

Internal Revenue Service

CERTIFIED

Department of the Treasury

TEGE Appeals Programs
300 N. Los Angeles Street
Los Angeles, CA 90012

Taxpayer Identification Number:

Date: DEC 02 2010

Person to Contact:

Number: **201108048**
Release Date: 2/25/2011

Employee ID Number:

Tel:

Fax:

Legend:

Refer Reply to:

AP:LA:EMW

In Re:

Exempt status

Tax Years: 12/31/99 and subsequent years

A =

B =

C =

UIL Index:

501.03-00

A

B

501.32-01

Dear _____ :

This is a final adverse determination as to your exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reason(s):

You are not operated exclusively for an exempt purpose as required in order to be described in section 501(c)(3). You have engaged to a more than insubstantial degree in activities that do not accomplish one or more exempt purposes. Your income has inured to the benefit of private individuals.

Contributions to your organization are not deductible pursuant to section 170 of the Internal Revenue Code. As a corporation that is not exempt from Federal income taxes, effective July 26, 1997, you are required to file corporate income tax returns (Form 1120) for the years shown above.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia must be filed before the 91st (ninety-first) day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for

filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

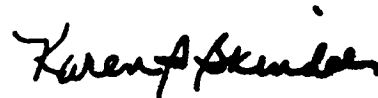
You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for Taxpayer Advocate assistance.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or 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 final adverse determination of your exempt status, as required by Code section 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,



Karen A. Skinder
Appeals Team Manager

cc:



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TEGE EO Exam Group 7949
9430 Research Blvd., Bldg I, Ste 301
Austin, TX 78759

ORG
ADDRESS

Taxpayer identification Number:

Form:

Tax Years: 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:

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

Thank you for your cooperation.

Sincerely,

R. C. Johnson
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

EXPLANATION OF ITEMS

NAME OF TAXPAYER
ORG

TAX IDENTIFICATION NUMBER
EIN

YEAR/PERIOD ENDED
19XX12/20XX12

LEGEND

ORG = Organization name XX = Date Address = address City = city State = state
Country = country County = county CPS = CPA President = president
CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7 & CO-8 = 1ST, 2ND, 3RD, 4TH, 5TH, 6TH, 7TH & 8TH COMPANIES RA-1 THRU RA-18 = 1ST THRU 18TH RA

ISSUES:

Whether ORG (ORG) should continue to maintain its exempt status under Section 501(c)(3) of the Internal Revenue Code, and if not, the effective date of loss of exemption.

Whether inurement exists in payments made to or for the benefit of President. of ORG

FACTS:

The ORG (herein referred to as "ORG") was incorporated on August 30, 19XX as a non-profit corporation in the State of State. ORG's Articles of Incorporation state that its purpose is to "operate exclusively for charitable and educational purposes, for the purpose of improving economic conditions among the Mexican American people of State." ORG was granted exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code on November 29, 19XX. ORG was also granted sections 509(a)(1) and 170(b)(1)(A)(vi) public support status in its initial and subsequent determination letters. ORG's accounting period is on a calendar year basis (December 31st).

In order to allow ORG to participate in gaming (bingo) as a fundraising activity, ORG amended its Articles of Incorporation in February 19XX. ORG's Articles of Incorporation were also changed to reflect ORG as a membership organization in order to comply with the State of State Bingo law. On February 26, 19XX, the State of State granted ORG a license to conduct bingo. These amendments, and changes to ORG's operations, were not submitted to the Internal Revenue Service.

In 20XX and 20XX, the Internal Revenue Service (herein referred to as "Service") conducted an examination of ORG's Form 990 for the tax period ending December 31, 19XX, but expanded the examination to include 20XX. The examination also expanded to Forms 990-T for the same tax years. To date, ORG has not responded completely to the following document requests: EO-05, 15, 18, 27, 28, 35, 37, 38, 39, 40, 44, 45, 46, and 47.

Specifically the following requested information has not been furnished:

EXPLANATION OF ITEMS

NAME OF TAXPAYER
ORG

TAX IDENTIFICATION NUMBER
EIN

YEAR/PERIOD ENDED
19XX12/20XX12

| | |
|---|--|
| <p>IDR's 5, 15, 35, 44 (See EXHIBIT A)</p> | <ul style="list-style-type: none"> • Specific timelines reflecting the dates of travel for President, RA-1, during 19XX. • Timeline reflecting dates of travel for RA-2 during 19XX. Response to IDR EO-15 is that he did not travel, but response to EO-5 indicates there was. This has never been explained. • Explain in writing conflicting information: Per airline ticket provided to examiner in response to IDR 5, someone traveled from Country to City and back to Country, at ORG's expense; not City to Country and back as ORG contends in explaining two short trips to Country. • Specific dates the principles are in Country. • Substantiating documents for all travel to Country, such as receipts, invoices, statements, visas/permits, confirmations of travel, letters, correspondence, etc. • More specifics on the business purpose of each trip to Country; documents substantiating business purpose of trips, ie. minutes, correspondence, etc. |
| <p>IDR's 27, 28, 40 (See EXHIBIT B)</p> | <ul style="list-style-type: none"> • How much did RA-3 pay into CO-1, and if she did not contribute, why? • Why does ORG make some payments to CO-1 directly (\$) and some indirectly (\$)? • When was CO-1 terminated? • Provide a copy of the written termination agreement • After termination, did ORG continue to fund CO-1? If so, why? |
| <p>IDR's 18, 37, 38, 45 (See EXHIBIT C)</p> | <ul style="list-style-type: none"> • Statement on how income and expenses of CO-1 as allocated to shareholders, including ORG. • For each listed expense on the profit-loss statement, explain how figures were arrived at. • Provide documents substantiating the amounts on the profit-loss statement. • Which cancelled checks makeup the expense items on the profit-loss statements? We need to see the cancelled checks and other substantiating documentation for expenses listed on the profit-loss statement. |
| <p>IDR 39, 46 (See EXHIBIT D)</p> | <ul style="list-style-type: none"> • Copy of cancelled check used by RA-2 to confirm the repayment of the \$\$ loan from ORG. |
| <p>IDR 47 (See EXHIBIT E)</p> | <ul style="list-style-type: none"> • Confirm our understanding of the facts presented in this IDR. • Written statement explaining roles of the principles in increasing ORG's rent payable to CO-2 at the bingo hall, where other organizations' rents are not increased, and in subsequently donating amounts back to ORG. |

President (President) founded ORG. He, along with his daughter, RA-1 (RA-1), operates and controls ORG. President is President, while RA-1 is Secretary. President also controls CO-2 (CO-2), a taxable entity. CO-2 is a related organization with respect to ORG by reason of common officers and directors. ORG pays President and RA-1 from ORG's bingo account and its general account. See Bingo Activity below.

ORG operates in an office located at "CO-3" hall in City, State. ORG does not pay any rent to headquarter its only office at this location; however, ORG does pay rent for bingo purposes. ORG is one of several organizations that operates bingo in this bingo hall.

NAME OF TAXPAYER
ORG

TAX IDENTIFICATION NUMBER
EIN

YEAR/PERIOD ENDED
19XX12/20XX12

Board of Directors/Meeting Minutes

President stated his philosophy about board members is that he wanted to have family members and close friends serve as the board members. In particular, he stated that he looked for individuals who support the goals set for ORG.

ORG's Form 990 discloses that ORG had eight members on the Board of Directors. The board does not meet on any set schedule; they usually meet two or three times a year; however, some of the listed members of the Board of Directors are no longer active in ORG. During the years of audit, some members include President RA-1, RA-2 (a.k.a. RA-2), RA-5 (employee of Organization's bingo operation), and RA-4 (another employee of Organization's bingo operation) and "others" as stated by President. When asked who was no longer active, President responded by stating RA-4¹ (City), RA-6 (Commissioner - RA-7), and RA-8 (City) are no longer active. President stated that when the activities slowed down, the interest of the Board of Directors declined.

For 19XX, ORG has minutes dated January 8, May 7, and November 29. For 20XX, minutes exist for January 15, April 8 and November 11. All minutes primarily focus on the bingo operation and the charter boat business.

Return Information

ORG describes its primary exempt purpose on Part III of the Form 990 as follows: "Improve economics of minority groups in State." However, the returns are blank where ORG is required to describe its exempt purpose achievements. See Exempt Activities below. **EXHIBIT F.**

The related organization, CO-2, is not listed on Part VI of Forms 990 for tax years ending December 31, 19XX and 20XX. **EXHIBIT F.**

For tax years ending December 31, 19XX and 20XX, ORG's Form 990 disclosed \$\$ and \$\$ of revenue respectively from "Bingo Games." **EXHIBIT F.** However, based on our examination, total bingo revenue was actually as follows:

TABLE DELETED

The 19XX Form 990 return has no Schedule A. On August 17, 20XX, the IRS Service Center requested a schedule A, but there is no record this schedule has been filed. The Schedule A for the 20XX return indicates that there were no transactions with officers and directors. It also discloses all income as "gifts, grants and contributions received" rather than gross receipts from sales of goods or services. The cash balances from the bingo account are not included on the balance sheet of Form 990. There are no loans or extensions of credit to officers and directors reported on Forms 990. A vehicle was included in ORG's balance sheet, but the vehicle was titled to President. See Other Assets below. **EXHIBIT F.**

Line 22, Grants and allocations, included \$ of distributions in 20XX. Line 23, Specific assistance to individuals, did not include charitable distributions, but rather loan payments on a debt of President. These

¹ RA-4 was an employee of the Organization in 19XX and 20XX per presented information. By 20XX, RA-4 was no longer an employee per review of the records.

| | | |
|--------------------------------|----------------------------------|------------------------------------|
| Form 886-A REV JANUARY 19XX | EXPLANATION OF ITEMS | January 4, 20XX Page 4 of 29 |
| NAME OF TAXPAYER ORG | TAX IDENTIFICATION NUMBER EIN | YEAR/PERIOD ENDED 19XX12/20XX12 |

were not program related loans. See Certain Loans below. There is nothing on the returns that informs the public of the existence of a boating enterprise in Country. See Charter Boat Business below.

