Internal Revenue Service

Department of the Treasury

Taxpayer Identification Number:

Release Number: **201313034**
Release Date: 3/29/2013
Date: December 5, 2012
A
B
C
D

Person to Contact:

Tel:
Fax:

Tax Period(s) Ended:

UIL: 501.00-00:501.33-00

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"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effectiveJanuary 1, 2002..

Our adverse determination was made for the following reasons:

You are not operated exclusively for exempt purposes described in section 501(c)(3) of the Internal Revenue Code. Your primary activity consisted of administering and managing a "donor advised" account on behalf of an individual who established the account using a controlled entity. The funds and other assets credited to this account were distributed or used to benefit the individual and/or other private persons, in contravention of Treas. Reg. § 1.501(c)(3)-1(d)(ii). Through the creation and operation of this donor advised fund, you facilitated tax avoidance by enabling this individual to shelter income and assets from the Collection Division of the Internal Revenue Service for a period of time. Moreover, you and this sole donor advised fund operated by you were funded through conducting an unrelated trade or business in contravention of Treas. Reg. § 1.501(c)(3)-1(e)(1). You allowed distributions from the account that were not in furtherance of section 501(c)(3) purposes. Thus, you are operated for a substantial non-exempt purpose because you more than insubstantially served private interests and operated a trade or business for a nonexempt purpose.

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

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

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 Code.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

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 matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

Karen A. Skinder
Appeals Team Manager

Enclosure: Publication 892
Notice 1214 Helpful Contacts for your "Notice of Deficiency"

Internal Revenue Service

Department of the Treasury
Tax Exempt and Government Entities

Date: **September 14, 2010**

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 UnagreedIssues,* 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 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG RA-1 Address City, State		**Year/Period Ended** 12/31/20XX, 12/31/20XX, 12/31/20XX, & 12/31/20XX,

LEGEND
ORG - Organization name XX - Date Address - address City - city
State - state POA - POA Director - director President -
president President-1 - President-1 Vice-President - vice president
Treasurer - treasurer Treasurer-1 - treasurer-1 Secretary - secretary
DIR-1 through DIR-4 RA-1 THROUGH RA-17 CO-1 THROUGH CO-25
District - district Officer - officer REF-1 through REF-6

ISSUE

Whether ORG (sometimes referred to as "ORG") operates exclusively for exempt purposes?

FACTS

Formation of ORG

Background: According to the Spring, 19XX issue of the CO-1, "CO-3 at CO-2" (CO-3/CO-2) was established to encourage each District to set up a "Foundation at CO-2." The newsletter explained that CO-3/CO-2 would, at some point in the future, establish itself as a separate organization with its own staff and its own facilities.

CO-2. (CO-2) is currently located in City, State at the same address as ORG. CO-2 is a large donor advised fund that was incorporated in by DIR-1. in 19XX, but the history of the Director family's involvement with donor advised funds extends back to the late 19XX's.

The CO-4 (CO-4) is a foundation at CO-2. Only CO-4 members can receive Officer commissions for assisting persons who set up "Foundations at CO-2."

Articles of Incorporation: The Articles of Incorporation for ORG, originally known as CO-3, were filed in the State of State by its Registered Agent, DIR-2, on December 23, 19XX. Amended Articles of Incorporation were filed August 10, 20XX to report that the name of the organization had been changed to ORG The name was amended a second time on October 23, 20XX to ORG

The stated purpose of ORG was "to encourage philanthropy for charitable purposes by individuals and entities, and in general, the corporation shall be authorized to conduct any lawful activity permitted by a State not-for-profit corporation consistent with §501(c)(3) of the Internal Revenue Code amended, or the corresponding section of any future United States Internal Revenue Law:"

Attachment A to the Articles of Incorporation provided purpose, powers and dissolution clauses that are, limited to *ones* allowable under Internal Revenue Code (Code) Section 501(c)(3).

Paragraph A required that, upon dissolution, the assets would be distributed to organizations exempt under §501(c)(3). Paragraph B stated that ORG would operate exclusively for §501(c)(3) purposes. Paragraph C promised that no asset would inure to the benefit of members, officers, directors, or other private persons "except that the corporation may, at its discretion, pay reasonable compensation for services rendered and make payments and distributions in furtherance of the purposes set forth herein."

Bylaws: On January 8, 20XX, DIR-1, as the sole incorporator of ORG, appointed President, Treasurer, and Secretary as it's first Board of Directors. The officers were elected *on* that same date. President was elected to serve as the President. Treasurer would serve as Treasurer. Secretary was elected to serve as Secretary. When asked to provide information about these officers, ORG identified Secretary as a long time employee of CO-2 *who* provided bookkeeping services on behalf of ORG. RA-2 supplied technology and other services to ORG. No detailed information related to President, who is now deceased, was available. The current Bylaws of ORG were adopted by the new Board on the same date the directors were appointed. The Bylaws contain provisions for the operations of ORG that include the following:

- Article III grants the Board blanket powers and authorities with the exception of authorities forbidden by the Articles of Incorporation and any substantial activity that do not further the purposes of *the* corporation, Section 3.2 requires *a* minimum of 3 directors. Section 3.3 provides that directors will serve until the next annual meeting. A director may be elected to succeed him or herself.
- Article IV, Section 1 of the bylaws states that *the* only notice for the annual meeting would be the date provided in the bylaws. That date is blank. Special meetings required 2 days advance notice to the board members. Directors can waive notice of meetings, but the waiver must be in writing. Two directors may constitute a quorum.
- Article VI states that the Secretary shall prepare and keep minutes of board meetings. The President may sign with other officer of the corporation deeds, mortgages, bonds, contracts, and any other instruments unless expressly delegated to some other officer. The Treasurer is required to give a bond for surety.
- Article VII requires the corporation to keep books and records of account and keep minutes of the proceedings of its Board of Directors.
- Article XIII gives the Board of Directors the power to modify any restriction or condition on the distribution of funds, if in the sole judgment of the Distribution Committee

(without the approval of any participating trustee, custodian, or agent), such restriction becomes inconsistent with the charitable needs of the community served.

Application for Exemption: ORG filed Form 1023, Application for Exemption Under Section 501(c)(3) of the Internal Revenue Code Section 501(c)(3) (Application), with the IRS, in

January, 20XX. The applicant stated that the organization would "encourage generosity, philanthropy and charitable giving (sometimes referred to herein as "GPCG"), both inside and outside the District, in order to restore, maintain, and extend our national heritage of individual, corporate, and community social responsibility and action." ORG had no assets but did intend to acquire office furniture, supplies and equipment.

ORG reported that donors would be allowed to establish funds for exclusively charitable purposes as described in Code §501(c)(3). The document also included a statement that, "The donor can offer the Foundation his or her advice about what to do with the funds, but the final decision rests with the foundation." The Application stated that, "The Foundation may receive and review requests for contributions from §501(c)(3) organizations and will monitor the amounts distributed to verify that the funds are used for charitable purposes described in Section 501(c)(3)."

The applicant went on to state that, while payment of commissions is frowned on by the - charitable community, it (ORG) would encourage members of the financial community, etc. to undertake a greater role in directing the resources to the private philanthropic sector by paying reasonable compensation for services rendered while restricting those payments to a reasonable portion of the gifts made.

