



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TE/GE EO EXAMINATIONS  
1100 COMMERCE ST. MAIL CODE 4920 DAL  
DALLAS, TEXAS 75242

501-19-00

Date: March 27, 2012

Release Number: **201237022**  
Release date: 9/14/2012

LEGEND

ORG - Organization name  
XX - Date Address - address

ORG  
ADDRESS

**Taxpayer Identification Number:**

**Form:**

**Tax Year(s) Ended:**

**Person to Contact/ID Number:**

**Contact Numbers:**  
(fax)

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear

On August 5, 20XX, we granted you exemption from federal income tax under Section 501(c)(19) of the Internal Revenue Code ("the Code"). On June 7, 20XX, we issued a group exemption for you and your subordinate organizations. We assigned you Group Exemption Number ("GEN") #.

We audited you for the year indicated above. We determined you did not comply with the rules and regulations of Section 501(c)(19) of the Code. Your tax exemption is revoked, effective June 13, 20XX. This is a final letter with regard to your exempt status.

On January 20, 20XX, we gave you our report of examination explaining why we believe this revocation is necessary. We told you of your right to contact the Taxpayer Advocate, and of your appeal rights.

You are required to file a federal income tax return for the tax period shown above. Unless an extension of time is granted or the return is already filed, send the return to the Ogden Service Center within 60 days from the date on this letter. Returns for later years are filed with the appropriate service center indicated in the return instructions.

Revenue Procedures 80-25 and 80-27 provide guidance on group exemptions. Per the procedures, when we revoke your tax exemption, we also revoke your group exemption. Effective June 13, 20XX, your Group Exemption Number # is no longer valid. **Please tell your subordinates of this action.** Each subordinate that wants tax exemption should file an individual application. Otherwise, each subordinate should file a federal income tax return.

You have the right to contact the Taxpayer Advocate Service. Their assistance is not a substitute for established IRS procedures, such as the formal appeals process. They 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. However, they can 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 at the beginning of this letter.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

**Internal Revenue Service**  
**Tax Exempt and Government Entities Division**  
Exempt Organizations: Examinations:EO:7922  
31 Hopkins Plaza, Room 1400  
Baltimore, Maryland 21201

**Department of the Treasury**

Date: March 27, 2012

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 organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

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

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter revoking your exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

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,

Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018  
Report of Examination  
Envelope

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG (ORG) EIN		Year/Period Ended 20XX12

LEGEND

ORG - Organization name      XX - Date      Address - address      City - city  
 State - state      Country - country      Secretary - secretary  
 Counsel - counsel      Bookkeeper - bookkeeper      CO-1, CO-2 & CO-3 - 1<sup>ST</sup>, 2<sup>ND</sup> & 3<sup>RD</sup> COMPANIES  
 RA-1, RA-2, RA-3 & RA-4 - 1<sup>ST</sup>, 2<sup>ND</sup>, 3<sup>RD</sup> & 4<sup>TH</sup>  
 RA      BM-1 THROUGH BM-22 - 1<sup>ST</sup> THROUGH 22<sup>ND</sup> BM

**ISSUES:**

1. Whether ORG meets the requirements for recognition of exemption as an organization described in §501(c)(19) of the Internal Revenue Code (Code)?
2. Whether contributions to ORG are deductible under §170(c)(3) of the Code?

**FACTS:**

A Form 1024, Application for Recognition of Exemption under Section 501(a), (1024) was filed July 1, 20XX and executed by Secretary, secretary. Tax exempt status was sought in accordance with §501(c)(19) of the Code. The identified contact person was BM-1 (BM-1). The address of the organization was indicated as Address, City, State, a United Parcel Service store where mail boxes are rented.

At part II of the 1024 activities are indicated as being insubstantial at that time other than “payment of office rental and telephone expenses”. Sources of support are identified as contributions from the public and membership dues.

The officers of the organization are indicated as: BM-2, director-president; BM-1, director-treasurer; and Secretary, director-secretary.

Membership is indicated as 119, consisting of War Veterans as defined by Congress.

With regard to the leasing of property, the 1024 reveals “Oral month to month lease only (\$ per mo.) with CO-1 (100 sq. ft office with one desk and chair), Address, City, State. No relationship other than arm’s length lessor-lessee.”

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Dues and membership assessments for the period January 1, 20XX through June 30, 20XX are listed as \$. Occupancy, or rent, for this period is listed as \$. Various activities directed at promoting or benefitting veterans are discussed therein.

The Articles of Association were certified on July 2, 20XX by president BM-2. The initial trustees are identified as: BM-2; BM-1; and Secretary. Membership is described as permissible war veterans. The adoption of the Articles of Association is indicated as June 13, 20XX.

ORG was issued a favorable determination letter of tax exempt status according to §501(c)(19) dated August 5, 20XX. This letter states in pertinent part:

“This ruling/determination is based on your representation that at least 75 percent of your members are past or present members of the Armed Forces”, “Based on your representation that at least 90 percent of your members are war veterans and that you are organized and operated primarily for purposes consistent with your current status as a war veterans organization, donors can deduct contributions made to or for the use of your organization”, “If, in the future, your organization does not meet this membership test or if your purposes, character, or method of operation changes, donors cannot deduct contributions to or for the use of your organization, as provided by section 170. Please notify your key District Director of any such change so that office may consider the effect on the deductibility of contributions by these donors.”