The Form 990 returns filed for the three years prior to conducting bingo (19XX, 19XX, and 19XX) reflected no income/expense and no activities for ORG². These three returns were filed in April/May 19XX.

President' signature is on each return Form 990.

Exempt Activities

For the tax years ending December 31, 19XX and 20XX, ORG provided documents with data from the 19XX's and 19XX's. See **EXHIBIT G**. President stated that studies and proposals had been completed many years ago and ORG did not have any current publications, nor have they submitted any recent proposals. Of the documents presented, the most recent document is a proposal submitted in March 19XX. Other publications in spiral bound books on a shelf in the bingo hall were all from the early to mid-19XXs. ORG also provided a coversheet with a current address at Address, City, State. ORG did not move to this location until about 19XX.

According to one undated publication titled, "The CO-4 - A Profile," ORG "provides neighborhood groups, community leaders, and public officials with the technical skills and knowledge necessary for active participation in the economic decision-making processes of their communities ..Capacity-building training and technical assistance is provided in four inter-related areas - housing, business, municipal, and industrial development..." The document states that ORG also conducts research on economic issues of importance to .³ President stated the last study ORG conducted was approximately ten to fifteen years ago when a study was conducted for the City area.

In support of its tax exemption before the examiner, ORG provided two letters drafted in response to a State bingo audit from CO-5. The letters describe some of ORG's activities with respect to that high school, but did not give specific dates, amounts and recipients of financial assistance; nor any specific dates, times and frequency of program services. There were no documents or financial expenditures corroborating the activities described in these two letters.⁴ The June 20XX letter estimated that the value of assistance has been "in the excess of thousands of dollars."⁵ However, there were actually no direct scholarships to CO-5 in 19XX.⁶

In response to our IDR EO-16, in order to clarify the information included in these letters, ORG provided a memorandum dated August 19, 20XX, from the CO-5 Academic Advisor. The memorandum explained qualifications for a scholarship, but it did not provide information on actual scholarships provided, nor did it address the year under examination.⁸

² Response to IDR #EO-04 (20XX Examination)

³ The address on this document reflected Address, City, State. A written response to Information Document Request #EO-10 indicated that this was ORG's former address from 19XX to 19XX..

⁴ The letters are dated December 6, 20XX and June 5, 20XX written to the State Lottery Commission.

⁵ We requested a breakout of this support in IDR #EO-17, whereby ORG responded by stating this was for "the approximate number of hours of consultation, times the cost of President' expertise..." The computation provided by ORG indicated the estimate was about 30 hours of service during the course of the academic year consulting on various programs, at \$ per hour, or \$.

⁶ Response to IDR 16

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|--------------------------------|----------------------------------|------------------------------------|
| Form 886-A REV JANUARY 19XX | EXPLANATION OF ITEMS | January 4, 20XX Page 5 of 29 |
| NAME OF TAXPAYER ORG | TAX IDENTIFICATION NUMBER EIN | YEAR/PERIOD ENDED 19XX12/20XX12 |

The examiner requested specific information, including the number of class visits and number of business experts recruited by ORG to talk to the CO-5 students.⁷ In response, ORG stated "No direct scholarship to CO-5 this year." However, in addition, ORG provided the following in response:

- a) 3/3/XX – ORG solicited donations for the CO-6 Scholarship Fund. \$ was donated to the fund. Check ##.¹⁵
- b) 3/20/XX – ORG participated in the Neighborhood Board Training Workshop.⁸ 11 participants.⁹
- c) 3/26/XX - Business seminar for 1 ½ hours, sponsored by the Young Entrepreneur's Society (YES) Club of CO-5.
- d) 6/20/XX – Community Economic Development and Job Creation Process Workshop.¹⁰ 25 participants.¹⁰
- e) 8/20/XX – City Partners Education Partnership Plan, partnering with CO-5.
- f) 11/19/XX – A fax from East City Healthy Neighborhood Initiative, for Christmas Bureau of County, benefiting two families.
- g) 12/3/XX – Purchased 19 turkeys, East City Neighborhood Center, check, account for S.
- h) 12/4/XX – Letter from RA-9 to State Lottery Commission supporting President. No specific information.

Other than the thanksgiving turkeys and the \$ to the CO-6 Scholarship Fund, there are no expenditures or minutes corroborating items provided above. ORG stated, "No cost were incurred".¹¹

In response to our concerns over ORG's exempt activities, President stated that up through the mid-19XX's, he pursued grants, conducted studies, worked with community leaders, worked with congressmen, and coordinated research activities in order to improve conditions for . ORG had very limited activity from 19XX until 19XX. President stated that in order to raise funds, ORG became involved in gaming (bingo) in 19XX. He asserted the plan was to use the money from the bingo operation to return ORG to its primary exempt activities of helping the learn about economics and how to work within the system.

According to President, the bingo operation was not making money quickly enough. A decision was made to go into the charter boat business to raise additional capital. The charter boat business was located in Country, State. President stated this activity was an "investment". See Charter Boat Business below.

Bingo Activity:

⁷ IDR 17

⁸ Discussion was held with President on March 25, 20XX concerning these agendas

⁹ For the event on March 28, 19XX, we randomly tried to locate six of the participants. For three of these individuals, no information could be located. The 4th individual was on ORG's payroll. For the 5th individual, the address was verified, but the phone number could not be verified. For the 6th individual, the participants name could be located, but the phone number and the address could not be verified.

¹⁰ For the event on June 20, 19XX, we attempted to locate six of the participants, randomly chosen. We could not locate verify the information on these individuals, nor could we locate them.

¹¹ Response to IDR #EO-19

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| Form 886-A REV JANUARY 19XX | EXPLANATION OF ITEMS | January 4, 20XX Page 6 of 29 |
| NAME OF TAXPAYER ORG | TAX IDENTIFICATION NUMBER EIN | YEAR/PERIOD ENDED 19XX12/20XX12 |

ORG is licensed to conduct three sessions of bingo games per week. Since first receiving its license in 19XX, ORG has been conducting bingo at CO-3 hall located at Address, City, State.

Each of the President family members – President, RA-1, and RA-2 () – all received paychecks from each of the exempt organizations (EO's) playing at the bingo hall.

According to President, RA-1 is the primary person involved with the handling of ORG's bingo operation, including preparing reports, monitoring the games, and ordering materials and supplies. She is involved in the completion and filing of ORG's Forms 990 and Forms 990-T. RA-1 stated that the figures on ORG's Form 990 and Form 990-T were calculated based on information she provided to the accountant/tax return preparer. See **EXHIBIT H** for profit and loss statements for the tax years ending December 31, 19XX and 20XX on bingo, as provided by ORG

RA-1 also handled the bingo operation and records for the other exempt organizations that play in the same bingo hall (CO-3). RA-1 had full signature authority over the bingo bank accounts for each of these organizations. The bingo operation for each of the exempt organizations, including ORG, was carried on in the substantially the same manner.

CO-3 hall is located in part of a strip mall. The entire shopping strip building is owned by _____, but only part of the building is leased for the bingo operation. The bingo hall portion is leased to CO-2 who in turn subleases it to the organizations that play bingo. CO-2 also operates the bingo games on behalf of these organizations. The bingo hall includes a for-profit concession stand owned by RA-2 (Joey), President' son. The concession business is referred to as “_____.” RA-2 was also a director of ORG. “_____” is not disclosed on Part VI on Form 990.

CO-2 is a private organization controlled by the President family members. This relationship is not disclosed on ORG's Form 990. The Internal Revenue Service never has recognized CO-2 as an exempt organization; however, CO-2 nevertheless filed Form 990 over several years. Although President stated that CO-2 included members from various organizations playing bingo at the bingo hall; expansion of our examination to the Form 990 filed by CO-2 revealed that CO-2 was comprised of two organizations – ORG and one other EO. The other EO had no actual involvement in this business.¹² The officers for CO-2 include President, President and RA-1, Secretary-Treasurer.

According to President, CO-2 was a cooperative of exempt organization (EO) members playing bingo at the facility. He stated that CO-2's purpose was to negotiate a better rent (paid per session of bingo) on a cooperative basis, rather than having the exempt organizations pay the maximum amount allowed by State law (\$ per session). For example, for the December 31, 19XX audit year, ORG paid approximately \$ per session for rent rather than the maximum \$ permitted by State law.

