

**Internal Revenue Service**  
Appeals Office  
701 Market Street, Suite 2200  
Philadelphia, PA 19106

**Department of the Treasury**

**Person to Contact:**

Employee ID Number:  
Tel:  
Fax:

**Refer Reply to:**

**In Re:**

EO Revocation

**Form Required to be Filed:**

1120

**Employer Identification Number:**

C

**Tax Period(s) Ended:**

**UIL:**

0501.09-03

Number: **201128037**  
Release Date: 7/15/2011

April 20, 2011

A  
B

**CERTIFIED MAIL**

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3), effective November 1, 2000.

Our adverse determination was made for the following reason(s):

You have failed to operate exclusively for one or more exempt purposes as required by IRC section 501(c)(3). You have not demonstrated that you engage primarily in activities that further an exempt purpose. You have failed to demonstrate that you serve a public rather than a private interest. You have operated more than insubstantially to further private interests and the purposes of substantial contributors and their economic interests.

Contributions to your organization are not deductible under IRC section 170 of the Code.

You are required to file Federal income tax returns on the form indicated above for the tax periods beginning on and after November 1, 2000 for any open tax years. File your return with the appropriate Internal Revenue Service Center per the instructions of the return.

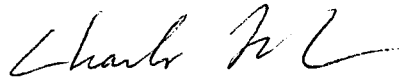
You have waived your right to contest this determination under the declaratory judgment provisions of Section 7428 of the Code by your execution of Form 906, Closing Agreement Concerning Specific Matters, an executed copy of which is being sent to you under separate cover.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. 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 want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

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

Sincerely,



CHARLES FISHER  
TEAM MANAGER

Enclosures:

Notice 1214 Helpful Contacts for your 'Deficiency Notice'

cc:



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

**DEPARTMENT OF THE TREASURY**

Internal Revenue Service  
1100 Commerce St.  
Stop 4920 DAL  
Dallas, TX 75242

May 4, 2009

A=

B=

Taxpayer Identification Number:

C=

Form:

990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

**Certified Mail - Return Receipt Requested**

Dear

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

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

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

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

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

Letter 3618 (04-2002)  
Catalog Number 34809F

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

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

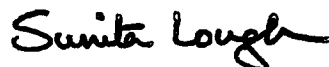
50 South 200 East  
Stop 1005 SLC  
Salt Lake City, UT 84111

Phone:

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,



Sunita B Lough  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

**EXPLANATION OF ITEMS**

Name of taxpayer

Taxpayer Identification Number

Year/Period ended

ORG

EIN

October 31, 20XX

**LEGEND**

ORG - Organization name      XX - Date      EIN - EIN      Family - family  
City - city      State - state      Agent - agent      BM-1, BM-2, BM-3 &  
BM-4 - 1<sup>ST</sup>, 2<sup>ND</sup>, 3<sup>RD</sup> & 4<sup>TH</sup> BM      President - president      V.P. - V.P.  
Secretary - secretary      RA-1, RA-2, RA-3, RA-4, RA-5, RA-6, RA-7, RA-  
8, RA-9, RA-10, RA-11, RA-12 & RA-13 - 1<sup>ST</sup> THRU 13<sup>TH</sup> RA      CO-1 THRU CO-  
35 - 1<sup>ST</sup> THRU 35<sup>TH</sup> COMPANIES

**ISSUE:**

Whether ORG's ("ORG") tax exempt status should be revoked effective November 1, 20XX, because it did not operate exclusively for exempt purposes as described in section 501 (c)(3).