Relating to its request for a group exemption, ORG through Secretary, Group 4301 secretary, via letter dated June 24, 20XX, provided membership data for each listed subordinate association. In this response it is indicated that ORG maintains a total membership of 66,055. Of the total membership 64,753 members are indicated as war veterans.

A CO-2 article dated April 7, 20XX quotes a cease and desist order issued by RA-1, an Assistant Attorney General for State, to ORG “Since the addresses you provided are fictional, unless you are able to provide me with a showing of legitimate activity by this organization ... you are on notice that you are not lawfully registered according to the Charitable Solicitation’s Act”. RA-1 further detailed efforts to locate a State officer of the ORG, BM-3, who “is not in the White Pages of State; nor is he in the White Pages anywhere in the U.S. Until BM-3 comes to talk to us, I’m going to assume he doesn’t exist.” RA-1 searched

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the address of BM-3 and “found nothing but some dirt and some mesquite”, it was a vacant lot. RA-1 could not locate another State officer identified as BM-4.

BM-1 was identified as being wanted for money laundering, engaging in corruption, and identity theft on the television program America’s Most Wanted which aired on November 20, 20XX and March 19, 20XX.

Counsel (Counsel) provided an affidavit to the State Attorney General for the state of State on July 2, 20XX. Counsel stated that she was general counsel for ORG and its State chapter for approximately four years from 20XX to the present. In her role as general counsel she spoke and emailed frequently with BM-1, an officer of ORG, and would meet on occasion with Counsel (Counsel) who serves as special counsel to the organization and previously was a board member of the organization. Counsel periodically spoke with Bookkeeper (Bookkeeper) who was a volunteer and bookkeeper for ORG. Counsel briefly met BM-5 (BM-5) in June of 20XX who operated an auto donation group known as CO-3 and briefly served within the month as a board member of ORG.

Counsel never met, spoke to, physically saw, or was able to confirm the existence of purported officers or board members of ORG or its State chapter including but not limited to BM-6, Secretary, BM-7, BM-8, BM-9, BM-10, BM-11, BM-12, BM-13, BM-14, BM-15, BM-16, BM-17, BM-2, BM-18, BM-15, BM-19, BM-20, BM-21, or any other alleged officer, board member, member of the association, or employee of the association other than BM-1, Counsel, Bookkeeper, or BM-5.

Counsel and BM-5 resigned. On Monday of the week of July 2, 20XX Counsel traveled to the State home of Bookkeeper to inspect financial and business records of ORG but was denied access by Bookkeeper. Counsel was informed by Bookkeeper that BM-1 directed Bookkeeper to prohibit anyone from gaining access to any ORG records. Counsel provided bank account numbers for six known bank accounts utilized by ORG. The employment tax adjustments were developed from information obtained through issuance of Summonses to the banks for the aforementioned accounts.

To her knowledge, Counsel does not believe that ORG had any physical offices or buildings and utilized UPS or other private mail boxes including the address in State.

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Counsel had not seen any evidence or proof that care packages had ever been shipped to troops overseas.

According to the State State Attorney General website, it's Charitable Law Section won a default judgment for \$\$, plus attorneys fees in May 20XX against ORG in its claim that ORG falsely claimed to raise money for veterans causes. The Office claims that while more than \$ was raised since 20XX, very little money was directed towards assisting veterans. According to the State Attorney General, the accused mastermind behind the plot, BM-1, has been on the lam since June 20XX and remains at large. "BM-1" is a stolen identity with his true identity yet to be determined. BM-1's alleged accomplice, Bookkeeper pled guilty on June 22, 20XX, to engaging in a pattern of corrupt activity, complicity to theft, money laundering, and tampering with records. She was sentenced to five years in prison in August 20XX.

According to a CO-2 newspaper article dated October 16, 20XX, State investigators discovered that BM-1 had stolen the name "BM-1" from a State state man years earlier. A nationwide warrant was issued for BM-1 on August 5, 20XX charging BM-1 with identity theft. State Attorney General RA-2 is quoted as declaring that ORG is a "sham charity". RA-2 stated that Bookkeeper "held herself out as an officer of this organization". RA-2 further stated that BM-1 had stolen a second identity, that of the leader of a small chapter of disabled veterans in State. BM-1 had an ID card for years from the state of State in the name of RA-3. RA-3 allegedly informed the reporter that a local police detective knocked on his door and informed him that his identity had been stolen. RA-3 indicated that he was informed that BM-1 had allegedly been using his information for over 10 years. RA-3 indicated that he had never heard of ORG.

An order was issued by the State Campaign Finance and Public Disclosure Board dated May 31, 20XX which states in pertinent part:

1. The Board imposes a civil penalty of \$ on the individual who represented himself as BM-1 for making a contribution in the name of RA-4 in violation of State Statutes, section 10A.29.



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2. The Board imposes an additional civil penalty of \$ on the individual who represented himself as BM-1, representing a separate civil penalty of \$ for each of the six contributions made under a false identity in violation of State Statutes, section 10A.29.