On March 6, 20XX, the State of State had assessed a fine against ORG in the amount of \$ for material violations including failure to make a charitable distribution of \$. The State also required ORG to pay \$ to replenish the bingo account for amounts not used for charity. **EXHIBIT M.** ORG executed a “Memorandum of Agreement and Consent Order” agreeing to the State's findings and remedies, which includes a fine and a correction in lieu of revocation of the bingo license. **EXHIBIT N.** The State

¹² See CO-2's minutes and actions taken by CO-2

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| Form 886-A REV JANUARY 19XX | EXPLANATION OF ITEMS | January 4, 20XX Page 7 of 29 |
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determined that ORG had violated section 20XX.454 and 20XX.457 of the State Bingo Enabling Act.
EXHIBIT K.

The examiner issued IDR EO-47 in order to clarify the purpose and timing of increasing only ORG's rent to CO-2 to \$ per session, after the State imposed the fine and ordered correction: and then explain why CO-2 makes a contribution back to ORG's general account.¹³ The examiner presented her understanding of these series of transactions to ORG on IDR #EO-47. To date the examiner has received no explanation of the purposes, motives, structure and timing of the transactions in proximity to correction with the State.

Charter Boat Business:

President stated that a decision was made to go into the charter boat business to raise additional capital for ORG. The business is named CO-1, located in Country, State.

According to Form 990, Part IV, Balance Sheet for the tax years ending December 31, 19XX and the December 31, 20XX, the boat enterprise is classified as an investment.¹⁴ This enterprise comprised a major portion of the organization's total assets on Form 990 as follows:

| | 12/31/ | | 12 31 XX | | 12/31/XX | |
|---------------------------------|--------|---|----------|---|----------|---|
| Investments in Equipment (boat) | \$ | % | \$ | % | \$ | % |
| Total Assets | \$ | % | \$ | % | \$ | % |

While ORG furnished \$ in capital for CO-1, it was not recognized as an owner. According to a notarized contract, RA-2 owned a 48% interest in CO-1 (24 shares) at a cost of \$ U.S., while RA-10 owned a 52% interest. Certificates of shares were provided to RA-2 on October 7, 19XX.

The following cashiers checks were paid to RA-11 for this purchase. ORG purchased the cashiers checks from CO-7 on September 26, 19XX as follows:

| | |
|-------|---------|
| Check | - \$\$ |
| Check | - \$ \$ |
| Check | - \$ \$ |
| Check | - \$\$ |

\$ \$ U.S. Dollars

RA-2 later endorsed the certificate of shares to ORG on December 15, 19XX.¹⁵ A "Title Holding Trust Agreement," dated September 30, 19XX, signed by President. and by RA-2, states that ORG is owner, RA-2 is Trustee, and President. is Successor. The document was not notarized. The document further states in part, "Owner possesses certain property, listed on Exhibit 'A'. Nevertheless, Owner desires to have title to these business assets held and maintained by Trustee." Exhibit A to this document has not been provided

¹³ After the State imposed the fines and the required corrections, ORG's rent increased to the \$ limit without explanation, while other organizations continued to pay the much lower cost per session, approximately ranging from \$ to \$. CO-2 collected the \$ rent from ORG and then made "donations" back to the ORG (not to the other organizations). ORG deposited the money to its operating account, which was used to pay the State's imposed fines and corrections. The State's Memorandum of Agreement and Consent Order required that ORG pay the fine and correction from other than the bingo account.

¹⁴ See also response to IDR 2 for classification as an investment.

¹⁵ Response to IDR 11

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| Form 886-A REV JANUARY 19XX | EXPLANATION OF ITEMS | January 4, 20XX Page 8 of 29 |
| NAME OF TAXPAYER ORG | TAX IDENTIFICATION NUMBER EIN | YEAR/PERIOD ENDED 19XX12/20XX12 |

to the examiner. There are no reasoned legal opinions by U.S. based attorneys that this property actually belongs to ORG.

President. and RA-10 signed a document titled, "Operating Agreement." Some of the information in the Operating Agreement is as follows:

- "Whereas ORG has acquired 48% ownership interest in CO-1 and has jointed with CO-1 in the purchase of a chartership which will be docked in _____, State and shall be made available for charter rental tours by individuals and groups entered in studying the marine life and history of the Country region and whereas, RA-10, of CO-1, is willing to serve as operator of the boat charter service, and Whereas President is willing to contribute his time and some of the resources of ORG in serving as Vice-President of CO-1...."
- Division of Profit and Losses – "President and RA-10 will contribute their services to this charter business. Thus, CO-1 and ORG each agree to bear half the cost of acquiring and maintaining the assets of the charter business until it becomes self-sustaining."
- Title Holding Trust – "The parties agree that title to the boat and any other equipment requiring a title will be acquired in the name of President, who agrees to serve as undisclosed title holding trustee of same. Upon direction of RA-10, as President of CO-1, President agrees to transfer legal title to any property he so holds to transferee designated by RA-10 in her joint capacity of manager and operator of the venture."
- Termination of Business – "Since ORG is a non-profit public charity, it may not continue to commit it's resources to this venture if it is unable to show a profit, which would provide a funding source for it's charitable endeavors. Therefore it reserves the right to give CO-1 a six month written notice of its decision to terminate the charter business and liquidate its assets."

ORG provided a written response to IDR #EO-02 to address its involvement in CO-1. Some of the information provided is as follows:

- "ORG began to invest in CO-1 SA de CV in October 7, 19XX, when it acquired 48% of the stock. CO-1 SA de CV is a chartership business. CO-1 takes people out on tours to see the Bay Bay."
- "RA-10 is the _____ and operator of the company. President is the Vice-President of the company."
- "The agreement between ORG and CO-1 is that ORG would help with acquiring the funds necessary to bring the boat up to where it would meet all the requirements to be licensed by the _____ of Communication and Transportation of the United States of State. This was to do the repairs and to buy the safety equipment required by law to get the legal permits. The rest of the agreement was that RA-10 would be responsible for obtaining all the permits from the various levels of government to be able to legally operate as a charter company, she would also be in charge of making sure all repairs be done to the boat and day to day operations of a success business."

NAME OF TAXPAYER
ORG

TAX IDENTIFICATION NUMBER
EIN

YEAR/PERIOD ENDED
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- "Under law, ownership is reflected in the corporate charter document. Since such law gives preference to individual ownership of assets used in the charter business, legal title to this stock is held for ORG by President, while ORG's true ownership, the stock is reflected in the operating agreement covering the boat charter business owned equally by CO-1 and ORG. Again, law prohibits any foreign ownership of a majority interest in any corporation, so only % of the stock is owned by President."
- "The maximum capacity of the boat is 30, including staff, each of whom pays \$ for a days cruise. While activities of each group may vary depending on their interest, fishing and underwater exploration (snorkeling, scuba diving, swimming) are favorite activities and the needed individual equipment may be rented."
- "When the boat was acquired in 19XX it required extensive renovation. Therefore it was not placed in service until sometime in 19XX. The boat faced stiffed competition and made only one trip per week and sometimes only every other week during season, which was December through April."

ORG provided a brochure for the charter boat owned by CO-1. The name of the boat was "BOAT" and the brochure stated the following:

- "Sail the Bay of Bay in our elegant 57 foot motor sailer carrying less than 30 passengers. You can share the companionship in a gracious and informal setting of relaxed adventure."
- "While we cruise to our destinations you can watch for dolphins, giant mantarays, giant turtles, whales (winter), troll for game fish with the assistance of our expert crew, or you can just relax sunbathe and enjoy our impeccable service."
- "At City or the Islands you will be able to snorkel or swim and admire the beauty of these magnificent ecological reserves."
- "We will take you to beautiful secluded beaches with clean sand and exuberant palm trees where you can swim, snorkel, kayak, read a book or just relax in the sun."
- "Continental breakfast, lunch and dessert, will be served on board with an open domestic bar ready to serve you during the entire trip."

The brochure makes no reference to ORG.

According to tax returns, Form 068, filed in State for CO-1 for the period 19XX through 20XX. CO-1 had no income received and no expenses during these years. However, the November 11, 20XX minutes indicate that CO-1 is no longer an investment because it was "standing on its own" as of September of 20XX.

While 19XX reflects direct expenditures of \$, the disbursement records in 19XX, 19XX and 20XX reflect the following checks written from ORG's general account, account # , to CO-1:

TABLE DELETED

| | | |
|--------------------------------|----------------------------------|------------------------------------|
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Checks issued by ORG to CO-1 were deposited in City, Country, State, account ##. President V. President and RA-10 have signatory authority over this account.¹⁶

To account for the direct payments to CO-1 in the previous table, we asked ORG to provide the actual receipts, statements, etc. to verify what these funds were used for. While ORG has not fully complied with this request, the following facts were extracted from some of the receipts and invoices provided in response to this request:¹⁷

- a) ORG provided a summary of all receipts and vouchers provided to the examiner on calculator tape by month. However, the summary mixes U.S. dollars with
: TABLE DELETED
- b) Of the total in (a), the following receipts were determined by the examiner to be in U.S. dollars:
- c) The remaining amount of (a), \$, is in .¹⁸ Using the foreign currency converter (oanda.com), this translates into \$ in U.S. Dollars.¹⁹
- d) The total amount of the receipts (vouchers) in U.S. dollars is \$ (\$\$ + \$), which is short of the \$,\$ of direct payments to CO-1 in 19XX and 19XX that the examiner seeks to account for. The specific business purpose for ORG to incur these expenses has not been clearly established.
- e) Some of these items were paid for by checks issued from ORG's general bank account, not from the account of CO-1. TABLE DELETED
- f) Several receipts were for food items and personal items – shampoo, etc. – purchased in State.
- g) Some of the receipts were for internet access.
- h) Some of the receipts indicated the name of RA-10. This included a cell phone bill.
- i) Many of the receipts were for the purchase of gasoline. The gasoline receipts were in Pesos (\$).

