneficiary), 62.5% by the CO-18 and 12.5% by CO-21.

From the information provided the facts indicate that ORG, at the direction of the trustees which include DIR-5, loaned \$\$ to CO-4, a company managed by DIR-5. The investment was then converted to equity shares that were then transferred to CO-18 which is primarily controlled by CO-18.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule Number or exhibit
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LAW:

Section 501(c)(3) of the Code provides that corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes... no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Regulations provides that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a)(1) of the Regulations provides that in order to be exempt as an organization described in section 501(c)(3), 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.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in 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.

Section 1.501(c)(3)-1(c)(2) of the Regulations 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. For the definition of the words "private shareholder or individual" see paragraph (c) of §1.501(a)-1.

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

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

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph 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 designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

TAXPAYERS POSITION:

In correspondence from ORG dated February 9, 20XX, an executed Form 6018, Consent to Proposed Action – 7428 was submitted. By execution of Form 6018, ORG preliminarily consented to revocation of their Determination Letter effective January 1, 20XX.

On February 19, 20XX Letter 3618, proposing the revocation and granting 30 days to protest the report, was issued. Upon the expiration of the 30 days no protest was filed.

GOVERNMENTS POSITION:

CITY LAND PURCHASE:

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ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests.

The facts indicate that the purchase of the land by ORG from CO-1, was not an arms length transaction but instead benefited the FAMILY in that

- CO-2 CAPITAL purchased the land from LAND which there has been no evidence of an appraisal for the sale;
- DIR-6 is the son of DIR-1;
- DIR-6 is/was the president of CO-2 Capital who sold the land to CO-1 and in which again there was no evidence of an appraisal during this sale;
- DIR-6 is/was the president of CO-1 Capital who sold the land to ORG and in which again there was no evidence of an appraisal during this sale.

The fact that CO-2 and CO-1 each held the property for only 8 months and then dissolved shortly after the sale of the land; in conjunction with the fact that the attorney for ORG stating, "...that there was no appraisal when the City property was purchased...;" and that the trustees had "...relied on the familiarity of the FAMILY with property values in the area..." all give greater suspicion to the transactions overall.

The news article indicates that the toxins in the land were discovered prior to the date of the news article of January 19XX. ORG purchased the land in May 20XX, 2 ½ years later. The land value would have surely dropped prior to the date of ORG purchasing the land; however without a contemporaneous certified appraisal an accurate fair market value of the land is uncertain. The county however does provide a value of \$\$ in 19XX and after. A certified appraisal was not conducted until 20XX which indicated a significant drop in the value of the land since the date of purchase.

Given the facts, it appears that CO-2, DIR-6 as president, purchased the land in January 19XX from LAND order to build a golf course; which was also on or around the time the land was discovered to contain toxins, which would have certainly devalued the land at that point in time. Not able to build a golf course due the toxins, CO-2 then only held the land for an 8-month period who would then sell the land to CO-1 who would also only hold it for an 8-month period before selling it to ORG at a value that may or may not have been the fair market value given the discovery of the toxins in the land. Without contemporaneous certified appraisals the value of the land during each sale remains unknown. To state that no appraisals were ever conducted for any of these transactions is unlikely since most land and property sales are accompanied by a certified appraisal.

ORG has not demonstrated that the transaction with DIR-6 was in fact at arms-length. Without a certified appraisal at the time the land was sold to ORG and in light of value of land recorded by the county, the facts indicate that ORG purchased land that was grossly overvalued. This transaction allowed the FAMILY to divest ORG of several hundred thousand dollars as illustrated below:

TABLE DELETED

In scenario 1 the purchase price is netted against the amount recorded with the county which indicates an over valuation of \$\$\$. This is probably unlikely in that the county records amount generally does not reflect the actual fair market value. In scenario 2 the purchase price is netted against the appraisal conducted in 20XX which indicates a presumed over valuation of \$\$\$. Scenario 2 would be more likely given that the value of land would have decreased prior to the purchase and not subsequent to the purchase. Because the discovery of

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toxins occurred in 19XX the value of the land would have decreased at that time not in 20XX. Therefore the FAMILY divested from ORG an estimated \$\$ above the fair market value from the sale.

Section 1.501(c)(3)-1(a)(1) of the Regulations provides that in order to be exempt as an organization described in section 501(c)(3), 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.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in 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.

Section 1.501(c)(3)-1(c)(2) of the Regulations 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.

Section 501(c)(3) of the Code provides and prohibits any part of the net earnings to inure to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Regulations provides that the words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for one or more of the 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 designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Based on the facts and circumstances as they have been presented, ORG's purchase of the land from CO-1 creates a private inurement transaction in that DIR-1 is the founder and trustee of ORG causing him to have an interest in the activities of ORG. As such he directed funds from ORG to purchase land at an amount above the fair market value from CO-1 where his son was president which resulted in serving the private interests of the FAMILY.

Therefore ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests of the FAMILY.

CO-3:

ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests.