3. The Board directs the Executive Director to monitor other states' efforts to locate the individual using the name "BM-1" to make political contributions in State. If this individual is located, the Executive Director is to work with the Office of the Attorney General to engage in efforts to collect the civil penalties imposed by this Order.

An initial appointment letter was sent via certified mail to the last known address of ORG on April 25, 20XX which was returned undeliverable. This was a UPS mailbox. The initial appointment letter contained an attachment which requested vast operational and financial records including but not limited to employment tax returns, books and records, and all financial accounts. There has not been a response to the examination notification letter. The contact telephone number as indicated on the filed Form 990 for 20XX is no longer in service.

Internal Revenue Service (IRS) internal records were searched for evidence of any filed employment tax or information returns.

No employment tax or information returns were filed for 20XX, 20XX, 20XX, 20XX, 20XX, or 20XX.

The only employment tax or information returns filed for 20XX, 20XX, 20XX, and 20XX were Forms 1098-C relating to the donation and subsequent sale of automobiles.

ORG filed a Form 990, Return of Organization Exempt from Income Tax, for the 20XX year. The following items are noted:

- Principal officer indicated as BM-6, Chairman
- Five voting members of the governing body
- Year of formation 19XX
- Legal domicile is State
- The return is signed by Secretary, Secretary, no return preparer
- One Form 1099 is indicated as filed
- No employees indicated

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- Books and records indicated in possession of BM-18, Office of CFO
- Officers, Directors, and Trustees listed as follows with no indicated compensation:
  - BM-6, Director and CEO
  - Secretary, Director and Secretary
  - BM-12, Director
  - BM-10, AD Govt Liaison
  - BM-22, AD Development
  - BM-11, ADPI
  - BM-13, Director
  - BM-1, Director & CFO
  - BM-14, Natl VP, EDU
  - BM-15,
  - BM-16, Joint Compliance Committee Chair
  - BM-17, Chief Auditor
  - BM-21, Acting Director
- Membership dues \$
- Grants \$
- Grants to individuals \$ – 39,922 recipients
- Professional Fundraising fees \$
- Volunteers 4,400,000 – value of \$
- Current membership approximately 66,939
- Voting members vote for the Board of Directors
- Each member of the Board must personally read and review all drafts of the Form 990
- CFO to certify that Form 990 prepared in accordance with GAAP
- Conflict of Interest Policy includes “no loan agreements or compensation to or with any director, officer, or staff member or with their family members”.
- The organization’s application for recognition of exemption is made available for public inspection at its principal and regional offices
- All paper copies relating to, in any way, shape, or form of official business for a period of three years or as otherwise required by law are retained
- With over 66,000 members nationwide and 40+ IRS recognized subordinates and offices or home offices of officers located in all 50 states, the Country, Country, the U.S. Country, Country, Country, the

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Federated States of Country and the Commonwealth of the Country there is no central depository for all documents

- Computer documents are placed into a centralized electronic file which is routinely and randomly checked to ensure that the document retention is working effectively and efficiently
- If the United States of America had a policy in place as a matter of foreign policy similar to that for American misfeasors in this regard “we would land the 82<sup>nd</sup> Airborne Division on top of any person, be he or she 13 years of age or older in whatever foreign country he or she lives, who sent a virus or any form of malware into any computer hard drive in the United States of America, with instructions from the President of the United States, to kill that person, and to kill any other person in that country that got in the way of killing that person, including the armed forces of such a country.”
- A permanent internal directive requires in writing that the Directors must exercise due diligence consistent with the duty of care that requires each Director to act in good faith; with care that an ordinarily prudent person in a like position would exercise under similar circumstances
- Clear established policies are in place with regard to the payments made to or reimbursed to anyone conducting business on behalf of the organization under an accountable plan

**LAW:**

Section 170(a) of the Code provides the general rule that there shall be allowed as a deduction, any charitable contribution, as defined in section 170(c), payment of which is made during the taxable year.

Section 170(c)(3) of the Code includes within the term “charitable contribution” as used in section 170, a contribution or gift to or for the use of a post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization organized in the United States or any of its possessions, and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 501(c)(19) of the Code provides for the exemption from federal income tax of a post or organization of veterans of the United States Armed Forces if such post or organization is:

- (a) organized in the United States or any of its possessions,

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(b) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets, and

(c) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

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

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

Section 1.501(c)(19)-1 of the Regulations provides that to be described in section 501(c)(19) of the Code an organization must be operated exclusively for one or more of the purposes listed in that section. Section 1.501(c)(19)-1(c)(8) of the regulations lists as one of these purposes the provision of social and recreational activities for the organization's members.

Section 1.501(c)(19)-1(c) of the Regulations provides that an organization described in section 501(c)(19) of the Code must be operated exclusively for one or more of the following purposes: (1) To promote the social welfare of the community as defined in section 1.501(c)(4)-1(a)(2) of the regulations, (2) To assist disabled and needy war veterans and members of the United States Armed Forces and their dependents, and the widows and orphans of deceased veterans, (3) To provide entertainment, care, and assistance to hospitalized veterans or members of the Armed Forces of the United States, (4) To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors, (5) To conduct programs for religious, charitable, scientific, literary, or educational purposes, (6) To sponsor

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or participate in activities of a patriotic nature, (7) To provide insurance benefits for their members or dependents of their members or both, or (8) To provide social and recreational activities for their members.