In addition to the checks written directly to CO-1, ORG made indirect payments by issuing other checks from its general bank account to 3rd parties, for equipment, supplies, etc. relating to CO-1. The total for these checks is \$\$ and \$\$ for 19XX and 20XX respectively.²⁰ See EXHIBIT J for this list.

¹⁶ Response to IDR 27
¹⁷ Response to IDR 18
¹⁸ Per calculator tape provided by ORG \$
Less: Paid in U.S. Dollars/Purchased in U.S. \$\$
Incorrectly included with 19XX receipts
Total Paid in \$
¹⁹ The average daily rate was \$ per \$U.S. Dollar in 19XX. See EXHIBIT I. Subtotal for each column in EXHIBIT I = +
+= total for the year. divided by 365 days = average per U.S. Dollar. \$ / avg. = \$ U.S. dollars.
²⁰ #

Below is a summary of all payments above that were made in connection with CO-1:

| | 19XX | 19XX | 19XX | 20XX |
|--|------|--------|------|------|
| Checks written directly to CO-1 | | \$\$00 | \$ | \$ |
| Payments to 3 rd Parties, for CO-1, (EXHIBIT J) | \$00 | | \$ | \$ |
| Add "Loans" to RA-2 | | | \$00 | |
| Payments Directly to President | | | | |
| Add President travel expenses | | | | |
| TOTAL | | | | |

Payments Directly to President:

In 19XX, ORG made payments to President for reimbursement of expenses he incurred in connection with the boat enterprise. There are no documents, vouchers, or receipts substantiating the expenditures, except for one receipt for S. In addition to the expenses above, ORG paid amounts that were categorized as "loans" to RA-2 ORG's Form 990 discloses that there were no loans to officers and directors. None of these amounts were included on Forms W-2 or 1099.²¹

TABLE DELETED

Travel Expenses:

According to a response to IDR EO-5, President had only two trips in 19XX:

- Left City to Country on 4/13/XX (Tuesday) and returned to City on 4/19/XX (Monday).
- Left City to Country on 8/10/XX (Tuesday) and returned to City on 8/17/XX (Tuesday).

However, airline ticket information shows that these trips are actually reversed. According to the evidence, President' trips were to the U.S., from State, not the other way around.

04/19/XX Depart Country, State to City, State,
 04/24/XX Depart City, State back to Country, State
 Total cost of airlines for this trip was \$\$

8/17/XX Depart Country, State to City, State,
 8/24/XX Depart City, State back to Country, State
 Total cost of airlines for this trip was \$\$

In order to clarify President' trips and his time outside the U.S. on ORG's expense, the examiner issued IDR #EO-35 to ORG. ORG responded with "An error was made in reporting the ticket dates." While ORG kept the airline ticket, other documents, such as receipts, visa copies, minutes, and correspondence confirming the business purpose of travel were either misplaced or not kept.²² A follow-up IDR #EO-44

²¹ Response to IDR 29
²² Response to IDR 35

was issued on December 1, 20XX. No information was received from ORG in response to this request.
EXHIBIT A.

For the tax year ending December 31, 20XX, ORG's profit and loss statement disclosed travel expenses at \$\$; however, ORG did not provide the examiner documents that confirm the existence of an accountable plan or the exempt purpose of these expenses. Travel expenses in 20XX were paid as follows:

| Check # | Date | Payee | Total Amount |
|-----------------------|----------|-----------|--------------|
| # | 9/30/XX | RA-1 | \$\$ |
| # | 9/30/XX | President | \$ |
| # | 10/24/XX | President | \$ |
| TOTAL "TRAVEL" | | | |
| 20XX | | | \$\$ |

Other Assets

Included on ORG's Form 990, Part IV, Balance Sheet for the December 31, 19XX and the December 31, 20XX Forms 990 was a "vehicle" listed at \$\$\$. There were no documents provided to substantiate the cost or exempt purpose of the vehicle; however, President, stated \$\$\$ was the cost of the vehicle. The vehicle is a 19XX Toyota 4Runner, acquired on August 13, 19XX, titled to the name of President Vice President. President is given title in order to facilitate travel to State.²³ The vehicle is used for travel to State; however, President states that there is no personal use of the vehicle; therefore, no logs are provided. According to President, the vehicle is used for ORG's errands and to pickup clients at the Airport.²⁴ President stated that for security reasons, the vehicle is kept at President's residence during nonbusiness hours.

Certain Loans:

ORG's Form 990, Part II, Line 23 listed the amounts paid for "specific assistance to individuals" as \$\$ and \$\$ for the periods ending December 31, 19XX and 20XX respectively. Included as an attachment to ORG's Form 990 was a supporting statement that indicated payments made to the following:

| | 19XX | 20XX |
|--------------|-------------|-------------|
| RA-12 | \$ \$ | |
| RA-13 | ,\$ | \$\$ |
| RA-14 | | |
| Total | \$\$ | \$\$ |

ORG made the following expenditures from its general operating account:

²³ The minutes from August 22, 19XX

²⁴ Response to IDR 4.

EXPLANATION OF ITEMS

NAME OF TAXPAYER
ORG

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EIN

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| Check # | Date | Payee | Amount | \$ |
|----------------|-------------------|--------------|---------------|-------------|
| | 01/05/XX | RA-15 | | \$ |
| <u>Check #</u> | <u>Date</u> | <u>Payee</u> | <u>Amount</u> | |
| | 07/08/XX | RA-15 | | \$ |
| 01/05/XX | | RA-16 | | \$\$ |
| | 03/01/XX | RA-15 | | \$ |
| 02/08/XX | | RA-16 | | \$\$ |
| | 04/01/XX | RA-15 | | \$ |
| 03/01/XX | | RA-16 | | \$\$ |
| | 05/02/XX | RA-15 | | \$ |
| 04/01/XX | | RA-16 | | \$\$ |
| | 06/02/XX | RA-15 | | \$ |
| 05/03/XX | | RA-16 | | \$\$ |
| | 07/06/XX | RA-15 | | \$ |
| 06/02/XX | | RA-16 | | \$\$ |
| | 08/02/XX | RA-15 | | \$ |
| 07/06/XX | | RA-16 | | \$\$ |
| | 09/01/XX | RA-15 | | \$ |
| 08/02/XX | | RA-16 | | \$\$ |
| | 10/01/XX | RA-15 | | \$ |
| 09/01/XX | | RA-16 | | \$\$ |
| | 11/04/XX | RA-15 | | \$ |
| 11/04/XX | | RA-16 | | \$\$ |
| | 12/01/XX | RA-15 | | \$ |
| 12/01/XX | | RA-16 | | \$\$ |
| | TOTAL 19XX | | | |
| | TOTAL 19XX | | | \$\$ |
| 1/5/XX | | RA-16 | | \$\$ |
| 1/7/XX | | RA-16 | | \$ |
| 2/1/XX | | RA-16 | | \$ |
| 3/4/XX | | RA-16 | | \$ |
| 4/4/XX | | RA-16 | | \$ |
| 5/2/XX | | RA-16 | | \$ |
| | TOTAL 20XX | | | \$\$ |

In the case of payments to RA-11, ORG made these expenditures to pay a promissory note dated August 27, 19XX on behalf of President, borrower. The note was for \$\$ payable to RA-17, lender, at an interest rate of 13% over a six-month period. The Loan was due to mature by February 27, 19XX. There are no contracts renewing the note. The name, "CO-8," was above the signature of President. The proceeds were used start the bingo business.²⁵

In the case of the payments to RA-18, ORG made these expenditures to pay a promissory note dated May 31, 19XX on behalf of President, borrower. The note was for \$ payable to RA-18, lender, at an interest rate of 11% in two annual installments of \$\$ plus interest, due May 31, 19XX and May 31, 19XX. There are no contracts renewing the note. The note is secured by restaurant equipment. President stated that his family had owned a restaurant. The proceeds were used to start in the bingo business.²⁶

None of ORG's payments on these notes were included on Forms W-2 or 1099.

LAW:

In General

Section 501(c)(3) of the Internal Revenue Code provides that Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for

²⁵ Response to IDR 24. However, it is noted that ORG did not receive a license by the State Lottery Commission to operate bingo until February 19XX.

²⁶ Response to IDR 25.

| | | |
|--------------------------------|----------------------------------|------------------------------------|
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public safety, literary, or educational purposes, ... no part of the net earnings of which inures to the benefit of any private shareholder or individual... are exempt from Federal income tax under this section.

