



**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: **201203020**

Release Date: 1/20/2012

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Since your exempt status has been revoked, you are required to file Form 1120, U.S. Corporation Income Tax Return, for all years beginning on or after January 1, 20XX.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

TE/GE Exempt Organizations Examinations Division  
915 Second Avenue, M/S W540  
Seattle, Washington 98174

Date: June 3, 2011

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

**Certified Mail - Return Receipt Requested**

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination  
Form 6018  
Form 4621-A

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

**LEGEND**

ORG - Organization name      XX - Date      City - city      State - state      Country -  
country      website - website      President - president      DIR-1 - 1<sup>st</sup> DIR      ACC-1 &  
ACC-2 - 1<sup>st</sup> & 2<sup>nd</sup> ACC      RA-1 through RA-7 - 1<sup>st</sup> through 7<sup>th</sup> RA      CO-1 through CO-34 -  
1<sup>st</sup> through 34<sup>th</sup> COMPANIES

**ISSUE:**

Whether the ORG (herein referred to as "ORG") is operated exclusively for exempt purposes within the scope of section 501(c)(3).

- Whether there is a substantial nonexempt commercial purpose served by the organization in that the organization is also providing significant private benefit to the organization's insiders, recipients, or contributors?

**FACTS:**

The ORG was incorporated on December 6, 20XX, as a non-profit corporation in the state of State. Previously, ORG was known as the ORG-1, a for-profit organization. The ORG-1 had the same purpose and goal as the ORG.

The ORG Articles of Incorporation state the purposes of the organization as follows:

"The Corporation is organized and shall be operated not for profit but exclusively for the promotion of the public interest by means of supporting charitable, educational, and scientific activities within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986 as amended. In furtherance of this objective, the Corporation shall have the following purposes:

- a) As provided at Section 509(a)(3) of the Internal Revenue Code, the Corporation shall be organized and operated exclusively for the benefit of, to perform the charitable functions of, or to carry out the charitable purposes of publicly supported organizations described in Section 509(a)(1) and 509(a)(2) of the Internal Revenue Code and Treasury Regulation Section 1.509(a)-4. Specifically, the Corporation shall be operated, supervised, or controlled by the following State nonprofit public benefit corporations: CO-1, CO-2 and CO-3, CO-4, CO-5, CO-6, North CO-4, CO-7 (the "Supported Organizations") and other similar organizations identified as set forth by the bylaws.
- b) The Corporation shall conduct activities and operations in order to improve communities, revitalize their economies and protect and utilize the State of State's natural resources.
- c) In the event the Supported Organizations cease operations, dissolve, or lose tax exemption, the Corporation's Board of Directors may designate another Section 509(a)(1) or 509(a)(2) organization to receive support, provided the designated organization is operated for charitable purposes similar to those of the Supported Organizations.

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

d) The Corporation shall have and exercise all rights and powers conferred on non-profit organizations under Section 35-2-118 of the State Nonprofit Corporation Act; provided, however, that the Corporation shall not engage in any activities or exercise any powers that are not in furtherance of the stated purposes of the Corporation.

The Articles also states that ORG is governed by Board of Directors, appointed by the supported organizations.

ORG' bylaws state that all powers are under the authority of the board of directors and that all business affairs are managed by the board of directors. They further state that the board of directors shall not be controlled by a disqualified persons and that each member of the board of directors shall have one vote.

The organization bylaws also state that ORG shall have as officers a President, Vice President, Treasurer, and a Secretary, and that the board of directors elects the officers on an annual basis.

The president's duties are controlled by the board of directors. The president manages the business affairs of the organization. The duties of the secretary shall be to create and maintain books and to be a custodian of the corporate records. The treasurer is responsible for all funds and securities of the corporation and shall receive and give receipts for moneys due and payable to the Corporation from any source, deposit all moneys in the Corporation's name, and submit the books and records to a Certified Public Accountant or other accountant for annual audit or review.

Additionally, the organization original bylaws also state that the organization will not have members.

### **Form 1023, Application for Recognition of Exemption**

In an application dated March 20XX, ORG applied for recognition as a tax exempt organization under section 501(c)(3) as a 509(a)(3) Type I organization, "operated, supervised and controlled by" one or more supported organizations.

ORG stated the following with regard to its past, present, and planned activities:

Applicant is organized to support the charitable activities of the following State nonprofit public benefit corporations described in Code Section 509(a)(2) and determined to be tax exempt pursuant to Code Section 501(c)(3) by the IRS: CO-15, CO-2 and CO-3, CO-4, CO-5, CO-6, North CO-4, CO-7, and other similar organizations identified as set forth by the Applicant's bylaws (the "Supported Organizations").

Applicant will improve communities, revitalize their economies and protect and utilize the State of State's natural resources by assisting with forest conservation programs that promote the

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

reforestation and management of forestlands which in turn helps to reduce soil, water and air degradation, while providing for enhancement of wildlife and recreational opportunities.

One hundred percent of Applicant's resources will be dedicated to conducting charitable programs or providing grants to its supported organizations.

- The primary charitable program to be conducted on behalf of the Supported Organizations is the development of incentive programs using "carbon offset credits" to corporations and other large polluters to fund environmental projects that will result in the replacement of forests and other similar natural resources that assist in cleansing the "green house gases" produced by carbon emissions.
- Dedicated to providing the educational programs, technical assistance, and financial support to the Supported Organizations for purposes of carrying out these environmental programs
- Applicant's employees and officers will be the primary agents responsible for conducting the oversight of Applicant's programs

ORG stated the following with respect to the relationship tests with the publicly supported organization its supports:

Applicant will be "operated, supervised, or controlled by" publicly supported organizations. Because the organization's articles and bylaws indicate that all of the members of the Applicant's board of directors will be appointed by the Supported Organizations.

The ORG stated the following with regard to its fundraising programs:

Applicant expects to receive federal and private grants for purposes of supporting Applicant's charitable programs. Additionally, Applicant expects to receive revenue from fees generated for administering its charitable conservation programs."

Based on the information provided in ORG's exemption application, on April 25, 20XX ORG was issued a determination letter advising the organization of recognition of exempt status under Section 501(a) as an organization described in Section 501(c)(3) of the Code and classified as a supporting organization described in Code section 509(a)(3).

As stated by President during the initial interview, the President of ORG is also a board member. President further stated that the Vice President and Secretary/Treasurer are in name only with no actual duties.

During the examination, it was disclosed that on October 18, 20XX, the organization amended its bylaws. The amended bylaws state that the organization shall have affiliate membership. The purpose of the affiliate members are as follows:

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

“Affiliate members shall be individuals or firms who have interest requiring information concerning carbon sequestration, and are in sympathy with the objectives of the Board. The dues of Affiliate Members shall be in such amounts as established annually by the Board of Directors.”

The IRS was not notified of this change to the organization’s bylaws.

**Form 990, Return of Organization Exempt From Income Tax**

The ORG Form 990 described its program service activities as follows:

The ORG Form 990 described its activities in relation to the accomplishment of its exempt purpose(s) as follows:

The ORG did not list the organizations it provided support nor identify that ORG was a supporting organization on its Form 990. ORG described itself as “an organization that normally receives a substantial part of its support from a governmental unit or from the general public section 170(b)(1)(A)(vi)” (within Part IV of the Form 990, line 11a).