**FACTS:**

ORG was founded in 19XX as non-profit corporation described in sections 509(a)(1) and 170 (b)(1)(A)(vi) of the Code and received recognition of its tax exempt status in November of 19XX. Its organizational documents state that it has the following charitable purposes: First, ORG is to "promote, stimulate and support research in any and all fields of education, and to publish and make available the findings of such research to the public and especially those in the educational professions." Second, ORG is to "give aid and assistance to organizations. . . to enable such organizations to maintain and carry on colleges where students. . . may obtain a sound education. . ." In 19XX, ORG amended its articles to add the following purpose: "to engage in and to perform activities that advance or benefit the educational; cultural; charitable; benevolent; civic, patriotic; social; fraternal; literary athletic; recreational; scientific or agricultural." BM-1 was one of the charter board members, but records show that he has not been on ORG's board for many years and was not on the board for any tax years in this case). Its offices are located in City, State on the campus of CO-1 (CO-1).

During the tax years under audit, its officers/members of the board of directors were:

1.      President, President
2.      V.P., Vice President
3.      Secretary, Secretary

ORG also had 9 other directors on the board. Its articles of incorporation allow for between 3 to 21 board members. According to ORG Board minutes and President, ORG had not been very active as an organization nor did it have any significant financial donors until BM-1 approached it in 19XX to become a supported organization for the then yet-to-be formed CO-2 (CO-2). CO-2 was created on August 22, 20XX, and ORG was named as its primary supported organization. ORG's December 7, 19XX board minutes indicate that there was a request from BM-1 asking that ORG be named CO-2's supported organization and that 30% of CO-2's net income would go to ORG "with BM-1

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maintaining a say over the use of those funds."<sup>1</sup> CO-2 applied for recognition of exempt status on November 9, 20XX, and received a determination letter recognizing it as an exempt organization described under section 501 (c)(3) effective as of August 22, 20XX. The determination letter further classified CO-2 as a supporting organization described in § 509(a)(3). According to its trust agreement, its primary supported organization is the ORG ("ORG"). BM-1 & BM-2 and various FAMILY members owned businesses were the primary contributors to CO-2.

ORG's first "donation" from CO-2 was pursuant to an agreement executed on December 10, 20XX. The agreement specified that ORG agreed to hold a "donation" of \$ in the "BM-1 & BM-2 Fund" until CO-2 received IRS recognition of its tax exempt status. The agreement also stated that an advisory committee, made up of BM-1 & BM-2, could offer written recommendations to ORG as to how money in the fund would be invested or distributed and that the ORG's board can not authorize any distributions that have not been recommended by the committee. Once ORG received the payment, it lent the entire amount to CO-3 ("CO-3"),<sup>2</sup> apparently in a pre-arranged transfer. In fact, the \$\$ check written by BM-1 was directly endorsed over to CO-3. After CO-2 received recognition of its tax exempt status, CO-3 paid ORG \$ plus interest (an additional \$\$). ORG then transferred the entire amount to CO-2 on May 8, 20XX. On the same day that CO-2 received the funds, it turned around and loaned \$\$ to CO-3. Essentially, the \$\$ never left the control of FAMILY or CO-3.

A review of its records shows that since at least 20XX, ORG has not been operating as an organization as described in its incorporation documents. For the most part, ORG merely received funds and then forwarded those funds to wherever/whomever the donor requests. ORG's board minutes and "donor" letters and e-mails show that ORG did not exercise any control over the funds that it receives. The funds were accepted and then simply transferred according to the donors' directions. Sometimes, ORG segregated the money in separate fund accounts, usually named after the donor or recipients, and held them until otherwise directed.

ORG's two largest contributors were CO-2 and RA-1, who was the mayor of City, City during the relevant tax years. There are numerous letters and other documents which show that BM-1, through CO-2, directed ORG specifically as to the use and ultimate recipients of the funds ORG received from CO-2. ORG set up a "BM-1 & BM-2 Fund" where funds from CO-2 would be placed. All of CO-2's "donations" to ORG were directed to be forwarded either to CO-1 for housing scholarships or to other charities.

