

**Internal Revenue Service**  
TEGE Appeals Programs  
300 N. Los Angeles Street  
Los Angeles, CA 90012

Department of the Treasury  
**CERTIFIED**

Release Number: **201115030**  
Release Date: 4/15/2011  
Date January 18, 2011

**Taxpayer Identification Number:**

**Person to Contact:**

Employee ID Number:  
Tel:  
Fax:

**Refer Reply to:**

AP:LA:EMW

**In Re:** Reclassification to private  
foundation

**Tax Years:** and subsequent  
years

**UIL Index:**

501.33-00

A

B

Dear

This is a final adverse determination regarding your private foundation classification. We hereby revoke the portion of our September 26, 2002 determination letter wherein we determined you were not a private foundation. We hereby determine that you are a private foundation and not an I.R.C. § 509(a)(3) supporting organization effective January 3, 2002.

We have made this adverse determination that you are not a supported organization for two reasons. First, you were not organized exclusively for one or more of the purposes specified in I.R.C § 509(a)(3)(A) in accord with the standards set forth in Treas. Reg. § 1.509(a)-4(c). Second, you were controlled directly or indirectly by one of your disqualified persons in contravention of the requirement of Treas. Reg. § 1.509(a)-4(j) that you not be so controlled in order to be classified as a supported organization.

This letter does not affect your status as an organization described under section 501(c)(3) of the Code and you continue to be described under section 501(c)(3) of the Code. As a private foundation, you are required to file federal Form 990-PF for the year(s) 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 Claims, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> (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.

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: Matthew Wride



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service

November 30, 2007

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we propose modifying your private foundation status under section 509(a) of the Internal Revenue Code (Code).

Your exempt status under section 501(c)(3) of the Code is still in effect.

If you accept our findings, take no further action. We will issue a final letter modifying your private foundation status.

If you do not agree with our proposed modification of private foundation status, you may provide additional information that you would like to have considered, or you may submit a written appeal. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organization 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.

If you request a conference with Appeals, you must submit a written protest within 30 days from the date of this letter. 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.

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

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

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,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 3498  
Publication 892  
Report of Examination

## Explanation of Items

Name of Taxpayer  
ORGYear/Period Ended  
12/31/20XX.  
20XX, 20XX and  
20XX

## LEGEND

ORG = Organization name      XX = Date      City = city      State = state  
 BM-1, BM-2, BM-3 - 1<sup>st</sup>, 2<sup>nd</sup> & 3<sup>rd</sup> BM      CO-1 & Co-2 = 1<sup>st</sup> & 2<sup>nd</sup> COMPANIES

## ISSUE

Whether the ORG should be reclassified as a private foundation?

## FACTS

The ORG (Foundation) was examined for the calendar years ended December 31, 20XX, 20XX, 20XX and 20XX.

The Foundation was created via a Declaration of Trust (Declaration) dated January 3, 20XX. BM-1 and BM-2 of City, State are listed as the Donor of the Foundation. BM-1 is listed as the Trustee.

The Declaration states that the Foundation was created for the purpose of establishing an organization which is described in IRC §§ 501(c)(3) and 509(a)(3).

The Declaration further provides that each year the Trustee shall distribute 35% of the net income of the trust to CO-1 (the "primary charity"). In addition to this distribution, each year the Trustee shall distribute a total of 50% of the net income to one or more identified charitable organizations or to the primary charity as directed by a majority of the Board of Directors (the "Board"). The Trustee may make discretionary distributions of the income in excess of 85% of the net income and principal of the Foundation to one or more of the organizations listed on Schedule A of the Trust document or to the primary charity. Schedule A of the Declaration lists one hundred twelve (112) additional charities including the primary charity. Schedule A is attached as Exhibit 1.

Section 2.3 of the Declaration states that "Notwithstanding anything to the contrary contained herein the Trustees appointed by the BM-1 & 2 family reserve the right to change the supported 501(c)(3) tax exempt organization to another 501(c)(3) tax exempt organization, at any time and for any reason if the BM-1 & 2 family appointed board members deem it, in their sole and absolute discretion, to be in the best interest of this Charitable Supporting Organization."