Federal Income Tax Regulation (Regulation) Section 1.501(c)(3)-1(a)(1) states: "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 Code section. If an organization fails to meet either the organizational test or the operational test, it is not exempt." (emphasis added)

Regulation Section 1.501(c)(3)-1(c) provides, "An organization will be regarded as 'operated exclusively' for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose." (emphasis added)

Regulation Section 1.501(c)(3)-1(c)(2) provides, "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 Sec. 1.501(a)-1." (emphasis added)

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

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

Section 1.501(c)(3)-1(e) of the regulations provides, in part, that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

In *P.L.L. Scholarship Fund v. Commissioner*, 82 T.C. 196 (1984), where bingo games conducted by a scholarship fund in a commercial establishment serving food and drink were found not operated exclusively for exempt purposes. The owners of the establishment, Pastime Lounge, Ltd. (P.L.L.), controlled the organization and allowed players to be solicited for food and drinks sold by their employees. The court stated, that a realistic look at the operations of these two entities (the P.L.L. and the Pastime lounge), however, shows that the activities of petitioner and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accounting of receipts and disbursements does not change that fact.

In *Help the Children, Inc. v. Commissioner*, 28 T.C. 1128 (1957); holding that the taxpayer was not exempt from taxation, the organization did not operate any charitable institutions. Its actual charitable function consisted of contributions to various individual doctors and institutions. Its principle activity was the

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profitable operation of bingo games. Thus, the purpose of the business for which the taxpayer operated was to engage in commercial activities for profit.

In *Pius XII Academy v. Commissioner*, T.C.M. 1982-97; *aff'd* 711 F.2d 1058 (6th Cir 1983); *cert. denied* 464 U.S. 982 (1983), the court found that the taxpayer's plans regarding the accumulation of income without more than a mere scintilla of an idea regarding the uses therefore provided the Commissioner with no way to conclude that the taxpayer's proposed operations (the school) would ever come to fruition and, if they did, whether they would accomplish only exempt purposes. Bingo was the organization's expected source of income. See also *Piety, Inc. v. Commissioner*, 82 T.C. 193.

Primary Purpose; Substantial Nonexempt Purpose

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

In making the appropriate analysis, it is necessary to focus on the purpose rather than the nature of the organization's activities. *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979); *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978); *Golden Rule Church Association v. Commissioner*, 41 T.C. 719 (1964); see *Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578 (1924); *San Francisco Infant School v. Commissioner*, 69 T.C. 957 (1978). An organization whose activities constitute a trade or business or generate a profit may still be exempt, provided that those activities accomplish an exempt purpose. Sec. 1.501(c)(3)-1(e)(1), Income Tax Regs.; *B.S.W. Group, Inc. v. Commissioner*, *supra*. Compare *Randall Foundation v. Riddell*, 244 F.2d 803 (9th Cir. 1957), [**11] with *Passaic United Hebrew Burial Association v. United States*, 56 F. Supp. 5 (D. N.J. 1963).

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

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

KJ's Fund Raisers v. Commissioner, T.C. Memo 19XX-424, *aff'd* 166 F.3d 1200 (2nd Cir. 19XX), petitioner also operated for the substantial private benefit of KJ's Place and its owners. A substantial nonexempt purpose thus characterizes its operation, disqualifying it from exemption under sections 501(a) and 501(c)(3). Citing *Better Business Bureau v. United States*, 326 U.S. at 283; *Copyright Clearance Center, Inc. v. Commissioner*, 79 T.C. at 803.

In *Church by Mail v. Commissioner*, 765 F.2d 1387 (9th Cir. 1985) *aff'g* TCM 1984-349 (1984), the Court noted that Church by Mail, Inc. ('Church') paid Twentieth Century Advertising Agency ('Twentieth') for services provided. Twentieth was owned and controlled by the two individuals who ran Church. The Tax Court had found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. In addressing whether Church operated for a substantial non-exempt purpose the 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated: "... The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or

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excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church. *est of Hawaii v. Commissioner*, 71 T.C. at 1080-81; see also *Presbyterian & Reformed Publishing Co. v. Commissioner*, 743 F.2d 148, 155 (3d Cir. 1984) (courts must look to all objective indicia from which a corporate actor's intent may be discerned); *United States v. Dykema*, 666 F.2d 1096, 1100 (7th Cir. 1981), cert. denied, 456 U.S. 983, 72 L. Ed. 2d 861, 102 S. Ct. 2257 (1982) (it is necessary and proper for the I.R.S. to survey all of the activities of an organization to determine whether a non-exempt purpose is furthered).

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

In *Housing Pioneers v. Commissioner*, 65 T.C.M. (CCH) §91 (19XX), aff'd, 49 F.3d 1395 (9th Cir. 19XX), amended 58 F.3d 401 (9th Cir. 19XX) ("*Housing Pioneers*"), the Tax Court concluded that an organization did not qualify as a section 501(c)(3) organization. The organization could describe only a vague charitable function of surveying tenant needs.

Commensurate Test

Section 502 of the Code provides that an organization whose primary purpose is the carrying on of an unrelated trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

However, Rev. Rul. 64-182, 1964 (Part 1)-1 C.B. 186, describes an organization that derived its income principally from the rental of space in a large commercial office building that it owned, maintained, and operated. The revenue ruling holds that the organization meets the primary purpose test of section 1.501(c)(3)-1(e) of the regulations because its charitable contributions are *commensurate in scope* with its financial resources and are in furtherance of its exempt function.

In *Ralph H. Eaton Foundation v. Commissioner*, 59 F.2d 527 (1955), a nonprofit corporation was formed to operate several business enterprises (farming, real estate, sports clothes, and construction). Its funds were payable to charitable and religious organizations, which were listed pursuant to appropriate investigation. During the period in controversy, the foundation earned over \$80,000 but made distributions to the charitable and religious beneficiaries in the total amount of \$6,550. In this case the business activity was not merely incidental to charitable or religious purposes. Rather, the court stated by way of dictum that its principal activities did not have the remotest connection with any religious, charitable, or educational enterprise.

In *Make a Joyful Noise, Inc. v. Commissioner*, 56 T.C.M. 1003 (1989), the Court concluded that the petitioner was not described in IRC 501(c)(3). The petitioner was organized in order to operate a camp for disadvantaged children and elderly citizens. While the organization maintained this goal, during its more than five years of operation, no progress was made towards its accomplishment. Initially the organization conducted its own bingo games. In response to a change in state law, the organization conducted bingo

games on behalf of other organizations. The Court found that the petitioner was principally engaged in the conduct of bingo games. The Court did not place any reliance on the organization's charitable goals when the evidence showed that no progress had been made towards the achievement of those goals.

Inurement and Private Benefit

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

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

... We have consistently recognized that while the prohibitions against private inurement and private benefits share common and often overlapping elements, *Church of Ethereal Joy v. Commissioner*, 83 T.C. 20, 5 (1984), *Goldsboro Art League, Inc. v. Commissioner*, 75 T.C. 337, 345 n. 10 (19XX), the two are distinct requirements which must independently be satisfied. *Canada v. Commissioner*, 82 T.C. 973, 981 (1984); *Aid to Artisans, Inc. v. Commissioner*, 71 T.C. at 5. Nonetheless, we have often observed that the prohibition against private inurement of net earnings appears redundant, since the inurement of earnings to an interested person or insider would constitute the conferral of a benefit inconsistent with operating exclusively for an exempt purpose. *Western Catholic Church v. Commissioner*, 73 T.C. 196, 209 n. 27 (1979), *affd. in an unpublished opinion* 631 F.2d 736 (7th Cir. 19XX). See also sec. 1.501(c)(3)-1(c)(2), Income Tax Regs. In other words, when an organization permits its net earnings to inure to the benefit of a private shareholder or individual, it transgresses the private inurement prohibition and operates for a nonexempt private purpose.

...The absence of private inurement of earnings to the benefit of a private shareholder or individual does not, however, establish that the organization is operated exclusively for exempt purposes. Therefore, while the private inurement prohibition may arguably be subsumed within the private benefit analysis of the operational test, the reverse is not true. Accordingly, when the Court concludes that no prohibited inurement of earnings exists, it cannot stop there but must inquire further and determine whether a prohibited private benefit is conferred. See *Aid to Artisans, Inc. v. Commissioner*, 71 T.C. at 5; *Retired Teachers Legal Fund v. Commissioner*, 78 T.C. 280, 287 (1982).

In *People of God Community v. Commissioner*, 75 T.C. 127 (19XX) the Court, in examining the compensation arrangement of an insider, noted that it is an established principle that the organization is entitled to pay reasonable compensation to an insider but the burden of establishing the reasonableness of the compensation fell upon the organization.

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In *Founding Church of Scientology v. United States*, 412 F. 2d 1197 (Ct. Cl. 1969), cert. den., 397 U.S. 1009 (19XX). The Court determined that the different arrangements between the organization and its founder, such as payment of ten percent or gross revenues, lending of money to him and his family, payment of expenses on their behalf, rental of property at inflated prices, resulted in inurement. The Court rejected the reasonable compensation defense. It stated: If in fact a loan or other payment in addition to salary is a disguised distribution or benefit from the net earnings, the character of the payment is not changed by the fact that the recipient's salary, if increased by the amount of the distribution or benefit, would still have been reasonable.