The ORG’s Form 990 reported the following revenue source:

	<u>TY 20XX</u>	<u>TY 20XX</u>
Contributions, gifts, grants:		
Direct public support	\$	
Govt. contributions and grants	\$	
Interest on saving/investments	\$	
 Total Revenue	 \$	

The ORG 20XX Form 990 reported that its officers and directors were not involved in the daily operation of the organization, as zero time was applied to section Part V-A, Current Officers, Directors, Trustees, and Key Employees. Additionally, the 20XX return reported the following information:

- Showed no employees employed in 20XX
- Schedule A—reported “none” to paying more than \$ to an independent contractor
- President signed the Form 990 as the Executive Director



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

The ORG 20XX Form 990 reported that its officers and directors were not involved in the daily operation of the organization, as zero time was applied to section Part V-A, Current Officers, Directors, Trustees, and Key Employees. Additionally, the 20XX return reported the following information:

- Showed no employees employed in 20XX
- Schedule A—reported “none” to paying more than \$\$ to an independent contractor
- Books are in the care of President at same address as the ORG
- President signed the Form 990 as the Executive Director

**Activities**

credit trading history

Unlike the Protocol, the United States (U.S.) government has not yet adopted a policy on carbon credit trading. The Protocol is defined by some as “originated at COP-3 to the UNFCCC in Country, December 19XX. It specifies emission obligations for the Annex B countries and defines the three so-called Country mechanisms: JI, CDM and emissions trading. It entered into force on February 16, 20XX”. The U.S. does not recognize the Country treaty.

The U.S. program established a voluntary trading program, the CO-8 (CO-8), without mandatory emissions reductions or the institution of a formal cap-and-trade system. The voluntary trading program (CO-8) was a study to start on a pilot basis in the U.S. Midwest.

The CO-8, a for-profit entity, was created in 20XX by a grant through the CO-9. The CO-8 described itself as

. RA-1 was the Chairman and CEO of the CO-8. The CO-8 was a wholly owned subsidiary of CO-10 Plc, a public stock company listed on the CO-11 of the CO-12. CO-10 Plc also owns the European CO-10, Europe’s leading CO2 emissions exchange.

In July 20XX, the CO-8 was acquired by the CO-13 (CO-13), a leading operator of regulated global derivatives exchanges and over-the-counter markets. Some of the key benefits of the acquisition are: 1) more shared European and U.S. utilities market customers, 2) additional global markets in emissions programs, 3) exposure to Asian commodities marketplaces with 25 percent stake in Tianjin CO-10, (Exhibit A).

In a cap and trade system, the trading or the trading market is defined as follows:

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

- trading is defined as "a market based mechanism for helping mitigate the increase of CO2 in the atmosphere".
- Carbon trading markets is defined as where they bring "buyers and sellers of carbon credits together with standardized rules of trade".

"Where the buyer of credits are businesses that emits CO2 to the atmosphere may have an interest or may be required by law to balance their emissions through mechanism of sequestration. These businesses may include power generating facilities or many kinds of manufacturers."

and

"Where sellers of credits are companies that manage forest or agricultural land might sell carbon credits based on the accumulation of in their forest trees or agricultural soils. Also businesses that reduce their emission may be able to sell their reductions to other emitters."

- The cap and trade system, as defined in the ORG handbook, works as follows: "the 'cap' puts a ceiling on emissions and each allowance authorizes one ton of CO2 emissions. Limiting the number of available allowances ensures the cap's integrity. Allowances are allocated among sources based on emission performance standards and representative fuel use. At the end of each year, every source must have enough allowances to cover its emissions for that year. Unused allowances may be sold, traded, or saved (banked) for future use.

### ORG history

The ORG was a participant in the design phase of the voluntary pilot trading market along with other domestic and foreign nonprofits and for-profit businesses.

In ORG's brochure titled "

, states that ORG was seeking financial support from the Governor's office to support its market based project development work. The financial support would be in a form of a \$ grant through the Governor's Office of Economic Opportunity to the Reclamation and Development Grants Program on behalf of ORG. The brochure went on to say, "the proposed grant would establish the ORG's ability to aggregate and enter large-scale carbon credit trades onto the market through the CO-8".

Additionally, the brochure stated that in 20XX, ORG conducted a pilot carbon credit trade between the Confederated Country and Country Tribes and a Country based firm. Previously, the ORG, under contract with the National Office of the Environmental Protection Agency (EPA), developed

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

planning protocols and a standards handbook for forestry based greenhouse gas projects, and now the ORG is field-testing the resulting planning handbook.

Moreover, the brochure went on to say the ORG projects were delivered to the market through the CO-8 (CO-8) under a contract with the CO-14. It stated that there would be an 8% program fee attached to all ORG trades. The program fee or income would be distributed to member organizations. It predicted that once ORG was fully operational, it would be developing projects and conducting trades across the U.S.

The ORG activities as described in the State Agriculture and Forest land-20XX report, was as follows:

“the Coalition is a quasi-public entity created with the help of the State Legislature. Landowners can receive complete cost sharing to plant trees on land that is not naturally regenerating to trees. In turn, they receive payments to store \_\_\_\_\_ in the land and the trees. Contracts are signed for upwards of 100 years with the \_\_\_\_\_ offsets transferred to CO-15, the private entity associated with the Coalition that actually holds the offsets. The idea is to help corporations mitigate their \_\_\_\_\_ emissions through purchasing the carbon offsets associated with the now forested land”.

In 20XX, ORG conducted its first international \_\_\_\_\_ credit trade between a tribal government (Country Country Tribe) and a for-profit organization based in Country for \$\$\$. Review of the contract revealed that the CO-16, a Country environmental group established in Country, paid the tribe \$\$\$ for their \_\_\_\_\_ sale. The money was wired transferred to ORG and then ORG remitted the money to the tribe. The contract also stated that the ORG acted as the facilitator and the CO-14 (City-based) arranged the transaction.

The CO-14 is an investment bank and consulting firm. The CO-14, CO-16, and the CO-8 are headed by the same individual, RA-1.

In a 20XX news article about the CO-17 selling its land, the article stated that the CO-17 was trying to sell its \_\_\_\_\_ rights to European companies, but because the U.S. has not signed the Protocol, it cannot, even though the tribe was considered a sovereign nation (Exhibit B).

### ORG current activities

In 20XX and 20XX, ORG programs were primarily funded by grants from the University under a subcontract agreement from the CO-18 (CO-18). The CO-18 was formed in 20XX to be part of the U.S. Department of Energy (DOE) sequestration research program. The partnership included public and private sector research institutions, businesses and state agencies. The CO-18 is headed by CO-19.

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

The ORG is at the forefront in the emerging field of the credit market (cap and trade system). In 20XX and prior years, President (President) stated that the ORG used its funding to further explore and develop the market activity in the state of State, specifically the capture and storage system--trading carbon credits that would be acceptable to the financial markets, i.e., setting standards or infrastructure.

Currently, ORG funding is only derived from credit trading. In the initial interview, President stated that they do not expect to receive any more grant monies. President stated that they never intended to live on grant monies. The organization's primary focus was making the market-based program work.

As indicated in its pamphlets/publications, ORG credit trades in the voluntary pilot trading market, the CO-8. ORG is also a member of the CO-8 as an Offset Aggregator, which is a CO-8-registered entity that serves as an administrative and trading representative on behalf of multiple project owners. The CO-8 requires that projects that produces less than 12,500 metric tons of CO2 equivalent of Exchange Offsets per year to register through a CO-8-registered aggregator.