In Senate Report No. 92-1082, 92nd Cong.2d Sess., Congress stated that for purposes of section 501(c)(19) of the Code, "substantially all" means 90 percent. Therefore, of the 25 per cent of the members that do not have to be past or present members of the Armed Forces of the United States, 90 percent have to be cadets, or spouses, etc. Thus, only 2.5 percent of a section 501(c)(19) organization's total membership may consist of individuals not mentioned above.

Section 1.6001-1(a) of the Regulations in conjunction with section 1.6001-1(c) provides that every organization exempt from tax under section 501(a) of the Code and subject to the tax imposed by section 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by section 6033.

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

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

Section 301.7701-3 of the Regulations provides in part that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8) (eligible entity) can elect its classification for federal tax purposes as provided in this section. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be

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classified as an association or to be disregarded as an entity separate from its owner.

**FRAUD:**

**Attributing Fraudulent Intent of Officers to the Corporation**

"[A] corporation can act only through its officers and ... it does not escape responsibility for acts of its officers performed in its capacity. Corporate fraud necessarily depends upon the fraudulent effect of the corporate officer." Hi-Q Personnel, Inc. v. Commissioner, 132 T.C. No. 13 (May 4, 20XX), citing Federbush v. Commissioner, 34 T.C. 740, 749 (1960), aff'd, 325 F.2d 1 (2d Cir. 1963). See also DiLeo v. Commissioner, 96 T.C. 858, 875 (1991). "Also, fraud of a sole or dominant shareholder can be attributed to the corporation. Sam Kong Fashions, Inc. v. Commissioner, T.C. Memo. 20XX-157, 89 TCM 1503, 1511 citing, Gold Bar, Inc. v. Commissioner, T.C. Memo. 20XX-211.

Section 7201 of the Code provides that any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 or imprisoned not more than 5 years, or both, together with the costs of prosecution. The elements of tax evasion are: willfulness; the existence of a tax deficiency; and an affirmative act constituting an evasion or attempted evasion of the tax. Sansone v. United States, 380 U.S. 343, 351, 85 S.Ct. 1004, 13 L.Ed.2d 882.

Section 7203 provides that any person required by this title or by regulations made under authority thereof to make a return, who willfully fails to make such return, at the time or times required by law or regulations, shall, in addition to other penalties provide by law, be guilty of a misdemeanor.

Section 7206(1) of the Code prohibits any person any person from willfully making and subscribing any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter. United States of America, Plaintiff-Appellee, v. Beverly M. Parker, Defendant-Appellant, 272 Fed. Appx. 289, 20XX WL 943234 (C.A.4. (N.C.)). Parker "submitted 1040 tax forms showing zero income, that she signed the forms under penalty of perjury, and that she in fact received significant

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income in” 1998 and 1999. Parker failed to file “any tax returns for 20XX and 20XX even though she received total taxable income of \$78,589 in 20XX and \$110,862 in 20XX.” “Parker took several steps to hide her assets from the Government, most of which involved the use of her business venture, North Point Management. For instance, Parker opened a business account for North Point Management using her son’s social security number and deposited receipts ... into that account.” “In addition, she used funds from the North Point Management bank account for personal expenses including payments on her and her husband’s personal credit cards, her mortgage, and her children’s cars.”

“Willfulness” for purposes of criminal tax laws requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of the duty, and that he voluntarily and intentionally violated that duty.” John L. Cheek, Petitioner, v. United States, 498 U.S. 192, 111 S.Ct. 604. Cheek filed federal income tax returns through 1979 but thereafter ceased to file returns although his income at all times far exceeded the minimum necessary to trigger the statutory filing requirement. See also United States of America, Plaintiff-Appellee, v. Joey K. Lansing, Defendant-Appellant, 263 Fed. Appx. 849 20XX WL 269019 (C.A. 11 (Fla.)). Justice Blackmun, with whom Justice Marshall joined dissenting expressed it, “incomprehensible to me how, in this day, more than 70 years after the institution of our present federal income tax system with the passage of the Income Tax Act of 1913, any taxpayer of competent mentality can assert as his defense to charges of statutory willfulness the proposition that the wage he receives for his labor is not income, irrespective of a cult that says otherwise and advises the gullible to resist income tax collections.” Cheek “presumably was a person of at least minimum intellectual competence.” Cheek was convicted of attempting to evade income taxes and failing to file income tax returns.