Most of the funds received from CO-2 were for the purpose of making housing scholarships to CO-1 ("CO-1") students. BM-1 proposed a housing scholarship "arrangement" to CO-1. This arrangement effectively allowed the FAMILY to get back

<sup>1</sup> CO-2's trust agreement was later amended to state that 33 and 1/3<sup>rd</sup> of CO-2's net income would go to support ORG.

<sup>2</sup> CO-3 is an S-Corp owned by BM-1, his six sons, and his sons' various trusts.

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the funds that it gave to ORG for housing scholarships in the form of rent payments, (hereinafter "the Arrangement"). BM-1 controlled the entire Arrangement; the following describes how the Arrangement worked:

1. CO-2 would send a letter or an e-mail every time it would forward a check to ORG. The accompanying letter or e-mail would "recommend" to ORG where those funds should be forwarded. While there were some letters that directed ORG to distribute the funds to other charities, almost all of the letters and emails directed ORG to send the funds to CO-1 (CO-1) to go towards housing scholarships for CO-1 students. These letters contained detailed instructions on where ORG was to send the funds, the amount to be sent, and notifying ORG that CO-1 had been informed to expect the money.
2. The housing scholarship students are required to reside in property owned by CO-4 ("CO-4"). CO-4 is an S-Corporation which owns various real properties. CO-4's shareholders are BM-1 and his six sons, who all own equal shares. CO-4 property is managed by CO-5, an S-corporation also owned by FAMILY members.
3. Once the housing scholarship recipients were selected, the students would be directed to CO-5's property manager who would assist the students in the paper work and in making arrangements to occupy a CO-4-owned property. Once the housing scholarship students occupied a CO-4-owned property, CO-3 would bill CO-1. CO-1 would then pay CO-5 from funds given to it by ORG
4. CO-3 would then forward those funds to CO-4.

CO-1 selected the students for the scholarships. The requirements were the following: full-time status, willingness to sign a rental contract, pay own rental deposit, pay own utilities. Preference was given for those with 3.0 GPA and higher and to upperclassmen.

The IRS interviewed Secretary, ORG's one time Secretary. Although she was not a board member, she attended every board meeting. Secretary stated that she was very concerned over the level of control that CO-2 exercised over ORG in regards to the Arrangement and resigned from ORG in protest. Secretary mentioned that ORG's board never voted on how to disburse the Arrangement money, and that ORG had absolutely no say in how the Arrangement money would be spent. Instead, BM-1, via CO-2, dictated how ORG was to spend those funds and ORG obeyed without question.

ORG's board minutes from December 8, 20XX state that board member BM-3 "reported that BM-1 (through BM-4) said 1) he likes donees to match what he gives and 2) BM-1 to direct where we donate his money." At the next ORG board meeting, on August 7, 20XX, BM-3 asked to amend the December 8, 20XX board meetings minutes to clarify that his comment regarding BM-1's money reflect that ORG was independent and that it "could not be bound by the FAMILY's request" but would be "sensitive" to them.

In addition to its participation in the housing scholarship arrangement, ORG maintained several funds, which were for the benefit of private individuals. ORG

Form 886-A (Rev.  
January 1994)

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solicited and distributed a significant amount of funds to cover medical costs of particular individuals, generally who had some connection to CO-1. For example, in 20XX, ORG made payments of about \$\$ for RA-2, who suffered from Tourette's syndrome. RA-2 was a student at CO-1 and ORG collected donations on his behalf and then paid part of RA-2's hospital bill. The \$\$, which ORG contributed to CO-6 (oncology unit of local hospital), had originally been collected by ORG to cover expenses of cancer patient RA-3, an adjunct CO-1 professor. These funds were only donated to the hospital because RA-3 died before the funds were used for her care. Donations were also solicited for RA-4, who had cancer. She was the wife of a CO-1 student. ORG collected funds to go towards her cancer treatments but she passed away before it could be used for that purpose. ORG stated that the funds, about \$\$, were disbursed in 20XX to help cover RA-4's funeral expenses. ORG received donations in the amount of \$\$ from RA-5 in 20XX to go towards covering the medical expenses for a particular cancer patient. After the patient passed away before receiving the funds, the funds were donated to CO-1's gymnastics team on the decedent's behalf. In 20XX and 20XX, ORG solicited funds in the amount of \$\$ to cover medical costs for CO-1's women's basketball coach, RA-6, who had cancer. According to CO-1, a very minute portion of what was collected was actually paid towards RA-6's bills, because his insurance company began covering more of the costs. When this happened, ORG was directed to put those costs in an "unrestricted" account to be used for other foundation purposes.