Attached to the Application was a resolution adopted on January 5, 20XX in which the Board of Directors "commits itself to obtain information and take other appropriate steps with the view of seeing that any participating trustee, custodian, or agent administers each restricted trust or fund and the aggregate of unrestricted trusts or funds of the REF-6..." The resolution was signed by President, Treasurer, and Secretary as directors.

Based on the information supplied by the applicant, Letter 1045 was issued by the Internal Revenue Service on February 29., 20XX recognizing ORG as an organization whose stated activities qualified for exemption from tax under the provisions of IRC section 501(c)(3).

ORG Governance: On June 28, 20XX, ORG's Board of Directors (Directors President, Treasurer and Secretary) took two actions by written consent. First, the Board approved the organization's name change to CO-3 Second, the Board accepted the resignations of the three directors. President, Treasurer and Secretary did not sign their resignations until July 19, 20XX, July 17, 20XX, and July 28, 20XX, respectively. In conjunction with the resignation of the original Board, the following persons were elected to serve as the officers and directors of ORG:

	Title	**Relationship**
DIR-2	**President**	**Son of DIR-1. and Director, Spouse of Vice President**

Vice President	**Vice President**	**Spouse of the DIR-2**
Treasurer-1	**Treasurer**	**Mother of DIR-2 and spouse of DIR-1**
DIR-3	**Director**	**None**
DIR-4	**Director**	**None**

Those five individuals served as the officer/directors of both the CO-2 and ORG from that date through December 31, 20XX. **DIR-1**. served as the CEO. No minutes for any meetings of the Board of Directors related to this change in governance have been provided: In fact, no minutes of any Board meetings were recorded prior to December 31, 20XX.

- All administrative, accounting, and financial activities of ORG continued to be conducted at the offices of CO-2 before and after the change in directors. Review of the officer signatures on the 20XX, 20XX, and the original 20XX Forms 990 found that President continued to be listed as the president in each of those years, and Secretary signed all those returns as Secretary. When asked to explain why Secretary signed the forms more than 2 years after she resigned as an officer, DIR-1 stated that Secretary signed those documents because "both ORG and she had simply forgotten that that she had earlier resigned as an officer."

ORG Operations Prior to Establishment of CO-5

According to its president, DIR-2, ORG was established to provide a variety of charitable, educational, scientific, and religious activities in the REF-6. During the first 2 years (20XX and 20XX), the organization did not receive sufficient revenues to engage in any substantive activities, and no expenses were incurred. However, per information included in the same correspondence, CO-2 (CO-2) transferred $ from six of its subaccounts to ORG at the direction of DIR-1. in January, 20XX. On or about March 10, 20XX, DIR-1. directed RA-3 to transfer $ back to CO-2. DIR-1 attributed the second transfer to requests by the donors who preferred to have those funds administered directly by CO-2.

On January 4, 20XX, $ was transferred into the ORG checking account as a donation from CO-2. This donation was reported on ORG's 20XX Form 990. When questioned about the timing of the reporting, the officers stated that the donation had been pledged in 20XX; therefore, it was reported on the 20XX Form 990. However, ORG has a cash basis accounting system. Also, on January 4, 20XX, ORG received $ from RA-4 and $ from two other sources. Four days later, 3 checks totaling $ were issued from the ORG checking account to the CO-6, the CO-7, and the

CO-8, all subaccounts held at CO-2. An additional $ check was paid to the CO-9, and $ was paid to CO-10 at that same time. All 5 of these checks were endorsed and deposited into CO-2's account at CO-11.

In May, 20XX, an additional $ was transferred from CO-2 to ORG. There is no evidence of any other activity until July, 20XX when discussions with RA-5 commenced. As a result of those discussions, CO-5 became the only donor advised fund (sub-account) at ORG in October, 20XX. CO-5 was the sole donor advised fund at ORG from that date through December 31, 20XX.

RA-5 and Her Business Enterprises

RA-5 is an author and nutritionist who promotes products through CO-12 (CO-12), CO-13, CO-14, CO-15, CO-16, and other companies.

CO-12 is a multi-level marketing company specializing in health food supplements and health products. Sales representatives recruit other distributors or sales representatives. This recruitment of down-line sellers is necessary to increase a sales representative's sales force and thus generate a greater number of sales. Down-line interests are generated when distributors sell products and earn income by creating a network of marketers. When down-line marketers sell products, "up-line" distributors may earn a commission on the sales. The terms "down-line interest" and "multi-level interest" are construed to be interchangeable.

RA-5's Involvement with Donor-Advised Funds

Per correspondence dated April 28, 19XX, RA-5 informed RA-6 at CO-12 (CO-12) that she had changed her will to "give all of my right, title and interest, including any of that represented by stock share certificates, in CO-14, a not-for- profit corporation, and CO-17., a for-profit corporation to the CO-18., a non-profit corporation organized for charitable purposes, ..." According to statements on the CO-2 website, CO-2 purchased a number of accounts from CO-18 in 19XX. In 20XX, RA-5 contributed CO-12 down-line account # to the RA-5 Foundation at CO-2.

Background of CO-19

CO-19 (sometimes referred to as "Company") was formed March 9, 20XX. Prospective Members were identified as RA-7, RA-5, and RA-8,with each owning a % interest in the Company. CO-20 was identified as the owner of the remaining %. Intended contributions were reported as $ each for RA-7, RA-7 and RA-8, with CO-20 contributing $.

RA-7 is RA-5's companion, assistant and caretaker. No information concerning RA-8 was available. ORG officers have stated that they were aware that CO-20 was formerly a member of the Company but no other history or information related to CO-20 was provided or found

through normal research methods. RA-9 exercised signatory authority for CO-21, a trustee for CO-20. Research found no records related to CO-21.

The Limited Liability Formation Agreement identified the purpose of the CO-19 to "be engaged in the business of providing business and financial management services, and any other business which is allowable for a State Limited Liability Company." The prospective members also agreed that:

- Cash and assets would be pooled so that the Company would be profitable, those profits would be honestly and equitably allocated to each member, and the needs of the customers would be met:
- A separate Capital Account would be maintained for each member and would be increased by the value of any additional contribution and decreased by any distribution, so that net profits and net losses could be determined by generally accepted accounting principles. Then those profits/losses would be allocated according to the Profit Allocation Plan.
- The office of the business where the records would be kept would be Address, City, State
- RA-7 was designated as the Business Manager, Treasurer, and Tax Matters Member. RA-5 was identified as Assistant Business Manager and the Secretary of the Company. RA-8 would be the Company Planner.

Per Receipt Certifying Member Interest in CO-19 dated March 19, 20XX, RA-7 received % interest in the Company for $ in cash, and other valuable consideration. On that March 9, 20XX CO-20 was allocated a % interest on receipt of $. The remaining % interest was received by RA-5 by a Receipt Certifying Member Interest in CO-19 dated March19, 20XX. According to the minutes of an organizational meeting dated March19, 20XX, RA-7 and RA-8 were all the organizers of the Company. The Receipt Certifying Member Interest in CO-19 was reported to have been read at the meeting and adopted as the Formation Agreement of the Company. RA-7, RA-5, CO-20, and RA-8 presented their contributions for Member Interest and the Receipt Certifying Member Interest in CO-19 was issued.