Section 2.4 of the Declaration is the "Final Distribution" clause. It states that "In the event the Trustee determines, in Trustee's sole and complete discretion, that the Trust Fund is too small to economically administer, then in such event the Trustee shall distribute the Trust Fund in its entirety outright and free of trust to such organization or organizations as described in Section 170(C)(2) of the code as the Trustee, in Trustee's total and complete discretion, shall determine."

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Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX, 20XX, 20XX and 20XX

Section 2.5 of the Declaration is the dissolution clause. It states that...“Upon winding up and dissolution of this Trust, after paying or adequately providing for the debts and obligations of the Trust, the remaining assets shall be distributed to a non-profit fund, foundation, or corporation which is organized and operated exclusively for charitable, educational, religious, and/or scientific purposes and which has established its tax exempt status under Section 501(c)(3) of the Code.” The Declaration does not specify the primary charity as the recipient of the assets upon the dissolution of the Foundation

Section 2.6 of the Declaration contains the Trustee’s Powers. It states that...”In addition to the powers granted herein, but consistent with the limitations stated herein, the Trustee shall have all of the powers entitled and granted to Trustees under the laws of the State of State and, in addition thereto and not by way of limitation, the Trustee shall have the power: to retain any asset originally or later contributed to the trust estate whether or not such asset be of a character permissible for investment by fiduciaries; to retain and purchase assets notwithstanding the lack of diversification of the trust assets; to retain, purchase, sell or exchange any and all stocks, bonds, notes or other securities or any variety of real or personal property, including stocks or interests in investments or mutual funds (including any of said items of or maintained by the Trustee); to change the situs of the trust and of any property which is part of the trust to any place in the United States of America or any other country; and to make distributions of principal or income in kind. Notwithstanding anything herein to the contrary, any of the powers, duties or authority given to the Trustee hereunder may be exercised and is under the control of and by the Board which shall be evidenced by a writing given to the Trustee and signed by at least three (3) members of the board. If the Trustee receives any such direction from the Board, the Trustee shall follow such direction and shall not be liable for following any such direction.”

Section 3 of the Declaration provides that the Board shall consist of 5 members, be the governing body of the trust, and that the members of the Board shall be determined as follows:

- Three Board members shall be appointed by the primary charity, \_\_\_\_\_; or its designated agent.
- Two Board members shall be from the class consisting of BM-1 and BM-2 and each of their descendents (the “BM-1 & 2 family”).

On May 8, 20XX, on behalf of the Foundation, a member of the Board, BM-3, signed Form 1023 (Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code) seeking recognition of the Foundation as exempt from tax pursuant to section 501(a) as an organization described in section 501(c)(3) and classification as a supporting organization pursuant to section 509(a)(3).

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. of Exhibit:
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Name of Taxpayer ORG		Year/Period Ended 12/31/20XX, 20XX, 20XX and 20XX

Form 1023, Part II, item 1 states "The purpose of the Organization is to distribute substantially all of its income to and for the use of various public charities and to help the CO-1 (the "Primary Charity") carry out its purposes and perform its functions of helping to provide children with better opportunities and a better world. Each year at least thirty-five percent (35%) of the net income of the Organization will be distributed to the Primary Charity. The Organization's Board of Trustees, which will include at least three (3) or a majority of the members, will be appointed by the Primary Charity. At least once a year and more often if prudent the Organization's Board will meet with Representatives from the Primary Charity to establish the use of the net income of the Organization and the distributions of the Organization. The Organization's distributions shall be made each year to carry out or fund one or more of the programs or functions of the Primary Charity. In addition, each year, at least fifty percent (50%) of the net income of the Organization shall be distributed among the designated charities listed on Schedule "A" of the Organization's Trust Indenture, as determined by the Organization's Board. Finally, the Organization may distribute the balance of the net income and/or all or part of the principal of the Organization to such designated (sic) charities as the Organization's Board may determine."

Minutes of the annual meetings were not provided. In answer to a request for the minutes BM-3 (board member and Promoter) responded by stating "None have been prepared as the meetings have been very simple in that all of decided to leave the assets invested as they are and the Trust Indenture does not require that minutes be kept of the meetings." The quote is copied exactly as written. It indicates that minutes were not maintained.

In Part II, item 2, Form 1023 states "The organization's principal financial support will be contributed by BM-1 and BM-2." Part II, item 4d states that BM-1 and BM-2 may be disqualified persons because they are substantial contributors to the organization.