ORG also maintained a "CO-21," which accepted donations from RA-1 and from many others. These funds were used to produce civic events designed to increase tourism, including the City Skyfest, the Children's Storybook Cavalcade Parade (Christmas parade), a Shakespeare Festival, and other civic festivals. Some of the funds were used to reimburse the city for expenditures the city made for these events, and some were spent directly for expenditures in connections with these events. According to ORG records, the Mayor submitted an annual accounting to the City Council to demonstrate how the funds were spent.

**Sources of ORG funds**

The ORG provided statements that detail the funds that came into ORG from various donors. The figures and the notations below are taken directly from the statements provided by ORG:

**Tax Years ending October 31**

20XX	20XX	20XX	20XX	20XX	20XX	19XX	1998
RA-7 -STOCK							
BM-1							
BM-1 Foundation*							
CO-21:							



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RA-1

Other Donors

Christmas Sodety

Christmas Parade Roats

CO-7

City Rotary

RA-8

RA-9

CO-8

CO-9

CO-10"\*

RA-10

RA-11

CO-11

CO-12

RA-12

RA-4 donors

RA-6 donors\*\*

CO-13

RA-3

Sub Total

Interest

Total Income

\*While ORG's records refer to an organization called the BM-1 Foundation, by all other indications, they are actually referring to CO-2.

As the schedule shows, ORG received a total of \$ from contributions during the tax years ending October 31, 20XX through 20XX (four years preceding the last taxable year that was reviewed, 20XX). Donors who contributed an aggregate of more than \$\$ and who are in excess of \$\$ (2% of the \$ in total support) are BM-1, CO-2, RA-1 and the CO-13. The major contributors during this time period were CO-2, which contributed \$ (but ORG's records, show the contribution to be \$\$), BM-1, who contributed \$\$, and RA-1 who contributed \$\$.

Funds that went through ORG to various recipients:

The ORG provided what they call expense statements that detail the funds that went through ORG from various donors to their ultimate recipients. The figures and the notations in the schedule below are taken directly from the statements provided by ORG.

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Please note that ORG's "expense" sheet below does not distinguish between CO-2 and  
BM-1's contributions:

Tax Years ending October 31

20XX	20XX	20XX	20XX	20XX	20XX	19XX	1998
For BM-1							
CO-1							
CO-13							
Returned to BM-1							
CO-14							
CO-15							
CO-16							
CO-1							
CO-17							
CO-18							
CO-19							
For CO-21							
CO-20							
Christmas Parade							
City Christmas Society							
CO-15							
CO-22							
CO-23							
CO-24 -CO-9							
CO-25							
CO-1							
CO-1							
CO-26							
RA-3							
Development							
CO-1							
CO-1							
CO-27							
CO-28							
CO-29							
CO-30							
CO-31							

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CO-32

CO-1

CO-33 -RA-2

For RA-4

CO-1 CO-34

CO-35

CO-6

Misc

Total

LAW

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

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

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under section 501 (c)(3).