Section 4958 of the Code, effective September 14, 19XX, was added to the Internal Revenue Code by the Taxpayer Bill of Rights 2 bill in 19XX (P.L. 104-168, enacted July 30, 19XX). In *Caracci v. Commissioner*, 118 T.C. No. 25 (20XX), the Court noted: "With the enactment of section 4958, however, the issue whether the tax-exempt status of ... tax-exempt entities should be revoked now must be considered in the context of the 'intermediate sanction' provisions. ... the intermediate sanction regime was enacted in order to provide a less drastic deterrent to the misuse of a charity than revocation of that charity's exempt status. The legislative history explains that 'the intermediate sanctions for 'excess benefit transactions' may be imposed by the IRS in lieu of (or in addition to) revocation of an organization's tax-exempt status.' H. Rept. 104-506, supra at 59, 19XX-3 C.B. at 107. A footnote to this statement explains: 'In general, the intermediate sanctions are the sole sanction imposed in those cases in which the excess benefit does not rise to a level where it calls into question whether, on the whole, the organization functions as a charitable or other tax-exempt organization'. Id. n. 15, 19XX-3 C.B. at 107. Although the imposition of section 4958 excise taxes as a result of an excess benefit transaction does not preclude revocation of the organization's tax-exempt status, the legislative history indicates that both a revocation and the imposition of intermediate sanctions will be an unusual case." (emphasis added)

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

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

Insider

In defining who is an insider, the court in *United Cancer Council, Inc. v. Commissioner*, 165 F. 3d 1173, 1176 (7th Cir. 19XX), stated: "The term "any private shareholder or individual" in the inurement clause of Section 501(c)(3) of the Internal Revenue Code has been interpreted to mean an insider of the charity.

EXPLANATION OF ITEMS

Orange County Agricultural Society, Inc. v. Commissioner, 893 F.2d 529, 534 (2d Cir. 19XX); *Church of Scientology v. Commissioner*, supra, 823 F.2d at 1316-19; *Church by Mail, Inc. v. Commissioner*, 765 F.2d 1387, 1392 (9th Cir. 1985); *American Campaign Academy v. Commissioner*, 92 T.C. 1053, 1066 (1989). A charity is not to siphon its earnings to its founder, or the members of its board, or their families, or anyone else fairly to be described as an insider, that is, as the equivalent of an owner or manager. The test is functional. It looks to the reality of control rather than to the insider's place in a formal table of organization. The insider could be a "mere" employee-- or even a nominal outsider, such as a physician with hospital privileges in a charitable hospital, *Harding Hospital, Inc. v. United States*, 505 F. 2d 1068, 1078 (6th Cir. 19XX)..."

Books and Records

Internal Revenue Code (Code) Section 7602(a) provides the authority "to examine any books, papers, records, or other data which may be relevant or material" for the purpose of ascertaining the correctness of any return....

Regulation Section 1.6033-2(i)(2) provides that, "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."

Section 6001 of the Code provides, "Notice or Regulations Requiring Records, Statements, and Special Returns" provides, in part: "Every person...shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe."

Regs. 1.501(c)(3)-1(d)(1)(ii) provides that the burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests.

Revenue Ruling 56-304, 1956-2 C.B. 306, states that charitable organizations are not precluded from making distributions of their funds to individuals, provided such distributions are made on a true charitable basis in furtherance of the purposes for which they are organized. In addition, it should maintain adequate records and case histories to show the name and address of each recipient of aid, the amount distributed, the purpose for which the aid is given, the manner in which the recipient was selected and the relationship that exists between the recipient and members, officers, and trustees of the organization or a corporation controlled by the such individuals; in order to establish that distributions are made for charitable purposes.

Section 274(d) "Substantiation Required" provides that no deduction is allowed under Section 162 for any traveling expense (including meals and lodging while away from home); for any item with respect to an activity which is of a type generally entertainment, amusement, recreation, or use of the facility used in connection with such an activity; or for any gifts, unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement- (a) the amount of the expense, (b) the time, place of travel, entertainment, amusement, recreation, or use of the facility or property, or the date and description of the gift (c) the business purpose of the expense or other item, (d) the business relationship to the taxpayer of the persons entertained, using the facility or property, or receiving the gift.

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Income Tax Regulation (Regulation) Section 1.274-5 addresses the substantiation requirements with respect to the business purpose of an expense. If the substantiation requirements are not met no deduction is allowed with respect to that expense.

Regulation Section 1.274-5T(b) identifies the elements that the taxpayer must substantiate with respect to the expenditure: (i) amount, (ii) time and place of travel, entertainment, amusement, recreation, or use of the facility or property, (iii) business purpose, and (iv) the business relationship to the taxpayer of each person entertained, using the facility or property, or receiving the gift. Section 1.274-5T(c) notes that a taxpayer must substantiate each element of an expenditure by adequate records or by sufficient evidence corroborating taxpayer's own statement. Section 274(d) contemplates that a taxpayer will maintain and produce such substantiation as will constitute clear proof of an expenditure referred to in Section 274. It states that a record of the elements of an expenditure made at or near the time of expenditure, supported by sufficient documentary evidence, has a high degree of credibility not present with respect to a statement prepared subsequent thereto when generally there is a lack of accurate recall. It states that the corroborative evidence required to support a statement not made at or near the time of the expenditure "must have a high degree of probative value to elevate such statement and evidence to the level of credibility reflected by a record made at or near the time of the expenditure supported by sufficient documentary evidence". It states that to obtain a deduction for travel, etc., a taxpayer must substantiate each element of the expenditure.

Return and Information Filing Requirement

Revenue Ruling 59-95, 1959-1 C.B. 627 provides, in part: "failure or inability to file the required information return or otherwise to 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."

Section 13.02 of Rev. Proc. 90-27, 19XX-1, C.B. 514, (April 30, 19XX), provides that a ruling or determination letter recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization.

Section 14.01 of Rev. Proc. 90-27, 19XX-1, C.B. 514, (April 30, 19XX) provides that a revocation or modification [of the exemption letter] may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented,...Where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change

Unrelated Business Income

Section 511 of the Code imposes a tax on the unrelated business taxable income of exempt organizations.

Section 512 of the Code provides that the "unrelated business taxable income" means gross income derived by any organization from any unrelated trade or business regularly carried on, less the deductions allowed which are directly connected with the carrying on of such trade or business...

Section 513(f)(1) of the Code provides that the term, "unrelated trade or business" does not include any trade or business which consists of conducting bingo games.

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Section 513(f)(2) of the Code defines a bingo game as any game of bingo of a type which usually the wagers are placed, the winners are determined, and the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game,...and the conducting of which does not violate any State or local law [Emphasis added].

GOVERNMENT'S POSITION

Pertinent to this case, we focus on whether the organization meets the compliance tests listed below:

- Operational Test: Charitable Activity and the Commensurate Test;
- Operational Test: Primary Purpose, Substantial Nonexempt Purpose;
- Operational Test: Inurement and Private Benefit;
- Incorrect and Incomplete Return Information;
- Section 4958 of the Code

Charitable Activity and the Commensurate Test

Based on the facts, we've only been able to identify and verify \$\$ and \$\$ in charitable expenditures for the tax years ending December 31, 19XX and 20XX respectively. For the same tax years respectively, ORG had \$\$ and \$\$ in gross receipts. In 19XX, these expenditures include some Thanksgiving turkeys, and \$ for the CO-6 scholarship fund. The \$\$ is charity made after the State began its audit. By his own account, President stated that the organization became "inactive." Based on this data, the percentage of ORG's gross receipts verified to be in furtherance of an exempt purpose is negligible. ORG has not satisfied the commensurate test. See *Ralph H. Eaton Foundation* and *Make a Joyful Noise, Inc.* cited above. We note from ORG's balance sheet, as disclosed on Form 990, that almost all increases in assets are almost entirely attributable to the investment in the boat operation.

Bingo Operation

Based on dollar volume, personnel resources, the minutes, and volume of records, the location of ORG's home office; the relationship of ORG with a taxable bingo enterprise controlled by President (CO-2), and the results of the commensurate test above, Bingo is ORG's primary activity. It also serves the private benefit of President and his son because they control the bingo operator, CO-2, and the concession business, the Galley. See *P.L.L. Scholarship Fund*, cited above.

President, RA-1, and President' son, each is on the payroll as workers for the bingo hall and each received paychecks from ORG's bingo account. In addition, the President family, through CO-2, operates and controls CO-3 for the other organizations that play in the same bingo hall. Based on the commensurate test and our search for specific exempt activity, the bingo profits are not funding charity during the year of audit, but rather something else. The boating operation and private interests are all that is remaining based on the evidence supported by statements that the organization became "inactive." Bingo, as a primary activity, does not accomplish an identifiable exempt purpose. This means that for the tax years ending December 31, 19XX and 20XX, the profits from bingo disclosed on Part I of Form 990 in the amounts of \$\$ and \$\$ (other than the \$\$ for Thanksgiving turkeys and \$\$ of post-State-audit charity in 20XX) support the private boat enterprise and private interests. This violates the provisions of Regs. 1.501(c)(3)-1(c) which requires that an organization's primary activity accomplishes an exempt purpose.

According to the State of State, ORG violated state law by failing to distribute up to \$ to charity. ORG was assessed a fine of \$ and replenish the bingo account for \$. ORG executed a waiver agreeing to these

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remedies in order to avoid loss of their bingo license. We sought explanations as to why only ORG's rent was increased to \$ per session soon afterward, which is paid out of the bingo account. After all, CO-2's purpose was supposed to negotiate a better rent on a cooperative basis, rather than having the participating bingo organizations pay the maximum amount allowed by State law (\$ per session). If the rent was so increased for just ORG, we wanted to know why CO-2 was donating that money back to ORG's operating account, which in turn paid the fine and made correction. We don't have a reasonable explanation for the purpose, motive and substance of structuring transactions this way, since it relates to public policy concerns.