Funds diverted from a charity to various shell corporations which resulted in such funds being utilized for personal purposes by those who formed and controlled the charity and shell corporations, constituted taxable income and resulted in convictions for filing a false return under §7602(1) and failure to file a return according to §7203. One of the defendants was convicted for failing to report all of his reportable income while the remaining two defendants were convicted for failure to file a tax return. United States of America, Plaintiff-Appellee, v. Carl Woodman, Robert Woodman, and James Woodman, Defendants-Appellants. The jury concluded “that the payments were income, not loans.” It was further determined that, “the circumstances of the payments lacked any of the usual indicia of a repayment obligation.” There “were no loan agreements, no

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requirements that Defendants pay interest, and no evidence that Defendants had to pay these “loans” back at any point in time.” “Woodman’s failure was willful because he filed a tax return in previous years, and therefore knew of his legal obligation to do so.” Carl Woodman was a co-owner of the charity; Robert Woodman was responsible for the payroll withholdings and bookkeeping; and James Woodman was the general manager responsible for signing payroll checks. The investigation of the charity “uncovered a four-year history of monetary transfers from WeShare (charity) to all three Defendants, either directly or indirectly through numerous shell corporations that Defendants owned or controlled.” Upon transfer of the funds to the various shell corporations, the defendants then “used these payments for personal expenses.”

In establishing fraud, the government need not establish direct evidence of the taxpayer's untoward state of mind. Because “[i]t is the rare taxpayer who announces to the world his intent to defraud the Federal Government,” the government may prove fraudulent intent by circumstantial evidence, and we can infer fraud from “any conduct, the likely effect of which would be to mislead or to conceal.” Richardson v. Comm'r, 509 F.3d 736, 743 (6th Cir.20XX); 26 U.S.C. §7454(a); Tax Ct. R. 142(b). (internal quotation marks omitted). While any effort to catalogue a list of evidence that satisfies this standard would be doomed to incompleteness, there are several telltale “badges of fraud”: where the individual fails to report income, fails to maintain and produce “adequate books and records” of financial activities, “conceal[s][his] income by dealing in cash” and, even though he has “business experience,” “give[s] implausible explanations of conduct.” (internal quotation marks omitted).

In U.S. v. Helmsley 91-2 USTC P 50,455941 F.2d 71 C.A.2 (N.Y.),1991, the Helmsleys arranged for hundreds of thousands of dollars of their personal expenses to be paid by companies they directly or indirectly owned and controlled and to be carried on the books of those companies as business expenditures. In this manner, Mr. and Mrs. Helmsley were able to reap two illegal tax benefits. First, by having the companies pay the expenses rather than distribute taxable income to the Helmsleys, the Helmsleys avoided personal income taxes. Second, because the various Helmsley companies involved treated the payment of these personal expenses as business expenditures, the companies enjoyed artificially inflated business expense deductions. The tax returns filed by the Helmsleys and by the various firms reflected the false billing.



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The jury convicted Mrs. Helmsley for aiding and assisting in the preparation or presentation of fraudulent tax returns for various Helmsley-controlled corporations and partnerships in violation of 26 U.S.C. § 7206(2). The evidence established that these Helmsley-controlled entities deducted as ordinary business expenses payments made in connection with the Dunellen Hall project (her personal residence). Moreover, the evidence established that these deductions were itemized on the books and records of the business entities as operating expenditures and not as salary or compensation.

Judge Walker instructed the jury that it could convict the defendants either if the deductions were improperly taken (i.e. overstated) or if the deductions were properly taken, but mischaracterized:

“An income tax return may be false, not only by reason of an understatement of income, but also because of an overstatement of lawful deductions or because deductible expenses are mischaracterized on the return.”

False statements about income do not have to involve substantial amounts in order to violate this statute. See, e.g., United States v. Citron, 783 F.2d 307, 313-14 (2d Cir.1986); United States v. Greenberg, 735 F.2d 29, 31-32 (2d Cir.1984)

“[M]illions of dollars of expenditures for Dunellen Hall paid by business entities in the Helmsley Organization were falsely reflected on the books and records of those business entities as expenditures for the operation of the businesses” and “gave rise to millions of dollars of false and fraudulent tax deductions on the Federal and New York State income tax returns filed by those business entities for the years 1983, 1984 and 1985.” In the context of Section 7206(2) “false and fraudulent” may mean mischaracterizing deductions as well as overstating them. See United States v. Gurary, 860 F.2d 521, 525 (2d Cir.1988), cert. denied, 490 U.S. 1035, 109 S.Ct. 1931, 104 L.Ed.2d 403 (1989); United States v. Bliss, 735 F.2d 294, 301 (8th Cir.1984).

The indictment and bill of particulars made it sufficiently clear that Mrs. Helmsley's assistance in entering the statements on the challenged lines of the tax forms violated Section 7206(2). Whether that violation occurred because the entries improperly stated deductions for what were essentially dividends or misleadingly characterized properly deductible compensation payments as other types of operating expenditures is inconsequential. In either case, what was

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entered on the tax return was false.

The defendants unlawfully, knowingly and willfully did aid and assist in, and procure, counsel and advise the preparation and presentation under, and in connection with matters arising under, the Internal Revenue Laws, of the U.S. Corporation and Partnership Income Tax Returns (Forms 1120 and 1065, respectively) for the Helmsley Organization business entities set forth below, which returns were false and fraudulent in that they included false and fraudulent business expense deductions.

Fraud is established by showing that the taxpayer intended "to evade tax believed to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such tax." Recklitis v. Commissioner, 91 T.C. 874, 909, 1988 WL 116976 (1988). Fraud "does not include negligence, carelessness, misunderstanding or unintentional understatement of income." United States v. Pechenik, 236 F.2d 844, 846 (3d Cir.1956).