In Easter House v. United States, 12 Cl. Ct. 476 (1987), *aff'd.*, 846 F. 2d 78 (Fed Cir. 1978), the Court of Federal Claims considered whether an organization that provided adoption and related health services to pregnant women who agree to place their

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newborns for adoption through the organization qualified for exemption under section 501 (c)(3). The court concluded that the organization did not qualify for exemption, in part, because the organization did not provide the health-related services to pregnant women who would keep their newborns or use the adoption services of another agency. Therefore, the court found that the organization's business purpose rather than a charitable purpose was the organization's primary goal.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that a school that individuals to become political campaign professionals was not entitled to exemption under section 501 (c)(3) because it was operated in a manner designed to train individual who would work for a particular political party. Accordingly, the court found the school to be serving a private interest within the meaning Treas. Reg. section 1.501 (c)(3)-1 (d)(1 )(ii).

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd. 166, F. 3d 1200 (2<sup>nd</sup> Cir. 1998), the court denied exemption under section 501 (c)(3) to an organization formed to raise funds for distribution for charitable causes because its fundraising activities also benefitted its founders. The fundraising activities, which consisted of selling instant lottery tickets, were held at its founders' lounge. The court found that a substantial purpose of the activities was to benefit the lounge by attracting new patrons and discouraging existing patrons from abandoning the lounge in favor of other establishments that sold lottery tickets.

Revenue Ruling 72-147, 1972 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under section 501 (c)(3) because it gave preference to employees of a business operated by the individual who also controlled the organization. Although providing housing for low income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than the public interest.

**TAXPAYER POSITION:**

In correspondence dated June 3, 20XX, ORG filed timely PROTEST with a request to seek a meeting with Appeals. ORG provided the following in support of their position:

*We are in receipt of the letter dated May 4, 20XX, and the attached report from the Service's examining agent. On behalf of the taxpayer, ORG (the 'Foundation'), we hereby protest the proposed revocation of the Foundation's tax exempt status under § 501(c)(3) of the Internal Revenue Code of 19XX as amended effective November 1, 20XX. We further protest the Service's alternative position that the Foundation be reclassified as a private foundation.*

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1. *The Foundation disputes the retroactive revocation identified in Form 886A, which would modify the Foundation's status as a publicly-supported charitable organization under Code § 501(c)(3) effective as of November 1, 20XX and that the Foundation is excluded from reliance on the Foundation's Determination Letter.*
2. *The Foundation disputes that more than an insubstantial part of its activities serves non-exempt purposes.*
3. *The Foundation disputes that it operates for the private benefit of the FAMILY related business.*
4. *The Foundation disputes that it operates for the private benefit of the individuals for whom it paid medical expenses.*
5. *The Foundation disputes that it fails the support tests and that it should be reclassified as a private foundation.*

**GOVERNMENT POSITION:**

The presence of a single substantial nonexempt purpose can destroy exemption regardless of the number or importance of an organization's exempt purposes. *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945); *Schoger Foundation v. Commissioner*, 92 TC. 380 (1981); *American Campaign Academy v. Commissioner*, 92 TC. 1053, 1065 (1989); *Orange County Agricultural Society, Inc. V, Commissioner*, 893 F. 2d 529 (2<sup>nd</sup> Cir. 1990). The operational test of Treas. Reg. § 1.501(c)(3)-(c)(1) is designed to insure that an organization's resources and activities are devoted to furthering exempt purposes. The operational test examines the actual purposes of an organization's activities and is not as concerned with the nature of those activities or the organization's statement of purpose. In order for an organization to meet the operational test, it must show that no more than an insubstantial part of its activities fail to further an exempt purpose, and that it serves a public rather than a private interest. Treas. Reg. §§ 1.501(c)(3)-1 (c)(1) and 1.501(c)(3)-1 (d)(1)(ii).

When an organization operates for the benefit of private interests, if that benefit is substantial, the organization by definition does not operate exclusively for exempt purposes. In *American Campaign Academy*, the Tax Court upheld the IRS' revocation of its tax exempt status on the basis of private benefit, because its activities provided a substantial benefit to a partisan political party. The Tax Court determined that this private benefit furthered nonexempt purposes revoked the petitioner's tax exempt status. It is also important to note that the private benefit is not limited to just monetary gains. In *American Campaign Academy*, the Tax Court found that there was a private benefit even though the benefit was to further a partisan purpose, not a financial one.