In ORG publications/pamphlets, ORG described itself as follows:

- 1) ORG's purpose is to provide an opportunity for landowners, tribes, state, and local governments to participate in a market-based conservation program that provides a marketable commodity while helping to offset the environmental impacts of carbon dioxide emissions.
- 2) ORG helps landowners sell carbon offset credits on the CO-8 (CO-8).
- 3) Since 20XX, ORG has been an official aggregator of carbon credits for the CO-8.
- 4) Carbon sequestration projects and the credit market provides an opportunity for landowners to help offset the environmental impacts of greenhouse gases, reverse soil, water and air degradation, and provide enhancement of wildlife and recreational opportunities while creating a new source of revenues for landowners and others.
- 5) Landowners enter contracts for five-year terms. 20 percent of the credits are placed into reserve pool. If at the end of the market period the project has not been lost or compromised, the 20 percent is returned to the project owner.

The ORG would place their client's credits onto the market place, the CO-8. The price of carbon is updated daily and is based on the current market place price. ORG credit trades twice per year with two pool per year or when requested by their clients or board members.

The carbon credit trading transaction falls into two categories:

1. credit trading on the CO-8

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

## 2. over-the-counter (OTC) transaction

The ORG conducts credit trading transactions on either the CO-8 or over-the-counter.

In 20XX, credits were selling for about \$ a metric ton and if the carbon credit market becomes mandatory in the U.S., the credit price could be as high as \$ or higher. In Europe, the price has reached about \$ to \$ a ton.

In 20XX and prior years, CO-8 charged its members a membership fee or annual dues of \$ per year. Currently, the annual dues are about \$\$ per year.

The over-the-counter transactions are voluntary trades directly between a buyer and seller. The price for is generally higher than on the CO-8. OTC transactions have no standards or registry—they are transactions with non-CO-8 members. OTC transactions are cash transactions.

The ORG has two types of membership:

1. Affiliate
2. Sub-aggregator

Affiliate members are described in the ORG amended bylaws. The bylaws state that to be an affiliate member, an entity can be a private company, nonprofit company, or a state. The members have to sign a confidentiality agreement and a nondisclosure agreement. Affiliate members will serve as advisors to the board, and have no voting power.

Affiliate members have access to training workshops and updated handbooks. They are also paid one percent (1%) commission of all carbon credit trades for projects they bring in or secure a listing agreement or a buy/sell agreement.

Affiliate members include private and nonprofit organizations in the U.S., the COUNTRY, and Country.

In 20XX, there were about 27 affiliate organizations (domestic and foreign).

The sub-aggregators are not described in the ORG articles, bylaws, or amended bylaws. Sub-aggregators of ORG are the following for profit entities:

- CO-19
- CO-20

Sub-aggregators assist landowners to participate in the credit market. Sub-aggregators conduct the initial outreach to landowners as well as developing and managing carbon pools.

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

They then turn the \_\_\_\_\_ pools over to the aggregators for marketing and sales (ORG). The sub-aggregators would receive the trade proceeds from ORG, deduct their administration fee, and then remit the proportionate payments to all pool participants.

According to ORG manuals and meeting minutes, ORG is trying to create a national tribal organization to be ORG sub-aggregators. The meeting minutes also show that ORG proposed to pay the sub-aggregators a 10% commission.

Program information

The ORG trading process includes performing data collection and reports to meet CO-8 criteria, securing contracts with landowners, securing third party verification, submitting projects to the exchange, conducting the trade, and distributing revenue to participants.

In the ORG business plan booklet, ORG stated that the purpose(s) of its program are as follows:

“The ORG program is designed to assist landowners in planning carbon sequestration activities and documenting the resulting \_\_\_\_\_ Sequestration Unit (CSU) in a manner that adheres to national standards and protocols, and meets the needs of potential buyers...ORG expects that in the future a federally based regulatory market will exist. At that point \_\_\_\_\_ credit trades will be conducted similar to existing commodity trades”.

The ORG actively solicits landowners to be involved in its \_\_\_\_\_ credit trade projects. ORG advertises that landowners can earn income in the \_\_\_\_\_ credit market by storing carbon. ORG has contractual agreements that are five (5) years or longer with farmers, ranchers, foresters, tribal and state governments to trade those landowners \_\_\_\_\_ credits on the CO-8 or over-the-counter. Then ORG would remit proportionate payments to pool participants.

The ORG conducts \_\_\_\_\_ trading for the following \_\_\_\_\_ offset projects: 1) Agricultural Methane, 2) Rangeland Soil Carbon, 3) Forestry, 4) Crop, and 5) Grass.

The ORG has application projects with private landowners and tribes in State, State, State, State, State, State, State, State, and other states. ORG also contracts internationally, i.e., Country and Country.

Individual projects are assembled into groups or pools that are large enough to qualify for sale on the CO-8. Prices are set by the market at the time trades are completed. Potential pool participants complete an application form. The application form is to submit carbon sequestration projects through the ORG.

According to ORG Handbook, the following shows the process outline for ORG portfolio sales:

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

1. A landowner agrees to prepare a project plan for implementation in the event that a sale is achieved.
2. A qualified resource professional works with the landowner to develop an Initial Proposal (IP) within the guidelines of the ORG Project Planning Handbook.
  - a. The IP is reviewed for technical adequacy by ORG Technical Adviser.
  - b. The IP is accepted by ORG as adequate
3. The landowner signs a Listing Agreement with ORG
  - a. Listing Agreement includes threshold price that seller will accept.
  - b. Landowner is provided with full information about payment schedules, fees, etc., so that they know exactly how the sale will function if it goes through.
4. ORG includes the IP within a prospective portfolio to broker.
5. Broker offers prospective portfolio to potential buyers.
6. Buyer makes buy offer through Broker.
  - a. Buy offer includes price, quantity, and term for purchase.
  - b. Buyer lists requirements, if other than regular, for monitoring, verification, qualifications for registry, etc.
7. ORG accepts offer and associated conditions if consistent with listing agreement. If not, ORG seeks landowner's approval prior to accepting offer.
8. Preliminary sale is executed
  - a. Some money (usually 1/2) is paid up front.
  - b. ORG has 6 months to firm up estimates, measurements, documentation, etc. and provide buyer with solid assurance. Buyer has money-back protection during this period.
  - c. Base line field measurements completed, contracts signed with landowner.
9. ORG provides the buyer with a Certificate of Assurance containing final measurements, conditions, commitments, etc. meeting buyer demands. Buyer accepts.
10. Sale is final. Final payments made to ORG.
11. ORG settles up with Landowners, Affiliates, Technical Providers, etc.

The ORG published and distributed the ORG's Sequestration Handbook. According to ORG's prior website postings, the handbook was available for a \$ fee. The handbook was free for viewing on its website if potential participants registered to the ORG website. ORG also makes available their Portfolio Standards for the agricultural and forestry practice for viewing if potential participants register to their website. The ORG handbook and Portfolio Standards are copyrighted documents and are not to be redistributed or copied.

It was noted in the 20XX minutes, where it discussed the future goal of ORG, that President was looking at commercial based planning for ORG, where ORG would do the trading. President mentioned the following: "I can sell everything I can get my hands on right now. If politics go south it was a great idea, but if politics go our way, it will be the largest in the U.S."