After the Operating Agreement was read and approved by the members, RA-8 withdrew as a member of the Company and sold his % interest to CO-19 for $. Ownership interest was then allocated % to RA-7, % to RA-5, % to CO-20. RA-7 was designated as the manager; RA-5 was assistant manager. RA-5 and RA-7 were granted blanket authority to sign checks on the bank accounts of the Company made payable to themselves or entities in which they have a financial interest.

According to the Operating Agreement of the CO-19, the Company was formed "to engage in the business of providing business and financial management services and any other business which a limited liability company may do and perform under the State LLC Act ..."

Article H, *Section* 3 required that the LLC maintain books and records which any member might inspect during normal business hours. Article III, Section 1 of the Operating Agreement stated that the Company would be managed as set forth in the Formation Agreement. Section 5 of Article III allowed the managers to devote time and efforts to other business interests unrelated to the Company; provided that Managers would not enter into transactions that directly compete with the business of the Company. Article III, Section 7 required that manager salaries were to be set by unanimous vote or written consent of Members.

Article IV, of the Operating Agreement:

- Required that *an* annual meeting of the members be held,
- Provided that *a* quorum would be two-thirds of the Members, as measured by their percentages of ownership,
- Stated that a two-thirds majority vote was required for Members to take action.
- Provided that each member would have one vote (or corresponding fraction thereof) for each one percent of ownership interest.

Article X, Section 2 *of the* Agreement states, "Any Member can withdraw as a member of the LLC upon (a) not less than ninety (90) days' written notice to the other Members, or (b) obtaining written consent of the Members."

Address, City, Sate was reported as the address for CO-20, and Address, City, State was reported as the principal place of business for CO-19.

CO-19 appears to have held a down-line CO-12 interest, account # which also appears to have been under the control of RA-5 as a managing member of the LLC.

Establishment of CO-5 at ORG

In July, 20XX, RA-5 and RA-7 began discussions with "DIR-1" (DIR-1.) and RA-3 concerning the CO-12 down-line interest held by CO-19. DIR-1 is the founder of CO-2 (CO-2), and RA-3 served as the CO-2 Treasurer until 20XX.

Notable among the documents exchanged during those discussions were the following:

- On September 9, 20XX, RA-7 transmitted a fax to RA-3 at CO-2. In that fax, RA-7 outlined a plan to make "RA-5's foundation with CO-2 (or the other one Founder mentioned) % owner, take RA-5 out as a member leaving me [RA-7] and one other person with % and after expenses the income would be the " foundations' [SIC]. We could hire RA-5 as a manager or something so she could make speeches for CO-12 and build a work with her down-line."

• An CO-2 Memo from RA-3, Title, Vice President Investments & Accounting, on September 10, 20XX introduced RA-5 to Attorney RA-10 as a person whose Federal tax liabilities exceeded $. RA-3 explained that the liability stemmed from RA-5's decision to stop filing tax returns to report her income.

• On September 13, 20XX, a memo from RA-3 advised RA-7 that "RA-11 has indicated that the IRS has its sites [sic] on CO-19." RA-11 is identified as the Officer for CO-5. RA-3 suggested that RA-7 might want to "abandon this one and start again without RA-5's name associated with it at all. In the light of these possibilities, I would not leave the down-line in CO-19 but transfer to CO-3 and operate out of there with a fresh new LLC and avoid any connections until RA-5 and RA-10 are able to resolve the IRS issues."

CO-19 submitted an "Application " to ORG on October 7, 20XX. CO-19 Financial was the proposed name. The donor was identified as CO-19. RA-5 and RA-7 signed the application as the managers of the LLC. RA-11 was named as the Officer (Officer).

The application provided a pro forma Proposed Charitable Purpose, "Any charitable, educational, scientific or religious activities that may be approved from time to time." The applicants chose to provide additional detailed purposes, "To maintain the nutritional and marketing business through CO-12 for the purpose of generating income for nutritional education and research, The CO-19 will continue to manage the business and advise the foundation. They will be paid reasonably for their services and RA-5 will continue to be the spokesperson magi [sic] with CO-12 Corp. Additional funds may be used to support other charitable organizations and ministries."

On the same date that the Application was submitted, RA-5 signed the Transfer of Ownership for CO-12 account ID # *from the* Company to "District Foundation FBO CO-5, RA-5 Manager." *And,* Successor Instructions were submitted to ORG by RA-5 to name RA-7, friend and companion, to serve as the "REF-2" in the event of RA-5's death or disability. ;

On October 10, 20XX, the members of CO-19 by resolution amended the Profit Allocation Agreement to provide that, effective November 7, 20XX, all income of the Company received from CO-12 would be charitably donated to ORG. The resolution reserved the right of the membership of the Company to "change the foundation receiving this gift." The resolution was signed by RA-9, RA-5 and RA-7. RA-3 of CO-2, signed an "Agreement to Accept CO-12 Membership" dated October 11, 20XX, on behalf of ORG.

Via a fax from CO-12 on October 14, 20XX, Secretary confirmed a conversation with RA-5 Friday the 11th. Secretary stated that RA-5's successor instructions had been received. Secretary

explained that for RA-7 and RA-10 RA-17 to be listed on "your" membership, they must relinquish any CO-12 membership they currently hold.

The fax went on to state that, 'We received a transfer of ownership from you today, but as we spoke before, you are to be the listed applicant for the new membership name . We also received successor instructions for CO-2 which we currently have the listed applicant or contact name as RA-3. Changes to *this* membership with CO-12 would need to be made by RA-3."

On October 25, 20XX, RA-9, authorized signatory, agreed to transfer all the right, title and interest of a % Member Interest held by CO-20 to ORG Project . The resolution was signed by RA-7 and RA-5 on October 25, 20XX. CO-3 Project # is the CO-5 subaccount at ORG

On that same date, "RA-5 with CO-19, of Address, City, State, CO-12 ID No." requested that CO-12 membership name be changed to "CO-3 whose Federal Tax Identification Number is #." RA-5 went on to acknowledge that "Under the new name and Federal Tax Identification Number, I will be receiving a commission check instead of using direct deposit."

RA-9 signed the October 25, 20XX resolution for CO-20 on October 29, 20XX. On October 30, 20XX, "RA-3, Signatory for CO-3," (ORG) accepted the % membership interest in the Company.

Minutes of a board of directors meeting reportedly held by phone on October 30, 20XX; listed RA-7, RA-5 and RA-9 as attendees. RA-9 in his role as signatory for CO-20 stated that "he wished to transfer the interest of CO-20 back to the LLC and withdraw as a Member of the LLC, and wished to receive as compensation therefore the sum of $." The members of the Company agreed to accept the withdrawal and pay the requested compensation upon execution of a Bill of Sales. The board members then resolved that the % interest be redistributed to ORG for the sum of $. RA-3 signed the document to accept the Company membership for ORG.[1]

Operations of CO-5

Revenues and Expenses: From October 20XX through July, 20XX, ORG received monthly income from CO-12 interest ##. Monthly payments from CO-12 were credited to the CO-19 REF-1 sub-account. From November, 20XX to July, 20XX, on receipt of the CO-12 monthly payment, the ORG routinely sent % of the amount of the CO-12 check to the CO-19. From July,

[1] A meeting of the members of the Company was held on 1/3/20XX. DIR-2, signatory for ORG' transferred the % interest back to the Company and withdrew as a member on that date. The Bill of Sales executed on 1/3/20XX transferred ORG' s interest to the Company for a payment of $.