Unlike the concept of private inurement, private benefit can exist when an organization confers a benefit on persons not having a personal and private interest in the activities of an organization, Le., disinterested third parties. *American Campaign Academy*, 92 T C. at 1068-69.

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A substantial part of ORG's activities consistent of delivering funds to be used for housing scholarships at CO-1. The funds used for the scholarships were derived from BM-1 via CO-2. BM-1 claimed charitable contribution deductions for the funds he "contributed to CO-2 that were ultimately transferred to ORG earmarked to be used for the housing scholarships. The scholarships were provided solely to students that stayed at housing owned by the FAMILY's corporation. The scholarship funds ultimately ended up in the FAMILY's pocket. Thus, ORG helped to facilitate a circular-financing arrangement that benefitted BM-1.

ORG did not operate exclusively for exempt purposes, because more than an insubstantial part of its activities was in furtherance of nonexempt purposes--the benefit of private interests. With respect to ORG's relationship with CO-2, ORG allowed itself to be used by BM-1 and CO-2 to further the business interests of the FAMILY enterprises. ORG maintained no control over the funds it received from CO-2, but merely did as BM-1 directed. ORG's board minutes demonstrate that, with respect to the funds it received from CO-2, it operated under the control of BM-1 and did not exercise any independent judgment as to how the funds would be used. ORG allowed itself to used as a conduit for the FAMILY funds, and to further the private interests of the FAMILYs. By providing scholarships only to students that rented housing from the FAMILYs, ORG, like the organizations mentioned in Easter House, American Campaign Academy and Rev. Rul. 72-147, furthered a substantial nonexempt business purpose and furthered private interests.

ORG also accepted "donations" for the benefit of particular private individuals, to pay for their health care. While the assistance that ORG provided to RA-2, RA-4, and others is admirable, it is not in furtherance of an exempt purpose because it does not benefit a charitable class of individuals in an objective and nonselect manner. In *The Church in Boston v. Commissioner*, 71 T.C. 102, the Tax Court held that where petitioner made grants to a variety of individuals allegedly in need, it had no "documented criteria which would demonstrate the selection process of a deserving recipient, the reason for specific amounts given, or the purpose of the grant," and thus was not operating in furtherance of exempt purposes. In *The Church in Boston*, there was no information to allow the IRS to determine "whether the grants were made in an objective and nondiscriminatory manner and whether the distribution of such funds was made in furtherance of an exempt purpose." Similarly, the Court in *La Verdad v. Commissioner*, 82 TC. 215, stated that "the distribution of grants must be made in an objective and nondiscriminatory manner in order to constitute an activity in furtherance of an exempt purpose." 82 TC. at 220. See also, *Solutions Plus, Inc. v. Commissioner*, TC. Memo 20XX-21 (A charitable organization's programs must also benefit the members of a recognized charitable class in a "nonselect manner," citing *American Campaign Academy*, 92 TC. at 1077).

There is no evidence in the case of ORG that the grants were made in an objective or nonselect manner. In fact, it appears that just the opposite occurred. ORG solicited the

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funds to make the grants, not to benefit the general class of those with illnesses, but for specific individuals. For example, ORG solicited funds from the general public, specifically for the purpose of paying the medical expenses of RA-2. By doing so, ORG served the private interests of RA-2. There is no evidence in the scant Board minutes or any other records as to how the decisions were made to engage in these activities. What is known is that more than an insubstantial part of ORG's activities was the solicitation and use of funds for particular individuals in the community.

Therefore, ORG's tax exempt status should be revoked on grounds that more than an insubstantial part of its activities serves non-exempt purposes and it operates for the private benefit of the FAMILY related businesses and the individuals for whom it paid medical expenses. Revocation is proposed effective November 1, 20XX, the year in which ORG entered into the relationship with CO-2.