Part III question 1 indicates the Form 1023 is being submitted within 15 months from the end of the month in which the Foundation was created or formed.

Based on the representations in the application, the Internal Revenue Service (IRS) issued a determination letter dated September 26, 20XX. This letter states that "...you are exempt from Federal income tax under section 501(a) of the Internal Revenue Code (Code) as an organization described in section 501(c)(3)." The letter further states "We have further determined that you are not a private foundation within the meaning of section 509(a) of the Code, because you are an organization described in section 509(a)(3)."

The Foundation filed Forms 990 for calendar years ended December 31, 20XX, 20XX, 20XX and 20XX. The forms indicate the following as contributions to the Foundation from BM-1 and BM-2.

Explanation of Items

Name of Taxpayer  
ORG

Year/Period Ended  
12/31/20XX,  
20XX, 20XX and  
20XX

Year 20XX 20XX 20XX 20XX

Cash \$0 \$0 \$0 \$0

Net income was reported in the amounts of:

Year 20XX 20XX 20XX 20XX

Net Income \$ \$ \$( \$) \$ \$ \$( \$)

The Forms 990 report grants for charitable purposes in the following amounts for the years under examination.

Year 20XX 20XX 20XX 20XX

Charitable Grants \$0 \$0 \$0 \$0

Throughout the four years under examination the Foundation did not make any grants to the primary charity and did not perform any activities or programs furthering the exempt purpose of the primary charity.

An attachment to the Form 990 for CYE 12/31/20XX states that "The entire donation by BM-1 and BM-2 in 20XX of \$\$ was invested in partnership CO-2 EIN with the intent that this investment be trust principal that would produce the income to make the required charitable donations each year. Capital gains and losses are treated as increases or decreases of fund balances and are not normally distributed, but become increases or decreases of trust corpus. Therefore, as of the end of 20XX, the only asset is the remaining investment in that partnership at 12/31/20XX. No distributions were made in 20XX." A similar statement is attached to the Forms 990 filed for CYE 12/31/20XX, 20XX and 20XX.

A letter dated January 10, 20XX explaining the late filing of returns for CYE 12/31/20XX, 20XX, 20XX and 20XX is attached to the Form 990 for CYE 12/31/20XX. The letter states that "In the initial year of existence, 20XX, BM-1, trustee of the foundation, received a donation of \$\$ which he classified as trust corpus and invested the entire amount in CO-2. This LLC would then generate the revenue to fund charitable donates. The LLC had negative gross receipts in 20XX, 20XX and 20XX; therefore, BM-1 did not file tax returns in those years. Not being in the habit of filing returns for the Foundation, he inadvertently overlooked the necessity to file in 20XX, which year had gross receipts in excess of \$\$. The letter is attached as Exhibit 2 to this report.



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Financial records were requested during the examination. Letters were mailed to the Trustee and all of the members of the Board of Directors because of a lack of taxpayer response. One board member, BM-3 responded by providing some information. BM-3 stated the Foundation:

- 1) does not have a checking account.
- 2) has not made distributions to the primary charity because the "...money manager is hoping that the market gets better so their (sic) will be income that can be distributed to the supported charity."
- 3) has not performed any activities in support of the primary charity.
- 4) has not maintained financial records other than the Schedule K-1 for Forms 1065 related to the Foundation's partnership interest in the CO-2.

## LAW

Code section 501(c)(3) exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Income Tax Regulations (Regulation) section 1.501(c)(3)-1(a)(1) provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

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

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

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

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
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In *New Faith, Inc. v. Commissioner*, T.C. Memo 1992-601, the court stated that an organization must substantiate its alleged charitable activities with specific documentation in the form of checks, invoices, receipts, contemporaneous journals, and other documentation.

Code section 509(a)(3) defines a supporting organization as an organization which:

509(a)(3)(A)- is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph 509(a)(1) or 509(a)(2) and:

509(a)(3)(B) is —

509(a)(3)(B)(i) operated, supervised, or controlled by one or more organizations described in paragraph 509(a)(1) or 509(a)(2),

509(a)(3)(B)(ii) supervised or controlled in connection with one or more such organizations, or

509(a)(3)(B)(iii) operated in connection with one or more such organizations, and

509(a)(3)(C)- is not controlled directly or indirectly by one or more disqualified persons (as defined in Code section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2).

