



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street
Dallas, TX 75242

501-03.00

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Date: September 12, 2011

Release Number: **201149033**

Release Date: 12/9/2011

LEGEND

ORG - Organization name

ORG
ADDRESS

Person to Contact:

Badge Number:

Contact Telephone Number:

Contact Address:

Employer Identification Number:

CERTIFIED MAIL

Dear

This is a final notice of adverse determination that your exempt status under section 501(c) (3) of the Internal Revenue Code is revoked. Recognition of your exemption under Internal Revenue Code section 501(c)(3) is revoked effective January 1, 20XX for the following reason(s):

You are not operated exclusively for an exempt purpose as required by Internal Revenue Code section 501(c)(3). You are not and have not been engaged primarily in activities which accomplish one or more exempt purposes. You are not a charitable organization within the meaning of Treasury Regulation 1.501(c)(3)-1(d); rather, your activities further a substantial nonexempt commercial purpose and serve private rather than public interests.

Contributions to your organization are no longer deductible effective January 1, 20XX.

Since your exempt status has been revoked, you are required to file Form 1120, U.S. Corporation Income Tax Return, for all years beginning on or after January 1, 20XX.

Income tax returns for subsequent years are to be filed with the appropriate Service Center identified in the instructions for those returns.

It is further determined that your failure to file a written appeal constitutes a failure to exhaust your available administrative remedies. However, if you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia before the (ninety-first) 91st day after the date that this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment.

To secure a petition form, write to the following address: United States Tax Court, 400 Second Street, NW, Washington, DC 20217.

Please understand that filing a petition for a declaratory judgment under IRC section 7428 will not delay the processing of subsequent income tax returns and assessment of any taxes due.

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 the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in 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.

This letter should be kept within your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892

Internal Revenue Service

Department of the Treasury
TEGE Exempt Organizations Examinations
1100 Commerce Street
Dallas, TX 75242

Date: April 4, 2011

Taxpayer Identification Number:

Form:

ORG
ADDRESS

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publications 892 and 3498
Agreement Form 6018
Report of Examination

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

ISSUE

Whether ORG located in City, State, continues to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code?

FACTS

ORG (ORG) was granted tax-exempt status as a Section (§) 501(c)(3) organization in August 20XX. The organization conducted its operations out of City, State. According to its Articles of Incorporation dated May 10, 20XX, the purposes of ORG are as follows.

The Corporation is organized and shall be operated exclusively for charitable and educational purposes, within the meaning of Sections 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"), including, without limitation, providing therapeutic riding lessons to disabled and at risk children and adults for the purpose of improving or developing the individual's overall well-being.

Per the organizations' May 10, 20XX articles, no director or officer of the corporation, nor any private individual, shall be entitled to share in the distribution of any of the corporate assets upon dissolution of the corporation or the winding up of its affairs. All remaining assets, after liabilities are paid, are to go to a like 501(c)(3) organization.

The last Form 990 submitted by the organization was for the tax year ending December 31, 20XX, was received on August 20, 20XX by the Internal Revenue Service (IRS). The exempt purpose for the organization as stated was to "provide therapeutic riding to disabled children and adults."

The return for the year ending December 31, 20XX, was marked as a final return by the organization. However, the organization failed to attach documents required by the form instructions for a termination. The return lacked a certified copy of articles of dissolution, and a plan of liquidation or termination. The return also lacked a schedule listing the names and addresses of all persons who received the assets distributed in liquidation or termination, the kinds of assets distributed to each, and each asset's fair market value. Additionally, the return indicated assets remaining at the end of the fiscal year, as reported on the Balance Sheet. Further, upon dissolution, ORG should have attached a statement explaining what took place. The return also lacked this statement. The Balance Sheet showed total assets of \$ comprised of land, buildings, equipment cost less accumulated depreciation as of December 31, 20XX. The Balance Sheet also showed a net assets/fund balance of \$ as of December 31, 20XX. Accordingly, this return was not accepted as final by the Internal Revenue service, and the organization is still listed as active per IRS records.

A review of the web site for the State Secretary of State showed that the organization was administratively dissolved on November 9, 20XX, and remains so.

The State Department of Justice's Charitable Activities Section (DOJ) investigated the organization in 20XX for the period May 20XX through April 20XX. The DOJ investigator issued a final report dated March 5, 20XX (attached as Exhibit 1). The issues stated on the final report were disposal of charitable assets,

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inurement of insiders, excess benefit transactions and theft. At the close of the investigation, the investigator secured an Assurance of Voluntary Compliance with an officer of ORG, DIR-1. Per that agreement. DIR-1 is prohibited from any involvement with nonprofit organizations.

The State DOJ referred ORG to the IRS due to the excess benefit transactions issues, which could affect its federal tax-exempt status. As a result of the referral, the IRS opened an examination of ORG due to the multiple instances of non-exempt and illegal activities.