Under charitable trust law, trusts violating law or public policy cannot qualify for charitable status. *Restatement Trusts (Second), 377, Comment c (1959); IVA A. Scott, The Law of Trusts, 377 (4th Ed. 1989).* Thus, the "illegality doctrine" encompasses illegal activity as well as activity in violation of public policy. See, *infra* Section 4.A. The Service views illegality as one of the criteria by which an organization's activities are evaluated. Rev. Rul. 80-278, 19XX-2 C.B. 175. ORG's violation of State law and public policy, and, the lack of answers to our questions relating to bingo transactions makes it very difficult for us to justify continued exemption under section 501(c)(3) organization. Rev. Rul. 80-278, *supra*.

President indicated that CO-2 was a membership organization consisting of exempt organizations playing bingo at the bingo hall. However, we determined that CO-2 was a private nonexempt business.

The Boat Operation

Regarding the boat, we have no reasoned legal opinion by a qualified U.S. based attorney, and no appropriate notarized legal documents, that permits us to agree that title to the boat operation has in fact passed to ORG. ORG acquired the business under President' son's name contributing at least \$\$ (\$ + \$,\$ + \$\$ + \$\$) toward this private venture. By President' account, Mexican law doesn't permit ORG to own shares in this activity.

Even if we assume the boat is actually an asset of ORG, it serves no exempt purpose. Any claims late in the audit that this activity is primarily "educational" are not supported by the record. Part III of Form 990, which affords ORG an opportunity to disclose its accomplishments towards purported educational purposes, is consistently blank for all tax years. Meanwhile, the brochure indicates that it is a recreational business. There is no evidence of studies, classes, research, curricula, qualified experts, certifications, affiliations with universities, or instructional materials ORG has produced about marine life or whatever subject ORG claims to teach. Further, ORG never voluntarily publicized this activity as *its own*. ORG has never informed the Service of this significant change in the exempt purposes, character or method of operation in accordance with Rev. Proc. 90-27, cited above, and its own exemption letter. Alternatively, ORG had already claimed this activity to be "an investment" which leads us to continue to question the purpose of this activity.

Regarding ORG's claims that the boat is "an investment," we note that the "investment" yields no income for ORG based on tax returns in State. However, we received conflicting information in the November 11, 20XX minutes that CO-1 was "standing on its own." Consistent with the establishment of section 4944 of the Code relating to jeopardy investments by private foundations, there is no evidence that this investment actually supports any exempt activities. Investments that are highly risky, in foreign countries, and that are speculative could jeopardize the exempt status of a private foundation where the charity's resources are exploited to test the validity of the investment for the benefit of its disqualified person. See rationale of *S. Rep. No. 552, 91st Cong., 1st Sess. 44 (1969)*. The same could be said here as the "investment" was acquired with ORG's funds in the name of President' son.

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Primary Purpose, Substantial Nonexempt Purpose

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

While the boat and bingo are pervasive, the charitable activities are not so obvious. We issued several document requests to identify concrete and specific exempt activity undertaken by ORG. There are fourteen IDR's either not fully or partially addressed. For those IDR's where there were responses, we received unrealized proposals, concepts, ideas, statements, and promises; very old records; and, records of activities of other organizations. For example, some responses stated "Hopefully next year we would be in a financial position to start doing some of the studies necessary to assess communities needs;"²⁷ "No direct scholarships to CO-5 this year;" "...trying to outreach as much as possible,"²⁸ "...much could be done to educate young minority students."²⁹ "He also stated he would rework the Community Development Handbook..."³⁰

The failure to provide the information we request need not consist of an outright refusal. We refer to false information required to be reported on Form 990. If the information we seek is relevant, the organization may be required to produce a concrete and responsive answer. Information that is superficially responsive or that dances around the factual point at issue could justify a finding that the facts being avoided would be detrimental to the organization. See *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989).

Based on the evidence, and the fact that primary purpose can be inferred from activities and the manner in which they are conducted, bingo in its own right, and the boat operation is the ultimate purpose of the organization's existence during the years of audit. *Living Faith Inc. v. Commissioner; B.S.W. Group, Inc. v. Commissioner*, cited above. *Better Business Bureau*, cited above, provides that an organization with a substantial nonexempt purpose will not qualify for exemption. The provisions of Regs. 1.501(c)(3)-1(a)(1) are therefore violated.

Inurement and Private Benefit

President controls ORG's operations and financial affairs. He founded the organization, and he makes decisions for ORG. He also exerts substantial influence over the organization for purposes of the excess benefits tax under section 4958 of the Code. President had stated that he wanted to have family members and close friends serve as board members, but when the organization essentially stopped doing business, board members became inactive.

Because we have determined that the boat operation is a private business venture, we must conclude that all monies paid and invested into the business by ORG (or for that matter, anywhere outside the U.S.) is paid for the benefit of President and his son.

If there are claims for reasonable compensation, ORG has not established to examiners that President performed any services that warrant the level of payments he receives either directly or indirectly. On the one hand, President' services in connection with bingo must be paid out of the bingo bank account by State

²⁷ November 29, 19XX minutes.

²⁸ January 17, 19XX minutes

²⁹ May 7, 19XX minutes

³⁰ January 15, 20XX minutes

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law. Assuming President and ORG do not violate State law, the money paid out of ORG's other bank accounts must be used for services in connection with activities other than bingo. Yet, there are no other substantive organizational activities remaining.³¹ By his own account there is very little charity and education in the years of audit. This is supported by the lack of documentation of exempt activities in the minutes and the lack of information on Part III of the Form 990. The logical and fair question then becomes, what is President and his son being compensated for from the operating account? We also don't have complete answers to the IDR's in **EXHIBIT A** over when President was out of the country. This bears directly on whether compensation for local bingo work was paid for services performed while President was possibly out of the country, an inurement issue.

To summarize inurement, President and his son benefited as follows:

| | | |
|------|---|-------------|
| 19XX | To acquire Shares for benefit of RA-2 | \$ |
| 19XX | Payment to CO-1 (deposited in account which President had signature authority) | \$\$ |
| 19XX | Cost of the Vehicle titled to President | \$ |
| | TOTAL INUREMENT 19XX | \$\$ |
| 19XX | Payments to CO-1 (deposited in account which President had signature authority) | \$\$ |
| 19XX | Payments to Others for CO-1 | \$ |
| 19XX | Payments to President not on Form W-2 (non accountable plan) | \$ |
| 19XX | Payments for President travel expenses (non accountable plan) | \$ |
| 19XX | Payments toward President' debts (reported on Part II of Form 990 as "assistance to individuals") | \$ |
| | TOTAL INUREMENT 19XX | \$\$ |
| 20XX | Payments to CO-1 | \$\$ |
| 20XX | Payments to Others for CO-1 ³² | \$ |
| 20XX | Payment to RA-2 for "Loan" not disclosed on Form 990 | \$ |
| 20XX | Payments for President travel expenses (non accountable plan) ³³ | \$ |
| 20XX | Travel Payment to RA-1 (non accountable plan) | \$ |
| 20XX | Boat Expense Paid to RA-1 | \$ |
| 20XX | Payment to toward President' debts (reported on Part II, Form 990 as "assistance to individuals") | \$ |
| | TOTAL INUREMENT 20XX | \$\$ |

At most, after analyzing responses to IDR EO#17, President may have earned \$\$ for 19XX, assuming we accept his estimates.

³¹ We already determined that the private offshore boat enterprise is not an activity of ORG; rather, a private activity.

³² See **EXHIBIT J**, payments include \$\$ + \$\$ + \$\$ + \$\$

³³ \$\$ + \$\$

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The examination determined the vehicle was a Toyota 4Runner that ORG purchased and paid for prior to the year under examination. The title to this vehicle was in President' name. Oral testimony provided during the examination indicated the vehicle was used by President to drive to and from work when he was in City and was also used for out of town trips (such as travel down to State). During the audit year, no personal use of the vehicle was included in President' income. ORG paid expenses relating to the vehicle. Without evidence that the vehicle serves any kind of a charitable purpose, or that it was ordinary and necessary to carry out a charitable program, we can only conclude that any expense ORG incurs for this vehicle is inurement.

Since inurement and private benefit issues are highly fact dependent, the courts do not look with favor on an organization's failure to provide relevant facts and they are not hesitant to find that an organization has failed to carry its burden. See Gondia Corporation v. Commissioner, T.C. Memo. 1982-422; Schoger Foundation v. Commissioner, 76 T.C. 380 (1981); The Basic United Ministry of Alma Karl Schurig v. Commissioner, 670 F.2d 150 (1982); First Libertarian Church v. Commissioner, 74 T.C. 396 (19XX); Church of Gospel Ministry, Inc. v. U.S., 58 AFTR 2d 86-5232 (D.C. D.C. 1986); Universal Bible Church, Inc. v. Commissioner, T.C. Memo. 1986-170.