Code section 4946(a)(1)(A) states that the term “disqualified person” means, with respect to a private foundation, a person who is a substantial contributor to the foundation.

Code section 4946(d) defines disqualified persons as members of the family of an individual as ones spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Regulation section 1.507-6(a)(1) defines the term “substantial contributor” as, except as provided in subparagraph (2) of this paragraph, with respect to a private foundation, any person (within the meaning of section 7701(a)(1)), whether or not exempt from taxation under section 501(a), who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the private foundation before the close of the taxable year of the private foundation in which a contribution or bequest is received by the foundation from such person. In the case of a trust, the

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term "substantial contributor" also means the creator of the trust. Such term does not include a governmental unit described in section 170(c)(1).

Regulations section 1.509(a)-4(c), regarding the organizational test of a 509(a)(3) organization, states that:

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

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

(2) Purposes. —In meeting the organizational test, the organization's purposes, as stated in its articles, may be as broad as, or more specific than, the purposes set forth in section 509(a)(3)(A). Therefore, an organization which, by the terms of its articles, is formed "for the benefit of" one or more specified publicly supported organizations shall, if it otherwise meets the other requirements of this paragraph, be considered to have met the organizational test. Similarly, articles which state that an organization is formed "to perform the publishing functions" of a specified university are sufficient to comply with the organizational test. An organization which is "operated, supervised, or controlled by" (within the meaning of paragraph (g) of this section) or "supervised or controlled in connection with" (within the meaning of paragraph (h) of this section) one or more section 509(a)(1) or (2) organizations to carry out the purposes of such organizations, will be considered as meeting the requirements of this paragraph if the purposes set forth in its articles are similar to, but no broader than, the purposes set forth in the articles of its controlling section 509(a)(1) or (2) organizations.

(3) Limitations. —An organization is not organized exclusively for the purposes set forth in section 509(a)(3)(A) if its articles expressly permit it to operate to support or benefit any organization other than those specified publicly supported organizations referred to in subparagraph (1)(iii) of this paragraph. Thus, for example, an organization will not meet the

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organizational test under section 509(a)(3)(A) if its articles expressly empower it to pay over any part of its income to, or perform any service for, any organization other than those publicly supported organizations specified in its articles (within the meaning of paragraph (d) of this section). The fact that the actual operations of such organization have been exclusively for the benefit of the specified publicly supported organizations shall not be sufficient to permit it to meet the organizational test.

Regulations section 1.509(a)-4(d) pertains to the organizational test and provides a definition of the term "specified organizations" used in Code section 509(a)(3)(A).

(1) In general. —In order to meet the requirements of section 509(a)(3)(A), an organization must be organized and operated exclusively to support or benefit one or more "specified" publicly supported organizations. The manner in which the publicly supported organizations must be "specified" in the articles for purposes of section 509(a)(3)(A) will depend upon whether the supporting organization is "operated, supervised, or controlled by" or "supervised or controlled in connection with" (within the meaning of paragraph (g) and (h) of this section) such organizations or whether it is "operated in connection with" (within the meaning of paragraph (i) of this section) such organizations.

(2) Nondesignated publicly supported organizations; requirements

(i) Except as provided in subdivision (iv) of this subparagraph, in order to meet the requirements of subparagraph (1) of this paragraph, the articles of the supporting organization must designate each of the "specified" organizations by name unless:

(a) The supporting organization is operated, supervised, or controlled by (within the meaning of paragraph (g) of this section), or is supervised or controlled in connection with (within the meaning of paragraph (h) of this section) one or more publicly supported organizations; and

(b) The articles of organization of the supporting organization require that it be operated to support or benefit one or more beneficiary organizations which are designated by class or purpose and which include:

(1) The publicly supported organizations referred to in subdivision (i)(a) of this subparagraph (without designating such organization by name); or

(2) Publicly supported organizations which are closely related in purpose or function to those publicly supported organizations referred to in subdivision (i)(a) of this subparagraph (without designating such organization by name).

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(ii) If a supporting organization is described in subdivision (i)(a) of this subparagraph, it will not be considered as failing to meet the requirements of subparagraph (1) of this paragraph that the publicly supported organizations be specified merely because its articles of organization permit the conditions described in subparagraphs (3)(i), (ii), and (iii) and (4)(i)(a) and (b) of this paragraph.