The State DOJ investigator's final report reveals the following:

- (1) The property owner evicted ORG from their program service location in February 20XX. ORG did not resume program services elsewhere subsequent to the eviction. The eviction was due to failure to pay rent.
- (2) In December 20XX, the Board of Directors received a \$ grant from the CO-1, which they used for personal gain by cash withdrawals and forged checks.
- (3) DIR-1, a director, sold two of the six horses owned by ORG to private individuals (RA-1) in exchange for \$, hay and sawdust pellets. DIR-1 also gave these same individuals a rototiller owned by the ORG.
- (4) DIR-1 sold a horse trailer owned by ORG, for which ORG paid \$, to a private individual (unnamed) for \$.
- (5) DIR-1 sold mats and water troughs to nonprofit corporation CO-2 (amount unknown).
- (6) DIR-1 and RA-1 held a month long garage sale in April 20XX, selling ORG's fencing, tack, furniture and equipment. There is no record of this money being deposited into ORG's bank accounts. Further, the former treasurer, RA-2, stated that checks were made payable to DIR-1 not ORG.
- (7) ORG owned an expensive horse named Keno, valued between \$ and \$ which was sold by DIR-1 in September or October 20XX. There is no record of the proceeds being deposited into ORG's bank account.
- (8) A second horse trailer was sold to CO-3 for \$. The trailer was valued between \$ and \$.
- (9) Between October and December 20XX, DIR-1 and RA-3, both directors, received checks for \$ each from ORG's initial supporter, RA-4, presumably to support ORG. However, the DOJ investigator could find no record of the checks being deposited or used for ORG.
- (10) For the period between August 20XX and June 20XX, there were 16 instances of checks being written by RA-3 to herself forging RA-2's signature. RA-3 was not an authorized signer on the accounts of ORG. Total dollar amount of these checks is \$.
- (11) For the period between August 20XX and June 20XX, there are nine instances of checks written by RA-2 either to herself or to cash. There is no evidence that the checks were deposited into her account, rather the investigator presumes they were cashed. The total amount is \$.

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(12) On January 23, 20XX, a cash withdrawal for \$ was made. The recipient is unknown. There is no evidence of deposit in RA-2, RA-3, or DIR-1's accounts.

(13) DIR-1 and RA-3 live together. RA-3 has gone through bankruptcy. She spends a considerable amount of money on State lottery video poker. DIR-1 is employed by Wal-Mart and RA-3 is a nurse.

(14) On June 8, 20XX, a final withdrawal of \$ was made to close ORG's bank account.

On December 17, 20XX, the IRS commenced an examination for the period ended December 31, 20XX by issuing a customized cover letter and Information Document Request (IDR) Number 001 to the ORG address on file in City, State. Since the IRS had sufficient information indicating that the organization was shutting down in 20XX and 20XX, IDR Number 001 requested that the organization submit documentation showing they had properly dissolved as an exempt organization, asset disposition records, and a statement as to the disposition of the organization's net assets. A response was due 30 days from the date of the letter, January 17, 20XX.

The initial correspondence sent December 17, 20XX, was returned unopened to the examining agent's office on December 30, 20XX, marked as "undeliverable."

On December 30, 20XX, the agent re-sent the original contents of the envelope via certified mail to the last known address of the former director, DIR-1, in City, State. This mailing was returned unopened to the examining agent's office on January 13, 20XX, marked as "undeliverable."

On January 19, 20XX, the agent sent a postal tracer to the Postmaster in City, State, requesting the last known address for ORG. The tracer was returned without an updated address, stating "Not Known at Address Given."

On January 20, 20XX, the agent re-sent the original contents of the envelope via certified mail to the address of the former treasurer, RA-2. RA-2 called a few days later and said she would try to locate any records she may have for ORG and send them to the agent. She stated that when she left the organization in 20XX, she handed over all of the records to RA-3 and DIR-1, so she was not sure she would have anything to provide to the agent. She called agent on March 1, 20XX, and advised that she did not have any records to provide to the agent.

To date, the agent has not received any additional documentation for this case other than what was provided by the State DOJ.

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.

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IRC § 6001 provides that every person liable for any tax imposed by the IRC, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

IRC § 6033(a)(1) provides, except as provided in IRC § 6033(a)(2), every organization exempt from tax under § 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws. The Secretary may also prescribe by forms or regulations the requirement of every organization to keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

IRC § 6043(b) provides that every organization which for any of its last 5 taxable years preceding its liquidation, dissolution, termination, or substantial contraction was exempt from taxation under § 501(a) shall file such return and other information with respect to such liquidation, dissolution, termination, or substantial contraction as the Secretary shall by forms or regulations prescribe; except that —

6043(b)(1) no return shall be required under this subsection from churches, their integrated auxiliaries, conventions or associations of churches, or any organization which is not a private foundation (as defined in § 509(a)) and the gross receipts of which in each taxable year are normally not more than \$5,000, and

6043(b)(2) the Secretary may relieve any organization from such filing where he determines that such filing is not necessary to the efficient administration of the internal revenue laws or, with respect to an organization described in § 401(a), where the employer who established such organization files such a return.