The timelines we requested in EXHIBIT A bears directly to the question of inurement from bingo compensation since, by state law, they can't be out of the country during the period for which they draw a salary from the bingo account

Incorrect Return Information; Failure to Produce Schedule A, Form 990

With regard to disclosures on Form 990, ORG consistently presents payments toward President' business loan as payments for charitable distributions on Part II of the return. Loans and extensions of credit to or for the benefit of officers or directors are not disclosed on Form 990's balance sheet, or on Schedule A, yet ORG claims to examiner there are loans. Also, the organization misstated gross receipts from bingo by almost dollars per year as follows:

| | 19XX | 20XX |
|---------------------------------|------|------|
| Bingo Gross Receipts - Actual | \$\$ | \$\$ |
| Bingo Gross Receipts - Reported | \$ | \$ |
| Return Understated | | |

There is no Schedule A filed for the 19XX year. Part III of the return discloses nothing when it comes to specific accomplishments of exempt activities. The Form 990 reports the vehicle as an asset of ORG when in fact it is actually titled to President' name. The bingo cash accounts are not included on the balance sheet. The related taxable entities "CO-2" and "the Galley" are not disclosed on Part VI of Form 990.

See Section 6033 and the regulations hereunder which state the information required to be furnished by section 501(c)(3) organizations. The fact that there is no Schedule A renders the 990 an incomplete return. See items required in Regs. 1.6033-2(a)(2)(ii), and in the instructions to Schedule A, Form 990. Revenue Ruling 59-95, cited above, provides that exemption can be terminated if the organization does not file the prescribed returns for exempt organizations.

Effect on Section 4958 of the Code.

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The Service has sufficient information to establish a pattern of control on the part of some insiders has resulted in continuing inurement to the insiders. We believe that a correction under IRC §4958 would not be sufficient to allow ORG to retain its exempt status. Apart from the inurement concerns, there continues to be private benefit, primary purpose, substantial nonexempt purpose, and primary activity concerns which in themselves disqualify ORG from exemption. Furthermore, it is expected that ORG will continue to be controlled by the same persons.

The government does not contend that family control is a statutory or regulatory cause for revocation. Many good organizations are family controlled. However, family control does offer unique opportunities for abuse. This is evident from case law cited in this report. In this case, as in all cases, family control is always a relevant factor when many other facts and circumstances indicate issues of private benefit and inurement. See Regs. Sec 1.501(c)-1(d)(1)(ii); *P.L.L. Scholarship Fund, supra*.

GOVERNMENT'S ALTERNATIVE POSITION

Assuming it is determined by an appellate authority that ORG should maintain its exempt status, we believe that Forms 990-T should be adjusted to reflect the additional income earned from the operation of bingo games, which are not in accordance with state law. While section 513(f) of the Internal Revenue Code excludes regular bingo games from unrelated business income (UBI), such games must be carried in a manner that "does not violate any State or local law" in order to be excluded from UBI. In lieu of revocation of bingo licenses, the State imposed a fine for material violations in the amount of \$. Further, the State required that correction be made in accordance with State law. ORG consented to the fines and corrections of violations on March 6, 20XX.

The amount of income generated from regular bingo is as follows:

| | 19XX | 20XX |
|--|------|------|
| Gross Bingo Income per EXHIBIT H (Revenue, less prizes & adjustments) | | |
| Less Total Expenses, EXHIBIT H | | |
| Disallow amounts determined as not constituting Charitable distribution. | | |
| Net Unrelated Business Income | | |
| Net Unrelated Income reported on Form 990-T, as amended ³⁴ | | |
| Adjustment to Unrelated Business Taxable Income | | |
| Total Tax on Net Unrelated Business Income | | |
| Tax Paid | | |
| Tax Due | | |

Historically, gross receipts consistently derive almost exclusively from bingo sales. For purposes of the public support test of 509(a)(1) and 170(b)(1)(A)(vi), sales to the public are excluded from the computation. Thus, ORG cannot be described as publicly supported under those sections.

³⁴ Includes the specific deduction of \$

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However, gross receipts is included in the public support computation under section 509(a)(2). Also, for purposes of section 509(a)(2), unrelated business taxable income must be accounted for in the gross investment income-unrelated business income test. For 19XX and 20XX, bingo determined to be carried in violation of State law rendered that income taxable as unrelated business income. For these two years, unrelated business income less taxes is \$ (\$ - \$), and \$ (\$ - \$). In spite of this level of unrelated business income, ORG remains a publicly supported organization (See **EXHIBIT O** for 509(a)(2) computations); however, it must be reclassified as a 509(a)(2) organization assuming it keeps its exempt status.

TAXPAYER'S POSITION:

Based on the taxpayer's letter dated March 4, 20XX, the taxpayer's position is that all questions and comments of examiner are loaded with guilt and insinuation.

Return Information. CPA, CPA of RA-7, State prepared ORG's Forms 990 for the years under examination. He is inexperienced in filing Forms 990. He failed to alert ORG that more detail was needed regarding specific charitable activities. He failed to contact ORG to inquire about non-monetary data requested on Form 990. President and his daughter, Veronica have no formal training in tax return preparation. They relied on CPA's qualifications as a CPA. Examiner does not understand the definition of gross receipts by adding bingo prize fees withheld into gross receipts per IDR EO-48.

Charitable activities. ORG's main focus has been on improving the economic knowledge and abilities of largely students in CO-5. Examiner dwells on inability to locate random students rather than substantive comments from school officials concerning ORG's courses in determining whether a insufficient amount of charity is conducted. After four years, most high school students relocate anyway.

Bingo. All questions have been pointless pertaining to CO-2. CO-2 is not subject to the jurisdiction of Exempt Organizations Division, since examiner determined that CO-2 was to be a for-profit entity. President has been given bad advice by his bingo attorney and by the State concerning the treatment of CO-2 as a not-for-profit corporation. Certain operating costs incurred by CO-2 are funded by the rents paid by the participating organizations. These costs are built into the rent CO-2 charges. ORG chose not to fight the charges made by the State for fear of loss of its bingo license. Bingo was ORG's sole source of income in 19XX. ORG paid the fine within 90 days and restored the \$ within a year. There has been no history of violation of the State's Bingo Enabling Act or its administrative rules. Examiner theorizes that the rents payable from the bingo account were increased for the purpose of steering those funds back into ORG's operating account to pay the fine and make correction, giving the appearance that the operating account paid these remedies. It is no violation of state law to raise the rents.

Tour/Charter Boat Venture. ORG is a partner with CO-1, a company, to generate revenue to provide visitors to Country with an educational opportunity to observe the area's marine life, similar to glass bottom boat tours in other parts of the U.S. During the first season, the mafia's tight grip effectively shut out newcomers such as CO-1 from the tour boat business. Public charities need not confine its charitable activities within the U.S. There is no evidence that President or his family have derived personal benefit from the boat, which is located half a continent away from their home. Frequent trips would be cost-prohibitive to them. President is currently negotiating with several prospective buyers who have shown an interest in the boat.

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Inurement, Private Benefit, Control. President is well known in the State community for his expertise in business matters and in helping solve social problems. His travels in South State are frequent, contacting community leaders. He counsels community leaders. President's control over ORG is vital in achieving the goals of the business. ORG does not pay large salaries or bonuses. There are no qualified retirement plans. The examiner has shown no questionable offshore bank accounts into which President could siphon cash. ORG has offered reasonable explanations for business expenses. Examiner has quoted no third parties provided to her, that has negated the importance ORG has been to them.

Missing IDR Responses. ORG shows that only IDR's 47 and 48 were not addressed, but that is because these requests were redundant. The information in those document requests was already discussed with the examiner. Examiner never sent ORG or its representative a list of missing responses.

CONCLUSION:

1. Based on the above, we propose to revoke ORG's tax-exempt status. This proposed revocation would become effective September 26, 19XX (the first date of payments made to acquire CO-1 in President, name). Any contributions to ORG are no longer deductible as charitable contributions. Any contributions to this organization by those who were in part responsible for, or were aware of, the activities or deficiencies on the part of the organization that gave rise to loss of exempt status will not be allowed as a deduction effective the date of revocation.

ORG will be required to file Forms 1120 for all tax years. See **EXHIBIT L** for conversion spreadsheet. The tax for 19XX and 20XX is estimated to be \$\$ and \$\$ respectively.

ORG will be required to file Forms 940, Employer's Annual Federal Unemployment Tax Return for taxable wages paid in 19XX and 20XX.

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

Since ORG has not provided the information needed to make a final determination of its exempt status, it is considered by the Internal Revenue Service that ORG has not taken all reasonable steps to secure such determination. Under Section 7428(b)(2) of the Code, not taking all reasonable steps, in a timely manner, to secure the determination may be considered as a failure to exhaust administrative remedies available to ORG within the Service, and may preclude the issuance of a declaratory judgment in the matter under judicial proceedings.

2. For the tax year ending December 31, 19XX, \$ has inured to the benefit of RA-2

For the tax year ending December 31, 19XX, \$\$ has inured to the benefit of President.

For the tax year ending December 31, 19XX, \$\$ has inured to the benefit of President.

For the tax year ending December 31, 20XX, \$\$ has inured to President.; \$\$ has inured to RA-2; and, \$ has inured to RA-1.

EXPLANATION OF ITEMS

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3. In the event it is held by an appellate authority that exemption is to be maintained, we propose that ORG be subject to unrelated business income tax for the conduct of Bingo which was determined by the State of State to be conducted in violation of State law. Adjustments of unrelated business taxable income for the tax years ending December 31, 19XX and 20XX are \$ and \$ respectively. We also propose that the organization be reclassified as a publicly supported organization with the meaning of section 509(a)(2) of the Code. See computations at **EXHIBIT O**.