(3) Nondesignated publicly supported organizations; scope of rule. —If the requirements of subparagraph (2)(i)(a) of this paragraph are met, a supporting organization will not be considered as failing the test of being organized for the benefit of “specified” organizations solely because its articles:

(i) Permit the substitution of one publicly supported organization within a designated class for another publicly supported organization either in the same or a different class designated in the articles;

(ii) Permit the supporting organization to operate for the benefit of new or additional publicly supported organizations of the same or a different class designated in the articles: or

(iii) Permit the supporting organization to vary the amount of its support among different publicly supported organizations within the class or classes of organizations designated by the articles.

(4) Designated publicly supported organizations

(i) If an organization is organized and operated to support one or more publicly supported organizations and it is “operated in connection with” such organization or organizations, then, except as provided in subparagraph (2)(iv) of this paragraph, its articles of organization must, for purposes of satisfying the organizational test under section 509(a)(3)(A), designate the “specified” organizations by name. Under the circumstances described in this subparagraph, a supporting organization which has one or more “specified” organizations designated by name in its articles, will not be considered as failing the test of being organized for the benefit of “specified” organizations solely because its articles:

(a) Permit a publicly supported organization which is designated by class or purpose, rather than by name, to be substituted for the publicly supported organization or organizations designated by name in the articles, but only if such substitution is conditioned upon the occurrence of an event which is beyond the control of the

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supporting organization, such as loss of exemption, substantial failure or abandonment of operations, or dissolution of the publicly supported organization or organizations designated in the articles:

(b) Permit the supporting organization to operate for the benefit of a beneficiary organization which is not a publicly supported organization, but only if such supporting organization is currently operating for the benefit of a publicly supported organization and the possibility of its operating for the benefit of other than a publicly supported organization is a remote contingency; or

(c) Permit the supporting organization to vary the amount of its support between different designated organizations, so long as it meets the requirements of the integral part test set forth in paragraph (i)(3) of this section with respect to at least one beneficiary organization.

(ii) If the beneficiary organization referred to in subdivision (i)(b) of this subparagraph is not a publicly supported organization, the supporting organization will not then meet the operational test of paragraph (e)(1) of this section. Therefore, if a supporting organization substituted in accordance with such subdivision (i)(b) a beneficiary other than a publicly supported organization and operated in support of such beneficiary organization, the supporting organization would not be described in section 509(a)(3).

In Revenue Ruling 79-197, 1979-1 CB 204 it was held that a newly created nonprofit organization is to pay its future income until a specific amount has been paid to specified organizations described in section 509(a)(1) or (a)(2) of the Code that appoint a majority of its governing body. The organization will dissolve after the specific amount has been paid and will distribute its assets to such specified organizations that a contributor, named in its articles of organization, selects. The organization is a private foundation and not a supporting organization.

Regulations section 1.509(a)-4(e) references the operational 509(a)(3) organization must comply with.

(1) Permissible beneficiaries. —A supporting organization will be regarded as “operated exclusively” to support one or more specified publicly supported organizations (hereinafter referred to as the “operational test”) only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by a specified publicly supported

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organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in §53.4945-4(a)(4) of this chapter. Similarly, an organization will be regarded as “operated exclusively” to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

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

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

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

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

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

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

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

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

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

Regulation section 1.509(a)-4(g) defines the meaning of “operated, supervised, or controlled by”.

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

(ii) A supporting organization may be “operated, supervised or controlled by” one or more publicly supported organizations within the meaning of section 509(a)(3)(B) even though its governing body is not comprised of representatives of the specified publicly supported



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organizations for whose benefit it is operated within the meaning of section 509(a)(3)(A). A supporting organization may be "operated, supervised, or controlled by" one or more publicly supported organizations (within the meaning of section 509(a)(3)(B)) and be operated "for the benefit of" one or more different publicly supported organizations (within the meaning of section 509(a)(3)(A)) only if it can be demonstrated that the purposes of the former organizations are carried out by benefiting the latter organizations.