Treasury Regulations (Treas. Reg.) § 1.503(c)(3)-1(c) Operational Test

(1) Primary activities. —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.

(2) Distribution of earnings. —An organization is not operated exclusively for one or more exempt purposes of its net earnings inure in whole or in part to the benefit of private shareholders or individuals. For the definition of the words “private shareholder or individual”, see paragraph (c) of §1.501(a)-1.

Treas. Reg. § 1.6001-1(c) states that in addition to such permanent books and records as are required by paragraph (a) of this section with respect to the tax imposed by section 511 on unrelated business income of certain exempt organizations, every organization exempt from tax under section 501(a) shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033. See section 6033 and §§1.6033-1 through -3.

Treas. Reg. § 1.6001-1(e) states that the books or records required by this section shall be kept at all times available for inspection by authorized Internal Revenue Service officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any Internal Revenue law.

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Treas. Reg. § 1.6033-1(h)(2) provides that every organization that has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the District Director for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of subchapter F (section 501 and the following), chapter 1 of the Code and IRC § 6033.

Revenue Ruling 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The IRS held that the failure or inability to file the required information return or otherwise to comply with the provisions of IRC § 6033 and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

In accordance with the above cited provisions of the Code and Regulations under IRC § 6001 and 6033, organizations recognized as exempt from federal income tax must meet certain reporting requirements. These requirements relate to the filing of a complete and accurate annual information (and other required federal tax forms) and the retention of records sufficient to determine whether such entity is operated for the purposes for which it was granted tax-exempt status.

TAXPAYER'S POSITION

The taxpayer's position is unknown at this time.

GOVERNMENT'S POSITION

ORG has failed to show that they meet the operational test for a § 501(c)(3) organization for the year under examination. In order to meet the operational test, they must show that they engage 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. Further, an organization is not operated exclusively for one or more exempt purposes of its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

From the State DOJ report we know that they lost their lease, ceased operations in 20XX, proceeded to sell or give away their assets, and divested themselves of their cash in 20XX and 20XX. They inappropriately sold or gave away their assets to non-§501(c)(3) organizations or individuals, thereby violating the law under §501(c)(3). In divesting their cash, there were multiple instances spanning three years (20XX to 20XX) where ORG's funds were inappropriately or illegally diverted from ORG to the officers. These activities are strictly prohibited by IRC § 501(c)(3) and Treas. Reg. 1.503(c)(3)-1(c).

The organization has demonstrated from the aforementioned that they did not operate for charitable purposes for the year under examination and in the year prior. Net earnings inured to the benefit of directors, which precludes the organization from being operated exclusively for exempt purposes. Without any operations, their main activities were divesting the assets, which is not an exempt purpose of a §501(c)(3) organization.

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During the examination, the agent attempted numerous times to contact the organization and officers, using numerous last known addresses. After many letters returned as "undeliverable," the last letter sent to the former treasurer elicited a response. RA-2 attempted to locate ORG records, including those supporting the distribution of assets. She was unable to find any.

ORG has failed to provide information about its exempt status, as required by the Code and Regulations. (IRC §6033(a)(1) and Treas. Reg. § 1.6033-1(h)(2)). By not complying with the Code and Regulations, the organization has jeopardized its exempt status. The IRS has only the State DOJ's report to show that the organization was not operating for exempt purposes. The organization has provided nothing to the contrary.

Since the check forgery and diversion of assets and cash occurred in 20XX and 20XX, the government believes that revocation back to the earliest documented instances of inurement is appropriate. The government proposes revocation of ORG's exempt status beginning January 1, 20XX.

CONCLUSION

ORG attempted to file a final return for the period ended December 31, 20XX and terminate its exempt status. However, since the IRS has information regarding non-exempt activities of the organization, termination of exempt status in this case is inappropriate.

During the examination, ORG failed to provide any records, as required by IRC §6033(a)(1). They have jeopardized their exempt status by failing to comply with record keeping requirements. Further, they have operated in a manner inconsistent with their exempt status in the distribution of their assets.

As a result of the examination, the IRS has determined that ORG has failed to operate for exempt purposes as a §501(c)(3) organization. They have ceased operations, inappropriately sold or given away their assets, and misappropriated funds. Accordingly, since the organization failed to operate primarily for exempt purposes their exempt status is revoked effective January 1, 20XX.