20XX through July, 20XX, ORG changed the regular monthly distributions to the LLC to $. These payments were recorded as charges against the CO-5 sub-account on ORG accounting records. See **Attachment** I for a *schedule of the* deposits and withdrawals from the ORG bank account from January 1, 20XX to December 31, 20XX.

When questioned about these payments, ORG provided the following explanations in correspondence:

- November 7, 20XX – "There was an informal agreement that CO-3 (later renamed ORG) would retain % of the revenues received in regard to the Multi-Level Interest to pay unrelated business income tax (within the meaning of Code §511) in connection with CO-3' s ownership of The Multi-Level Interest. That was the extent of the understanding."
- May 17, 20XX — "In addition to itemized expenses the Company incurred in connection with the operation of the down-line interest, ORG paid approximately $ *per* month to the *Company* which represented compensation to be paid various personnel *of* the *Company* that operated the down-line interest." In subsequent correspondence, ORG identified RA-7 and RA-21 as employees *who* received Compensation from the Company.
- September 12, 20XX ORG explained that there was no % agreement. "Rather, ORG voluntarily began paying $ per month to the Company because *paying* a fixed, rather than a fluctuating amount would enable the LLC to'-plan adequately for the number of employees it could hire and retain to maximize the revenues the down-line could generate for the ultimate benefit of ORG and CO-2."
- October 8, 20XX ' "ORG believed that by limiting its support of the Company to % of the income ORG received from the down-line, it could adequately support the down-line for the ultimate benefit of CO-2 and ORG and leave a balance *which* could also be used to support its charitable purposes."

During that same time period, additional payments were made to CO-19 by ORG based on monthly Transaction Forms submitted by RA-5. These Transaction Forms were normally accompanied by a listing of Actual and *Projected* Expenses from CO-13 REF-3 or invoices for Labor and expenses for RA-12. State corporate records identify RA-5, RA-7 and RA-12 as the managers of *CO-13*. Those expenses included:

- Salary/Consulting *fees paid to* RA-12,
- Lease payments *at* the address of CO-13,
- Various office expenses including $ per month for office supplies and the same amount *for FedEx* fees,
- Legal expenses described as "trademark application, redo corporate structure, inventions and patents, trademark fees,"

• Preparation of REF-4 (CO-13) tax returns, revision of a business plan for a potential investor, auto insurance and maintenance, and mileage reimbursements at the standard rate.

See **Attachment** II for a schedule of the expenses reported on the listings. The list is not all inclusive since documents related to some disbursements to the Company were not provided

When asked to provide detailed documents to verify Company expenses, DIR-2 provided oral testimony during the 4/25/XX interview. DIR-2 stated that ORG had requested vendor invoices and purchase receipts from the Company, but none had been provided. Further DIR-2 indicated that because ORG was a limited partner, ORG could not force the Company to produce those documents. Later, in it's response to Information Document Request 5 on December 3, 20XX, ORG defended its disbursements of the income from the down-line interest by quoting the Uniform Management of Institutional Funds Act. The response stated that the board of directors of State charities is required to "act with care, skill, prudence, and diligence ..."

RA-11 was paid a commission of approximately % through CO-24 for serving as the Officer, and % of each CO-12 check was allocated to ORG as Marketing Service Fees.

IRS **Levy:** On July 19, 20XX, CO-12 notified RA-5, that a notice of a tax levy against her next CO-12 commission check had been received from the Internal Revenue Service. The levy was, in fact, issued against "CO-3, EIN as nominee, transferee and/or holder of a beneficial interest of RA-5." RA-5 contacted CO-2/ORG on July 20, 20XX to request assistance. That same day, DIR-2 sent a letter to RA-13 at the Internal Revenue Service stating "this project of ORG. was authorized on October 7, 20XX."

On July 23, 20XX in a letter from RA-5 to DIR-2 on "CO-14" letterhead, RA-5 declined to have DIR-2 contact her friends for a gift. And, RA-5 questioned whether DIR-2 would give the money received to her instead of paying his own tax obligation. Her analogy was, "It seems to me that you have asked (CO-2) to pay (CO-3) bill!" CO-2 is the account number for the RA-5 Foundation at CO-2. CO-3 is the account number assigned to the CO-5 at ORG.

In an email to RA-14 at CO-12 on August 2, 20XX, Attorney RA-15 identified his law firm as the representative of ORG. RA-15 requested "any documents in REF-5's possession, such as an assignment, etc :.. that demonstrates that the down-line interest was conveyed from RA-5 to CO-3." Later that day RA-14 requested RA-5's approval to provide those documents to RA-15. One of those documents was a Fax on 10/4/20XX from RA-5 to RA-16 at CO-12. In that fax, RA-5 thanked RA-16 for helping her with her estate problems. She also stated that *she* was "ready to sign the transfer of Membership to ORG of City, State with one exception. I want to be able to be the Manager of my down-line (and the Foundation agrees that that is fine with them) ..."

In a second letter dated August 3, 20XX POA, Power of Attorney for RA-5, and RA-15, representing ORG requested a Collection Due Process Hearing with the Internal Revenue Service. The letter pointed out that:

- RA-5 had made an offer in compromise, but the IRS had continued collection activity:
  A levy had been issued to the CO-12 Companies on the belief that RA-5 had transferred a down-line interest to ORG in 20XX;
- RA-5 was not an officer, a director, nor an employee of ORG:
- RA-5 receives no compensation or other payments from ORG;
- The levy relates to property owned by ORG, not RA-5

From July, 20XX to October, 20XX, the CO-12 checks issued to ORG for account ## were mailed directly from CO-12 to the IRS to reduce RA-5's tax liability. During that time CO-2/ORG officers, RA-5, and their attorneys gathered records and formulated strategies in an attempt to release and reverse the levy. During that same time period, with the exception of $ from the final liquidation of an investment account, the only income received by CO-5 sub-account resulted from transfers/donations from the RA-5 Foundation at CO-2.

On October 28, 20XX, RA-7, as manager of CO-19, provided a notice of a potential claim against ORG for its failure to make payments to CO-19. According to that letter, "We hereby demand that you immediately reinstate the funding mechanism to support the work of CO-19's employees for your benefit." A subsequent notated copy of RA-7' letter advised RA-7 that "DIR-1"(DIR-1.) had spoken to RA-5 and had been assured that there was no intention to sue. DIR-1 warned RA-7 that in the event that the letter was, in fact, a notice of intention to sue, distributions from the account would be frozen to save for a potential lawsuit.