Both DIR-1 and DIR-5, Trustees of ORG, were members of the advisory board of CO-3 in addition to being shareholders. CO-3 was experiencing serious financial challenges and sought capital to continue its operation. DIR-1 invested approximately \$\$ from CO-14 in addition to lending \$\$ from ORG, that was un-secured, knowing that CO-3 was experiencing serious financial challenges and had losses prior to ORG's \$\$ loan. As

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investors in CO-3, both DIR-1 and DIR-5 had an interest in CO-3 in that both stood to benefit financially should CO-3 succeed. Conversely both DIR-1 and DIR-5 had much to lose should CO-3 fail.

The trustees also had an interest in ORG in that both were trustees and DIR-1 the founder. They directed funds to CO-3 a company they had a personal vested interest in. For this reason this transaction caused the net earnings of ORG to inure to the benefit of private shareholders and/or interested individuals.

Section 1.501(c)(3)-1(a)(1) of the Regulations provides that in order to be exempt as an organization described in section 501(c)(3), 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.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in 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.

Section 1.501(c)(3)-1(c)(2) of the Regulations 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.

Section 501(c)(3) of the Code provides and prohibits any part of the net earnings to inure to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Regulations provides that the words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for one or more of the 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 designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Based on the facts and circumstances as they have been presented, ORG's loan to CO-3 creates a private inurement transaction in that DIR-1 is the founder and trustee while DIR-5 is a trustee of ORG causing them both to have an interest in the activities of ORG. As such the trustees directed \$\$ from ORG to be lent to CO-3; a loan that occurred in 20XX and in which no loan agreement was executed until 20XX – which was unsecured. Because both trustees were shareholders and were active members of the board of advisors of CO-3 and in addition to DIR-5 being paid for raising money for CO-3 they also have a vested interest in CO-3. Their intention of the loan was not to make a prudent investment that was in the best interest of ORG in hopes of realizing a return, but rather it was to aid a failing company in order to salvage the significant investment that DIR-5 and CO-14 had already made. As such this transaction served the private interests of the trustees.

Therefore ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests of DIR-1 and DIR-5.

CO-5 STOCK:

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ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests.

ORG, at the direction of DIR-5 and DIR-1, Trustees, purchased \$\$ of CO-5 stock. DIR-5 held a position with CO-5 subsequently known as CO-5. As such he had a vested interest in the activities of CO-5.

As trustees for ORG, DIR-5 and DIR-1 have an interest in the activities of ORG as well, in addition to DIR-1 being the founder of ORG

Section 1.501(c)(3)-1(a)(1) of the Regulations provides that in order to be exempt as an organization described in section 501(c)(3), 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.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in 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.

Section 1.501(c)(3)-1(c)(2) of the Regulations 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.

Section 501(c)(3) of the Code provides and prohibits any part of the net earnings to inure to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Regulations provides that the words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for one or more of the 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 designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

As trustees of ORG, purchasing stock in a company that DIR-5 also has an interest in creates an inurement situation. Because DIR-5 has a vested interest in the activities of CO-5, as well as ORG, the purchase of stock caused net earnings to inure in whole or in part to the benefit of DIR-5, serving his private interests.

Therefore ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests.

CO-4:

ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests.

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As the facts demonstrate, ORG, at the direction of the trustees which include DIR-5, loaned \$\$ to CO-4, a company managed by DIR-5. As a manager of CO-4, DIR-5 has a vested interest in the activities of CO-4. DIR-5 is also a trustee to ORG having an interest in its activities as well.

The investment was then converted to equity shares that were then transferred to CO-18 which is primarily controlled by CO-18.

Section 1.501(c)(3)-1(a)(1) of the Regulations provides that in order to be exempt as an organization described in section 501(c)(3), 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.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in 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.

Section 1.501(c)(3)-1(c)(2) of the Regulations 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.

Section 501(c)(3) of the Code provides and prohibits any part of the net earnings to inure to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Regulations provides that the words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for one or more of the 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 designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

The loan and/or investment from ORG to CO-4 would be considered inurement for the following reasons. DIR-5, as a trustee, has a personal and private interest in ORG. DIR-5 is also the manager of CO-4 causing him to have a vested interest in CO-4. As such DIR-5 is in a position to personally benefit financially from the business successes of CO-4. Therefore the investment in CO-4 would benefit DIR-5 directly resulting in ORG serving the private interests of DIR-5.

In addition when the CO-4 investment was transferred to CO-18, this caused ORG to no longer have control over this activity. In that 62.5% of CO-18 is controlled by the CO-18 and only 12.5% is controlled by ORG. This also caused the investment to serve the private interests of DIR-1.

Therefore ORG's Determination Letter should be revoked because ORG did not operate exclusively for exempt purposes by allowing net earnings to inure to the benefit of individuals having an interest in the activities of ORG thus serving private interests.

CONCLUSION:

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The Determination Letter for ORG, granting federal tax exemption pursuant to Section 501(c)(3), should be revoked for not operating exclusively for tax exempt purposes? The revocation will be effective January 1, 20XX.