### Outreach and Workshops

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

Initially, ORG conducted workshops to provide information regarding credit trading to landowners and other interested parties—specifically the process to develop and place projects on the CO-8. ORG advertised in its web site and publications that it was developing a trading infrastructure, such as setting procedures, setting contract guidelines for emitters and landowners, securing offsets against loss, monitoring, measuring, verification of offsets, and needs landowners to help to test it. See also Exhibit D.

In subsequent years, the workshops were presented to private landowners to advertise ORG's services, such as advising of the potential of earning income from carbon sequestration in their land. ORG advertised that their program was

. ORG also claimed that the  
was a potential source of revenue for private landowners, a new marketable commodity.

Currently, ORG continues to actively solicit for landowners (farmers, ranchers, foresters, tribal and state governments) to participate in its offset projects. ORG advertises in its publications, flyers, and website that landowners can earn income in the credit market by storing . According to ORG's meeting minutes and comments made by President June 3, 20XX, the workshops were a way for the organization to sign up affiliate members and private landowners for project offset credit applications.

In one of its publications/flyers, ORG advertised that the CO-8 allows landowners, who enroll newly planted grasslands, to earn offsets as follows:

- Zone A: includes most Midwest and east coast, Country province of Country, Country, Country and Country. The soil offset that can be earned is at a rate of 1.0 metric tons of CO<sub>2</sub> per acre per year to land managers for planting undertaken on or after January 1, 19XX. The grass cover must be maintained through 20XX.
- Zone B: includes most southern states. The soil offset that can be earned at a rate of 0.4 metric tons of CO<sub>2</sub> per acre per year to land managers for planting undertaken on or after January 1, 19XX. The grass cover must be maintained through 20XX.

In other publications/flyers, ORG advertised the amount participants can earn as follows:

- Producers will be credited with 0.2 – 0.6 metric tons of for each acre of eligible no-till cropping and 0.4 – 1.0 ton per acre for qualifying grass stands each year of the contract.
- On native rangeland in the eligible territory, producers can earn .12 to .52 metric tons per acre with an implemented grazing plan to improve the range vegetative growth. Rotational or managed grazing is used to restore or maintain range conditions and increase the stored. The price per ton on the CO-8 varies every trading day.

In a public press release, dated March 11, 20XX, ORG advertised the following regarding its carbon credit trading activities:



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

“The ORG (ORG), a State-based organization, allows Ag producers and landowners to earn income by storing in their soil through no-till crop production, long-term grass seeding practices, grazing management practices, grassland, forestry, and methane capture projects....Once credits sell, landowners earn income based on the acres they have enrolled. As an example, this month, ORG distributed over \$\$ to 66 landowners for the sale of their carbon.”

In a ORG letter to third parties on May 20XX, ORG states that ORG has a total of 268 landowners and 1,903,908 acres that it represents on behalf of multiple project landowners.

On its sub-aggregator website, the sub-aggregator advertised that the landowners

Exhibit C, titled Partnering for the Environment, are copies of pamphlets/publications that ORG gives out to prospective landowners/affiliates at ORG workshops (ORG portfolio).

In the ORG portfolio, ORG described the benefits of its activities to the emitters and to the private landowners as follows:

ORG’s benefits to emitters:

- Industry may find that purchasing CSU’s as an offset for their emissions is an economical way to meet their emission reduction needs.
- Enhances the health and sustainability of the ecosystem.
- Offers participating corporations a cost-effective way to produce enough CSU’s to achieve their dioxide emission reduction goals.
- Companies can take voluntary steps now to establish their own emissions credit programs for greenhouse gases, in anticipation of “some type” of GHG market-based initiative, which seems likely, at some point, either on a national or international scale. By doing so, they can demonstrate their commitment to reducing dioxide emissions and best position themselves to have their reductions recognized whenever a formalized federal program is introduced.
- Create positive public relations.

ORG’s benefits to landowners:

- Landowners gain the practical experience in producing credits for future markets.
- Flexible contractual agreements.
- sequestration credits offer landowners a new potential source of revenue.
- Enhances the health and sustainability of the ecosystem.

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

The portfolio advertised the amount of income a prospective landowner expects to earn from the credits, as well as how credits are priced and when income is received by the landowners, as follows:

- The concept of credits trading is similar to dealing with any other agricultural commodity exchange.
- During each production year, a database of all land tracts under contract will be assembled and transmitted to the CO-8.
- CO-8 verifiers will randomly select a portion of the tracts for a spot check that includes field visits.
- Immediately after the end of the calendar year, the credits will be placed in ORG's trading account and sold.
- The individual producer will receive his or her share of the sale proceeds immediately following the pool of credits is sold.

At the end of the pamphlets/publications, instructions were given to call President or RA-2.

In ORG business plan booklet, ORG states the following regarding its marketing efforts:

"The ORG targets the majority of its business activities toward placing CSU'S on the CO-8, and other emerging markets...Under a market-based approach, these companies can buy and trade their credits through the market just as any other commodities are traded".

The ORG marketing goal is to continue to trade in the market-based program that is capable of reaching out across the U.S., and to expand into other tradable offsets, such as wind solar, fuel switching, methane, etc. for trade on the CO-8.

#### ORG website

The ORG website address is website. The home page tabs shows the following topics: Home, Contact Us, Soil calculator, cropland, forestland, methane, rangeland, grassland.

The Home page tab provides the following information about ORG:

- As stated on the organizations web site, ORG's

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

- The trading will create new revenue source for producers in the following areas:
  - No-tilled fields and newly established grasslands
  - Rangeland, forest that's been committed to an improvement program
  - Forested land that has managed reforestation or new plantings
  - On-farm methane digesters
- The benefits of the program helps the environment in the following ways:
  - Soil quality improvements
  - Water quality improvements
  - Water quantity increase
  - Energy conservation
  - Air quality improvements
  - Wildlife habitat improvements

Under the main menu tab, "About ORG", the following was stated regarding ORG's process and programs:

- credits can be earned via no-tilling cropping, seeding grasses or alfalfa, native rangeland enhancement, forestry, and methane digesters.
  - No-till—can earn credits at a rate of .2 to .6 metric tons of carbon per acre annually
  - Seeded grass stands—can earn credits at a rate of .4 to 1.0 metric tons per acre annually
  - Native rangeland—can earn credits at a rate of .12 to .52 tons per acre annually
  - Forestry—can earn several tons of credits annually
  - Methane offset—can earn tons of credits annually. Each ton of methane captured earns 18 tons of credits
- The web site describes the purpose of ORG as follows:

"ORG's purpose is to work with the program and act as a fiscal agent who is actually contracting and selling the offsets on the CO-8. Income earned from aggregating acres will result in revenue paid to individual landowners, and ORG's to continue the good work of land stewardship".

Under the Main menu tab, "ORG's Advantage", states the following regarding the formation and activities of ORG:

"ORG is designed to assist landowners in planning n sequestration activities and documenting the resulting (CSU) in a manner that adheres to national standards and protocols while meeting the needs of the buyers. The term ' Sequestration

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

Unit' represents the amount of organic \_\_\_\_\_ in the wood or soil that is equivalent to the removal of one metric ton of CO2 from the atmosphere."

- ORG is a partnering member of the CO-21, whose purpose is to field-test a proposed trading system.