RA-5 Bankruptcy: Finally, in October of 20XX, RA-5 declared bankruptcy. Bankruptcy laws prevented IRS levies against the CO-12 payments to ORG for the remainder of 20XX. Payments from the CO-12 account to ORG resumed that month. And, ORG resumed its monthly disbursements to CO-19. In March, 20XX, ORG distributed $, reported to be the total of residual CO-12 payments held by ORG, to RA-5's bankruptcy account. The CO-12 membership interest was also forfeited to the bankruptcy account.

On January 10, 20XX, the Internal Revenue Service filed an Adversary Complaint against RA-5 requesting that the bankruptcy court determine that her federal income tax was non-dischargeable and to determine the extent and validity of federal tax liens. The Complaint stated that RA-5's tax liability *for 19XX* through 20XX with interest and penalties was $. Per that complaint, "In the early 19XXs, RA-5 became involved with promoters of abusive tax avoidance schemes involving sham trusts to shelter income. The IRS audited RA-5 and assessed over $ in taxes. As the result of an IRS audit, RA-5 agreed to collapse the trusts, but continued to avoid

payment of her outstanding taxes holding assets in the name of and diverting income to various nominees, such as CO-25, CO-2, and CO-3."

The IRS also alleged that RA-5 was attempting to shelter substantial income from IRS collection by transferring her down-line interest in a multi-level marketing plan to ORG. "Now, according to the Debtor [RA-5], she has diverted her income to an entity known as CO-2 that she failed to disclose in her schedules or statement of financial affairs this case."

On July 17, 20XX, RA-5 filed an Original Disclosure Statement *for* Case Number # in the United States Bankruptcy Court Eastern District of State Marshall Division. According to that document, "The Debtor has been an author, lecturer and noted nutritionist for over 40 years. She has been instrumental in helping to develop various nutritional and health products which are generally marketed by and through her CO-22 organization which is managed by CO-12 Companies located in City, State. The CO-22 is generated through CO-19, a State Limited Liability Company of which the Debtor held a Percent (%) interest prepetition. She had previously conveyed (%) to the CO-3 ("CO-3"), a non-profit, tax exempt organization in City, State This transfer occurred following the date when the IRS had actually filed a federal tax lien against the Debtor. As a result of the previously mentioned Adversary Proceeding with the IRS, the Debtor has requested that CO-3 turn over the % interest conveyed to her through her disbursing Agent, which has been agreed by CO-3's counsel ..."

The document went on to state, "The Debtor's significant problems arose as a result of her acceptance of poor advice from individuals and groups concerning tax reporting and income tax liabilities."

The Agreed Final Judgment found that RA-5's federal income tax liability was non dischargeable. The court also found that the IRS had "valid tax liens that attach to all property and interest in property, regardless of record ownership." The judgment continued by ordering that RA-5's federal tax liabilities attach to the down-line interest, CO-12 ID ## previously held in the name of CO-19 for the debtor's benefit.

Financial Data & Calculations: During the period from January 1, 20XX through December 31, 20XX the sole checking account for ORG was held at CO-11 in City, State in account number #. No separate checking account was established for the CO-19. Receipts from all sources, including CO-12 payments, were deposited into this account. And, all checks written, including checks to the Company were issued from this account.

The only other financial account held by ORG was an investment account that was established at CO-23 in City, State. The account was initially funded with a $ withdrawal from the checking ORG checking account to purchase of shares on March 30, 20XX:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG RA-1 Address City, State		**Year/Period Ended** 12/31/20XX, 12/31/20XX, 12/31/20XX, & 12/31/20XX,

REVENUES

Total ORG Revenue 20XX through 20XX (For annual detail, see Attachment III.)

CO-2 contributions	$					
Other donations (subsequently transferred to CO-2)				$$		
CO-12 Acct ## receipts				$$		
CO-2 donations from RA-5 Foundation		$$				
Income from RA-5		$$				
Interest & Investments				$$		
Earnings on CO-19 (See K-1 Schedule below.)				$$		
Total Revenues				**$$**		

ORG's Income from Company Operations as reported on Forms 1065 and K -1

	First copy 20XX		**Amended 20XX***		**20XX**	**20XX**
Ordinary Income	$$	$$**	($$)	$$		
Short term capital loss	($$)	($$)				
Charitable Contributions	($$)				($$)	($$)
Section 179 Expense	($$)					
Net after deductible expenses	$$					
Non deductible expense	($$)			$$		
Net earnings	$$	$$	($$)			
					($	$$

*ORG provided 2 K-1's *for 20XX* for its CO-19 earnings. Those documents did not match. The 2nd copy was accepted as correct since the amount reported as the ending capital account balance was reported as the beginning balance on the 20XX K-1.

**CO-19 credited % of its 20XX net earnings to ORG. However, ORG was a partner for only the last quarter of that year.

EXPENSES

Total ORG disbursements 20XX through 20XX (For annual detail see Attachment III)

ORG Operating Expenses	
Accounting	$$
Annual Corporate Filings	$$

IRS Late 990 Filing Penalties $$

Expenses associated with CO-5

Transfers to CO-2/RA-5 Foundation to purchase books from RA-7-RA-5	$$	
Officer Expense		$$
Checks to CO-19 LLC	$$	
RA-5 Legal fees	$$	
Postage	$$	
Bank Charges	$$	
U BIT Tax/penalty on CO-12 income	$ $	
	$$	
Donations	$ $	
Total ORG Expenses		**$$**

Comparison of ORG income from CO-12 payments to total RA-5/Company related expenses

Income from CO-12 payments	$$	
Paid directly to CO-19, LLC RA-5 and Levy related legal expenses paid to vendors	$ $	
Transfers to RA-5 FDN to buy books from RA-7 RA-5 Enterprises	$ $	
Amount returned to RA-7/RA-5 Control		**$$**
Other related expenses		$ $
Total RA-5/CO-19 expenses		**$$**

Percent of CO-12 income to distributed to the RA-5/Company expenses ($$/$$) **%**

Percent of ORG donations out to total

income ($/($) %

It should be noted that no Forms 990-T were filed and no unrelated business tax was paid by. ORG until August, 20XX when delinquent Forms 990-T were filed for the tax years 20XX and 20XX. The taxable income reported on those returns was the "commission revenue" received from CO-12 account ##.

LAW

§501(c)(3) of the Code provides, in pertinent part, for the exemption from federal income tax of corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for pub l i c safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), 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 §1.501(c)(3)- 1 (a)(1) of the Tax Regulations states that in order to be exempt as an organization described in section 501(0(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

§ 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

§1.501(c)(3)-1(d)(1)(n) of the regulations provides that an organization is not organized or operated for an exempt purpose unless it serves a public rather than a private interest. Even though an organization serves a public interest, it will not qualify for status under §501(c)(3) of the Code if it also serves a private interest more than incidentally. Therefore, the organization must 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 interest.

§1.501(a)-1(c) The words "private shareholder or individual" in §501 refer to persons having a personal and private interest in the activities of the organization.

TAX-REGS, §1.704-1. Partner's distributive share, Part 02 of 02
(2) Basic tests as to ownership

(i) In general. —Whether an alleged partner who is a donee of a capital interest in a partnership is the real owner of such capital interest, and whether the donee has dominion and control over such interest, must be ascertained from all the facts and circumstances of the particular case. Isolated facts are not determinative; the reality of the donee's ownership is to be determined in the light of the transaction as a whole. The execution of legally sufficient and irrevocable deeds or other instruments of gift under State law is a factor to be taken into account but is not determinative of ownership by the donee for the purposes of section 704(e). The realities of the transfer and of the donee's ownership of the property attributed to him are to be ascertained from the conduct of the parties with respect to the alleged gift and not by any mechanical or formal test.