Because direct proof of the taxpayer's intent is rarely available, fraudulent intent may be established by circumstantial evidence and reasonable inferences drawn from the facts. Spies v. United States, 317 U.S. 492, 498 (1943); Stephenson v. Commissioner, 79 T.C. 995, 1006 (1982), affd. 748 F.2d 331 (6th Cir. 1984). Indicia of fraud include consistent underreporting of income tax liability, Holland v. United States, 348 U.S. 121, 137-139 (1954); concealing income from return preparers, Korecky v. Commissioner, 781 F.2d 1566, 1569 (11th Cir. 1986), affg. T.C. Memo. 1985-63; diverting corporate funds to the taxpayer's personal use, United States v. Thetford, 676 F.2d 170, 175 (5th Cir. 1982); using a corporation to disguise the personal nature of expenses, Truesdell v. Commissioner, 89 T.C. 1280, 1302-1303 (1987); and failing to cooperate with tax authorities, Bradford v. Commissioner, 796 F.2d 303, 307 (9th Cir. 1986); Petzoldt v. Commissioner, supra at 700.

Badges of fraud were described in Bradford v. Commissioner, 86-2 USTC 796 F.2d 303, 307 (9<sup>th</sup> Cir, 1986) as: (1) understatement of income, (2) inadequate records, (3) failure to file tax returns, (4) implausible or inconsistent explanations of behavior, (5) concealing assets, and (6) failure to cooperate with tax authorities.

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See Denali Dental Services v. Commissioner, T.C. Memo.1989-482 (corporation a sham where its checking account was used as a "pocketbook" for payment of shareholder's personal expenses).

### **Helmsley Conspiracy Issue**

The general federal conspiracy statute, 18 U.S.C. § 371 (1988), reads in pertinent part:

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

The Helmsleys did unlawfully, willfully and knowingly combine, conspire, confederate and agree together ... to commit offenses against the United States, to wit, violations of Title 26, United States Code, Sections 7201 and 7206, and Title 18, United States Code, Section[s] 1341, and to defraud the United States and an agency thereof, to wit, the Internal Revenue Service of the United States Department of Treasury.

### **Corporate Fraud Issue**

In deciding whether a corporation has acted fraudulently, we examine the actions of the corporation's officers. DiLeo v. Commissioner, supra at 874; Kahrahb Rest., Inc. v. Commissioner, T.C. Memo.1992-263 ("A corporation can act only through individuals who are its officers or employees"). The fraud of a sole or dominant shareholder may be attributed to the corporation. E.J. Benes & Co. v. Commissioner, 42 T.C. 358, 383, 1964 WL 1198 (1964), affd. 355 F.2d 929 (6th Cir.1966).

Although a corporation may be organized under the laws of a State, it may be disregarded for Federal tax purposes if it is no more than a vehicle for tax avoidance and void of a legitimate business purpose. See Gregory v. Helvering, 293 U.S. 465 (1935); American Sav. Bank v. Commissioner, 56 T.C. 828, 838 (1971); Aldon Homes, Inc. v. Commissioner, 33 T.C. 582 (1959). While a taxpayer is free to adopt the corporate form of doing business, a corporation must engage in some meaningful business activity to be recognized as a

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separate entity for tax purposes. See Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943); Achiro v. Commissioner, 77 T.C. 881 (1981). Avoiding taxation is not a business activity. See National Carbide Corp. v. Commissioner, 336 U.S. 422, 437 n.20 (1949); Higgins v. Smith, 308 U.S. 473 (1940)

In United States of America v. William L. Walton, 909 F.2d 915, USTC, the Court identified criteria to be used in determining whether a corporate identity may be disregarded, i.e. whether a corporation serves merely as an alter ego of its shareholders as:

- (1) the absence of normal corporate formalities
- (2) commingling of personal and corporate funds
- (3) siphoning of corporate funds by a dominant shareholder, and
- (4) the fact that the corporation is merely a façade for the personal operations of the dominant stockholder

The court pierced the corporate veil.

A two pronged test was utilized in Labadie Coal Company v. Harry Black, DBA FAI Trading, LTD. 672 F.2d 92. The court stipulated that piercing the corporate veil is only relevant if it is established that the corporate entity itself exists. The court focused on two issues: (1) is there such uniformity of interest and ownership that the separate personalities of the corporation and the individual no longer exist and (2) if the acts are treated as those of the corporation alone, will an inequitable result follow. With regard to the establishment and maintenance of corporate formalities, the court stated that those “who wish to enjoy limited personal liability for business activities under a corporate umbrella should be expected to adhere to the relatively simple formalities of creating and maintaining a corporate entity.” “Furthermore, the formalities are themselves an excellent litmus of the extent to which the individuals involved actually view the corporation as a separate being.” The focal point in such a case should be whether the corporation “is in fact the alter ego or business conduit of the person in control.” “The question is one of control, not merely paper ownership.” The Court cited commingling of funds and other assets of the corporation with individuals as well as non-corporate personal uses of such assets as indicia of lack of corporate separateness. The use of the same office or business location by the corporation and its individual shareholders was a factor to consider in determining separateness.