In prior year web site postings, the following information was shown regarding ORG past activities:

- In 20XX web posting, the ORG website stated the following regarding its activity intentions:

"While the ORG intends to assist landowners with the sale of CSUs in national and international markets to the extent possible, it must be recognized that the \_\_\_\_\_ credit market only exists in an experimental state, and ORG makes no express or implied commitment that any project will be successfully sold on the market now or at any time in the future. Prices for CSUs will be a function of the market condition at the time of sale and ORG makes no implied or express commitment to the prices that will be in effect at any time now or in the future. Landowners retain the right to accept or reject purchase offers received through the ORG or its representatives."

- In 20XX web postings, the ORG website described the following regarding its solicitation of potential clients:

ORG solicited for landowner, tribal government, for-profit organizations and other corporations to participate in the newly emerging \_\_\_\_\_ offset voluntary trading market. In order for the "trading infrastructure" to take place and become widespread, it needs to be tested and developed.

The web site went on to say that the CO-21 (DOE) Regional Partnership was organized to field-test a proposed trading system developed during the last two years by the partnership members.

In 20XX web postings, the web site mentioned that the ORG "

\_\_\_\_\_." See also Exhibit D, ORG's prior web postings.

### **ORG Books and Records**

In the initial interview, President stated that in 20XX, the ORG revenue was primarily derived from grants from the Department of Energy (DOE) through the University and the (DNRC). In 20XX, ORG revenue derived from grants from the University, \_\_\_\_\_ trade, and interest income.

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

The ORG funding source was also derived from a revolving loan agreement with CO-22. According to the loan contract, the revolving loan amount was for a short-term loan of \$ at an interest rate of %. The loan document was signed by President as an agent of the association. The term of the loan states that not more than \$ can be borrowed at one time.

The loan funds were initially deposited into the organization's CO-23 three investment accounts:

- ACC-1-restricted
- ACC-2-restricted
- CO-23, Management Pool

It was noted that the ACC-1 and ACC-2 investment accounts are related to ORG's trading activities. Per conversation with President on May 3, 20XX, he stated that the ACC-2 is composed of income derived from the 20 percent (20%) kept as reserve pool (as indicated in landowners contract) and grant money, the management pool is composed of income from the CO-19 grant and is used for ORG operation, and the ACC-1 is used to replace offsets that may have been lost.

#### ORG personnel

DIR-1 is the President/Board member of ORG and the current Chairman of the CO-24. DIR-1 is also the current Judge at City of City, State. DIR-1 and other officers/board members are not compensated for their work at the ORG, except for reasonable reimbursed travel expenses.

Per conversation with DIR-1 on April 23, 20XX, the contracts and agreements ORG enters into are signed by him or President. DIR-1 stated that he would sign most of the contracts. DIR-1 also stated that he and the other board members would setup general policies of ORG but would not be involved in the day-to-day activities, including maintaining financial records.

In the initial interview, President stated that the Vice-President, Secretary, and the Treasurer were not involved in the day-to-day activities of ORG. They had no actual duties at ORG.

ORG contract out for staffing, data management, and technical services. In the years under examination, ORG had one employee, the office manager. The office manager is responsible for the following, according to the ORG business plan booklet:

- Bookkeeping
- Clerical and office management services
- Assist in the management of ORG portfolios

The office manager is the only staff employed by ORG. The Executive Director (President) supervises the office manager.

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

Per conversation with President on May 3, 20XX, he said that the office manager, RA-3, was let go on April 1, 20XX because of budget constraints. President said that he volunteered to take care of the daily business affairs of ORG without compensation.

The ORG hired an outside bookkeeping service to prepare its Form 990 return. President stated that the bookkeeping service handles the ORG financial records. A discussion with the bookkeeping service, CO-25, revealed that they only prepare the Form 990 return for ORG. They claimed that the financial records are maintained by the ORG.

The ORG contract out its work to two primary individuals/entities:

1. CO-26 (CO-26)
2. CO-27

The CO-26 offers its executive director/broker and marketing director services to ORG. CO-26 is a for-profit partnership organization owned by President and RA-2, a husband and wife partnership. President is the executive director and RA-2 is the marketing director for ORG. Income received by the executive director and the marketing director was paid on Form 1099-MISC.

In ORG business plan booklet, it states that President of CO-26 is responsible for overseeing all management and financial affairs of all ORG projects, program development, and management activities including day-to-day supervision of ORG staff and oversight of all contracted services.

In meeting minute dated April 14, 20XX, President stated the following regarding his contribution to ORG and his request to have a seat on the board:

“President reported on monies contributed by the CO-26s (CO-26) so that ORG would remain competitive and viable. Between CO-27 and CO-26s, a total of \$ has been contributed to further ORG’s efforts.”

And

“It was the consensus of all parties that a 5 to 10-year contract be entered into for both the CO-26 and CO-27 versus CO-26 and the CO-27 having a seat on the board. A discussion was held regarding the profit share percentages for CO-26 and the CO-27. It was the consensus of the board that CO-26 and the CO-27 receive the 2.5% of profit after securing the budget monies for operations including the sub-contractor fees and dividends to organizations.”

In an internet news article, President was described as having founded ORG. The article stated that President used to work for the CO-28 (CO-28) as a coordinator and that he left his job at CO-28 and formed ORG in 20XX to pursue the trading market (see Exhibit E). See also

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

Exhibit F, President's resume stating that he was instrumental in the creation of the ORG. A discussion with the office manager noted that this organization was "his baby".

In the ORG business plan booklet, it states that RA-2 of CO-26 is responsible for "marketing activities for the ORG, including congressional, state, and local government contacts, and lobbying on behalf of ORG, industry, landowner and other nongovernment organizations, associations, and other nonprofit contacts for the ORG and direct contact with potential buyers, sellers, and brokers of

The ORG also hired RA-4 of CO-27 to be the primary technical advisor for ORG. Income received by RA-4 was paid on Form 1099-MISC.

RA-4 of CO-27 has been involved with ORG since inception. CO-27 specializes in analyzing and presenting natural resource management and policies. RA-4 is the president of CO-27. He also served as a technical advisor to the CO-29 and he co-chaired the technical workshop on carbon sinks sponsored by the White House in 1993 to explore forestry and agricultural activities for President's "Climate Change Action Plan".

According to ORG business plan booklet, RA-4 is responsible for portfolio design and project development. In 20XX, RA-4 was also the chairman of the ORG Technical Standards Committee.

According to ORG 20XX budget proposal, CO-26 and CO-27 compensations increased and that the two entities continue to be a substantial contributor of ORG. The information below notates what was discussed with respect to the role of CO-26 and CO-27:

- CO-26 to receive a base contract payment of \$
- The CO-27 will receive a contract payment of \$. The CO-27 will receive a fee of 2.5% of the gross for each company from the sales of offsets. This fee will also be applicable to revenue which exceeds the operational needs of the ORG.
- CO-26 will be responsible for the overall management and marketing of ORG and will be the principle developer of crop grass, methane, and range offsets.
- The CO-27 will be responsible for technical assistance and review of projects as well as the development of a strong forestry and fuel switching portfolio for ORG.

### Contracts

The following information details some of the submitted contracts.