TAX-REGS, § 1.6033-2(i)(2) requires every organization which is exempt from tax, whether or not it is required to file an annual information return, to submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (section 501 and following), chapter 1 of subtitle A of the Code, section 6033, and chapter 42 of subtitle D of the Code, See section 6001 and § 1.6001-1 with respect to the authority of the district directors or directors of service centers to require such additional information and with respect to the books of accounts or records to be kept by such organizations.

In *National Found., Inc. v. United States, 13 Cl. Ct. 486 (1987)* (NFI), the court found that the plaintiff demonstrated the structural controls necessary to retain its exempt status where the evidence showed that the organization would refuse to administer a project if it did not meet five stringent standards:

1. That it be consistent with a the charitable purposes specified in section 501(c)(3);
2. That it have a reasonable budget;
3. That it be adequately funded;
4. That it be staffed by competent and well trained personnel; and,
5. That it be capable of effective monitoring and supervision by NFI.

The court also found that donors had relinquished all ownership and control over the donated funds or property to NFI and that NFI exercised its discretion in authorizing charitable distributions of the funds.

New Dynamics Foundation, Inc. v. United States; No. 99-197T provides a case in which the donor advised fund demonstrated inadequate controls. New Dynamics Foundation, Inc. (NDF) was initially operated as a "sub-account" under the National Heritage Foundation (NHF). NDF was later spun-off into a "west coast version of NHF." In that case, the court distinguished NFI, finding no indication that New Dynamics Foundation had a set of standards designed to prevent abuse of its funds or that donors relinquished all ownership and custody of the donated funds or property. In denying NDF's request for a declaratory judgment that it was exempt under IRC § 501(c)(3) the court commented that unlike NFI"...there is no indication in the case sub judice,

that plaintiff had, let alone enforced, a comparable set of standards -- a strong indication, in this court's view, that it was not serious about preventing the abuses of its funds."

In *Addis v. Commissioner, 118 T.C. 528 (2002), affd 374 F.3d 881 (9th Cir. 2004) and Weiner v. Commissioner, T. C. Memo. 2002-153,* the Tax Court held that National Heritage Foundation Form 886-A (R.ev.4-68) Department of the Treasury Internal Revenue Service failed to provide a good-faith estimate of the value of goods and services that the taxpayer received in consideration for contributions the taxpayer made to NHF in connection with a charitable split dollar life insurance arrangement and therefore denied the taxpayer's charitable contributions for 1997 and 1998 entirely.

In *Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 2443 (1945),* the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The importance of this finding was emphasized by the addition of § 1.501(c)(3)-1(c)(1) to the tax regulations which provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. Thus the operational test standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations that further nonprofit goals outside the scope of section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

Retired Teachers Legal Defense Fund v. Commissioner, 78 T C 280, 286 (1982) concluded that prohibited private benefit may include an "advantage; profit; fruit; privilege; gain or interest."

In *American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989),* the Tax Court held that an organization that, as its primary activity, operated a school to train individuals for careers as political campaign professionals was not operated exclusively for exempt purposes as described in section 501(c)(3) of the Code because the school's activities conferred impermissible private benefit. The court defined "private benefit" as "nonincidental benefits conferred on disinterested persons that serve private interests."

In *Plumstead Theatre Socy., Inc. v. Commissioner, 675* F.2d 244 (9th Cir.1982), affd. per curiam 74 T.C. 1324 (1980), a nonprofit arts organization furthered its charitable purposes by participating as sole general partner in a partnership with private parties to produce a play. With *Housing Pioneers, Inc. v. Commissioner,* 49 F.3d 1395 (9th Cir.1995), affd. T.C. Memo.1993 120 on the other hand, the organization that did not qualify as a *§501(c)(3)* organization because its activities performed as co-general partner in for-profit limited partnerships substantially

furthered a non-exempt purpose, and serving that purpose caused the organization to serve private interests. It had no management responsibilities and could describe only a vague charitable function of surveying tenant needs.

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974) ("Harding "), a nonprofit hospital with an independent board of directors executed a contract with a medical partnership composed of seven physicians. The contract gave the physicians control over care of the hospital's patients and the stream of income generated by the patients while also guaranteeing the physicians thousands of dollars in payment for various supervisory activities. The court held _that the benefits derived from the contract constituted sufficient private benefit to preclude exemption.

In *Redlands Surgical Servs. v. C.I.R,* 113 T.C. 47, 1999 WL 513862 (1999) the court found "impermissible private benefit. resulted from a nonprofit hospital's contract with a physician group, giving them a virtual monopoly over care of the hospital's patients and the income stream they represented, and providing the physician group with fees for supervising the hospital's medical staff." The court went on to state that Redlands Surgical Services "has ceded effective control over the operations of the partnerships and the surgery center to private parties, conferring impermissible private benefit"

In *est of Hawaii v. Commissioner,* 71 *T.C.* 1067 (1979), affd in unpublished opinion, 647-F.2d 170 (9th Cir. 1981), the Tax Court concluded that the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in section 501(c)(3) of the Code.

A tax exemption is a matter of legislative grace, and an organization seeking an exemption must prove that it "comes squarely within the terms of the law conferring the benefit sought". *Nelson v. Commissioner,* 30 T.C. 1151, 1154, 1958 WL 1079 (1958); see also *Fla. Hosp. Trust v. Commissioner,* 103 T.C. 140, 153, 1994 WL 400439 (1994), affd. 71 F.3d 808 (11th Cir.1996).

In *Church of Scientology v Commissioner,* 823 F.2d 1310, 1318 (9th Cu. 1987), the Ninth Circuit noted that it found the taxpayer's arguments unpersuasive in large part because the taxpayer presented little documentation to show that the majority of the money was used for Church purposes and failed to present the documentation necessary to trace the source and use of Church monies.

The Tax Court in *Bubbling Well Church of Universal Love, Inc. v. Commissioner,* 74 T.C. 531

(1980) noted that the taxpayer failed to establish that it was not operated for the private benefit of its founders, The taxpayer claimed to have expenditures for maintenance and supplies, office supplies and maintenance and supply inventory The taxpayer made a general statement that the amounts were for hymnals, church and office equipment, postage, etc. This was found not to be adequate. The taxpayer claimed to follow Protestant forms of ritual but there was no direct information about the services conducted or who attended. No objective facts were provided to explain the purposes of a trip to Germany. Only vague information was provided making it probable that virtually all of the income benefited the founders. Inadequate information was given about how compensatiori-was determined and there was virtually no objective information about the services performed.