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The Court in Charles E. Wolfe v. United States of America, 798 F.2d 1241 confirmed that a corporate entity "could have a valid business purpose (giving it separate tax status), and at the same time be so dominated by its owner that it could be disregarded under the alter ego doctrine." "Indeed, a corporation will be disregarded where it is used to evade a public duty, such as paying taxes."

Private benefit was addressed in American Campaign Academy v. Commissioner of Internal Revenue 92 T.C.1053 (1989). When an organization operates 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, the organization by definition does not operate exclusively for exempt purposes. Prohibited private benefits may include any "advantage; profit, fruit; privilege; gain; or interest." Occasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefits. Inurement is a component of private benefit.

Exempt status under §501(c)(3) was denied on the basis of private benefit to the founders of the organization in Church of Ethereal Joy, v. Commissioner of Internal Revenue, 83 T.C. 20 (1984). See also People of God Community v. Commissioner of Internal Revenue, 75 T.C. 127 (1980).

### **TAXPAYER'S POSITION:**

The taxpayer has not responded to the examination request or this report.

### **DISCUSSION:**

#### **FRAUD**

In this case, the fraud is to be inferred from the surrounding facts and inferences drawn from the facts involving BM-1. As indicated in Richardson v. Commissioner "telltale" badges of fraud include: failure to report income, failure to maintain and produce adequate books and records, concealment of income by dealing in cash, and implausible explanations of conduct. Fraud is established by showing that the taxpayer intended "to evade tax believed to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of tax." See Recklitis v. Commissioner. Diverting corporate funds to the taxpayer's

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personal use and disguising the personal nature of expenses evidences fraud. See United States v. Thetford and Truesdell v. Commissioner.

In Bradford v. Commissioner badges of fraud included: (1) understatement of income; (2) inadequate records; (3) failure to file tax returns; (4) implausible or inconsistent explanations of behavior; (5) concealing assets; and (6) failing to cooperate with tax authorities.

First and foremost BM-1 attempted to conceal and mislead the Service as to his true identity since at least 20XX. BM-1 has been indicted in the State of State for identity theft and the State of State has proposed fines against BM-1 for same. The notoriety of BM-1's identity theft, among other acts, resulted in a focus on him on "America's Most Wanted" in 20XX and 20XX after a nationwide warrant was issued for his arrest. Bookkeeper, identified as a bookkeeper and volunteer for ORG, informed Counsel that BM-1 advised Bookkeeper to prohibit access to any ORG records. Bookkeeper plead guilty in June 20XX in the State of State for: engaging in a pattern of corrupt activity, complicity to theft, money laundering, and tampering with records.

We believe that BM-1 devised a scheme some time before 20XX, to perpetrate fraud through the creation of a tax exempt organization in order to unduly enrich himself through the mechanism of tax evasion. It is averred that BM-1 stole the identity in the event that such fraudulent activity was discovered there could be no association or attribution of the criminal activity.

The initial overt act of fraud perpetrated by BM-1 was the preparation and filing of the exemption application for ORG. Counsel states that she is not aware of the existence of any officers, directors, trustees, or members of ORG, specifically any individuals listed in its application for tax exempt status states or any filed Form 990. The filed Form 990 for 20XX by ORG lists thirteen officers and directors; membership dues of \$; 39,922 recipients of grants; 4,400,000 volunteers; and 66,939 members of forty plus subordinate entities located in all fifty states. The validity of these facts does not comport with the fact that no other officer, director, trustee, member, grant recipient, volunteer, or anyone else has revealed themselves as being associated with ORG in any manner given the widespread government and media attention.

The bank accounts for ORG were analyzed and no evidence of any membership dues was identified as being received by ORG. The only sources of income

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determined were from direct mail and telephone solicitations and automobile donations.

For each of the years 20XX through 20XX, charitable or veterans related disbursements averaged less than \$ per annum. A review of the bank accounts did not reveal funds utilized for any care packages prepared and delivered to veterans. Counsel stated under oath that she could not attest to this activity being carried out.

It is concluded that BM-1 was the sole individual in control of ORG and the only actual individual, hence the exemption application was filed by a false individual, in addition to the listed officers therein, and all Forms 990 filed were filed by a false individual, in addition to the listed officers therein.

For profit and non-profit entities alike generally do not make substantial disbursements in cash. Substantially all of the documented disbursements by ORG by check were to the fundraising companies and lawyers. Substantially all of the remaining disbursements were ATM withdrawals, cashed checks, and checks payable to BM-1, Bookkeeper, and Counsel.

It is concluded that since BM-1 was the only signatory to the bank accounts, he controlled all facets of the finances of ORG. All checks were signed by BM-1. BM-1 never caused a Form W-2 or 1099 to be issued to himself, Bookkeeper, Counsel, or any other individual or entity. BM-1 as such, did not report any income on any filed return for any year from ORG. BM-1 evidenced knowledge of income and employment taxes by virtue of Article VII of the Articles of Association for ORG, believed to be falsely executed and submitted by BM-1, which addresses the payment of reasonable compensation for services. Compensation of officers, including BM-1, on the exemption application is indicated as zero. The filed Form 990 for 20XX lists zero compensation for officers, directors, etc., which includes BM-1. One Form 1099 is indicated as being filed for 20XX. BM-1 is listed as the CFO. An attachment to the return stipulates that each member of the Board must personally read and review all drafts of the Form 990.