Contract with CO-26 (CO-26):

The contract with the CO-26 and ORG was for 20XX and 20XX. The contract identified the CO-26 as the subcontractor and the ORG as the contractor. The two parties have entered into a research subcontract with the CO-19 Office of Sponsored Programs Agreement. The contract

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

stated that President, as project manager, would provide coordination and project development/contracting activities for all ORG and DOE related activities. RA-2, partner of CO-26, as project marketer, would provide marketing and coordination of all activities related to ORG and DOE. The contract states that they will be independent contractors acting as project broker and marketing director/staff and facilities coordinator for ORG.

The CO-26 will charge ORG \$ per hour per separate services rendered as either project broker and marketing director. In addition, ORG to pay CO-26 a fee based on a "graduated scale of percentages of the cumulative gross collected revenues from each project". Project expenses will be reimbursed by ORG for lodging, per Diem, and all out-of-state and instate travel costs.

The ORG places no restrictions on President or RA-2's place of work or the amount of time devoted to providing the services to ORG.

The ORG 20XX contract between CO-26 and ORG contained the same contract language as in 20XX and 20XX year contract.

Contract with the CO-17:

The contract with the CO-17, specifically with RA-5, states that ORG projects include private, state lands, and tribal lands. The CO-17 will act as a subcontractor, independent contractor, and will receive \$ as payment for services rendered. The CO-17 will be reimbursed for project related expenses via submission of an invoice to ORG. The contract states that RA-5, RA-6, will provide technical and coordination assistance for development of projects in the tribal portfolio.

Contract with the Confederated Country and Country Tribe:

The agreement was between the Confederated Country and Country Tribes, ORG, and the CO-16. The CO-16 was established under the laws of Country.

The agreement was to sell greenhouse gas emission offsets to the CO-16 during the years 20XX through 2081 and to delivery of 80% of the buffer in the year 2101. The Tribe was to maintain carbon storage through the end of year 2101. The purchased price of the greenhouse gas emission offsets was \$\$\$. The money was to be transferred to a bank account in the United States specified by the ORG and then ORG would remit the money to the Tribe.

The ORG was introduced to the CO-16 by a company called the CO-14 based in City.

Contract with CO-19, a sub-aggregator of ORG:

The contract was entered into agreement on January 20XX, between CO-19 and ORG. The contract states that the CO-19 is a limited liability company located in City, State. The CO-19 will act as a sub-aggregator for ORG to "



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

The contract identified President as the project broker for ORG and that all written communications regarding this agreement should be to President.

The contract stated the goal and purpose of the sub-aggregator's role as follows:

"The goal of ORG and CT is to develop, qualify and market XFOs under CO-8 rules in an effective and efficient manner that returns revenue to the certified landowner. The ultimate goal is to provide a means for family forest landowners to participate in sequestration markets, to earn a revenue stream from their growing forest, to offset real estate taxes, land management expenses and other costs so family forests can continue to grow and provide all the associated benefits to the landowners and society."

The contract also set guidelines on the duties and obligations of the ORG and the CO-19. The contract states that the ORG will be the carbon broker for the CO-19's offset programs, specifically the managed forest pools. The ORG will be the "administrative representative" on behalf of CO-19. As an administrative representative, ORG will:

- establish a CO-8 Registry Account on behalf of CO-19;
- obtain CO-8 approval on CO-19 offset programs to participate in the CO-8 market;
- review and manage all forest pools developed by CO-19;
- arrange for verification and registration of all managed forest pools amounts on the CO-8 registry
- pay all registration, trading, and verification costs from gross pool sale proceeds
- sell registered pools upon approval from CO-19
- remit balance of gross sale proceeds to CO-19

The duties and obligations of CO-19 are to:

- to "conduct outreach to CO-30 members and forestry consultants to inform and train them in creating CO-8-qualified managed forest offset projects."
- The CO-19 will accept project applications from CO-30 members and maintain their pool summary records. Provide pool summary records to ORG for review and verification.
- At the discretion of CO-19, will provide ORG with the timing and details of trading each managed forest pool (the CO-19 will advise the ORG of when to trade their managed forest pool project).
- The CO-19 will receive the trade proceeds from ORG, deduct their administration fee, and remit the "proportionate payments to all pool participants"

Contract with Affiliate members:

- Contract with CO-31 (CO-31):

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

The contract was with CO-31 and ORG. The goal of CO-31 was to "CO-31 wants to promote ORG's work in the \_\_\_\_\_ and then bring \_\_\_\_\_ sequestration projects to the ORG to be placed in the CO-8 to be traded. In exchange for its efforts promoting trading \_\_\_\_\_, the CO-31 wants exclusive rights to bring \_\_\_\_\_ sequestration projects from \_\_\_\_\_ through ORG to the CO-8 for one (1) year."

The contract states that the ORG would pay CO-31 1% commission for all CSU's sold by ORG that are brought from the \_\_\_\_\_ to ORG. The contract also states that as a member of ORG, the CO-31 will have access to ORG confidential information.

- Contract with the CO-32:

The contract was in June 20XX. The contract states that the ORG would pay the CO-32 two and one-half percent (2.5%) of the gross trade revenues for all \_\_\_\_\_ trades for projects they bring in or secure a listing agreement or a buy/sell agreement and the ORG will receive seven and one-half percent (7.5%) as commission.

- Contract with the CO-33:

The contract was in December 20XX. The contract states that the ORG would pay the CO-33 two and one-half percent (2.5%) of the gross trade revenues for all \_\_\_\_\_ trades for projects they bring in or secure a listing agreement or a buy/sell agreement.

Financial information

The ORG Profit and Loss statement shows revenues deriving from the following sources:

TY 20XX:

DNRC grant	\$
DOE-CO-19 grant	\$
Total revenue	\$

The ORG Profit and Loss statement shows the following expenses for contracted services:

Marketing Director-RA-2	\$
Project broker-President	\$
RA-4, CO-27	\$
RA-5, CO-17	\$
	\$

The ORG filed Form 1099-MISC for the following individuals:

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

Form type	Namee		Amounts
1099-MISC	RA-5, CO-17	\$	
1099-MISC	CO-27		\$
1099-MISC	CO-26s, Inc.	\$	
			\$

A review of ORG financial records shows ORG underreporting CO-26 income of \$.

The ORG filed Form W-2 for administrative services for the following individual:

Form type	Namee	Amounts
W-2	RA-8	\$

The contracted service for the above individuals (subcontractors) works as follows:

1. President, RA-2, RA-4 and RA-5 would submit an invoice detailing their work to ORG (work record).
2. President would approve of the invoices
3. The invoices are then submitted to CO-19 for payment of services rendered
4. CO-19 would submit the check to ORG
5. ORG would then issue the checks to the subcontractors (checks are signed by President)

The approval for payment of the subcontracted services rendered was by President, including his own services. President also approved of the ORG's expenses, including his own expenses.

President and RA-2 of CO-26 charge ORG \$ per hour for professional services rendered. ORG also pays President's travel expenses to conduct ORG work. This included meals, lodging, airfare, etc. President and RA-2 also had use of the ORG's credit card—The CO-34 card. The charges to the CO-34 card were approved by President.

RA-4 of CO-27, located in City, State, charge ORG \$ per hour for professional services rendered. ORG also pays for RA-4's travel expenses. This included lodging, airfare, meals, etc. RA-5 of the RA-6, located in City, ID charge ORG \$ per hour—this includes his salary and the tribe's standard fringe benefit package.