**CONCLUSION:**

Because more than an insubstantial part of its activities serves non-exempt purposes and it operates for the private benefit of the FAMILY related businesses and the individuals for whom it paid medical expenses, ORG's

Determination Letter, granting exemption under Section 501 (c)(3) of the Code should be revoked effective November 1, 20XX.

ORG's formal protest, request for Appeal dated June 3, 20XX and analysis is of no consequence to the argument submitted by the Service.

**ALTERNATIVE ARGUMENT:**

**LAW**

Section 509(a) of the Code states that all organizations, domestic or foreign, described under §501(c)(3) will be considered private foundations unless the organization can also be described under §§ 509(a)(1) and 170(b)(A)(vi); or §509(a)(2).

I.R.C §§ 509(a)(1) and 170(b)(1)(A)(vi) organizations normally receive a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (a) from governmental units referred to in subsection (c)(1) or from direct or indirect contributions from the general public.

Section 1.170A-9(e) of the Regulations will consider organizations as publicly supported for the current year if the organization normally receives at least 33 1/3 percent of its total support from a governmental unit or the general public in the four taxable

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years immediately preceding the current taxable year. Contributions by an individual, trust, or corporation shall be taken into account as "support" from direct or indirect contributions from the general public only to the extent that the total amount of the contributions by any such individual, trust, or corporation does not exceed 2 percent of the organization's total support.

Section 509(a)(2) of the Code, in relevant part, includes a domestic or foreign organization described in §501 (c)(3) that normally receives more than one-third of its support in each taxable year from any combination of gifts, grants, contributions, and gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business from persons other than disqualified persons (as defined in section 4946) with respect to the organization; and normally receives not more than one-third of its support in each taxable year from the sum of gross investment income and the excess of the amount of the unrelated business taxable income over the amount of the tax imposed by section 511.

Section 4946(a)(1) of the Code, in relevant part, defines a "disqualified person" as a person who is

- (A) a substantial contributor to the foundation,
- (B) a foundation manager (within the meaning of subsection (b)(1)),
- (C) an owner of more than 20 percent of
  - (i) the total combined voting power of a corporation,
  - (ii) the profits interest of a partnership, or
  - (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,
- (D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (8), or (C),
- (E) a corporation of which persons described in subparagraph (A), (8), (C), or (0) own more than 35 percent of the total combined voting power,
- (F) a partnership in which persons described in subparagraph (A), (8), (C), or (0) own more than 35 percent of the profits interest,
- (G) a trust or estate in which persons described in subparagraph (A), (8), (C), or (0) hold more than 35 percent of the beneficial interest,

ORG's public charity status should also be revoked. ORG fails to meet the 33 and 1/3<sup>rd</sup> support test for either

I.R.C. §§ 509(a)(1)/170(8)(1)(A)(vi) or 509(a)(2) organizations. Therefore, it should be reclassified to a private foundation. Please see the calculations, marked as Exhibits 1 and 2, which clearly show that ORG fails all of the public support tests.

**CONCLUSION:**



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Because ORG did not satisfy the required support tests, ORG should be reclassified as a private foundation.

Date: 7/18/20XX

Taxpayer's name: ORG

Period: 10/31/20XX

Examiner's name: AGENT

**Public Support Test -IRE 170(b)(1)(a)(vi) and 509(a)(1)**

Public support	\$	
Total support	\$	
509(a)(1) test	%	Facts/ Fail

This computation should not be considered if the organization is primarily supported on gross receipts from related activities. See Regulations 1.170A-9(e)(7)(ii).

Date: 7/18/20XX

Taxpayer's name: ORG

Period: 10/31/20XX

Examiner's name: AGENT

**Public Support Test – IRC 509(a)(2)**

Public Support	\$	
Total Support	\$	
Over 1/3 Support	%	Fail
Under 1/3 Support Test (Investment income and Net income from UBI)	%	Fail

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