“Willfulness” for purposes of criminal tax laws requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of the duty, and that he voluntarily and intentionally violated that duty.” We believe that BM-1 willfully constructed a scheme to commit tax evasion by stealing an

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identity, fraudulently forming a tax exempt veterans organization, and diverting funds for his own private purposes. Justice Blackmun expressed it, "incomprehensible to me how, in this day, more than 70 years after the institution of our present federal income tax system with the passage of the Income Tax Act of 1913, any taxpayer of competent mentality can assert as his defense to charges of statutory willfulness the proposition that the wage he receives for his labor is not income, irrespective of a cult that says otherwise and advises the gullible to resist income tax collections." John L. Cheek, Petitioner, v. United States. BM-1 has demonstrated through the complexity of his scheme that he is "a person of at least minimum intellectual competence."

BM-1 has failed to cooperate with the Service in providing any books, records, or communications in connection with this investigation. BM-1 has failed to maintain valid contact information for ORG. BM-1 has not surfaced since his disappearance in 20XX and since a nationwide warrant was issued for his arrest.

BM-1 has utilized ORG as his personal pocket book siphoning off at least \$1.1 million from ORG for the identified four and a half years from 20XX through 20XX thus revealing that he created ORG as a façade for his personal purposes. ORG contributed a negligible amount of its funds for charitable or veterans purposes and in essence had no legitimate purpose other than serving as a vehicle for tax evasion by BM-1. The illegitimate criminal purposes for which ORG was formed results in its corporate veil (recognizing that ORG was formed as an association) being pierced. United States of America v. William L. Walton.

### **TAX EXEMPT STATUS**

In determining whether there is inurement to a private shareholder or individual for purposes of §501(c)(19), it must be determined whether there is an excessive benefit flowing to a key insider. Inurement to insiders may consist of a payment that is excessive and may be in the form of salary, rents or compensation for services. In determining whether the inurement proscription under §501(c)(19) of the Code has been violated, it may be useful to review precedent arising under §501(c)(3).

Any unjust enrichment, whether out of gross or net earnings of an organization described in §501(c)(3) of the Code, may constitute inurement. See People of God Community v. Commissioner, supra. The inurement proscription applies to persons who, by virtue of their position of control or influence in the organization,



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have a personal and private interest in its affairs. *Supra*, at 133. Inurement need not be substantial, either in relative or absolute terms, in order to bar an organization from exemption under §501(c)(3). See Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash. 1963). Benefits to private interests which may violate the inurement proscription are not limited to monetary benefits but also include any ““advantage, profit, fruit, privilege, gain, or interest.” See Retired Teachers Legal Defense Fund, Inc. v. Commissioner, 78 T.C. 280 (1982). Inurement is generally considered to be confined to situations involving “insiders;” that is, persons who hold a position of control or dominance within an organization. Senior Citizens of Missouri, Inc. v. Commissioner, T.C. Memo 1988-493.

As BM-1 was the sole individual in control of ORG and its purported subordinate entities, he maintained a personal and private interest in the affairs of these entities. Through BM-1s complete dominance over ORG and its purported subordinate entities, he caused funds from such entities to be diverted to his personal and private interests.

The inurement proscription does not bar an organization from paying reasonable compensation to its employees. Mabee Petroleum Corp. v. U.S., 203 F.2d 872 (5th Cir. 1953). The reasonableness of compensation is determined utilizing the same principles as are applied in cases involving section 162 of the Code. None of the funds diverted to BM-1 by BM-1 were reported by either ORG or BM-1 as legitimate compensation.

ORG and its subordinate entities have not provided any evidence that its net earnings have not inured to the benefit of BM-1, a “private individual” for purposes of §501(c)(19) of the Code. There were no other officers, directors, or trustees, other than BM-1. The facts in this case support a finding of inurement to BM-1. See People of God Community v. Commissioner.

Based on the information available, ORG and its subordinates do not qualify for exemption under §501(c)(19) of the Code. ORG failed to establish qualification as it has not provided any books and records in response to the examination commenced by the Service and the net earnings of ORG inured to the benefit of BM-1 through his fraudulent embezzlement of funds therefrom.

As the sole purpose of ORG and its subordinate entities was to facilitate the fraudulent conveyance of funds for the private benefit of BM-1, such fraudulent

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purpose represents a substantial non exempt purpose which precludes entitlement to tax exempt status under §501(c)(19). As the original application for tax exempt status filed by BM-1 was false and the purposes for which ORG and its subordinates were formed were for fraudulent purposes, the effective date of revocation is June 13, 20XX, the indicated date of formation of ORG.

As ORG has not established that it ever maintained a membership, much less a membership comprised of war veterans, contributions under §170(c)(3) are not deductible to ORG, effective June 13, 20XX, the indicated date of formation of ORG.

**CONCLUSION:**

**GOVERNMENT'S POSITION:**

1. The tax exempt status of ORG as an organization described in §501(c)(19) of the Code is revoked effective June 13, 20XX.
2. Contributions to ORG are no longer deductible under §170(c)(3) of the Code effective June 13, 20XX.