TY 20XX:

The ORG Profit and Loss statement shows the following revenue sources:

contracts	\$
DOE-CO-19 grant	\$

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

Total revenue                   \$

The ORG Profit and Loss statement shows the following expenses for contracted services:

Marketing Director-RA-2	\$
Project broker-President	\$
RA-4, CO-27	\$
RA-5, CO-17	\$

The ORG filed Form 1099-MISC for the following individuals:

Form type	Namee	Amounts
1099-MISC	RA-6	\$
1099-MISC	RA-6, RA-5	\$
1099-MISC	CO-27	\$
1099-MISC	CO-26	\$

The ORG filed Form W-2 for administrative services for the following individual:

Form type	Namee	Amounts
W-2	RA-7	\$

The contracted service for the above individuals (subcontractors) works as follows:

1. President, RA-2, RA-4 and RA-5 would submit an invoice detailing their work to ORG (work record).
2. President would approve of the invoices
3. The invoices are then submitted to CO-19 for payment of services rendered
4. CO-19 would submit the check to ORG
5. ORG would then issue the checks to the subcontractors (checks are signed by President)

The approval for payment of the subcontracted services rendered was by President, including his own services. President also approved of the ORG's expenses, including his own expenses.

President and RA-2 of CO-26 charge ORG \$ per hour for professional services rendered. ORG also pays President's travel expenses to conduct ORG work, including meals, lodging, airfare, etc. President and RA-2 also had use of the ORG's credit card—The CO-34 card. The charges to the CO-34 card were approved by President.

RA-4 of CO-27, located in City, State, charge ORG \$ per hour for professional services rendered. ORG also pays for RA-4's travel expenses, including lodging, airfare, meals, etc.

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

trading transactions:

The ORG financial records, i.e., Profit and Loss statement, general ledger, etc., did not report trading activities. A review of ORG 20XX through 20XX meeting minutes revealed that ORG conducted trading activities and received income from the trades since inception. The 20XX meeting minutes showed that revenues were received from trade projects with private landowners and affiliate members. In 20XX, ORG reported revenues of \$ from contract. Per conversation with President, the trade revenues were derived from selling offsets to a Mexican nonprofit company (Mexico trade) and from a reverse auction with the U.S. House of Representatives (Exhibit G).

The following information was shown in the 20XX meeting minutes:

- trading activities was with 66 landowners (Crop pool #1), Gross of \$
- Forestry pool, Gross of \$

Upon request, ORG provided a list of the 66 landowners. A review of the 66 landowners revealed that they were primarily individuals and for profit businesses. It was also revealed that these individuals and business entities were not the ORG supported organizations.

Upon request, ORG provided handwritten spreadsheets of trading transactions with the 66 landowners. The spreadsheets showed a proportionate income distribution to the landowners, CO-26, CO-27, and affiliate members. The spreadsheets also showed trading fees deducted from the transactions. President stated that the trade on the CO-8 was done in vintage years/credits.

According to the ORG Handbook and CO-8 website, the minimum trading unit on the CO-8 is one Exchange Offset. Each exchange is identified by annual Vintage. Annual Vintage means the year it was eligible under CO-8 rules to be used for compliance with the CO-8 emission reduction schedule, "all CO-8 offsets are issued on a retrospective basis, with the CFI vintage applying to the program year in which the GHG reduction took place. Projects must undergo third party verification reports are then inspected for completeness by the Financial Industry Regulatory Authority (FINRA)."—this means participants are eligible for backdated sequestration credits, back to 20XX when CO-8 started trading.

The following information was provided by ORG detailing the gross sales receipt of trade on the CO-8 (with 66 landowners, representing 110,379 acres and 73,402 metric tons), and proportionate payments and commissions paid to pool participants.

Trade proceeds for Pool #1 (66 landowners in the pool):

20XX year:	RA-8	Total	Net
------------	------	-------	-----

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

	<b>Gross</b>	<b>ORG 5%</b>	<b>CO-26 2.50%</b>	<b>Group 2.50%</b>	<b>Affiliates 1%</b>	<b>withheld</b>	<b>amount 89%</b>
Gross for Grass							
Gross for No Till							
<b>20XX year:</b>							
	<b>Gross</b>	<b>ORG 4% or 5%</b>	<b>CO-26 2.50%</b>	<b>RA-8 Group 2.50%</b>	<b>Affiliates 1%</b>	<b>Total withheld</b>	<b>Net amount 89%</b>
Gross for Grass							
Gross for No Till							
Grand total for 20XX and 20XX							

The above table shows the disbursements from the proceeds for the sale of their carbon to the individual landowners, ORG, CO-26, and others as follows: 89% to landowners, 5% to ORG, 2.50% to CO-26, 2.50% to The CO-27, and 1% to Affiliate members.

According to President, the income from the trade sale was withheld and was not distributed to the participants in the pool until 20XX (\$ in 20XX vintage year and \$ in 20XX vintage year). The net amount of \$ and \$, respectively, was disbursed to private landowners in 20XX.

The payments to landowners were at net of fees. On occasions, the fees associated with trading on the CO-8 were paid for by grants received by ORG, sub-aggregators or via revenues received through subsequent trades. Additionally, the trading fees are sometimes reimbursed back to the private landowners. The trading fees for vintage years 20XX and 20XX were later reimbursed back to private landowners by the ORG of \$. Per meeting minutes dated April 14, 20XX, there were over \$ in fee reimbursements, making the total net amount disbursed to landowners of \$.

Sometimes when the carbon credits are traded, the trade income would be used to pay for the trading fees. The trade income from this transaction would not be reported on the financial statements.

The following table also shows the disbursements from the proceeds for the sale of carbon to the CO-17--Forestry pool project. The trade was conducted with a Mexican nonprofit company (Mexico Trade) in connection with a reverse auction with the U.S. House of Representatives. The forestry carbon sequestration pool was conducted in 20XX and income was recognized in 20XX.

Trade proceeds (Forestry pool):

	<b>Gross</b>	<b>ORG</b>	<b>CO-26</b>	<b>CO-27</b>	<b>Landowner-CO-17</b>
20XX year:					
20XX year:					
Grand total					

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

The ORG financial records shows that the payment to the CO-17 was after taking into account the funds that went to CO-26, RA-8, and ORG. The disbursements were made in two payments. Check # for \$ was made in 20XX and check # for \$ was made in 20XX as final payment.

**LAW:**

IRC section 501(c)(3) describes certain organizations exempt from taxation under section 501(a) of the Code and reads as follows:

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.

Section 1.501(c)(3)-1(a)(1) of the Regulations provides that in order to be exempt as an organization described in section 501(c)(3) 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. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes. The organization will not qualify for exemption if a nonexempt activity is more than an insubstantial part of its activities, or if an activity of the organization has more than an insubstantial nonexempt purpose.

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

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

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

Section 1.501(c)-1(d)(3) of the regulations defines the term "educational" as including the instruction or training of the individual for the purpose of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the 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 Living Faith, Inc. v. Commissioner, 950 F. 2d 365, a nonprofit organization which operated restaurants and health food stores in accordance with the doctrines of the Seventh-day Adventist Church. The court found that Living Faith conducted its operations with a substantial commercial purpose, and therefore does not qualify as a tax-exempt organization.

Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6<sup>th</sup> Cir. 1974), the court holds that the transfer of funds directly to the disqualified persons and to their business served the financial interests of the disqualified persons and/or their business.

