



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examinations

1100 Commerce Street, MC 4920 DAL

Dallas, TX 75242

501.03-00

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

January 12, 2012

Number: **201218023**
Release Date: 5/4/2012

LEGEND

ORG - Organization name

XX - Date Address - address

Taxpayer Identification Number:

Person to Contact:

Identification Number:

Contact Telephone Number:

ORG

ADDRESS

CERTIFIED MAIL

Dear _____ :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated July 13, 20XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

You are not operating exclusively for any charitable purpose, educational purpose, or any other exempt purpose. Our examination reveals that you are not engaged primarily in activities which accomplish charitable, educational or other exempt purposes as required by Treas. Reg. 1.501(c)(3)-1(c)(1). Your activities, including your financial transactions, more than insubstantially furthered non-exempt purposes.

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States

Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to these courts at the following addresses:

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate 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 contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosure:
Publication 892

Letter 3607(04-2002)
Catalog Number: 34198J

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
625 Fulton St. Room 521
Brooklyn, NY 11201

Department of the Treasury

Date: August 1, 2011

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

ORG
ADDRESS

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 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 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended 12/ 31/20XX

LEGEND

ORG – Organization name XX – Date State – state CO-1 through CO-12 = 1ST through 12th
COMPANIES

ISSUE #1

Whether revocation of the ORG’s tax-exempt status is necessary because the organization is not operating for exempt purposes.

FACTS

ORG (ORG) incorporated on November 20, 20XX in the State of State. Per its Certificate of Incorporation the purpose for which the organization was formed was:

To create, form and establish a center to aid and assist emerging artists: to promote, foster and encourage the artistic development of individuals: to provide education and training in a variety of art forms: to assist emerging artists by providing a forum for the free exchange of information; to own, operate and maintain real property to serve as a permanent home for the center; to stimulate community interest in the purposes of this corporation; to raise funds and solicit donations from interested individuals, charitable, educational and scientific organizations and foundations, and other interested organizations and foundations, agencies, institutions, associations and corporations and to administer and expend such funds in furtherance of the corporate goals and purposes; to aid, assist, cooperate, co-sponsor and otherwise engage in concerted action with private, governmental and other agencies and organizations with the same or similar objectives; to solicit, collect and otherwise raise money for the charitable and benevolent purposes of this corporation and to expend such monies and generally to aid and assist emerging artists by all available means and methods.

ORG filed an application for recognition of exemption, Form 1023, with the Internal Revenue Service on February 25, 20XX. Per its application for recognition of exemption, the ORG is a program and service organization for artists and arts organizations. The four areas of concentration include development of projects, audiences, careers, and organizations. Per letter dated July 13, 20XX the Internal Revenue Service granted the ORG exempt status under section 501(c)(3). The ruling letter held that the organization was a public supported organization described in sections 509(a)(1) and 170(b)(1)(a)(vi) of the IRC.

The activities of ORG are providing fee based consulting services at or above cost for management, marketing, and fundraising to artists and arts organizations. The organization is not supported by contributions from the public, government or private foundations or grants. The table on the following page is a breakdown of ORG’s revenues for the examination period by client.

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<u>Client</u>	<u>Consulting Fees</u>	<u>Description</u>
CO-1	\$	
CO-2	\$	Dance/Theater
CO-3	\$	School/Internship
CO-4	\$	Print Center/School
CO-5	\$	Dance Company
CO-6	\$	Ballet Company
CO-7	\$	Choreographer
CO-8	\$	Empowerment zone
CO-9	\$	
CO-10	\$	Public Charity for playwrights, lyricists, and composers writing for the American stage
CO-11	\$	
CO-12	\$	
Total Consulting Income	\$	
	\$	
Contribution	\$	
Total ORG Income	\$	

The organization receives the majority of income from consulting fees and very limited public support. Forms 990 filed by ORG for the year ending December 31, 20XX reported on Form 990, Schedule A, Part II Public Support Schedule, the following:

Tax year ending	Public Support Income	Other Income	Total Income	% Public Support of Income
December 31, 20XX	\$	\$	\$	%
December 31, 20XX	\$	\$	\$	%
December 31, 20XX	\$	\$	\$	%
December 31, 20XX	\$	\$	\$	%
December 31, 20XX *	\$	\$	\$	%

* Per Examination

LAW

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

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Section 1.501(c)(3)-1(a) of the Income tax Regulations (Treas. Reg.) provides that in order to be exempt as an organization described in IRC § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in § 501(c)(3). If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC § 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.

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that the operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private rather than a public interest.

Treas. Reg. § 1.501(c)(3)-1(d)(ii) provides that an organization is not organized or operated exclusively for one or more of the purposes specified in IRC 501(c)(3) unless it services a public rather than a private interest.

Treas. Reg. § 1.501(c)(3)-1(e)(1) holds that an organization that is primarily formed to operate an unrelated trade or business is not exempt under IRC § 1.501(c)(3).

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Business Bureau v. United States, 326 U.S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); American Campaign Academy v. Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F.2d. 340 (4th Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). 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 interests, the organization by definition does not operate exclusively for exempt purposes. American Campaign Academy v. Commissioner, supra at 1065-1066.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that was ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost" and finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In Rev. Rul. 72-369, 1972-2 C.B. 245 an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the

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Code. The organization enters into agreements with unrelated section 501(c)(3) organizations to furnish managerial and consulting services on a cost basis. This revenue ruling stated that:

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the 'operational test,' the organization's resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code and the applicable regulations. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

TAXPAYER'S POSITION

ORG has indicated that they will agree to revocation of the 501(c)(3) exempt status.

GOVERNMENT'S POSITION

The government concludes that the ORG does not satisfy the requirements for continued exemption under section 501(c)(3). The organization is not operated exclusively for exempt purposes since it fails the operational test. The organization's primary activity is consulting and management services for a fee, which does not promote exempt purposes and is a substantial commercial purpose. The organization promotes the private interests of its clients and not the public interest.

The organization's primary activities consulting work does not promote exempt purposes as required by Treas. Reg. § 1.501(c)(3)-1(c)(1) which states "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."

An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as stated in Treas. Reg. § 1.501(c)(3)-1(e)(1). ORG does not meet these requirements, since the primary purpose is operating a consulting and management business.

Like the revoked organizations described in Rev. Rul. 72-369, 1972-2 C.B. 245 and B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), ORG primarily provides consulting and management services, income is exclusively from consulting service fees and operating the same as a commercial businesses organized for profit.

CONCLUSIONS

The Service proposes to revoke the exempt status of ORG effective January 1, 20XX the first day of the tax year under examination.