In *The Church in Boston v. Commissioner,* 71 T.C. 102 (1978), the court concluded that the operational test was not satisfied where the taxpayer could not adequately document grants that it made. The taxpayer stated the grants were made in furtherance of a charitable purpose to wit, to assist the poor who were in need of food, clothing, shelter and medical attention. The only documentation for the grants was a list of grants made which included the name of the recipient, the amount of the grant and the "reason" for the grant which was specified as either unemployment, moving expenses, school scholarship or medical expense. Some grants were made to the taxpayer's officers. The court found this was inadequate and that there needed to be documented criteria which would demonstrate the selection process of a deserving recipient, the reason for specific amounts given, or the purpose of the grant.

In New Concordia Bible Church v. Commissioner, T.C. Memo. 1984-619, the court noted that complctc information about disbursements was required to ensure there is no inurement. There needs to be details about services provided in exchange for support.

APPLICATION OF LAW TO ORG OPERATIONS

The analysis of any organization's qualification for recognition as one described in Code §501(c)(3) must begin with the organizational and operational tests discussed in Treas. Reg. § 1.501(c)(3)-1. That regulation points out that, "If an organization fails to meet *either* the organizational test or the operational test, it is not exempt." _

Organizational Test

The organizational test requires that the governing instruments limit the purposes of the entity to ones described in Code §501(c).(3) and may not expressly empower the organization to engage, other than as an insubstantial part, in activities which in themselves are not in furtherance of one or more exempt purposes. In order to establish that it is operated exclusively for one or more exempt purposes, the assets must, also, be irrevocably dedicated to §501(c)(3) purposes.

Therefore, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, o r to the Federal government, or to a State or local government, for a public purpose.

Review of the original Articles of Incorporation filed on December 23, 19XX found that the specific purpose was to "encourage philanthropy for charitable purposes." Attachment A to the Articles of Incorporation provides purpose, powers, and dissolution clauses that closely follow the standard ones that have been adopted by many organizations and are provided in IRS publications as the model for provisions that are adequate to meet the organizational requirements of §501(c)(3). Therefore, ORG meets the organizational test required by §501(c)(3).

Operational Test

Preface

„Any charitable, educational, scientific or religious activities that may be approved from time to time... To maintain the nutritional* and *marketing business through CO-12 Corp for the* purpose of *generating income for nutritional education research. The CO-19 will continue to manage the business* and *advise the foundation. They will be paid reasonably for their services and RA-5* will *continue to be the spokesperson. Additional funds may be* used *to support other charitable organizations and* ministries."- *CO-5 Proposed Charitable Purpose 10/7/XX.

As pointed out *in* New Dynamics Foundation, Inc. v. United States; No. 99-197T, *"[T]he critical inquiry under the operational test is on the 'purposes towards which an organization's activities are directed."* In applying *Tax* Regulation § 1.501(c)(3)-1(c), ORG must "engage primarily in activities which accomplish one or more of such exempt purposes *specified in* section 501(c)(3)."

Prior to the Pension Protection Act of 20XX the term "donor advised fund" was not defined *in* the Code. However, the term was understood to refer to separate funds or accounts established and maintained by public charities to receive contributions from a single donor or a group of donors. The charities had ultimate authority over how the assets in each account were invested and distributed, but the donors, or individuals selected by the donors, were permitted to provide nonbinding recommendations regarding account distributions and/or investments.

CO-5 was the only donor advised fund at ORG from its inception in 19XX through December 31, 20XX; therefore, its operation must be the focus of the analysis in evaluating ORG's activities and whether it operates in an exempt manner. And, among the historical facts that must be considered in this analysis are ORG's close association with CO-2 and the governing body, facilities and staff shared by the two.

While ORG had a relatively short history and states that the organization struggled in its early years, its directors, officers, and the CO-2 staff that provide services t o ORG had many years of experience operating a donor advised fund that is arguably one of the largest in the country. -

ORG Operations

The only documented activities of ORG and its only sub-account, CO-5, from 1/4/20XX to 12/31/XX were:

- Receipt of three small donations on 1/4/20XX that were transferred to CO-2 subaccounts four days later,
- Receipt of $ in "endowment" funds transferred from CO-2,
- Communications with RA-5 related to the transfer of the CO-12 down-line interest, acceptance of that transfer and subsequent CO-12 checks, and acceptance of the CO-19 partnership interest,
- Payments to and for CO-19, Charitable contributions totaling $ as requested by RA-5, manager of the Company, and
- Attempts to obtain a release of the levy precipitated by RA-5's personal tax liability.

ORG Structural Control

National Found., Inc. v. United States, supra provides the elements that demonstrate structural controls necessary *for* a donor advised fund to retain its exempt status. NFI would not accept a project unless it met *five* stringent standards:

1. That the purpose of the project (sub-account) be consistent with the charitable purposes specified in 501(c)(3);

ORG has provided no evidence that any officer, director or authorized representative of ORG ever questioned RA-5's expectations that the CO-5 would:

- Maintain the nutritional and marketing business,
- Conduct nutritional education research,
- Allow the LLC RA-5 and RA-7 managed to operate the business with RA-5 as the spokesperson with CO-12, and

Pay for those services.

When asked if ORG examined financial statements, earning reports, balance sheets, etc, ORG officers stated that because the Company was newly formed, it did not have any history to examine. However, the CO-12 reports stated that account # (the down-line interest that was transferred to the CO-19 and then to ORG for the benefit of the CO-5 sub-account) has been an CO-12 account since 19XX and has earned nearly $ since inception.

The ORG/CO-2 officers had accepted a similar membership transfer to the RA-5 Foundation at CO-2 the previous year and would have been aware that RA-5 had been involved with CO-12 for many years. ORG officers were cognizant of the fact that RA-5 had written several books on nutrition. And, the officers were aware that RA-5 had an outstanding federal income tax liability exceeding $. Yet, these officers tacitly accepted that RA-5 was and would remain the manager of CO-19. No contemporaneous documents have been provided to demonstrate that any ORG officer or director:

- Investigated the operations of the nutritional or marketing business,
- . Determined whether CO-19 had employees who had the expertise to conduct the nutritional research,
- Questioned how the research results would be disseminated to benefit the public, or
- Attempted to retain the rights to patents and/or copyrights developed through funding from ORG which were awarded to CO-13 and/or other for-profit companies controlled by RA-5.

There is no contemporaneous record of any occasion when an officer or director questioned the value of the CO-19 membership or the possible lack of donative intent behind the transfer to CO-5. ORG officers did not assess the value of the down-line for tax purposes, nor, was there any evidence that financial statements, tax returns, revenue and/or expense reports were examined to evaluate the earning potential of the CO-12 account or the value of % interest in CO-19.

(2) That the sub-account have a reasonable budget;

ORG has provided no evidence that a budget was solicited or submitted prior to acceptance of the application. Instead, the officers stated that because ORG was an organization in its infancy which needed `seed' funding, it accepted the CO-19 Application (sub-account) in spite of the uncertainties and with knowledge of RA-5's tax liabilities.

(3) That the sub-account be adequately funded;

ORG may have believed that the Foundation would be adequately funded by the CO-12 payments. But, there is no record that the earnings history of the down-line was solicited or examined. No annual budget was prepared. And, there is no record that the officers reviewed or discussed the operations of CO-19 before or after accepting the application.

f4) That the sub-account be staffed by competent and well trained personnel;

When ORG was asked to provide the names and the qualifications of the employees and contractors who were compensated by CO-19, RA-7 and RA-21 were the only employees

identified. In correspondence, RA-17, as the current vice-president of ORG, responded that that since ORG did not hire those persons, it was not aware of the qualifications that led to the selection of these individuals. When asked to provide employment tax form, DIR-4 responded that the individuals were not employees of ORG; therefore, ORG does not have copies of those forms.