Church by Mail, Inc. v. Commissioner, 769 F. 2d 1387 (9<sup>th</sup> Cir. 1985) and est of Hawaii v. Commissioner, 71 T.C. 1067 (1979) states that an organization has a substantial commercial purpose that serves a private rather public interests, it will not be recognized as exempt.

Rev. Proc. 20XX-52, with respect to revocation or modification of a determination, states in part, the revocation or modification of a determination letter or ruling recognizing exemption may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which section 503 of the Code applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization.

**TAXPAYER'S POSITION:**

**GOVERNMENT'S POSITION:**

Based on the facts and circumstances described above, it is the government's position that the ORG does not qualify as an organization exempt from tax because ORG did not operate exclusively for purposes described under IRC 501(c)(3). Therefore, the government is proposing the revocation of the organization's tax exempt status under IRC section 501(c)(3).

**With respect to non-exempt commercial purpose(s):**

The ORG's primary activity and purpose since inception is the trading of carbon offsets on the public market, CO-8 (CO-8) and to eventually carbon credit trade nationally. The ORG, in conjunction with the CO-8, was formed to setup an infrastructure for the voluntary cap and trade



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

system in the                    sequestration market. The conduct of                    trade onto the market place is a non-exempt commercial activity.

The facts show that the net income of ORG is not being distributed to benefit the supported organizations; rather it is directed to private for-profit domestic and foreign entities. ORG is an environmental brokerage firm that provides services such as matching buyers and sellers, organizing and constructing trade deals in the carbon sequestration trading market.

As an Offset Aggregator for the CO-8, the ORG is acting as a conduit organization for private landowners and for-profit entities. Through an offset aggregator, small landowners can be registered and sell                    . Offset Aggregators serve as administrative and trading representatives on behalf of numerous individual participants.

The ORG is being used as a conduit to accomplish a prohibited transfer of money or property--is acting as a mere conduit in a transfer between the private landowners and purchasers through the CO-8.

As an intermediary organization, ORG is providing a commercial facilitator service operated for a substantial non-exempt purpose and private benefit, factors that is inconsistent with section 501(c)(3) status.

ORG web site states that ORG's purpose was to "act as a fiscal agent who is actually contracting and selling the                    offsets on the CO-8". The ORG marketing goal is to continue to trade in the market-based program that is capable of reaching out across the U.S., and to expand into other tradable offsets, such as wind solar, fuel switching, methane, etc. for trade on the CO-8. Additionally, it was stated, in the 20XX meeting minutes, that President was planning on conducting ORG activities on a commercial basis.

**With respect to private benefit/interests:**

An organization is described in section 501(c)(3) only if no part of its net earnings inures to the benefit of any private shareholder. The inurement prohibition serves to prevent the individuals who operate the charity from siphoning off any of a charity's income or assets for personal use. An organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders or individuals.

In the years under examination, it was determined that the ORG's net earnings have inured to the benefit of its insiders. The insider is in a position to exercise control over the organization's net earnings as if they were his/her own by using them at will rather than within the limitations. In effect, the insider is using the public's "net earnings" for his/her own benefit. The facts show that President is able to use the organization's funds as if they were his own. President had supervision over the office manager. All the checks written are signed by President. President also signed tax returns and controlled all the brokerage accounts.

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

In addition, ORG's net earnings benefited individual private landowners as well as for-profit entities. Helping private landowners such as ranchers, farmers, private forest owners, and other corporations sell \_\_\_\_\_ from their land is not a charitable purpose nor are they considered members of a charitable class under IRC 501(c)(3).

When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interest, the organization by definition does not operate exclusively for exempt purposes. Section 1.501(c)(3)-1(d)(1)(ii).

Income received by private landowners as a result of \_\_\_\_\_ trading on the CO-8 benefits an individual or for profit entity and consequently a prohibitive transaction under IRC section 501(c)(3).

ORG received grants from CO-19 and used a majority of the funds to pay for contracted out services, specifically to President, RA-2, and other consultants. A miniscule amount was paid to conduct the administrative duties of ORG. The supporting organization was supposed to support the eight supported organizations, but none was actually spent to support its charitable activity in comparison to the amount that was spent for the personal benefit of the executive director, marketing director, consultants, and private landowners/businesses.

ORG advertised in its promotional materials that carbon trading was a way for private individuals or landowners to make money from selling \_\_\_\_\_ offsets in that it offers "landowners an opportunity to realize revenue from a new source".

Essentially, private landowners are being paid to sequestered \_\_\_\_\_ from their land and their independent-contractors are urged to promote the ORG activities, where these contractors are recruited with the promise of earning a lot of money. In recruiting its contractors, the ORG advertised that its operation would make money for its contractors.

The ORG's Form 990 reported the following revenue source:

	<u>TY 20XX</u>	<u>TY 20XX</u>
Contributions, gifts, grants:		
Direct public support	\$	
Govt contributions and grants	\$	
Interest on saving/investments:	\$	
 Total Revenue	 \$	

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

A review of the organization's financial records indicate that the \$ in revenue reported in 20XX year should be reported as from government contributions and grants via CO-19, not direct public support. The funds of \$ in 20XX and \$ in 20XX year were derived from the DNRC via CO-19 and not directly from government grants or contributions. It was also noted that in 20XX, the \$ was from trade activity, not public contributions.

In 20XX, of the total revenue received, \$ of the ORG's funds (76%) have been distributed to the CO-26 partnership and private consultants, of which \$ went to the CO-26 partnership (65%), not including the profit sharing the CO-26 and the consultants were to receive (5% combined) for every carbon trade conducted. Only \$ went to pay for the office manager.

In 20XX, of the total revenue received, \$ of the ORG's funds (82%) have been distributed to the CO-26 partnership and private consultants, of which \$ went to the CO-26 partnership (60%), not including the profit sharing the CO-26 and the consultants were to receive (5% combined) for every carbon trade conducted. Only \$ went to pay for the officer manager.

With respect to the ORG trading transactions, of the total revenue generated from the trade in 20XX (\$), only \$ went to ORG and \$ was distributed to private landowners. The rest of the funds were distributed to the CO-26 and CO-27. In 20XX, of the total revenue generated from the trade (\$), only \$ went to ORG and \$ was distributed to private landowners. The rest of the funds were distributed to the CO-26 and CO-27

Consequently, the ORG is providing more than an insubstantial benefit to insiders, President, RA-2, RA-4, through direct compensation and other payments to or for the benefit of these insiders, and through payments to controlled for-profit businesses.

### CONCLUSION:

The ORG does not qualify as an organization exempt from tax because ORG did not operate exclusively for purposes described in IRC 501(c)(3), ORG net earnings inured to the benefit of private individuals, and that more than an insubstantial part of its activities furthered private purposes rather than exempt purposes.

The ORG's primary activity and purpose since inception has consisted of the trading of carbon offsets on the public market, CO-8. The income generated from trading serves a substantial nonexempt purpose of promoting private business interests.

Additionally, ORG's activities does not serve a charitable class and thus, does not operate to further a charitable purpose(s) within the meaning of section 501(c)(3).

The ORG exemption should be revoked effective January 1, 20XX.

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

The ORG is required to file Federal income tax returns on Form 1120 for any years that are still open under the statute of limitations, for tax periods after December 31, 20XX.