Regulations section 1.509(a)-4(j) regarding control by disqualified persons states that:

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

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interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

Regulation section 1.508-3(b)(5) states that in the case of an organization which:

(i) Has been classified as an organization described in section 509(a)(1), (2), (3), or (4),  
and

(ii) Subsequently receives a ruling or determination letter stating that it is no longer described in section 509(a)(1), (2), (3), or (4), but is a private foundation within the meaning of section 509, such organization shall have one year from the date of receipt of such ruling or determination letter, or the final ruling or determination letter if a protest is filed to an earlier one, to meet the requirements of section 508(e). Section 508(d)(2)(A) shall not be applicable with respect to gifts and bequests made during this one-year period if such requirements are met within the one-year period.

### GOVERNMENT'S POSITION

The tax exempt status of the ORG remains in effect. However, the foundation status as a 509(a)(3) supporting organization should be modified to that of a private foundation.

Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private foundation is intentionally inclusive so that all organizations exempted from tax by IRC § 501(c)(3) are private foundations except for those specified in IRC § 509(a)(1) through(4). Roe Foundation Charitable Trust v. Commissioner, See Quarrie, supra. The Foundation currently is excepted from private foundation status because it is currently classified as an organization described in section 509(a)(3) which defines supporting organizations.

Public charities (organizations described in section 501(c)(3) that meet the requirement of sections 509(a)(1) or (2)) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations are similarly excepted from private foundation status. Supporting organizations are excepted if they are subject to the scrutiny of public charities that provide sufficient oversight to keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie, 603 F.2d at 1277-78.

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

1) Organizational and Operational Tests under section

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509(a)(3)(A)

- 2) Relationship Test under section 509(a)(3)(B)
- 3) Lack of Disqualified Person Control Test

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons.

### **1) Organizational Test**

The Foundation fails the organizational test.

The Foundation's dissolution clause allows distributions to organizations other than the specified publicly supported organizations upon termination of the Foundation. The possible beneficiaries are not limited to the CO-1 or to the organizations specified on Schedule A of the Foundation's Declaration of Trust.

The language in section 2.4 of the Declaration, applying to the final distribution of funds states that "In the event the Trustee determines, in Trustee's sole and complete discretion, that the Trust is too small to economically administer, then in such event the Trustee shall distribute the Trust Fund in its entirety outright and free of trust to such organization or organizations as described in Section 170(c)(2) of the Code as the Trustee, in Trustee's total and complete discretion, shall determine."

The dissolution clause in section 2.5 of the Declaration must be added to section 2.4 to obtain a complete understanding of the final distribution. Section 2.5 states that "Upon winding up and dissolution of this Trust, after paying or adequately providing for the debts and obligations of the Trust, the remaining assets shall be distributed to a non-profit fund, foundation, or corporation which is organized and operated exclusively for charitable, educational, religious, and/or scientific purposes and which has established its tax exempt status under Section 501(c)(3) of the Code."

Section 2.3 of the Declaration states that "Notwithstanding anything to the contrary contained herein the Trustees appointed by the BM-1 & 2 family reserve the right to change the supported 501(c)(3) tax exempt organization to another 501(c)(3) tax exempt organization, at any time and for any reason if the BM-1 & 2 family appointed board members deem it, in their sole and absolute discretion, to be in the best interest of this Charitable Supporting Organization."

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The "Final Distribution" and "Dissolution" clauses do not state the primary charity is the recipient of the assets upon the dissolution of the Foundation. Per section 2.3, the Trustee can change the primary charity at will. Therefore, the Foundation's Declaration does not meet the organizational test requirements for section 509(a)(3) classification. See Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7<sup>th</sup> Cir. 1979). (holding that the organizational test was not satisfied where the trustee had the power to substitute beneficiaries when, in the judgment of the trustee, the uses of the named beneficiaries became unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public). To comply with the organizational test the assets should be distributed to the primary charity. Therefore, the Declaration does not comply with the organizational test.

## 2) Relationship Test

As set forth in Treas. Reg. § 1.509(a)-4(f)(2), there are three permissible relationships:

- (a) operated, supervised, or controlled by;
- (b) supervised or controlled in connection with; and
- (c) operated in connection with one or more publicly supported organizations.

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

In the present case, three members of the five members of the board are appointed by the supported organization per the Declaration. The remaining two are from the class consisting of BM-1 and BM-2 and each of their descendants (the "BM-1 & 2 family") Therefore, the Foundation has satisfied the requirements of being in a relationship "operated, supervised or controlled by" the primary charity.

## 3) Control by a Disqualified Person

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The Foundation is under the control of disqualified persons. The Foundation is not a supporting organization under Code section 509(a)(3) because it is controlled directly or indirectly by one or more disqualified persons.

BM-1 and his wife BM-2 are disqualified persons because they are substantial contributors. They are the only contributors to the Foundation, and have contributed \$\$ during calendar year ended December 31, 20XX. Therefore, they are substantial contributors and disqualified persons as defined in Code section 4946(a)(1)(A) and (D). BM-1 is the Trustee of the Foundation. Per the Declaration, BM-1 and BM-2 serve on a five member board of directors. However, the Forms 990 for 20XX, 20XX, 20XX and 20XX all state that the only officer, director, trustee and key employee of the Foundation is BM-1.

Treas. Reg. § 1.509(a)-4(j)(1) provides that for purposes of section 509(a)(3)(C), an organization will be considered "controlled" if the person, by reason of his position or authority, may require the organization to perform any act which significantly affects its operations or prevents such organization from performing such act. All facts and circumstances are taken into consideration in determining whether a disqualified person controls an organization. *Id.* There is no indication that any representatives of any of the organizations named in the Declaration of Trust had any input into the operations of the Foundation. There are no minutes. Per the Forms 990, only BM-1 is an officer, director, trustee and key employee. He is listed as the Trustee. Thus, BM-1 is a disqualified person, directly controlling the Foundation.

Further, control by a disqualified person includes, but is not limited to, the right of any substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization. (See Regulations section 1.509(a)-4(j) in the Law section of this report.)

The governing instrument expressly empowers the Trustee to change the primary charity. Section 2.3 of the Declaration states that "Notwithstanding anything to the contrary contained herein the Trustees appointed by the BM-1 & 2 family reserve the right to change the supported 501(c)(3) tax exempt organization to another 501(c)(3) tax exempt organization, at any time and for any reason, if the BM-1 & 2 family appointed board members deem it, in their sole and absolute discretion, to be in the best interest of this Charitable supporting Organization." This language obviously gives the Trustee the authority to select the primary charity as he deems desirable. The Trustee has the authority to unilaterally determine the primary charity. According to Regulation 1.509(a)-4(j) the Foundation is under the control of a disqualified person.

The dissolution and final distribution of assets is another area verifying the Foundation is under the control of a disqualified person. Section 2.4 of the Declaration indicates the "...Trustee shall distribute the Trust Fund in its entirety...to such organization or organizations as described in

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Section 170(c)(2)...in Trustee's total and complete discretion, shall determine." The Trustee also has the power to determine the Trust corpus is too small to economically administer and distribute it to any organization described in section 170(c)(2) he selects.

Also, it is apparent that the primary charity is not controlling the Foundation. No grants were made to it in any of the four years examined despite the requirement that at least 35% of the Foundation's net income be distributed to it each year. The Foundation had net income for CYE 12/31/20XX and 20XX and a net loss for CYE 12/31/20XX and 20XX.

Accordingly, the Foundation should be reclassified as a private foundation because it does not qualify as a supporting organization under the requirements set forth in Treas. Reg. § 1.509(a)-4(j).

The Foundation will not qualify as a 509(a)(1) or 509(a)(2) public charity. With only one contributor it will not pass the support tests applicable to public charities. Therefore, the Foundation is a private foundation.

### **CONCLUSION**

This modification of private foundation status is effective as of January 3, 20XX. Retroactive reclassification is appropriate because the Foundation represented in its exemption application that it would not be under the control of a disqualified person. It was. The Foundation represented that the primary charity would be attentive to its operations. It was not. Therefore, retroactive reclassification to private foundation status is applicable.

The effect of this determination will be that the Foundation is required to file Form 990-PF Return of Private Foundation. The Form 990-PF should be filed for tax years ending December 31, 20XX, 20XX, 20XX, 20XX and 20XX. Subsequent returns are due no later than the 15<sup>th</sup> day of the 5<sup>th</sup> month following the close of the Foundation's accounting period.

Send your returns to the following mailing address:

Internal Revenue Service Center

**Note:**

Form 990-PF is required for each tax year until private foundation status is terminated under IRC 507.