(5) That it be capable of effective monitoring and supervision

Despite the fact that it held a % ownership interest in CO-19 (which conveyed nearly all the member voting control to ORG), ORG has not documented any occasion when an officer or representative attended any board meetings or even requested minutes of those meetings. No ORG officer or other authorized person has provided any records of informal conversations, calls or correspondence to confirm that disbursement requests were valid business expenses. With the exception of travel expenses for one RA-5 speaking engagement in 20XX and invoices provided for expenses in the last 2 months of 20XX, the only invoices provided consisted of a list of undocumented operating expenses attached to the ORG Transaction Form. From 11/20XX through 11/20XX the invoices were provided on CO-13 letterhead. From 11/20XX to 8/20XX, the source of the listing in some months was not identified. In other months, the list referenced RA-21, one of the managers of CO-13.

Other disbursements from ORG to the CO-19 were routinely made without any documentation. When asked to provide records of contacts with the Company, ORG reported that the discussions were primarily oral, and ORG had no other documents related to those payments.

The antithesis of the *CO-18.* case can be found in ***New Dynamics Foundation, Inc.*** Like New Dynamics Foundation there is no indication that ORG has a set of standards designed to prevent abuse of its funds or insure that donors relinquished all ownership and custody of the donated funds or property. Instead, ORG's pattern of returning the CO-12 income to pay the alleged operating expenses of CO-19, while it continued to be managed and controlled by RA-5 and RA-7, suggests that the donor did not truly relinquish ownership and control over the donated funds and property. ORG 's lack of involvement and RA-5's control of the CO-12 account were clearly evidenced by the fact that CO-12 notified RA-5, not ORG, that an IRS levy had been received against **her** account nearly 2 years after she had transferred ownership of the CO-12 account.

The *Addis v. Commissioner* and *Weiner v. Commissioner* cases provide instances where donors received substantial benefits while the documents structuring the transaction avoided stating that any obligations were imposed on the donee (NHF). In both cases, the court found that the taxpayers contributed money in the amount of the premium that the donee was required to pay to be eligible for a portion of the death benefit on the donors' lives. NHF would then pay the premium on a split dollar life insurance policy with the donated funds and issue a confirmation to

the taxpayer acknowledging the charitable contribution, along with a statement that NHF "did not provide any goods or services to the donor in return for the contribution."

As part of the *Addis v. Commissioner* decision the court stated that, "Petitioners and NHF designed a scheme purporting to provide no benefits to petitioners in exchange (or consideration) for petitioners' payments. However, petitioners received substantial benefits from NHF under the life insurance policy. In the documents structuring this transaction, petitioners and NHF avoided stating any obligation of NHF and made it appear that petitioners made an outright gift to NHF with no quid pro quo. However, petitioners expected, and they told NHF that they expected, NHF to use their contributions for both their and NHF's benefit."

Like the donations by Addis and Weiner, the transfer of the CO-12 down-line interest appeared to
be an outright donation of a valuable asset. Unlike Addis and Wiener, the donation was not structured to provide a tax deductible contribution. But, CO-2/ORG officers were aware that RA-5 already had a substantial outstanding tax liability.

ORG has pointed out that it was under no legal obligation to approve payments to the down-line. But, in fact, all requests for payments were approved as long as the CO-12 payments were providing an income stream to ORG. And, after those payments were made, ORG stated that, as the "junior partner," it was not in a legal position to access invoices, influence day to day operations, be part of the employee selection and compensation process, or access the employment tax records to verify the validity of the expenses.

The ultimate result was that ORG allowed RA-5 and RA-7 to continue to control the CO-12 income circuitously by having ORG receive the income for the benefit of the CO-19 Financial sub-account and then requesting disbursements from the sub-account to CO-19. Those funds were used to pay the expenses of for-profit entities controlled b y RA-5 and RA-7.

ORG Partnership Control

As evidenced by the Schedule K-1 provided to ORG by the Company, CO-19 elected to be treated as a partnership. IRC § 1.704-1 provides that the reality of the transfer and of the donee's ownership of interest in a partnership attributed to him are to be ascertained from the conduct of the parties with respect to the alleged gift and not by any mechanical or formal test. The execution of legally sufficient and irrevocable deeds or other instruments of gift under State law is a factor to be taken into account but is not determinative of ownership by the donee for the purposes of section 704(e).

A §501(c)(3) organization may form and participate in a partnership, including an LLC treated as a partnership for federal income tax purposes, and meet the operational test if participation in the

partnership furthers a charitable purpose, and the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners. *See Plumstead* and *Housing Pioneers.* Similarly, a §501(c)(3) organization may enter into a management contract with a private party giving that party authority to conduct activities on behalf of the organization and direct the use of the organization's assets provided that the organization retains ultimate authority over the assets and activities being managed and the terms and conditions of the contract are reasonable, including reasonable compensation and a reasonable term. *See Broadway Theatre League.* However, if a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be organized and operated exclusively for exempt purposes.

Revenue Ruling 98-15 in Situation 1 and Plumstead Theatre Society, Inc describe partnership agreements which are structured in a manner that permits the charity to control the partnership. In both cases, the exempt organization structured the partnership agreement, to permit the organization to act exclusively in furtherance of exempt purposes. In contrast, ORG has claimed that the "limited partnership agreement" [sic] positioned it as nothing more than an investor who "merely passively maintained the down-line asset by receiving a share of income from the CO-22 and making distributions to maintain a capitol asset of the organization." Under those circumstances, ORG argues that it could not exercise the control necessary to insure that its. Assets are dedicated to charitable purposes.

ORG defends its disbursements of the income from the down-line interest by quoting the Uniform Management of Institutional Funds Act. The response stated that the board of directors of State charities are required to "act with care, skill, prudence, and diligence ..." ORG has not provided evidence of any due diligence investigation into the character or history of managing members of CO-19, RA-5 and RA-7. In addition, the officers did not:

- Assess the value of the down-line interest or report that interest as an asset on its balance sheet,
- Question CO-19, RA-5, or RA-7' donative intent,
- Question why the donor in CO-19 did not request a valuation for tax purposes,
- Consider the implication of RA-5's failure to report the donation on her taxes,
- Consider the advantages of selling the down-line interest,
- 'Exercise its voting right to withdraw from or alter the Limited Liability Company Agreement, or
- Consider employing a different company to maintain the down-line interest.

After accepting the down-line interest, ORG promptly accepted what its officers have described as a "junior partnership interest" in CO-19, the donor of the interest, and allowed the managing members of the LLC to continue to manage the interest without question. Like the organizations described in *Harding Hospital, Inc.* and *Redlands Surgical Servs,* ORG exercised no control over the operations of the Company. Instead, the officers of ORG have continually maintained that as a "junior partner", they have no authority to control the daily operations of the "limited partnership."

There are no records of member or board of director meetings, requests for additional information, or discussions concerning the low return on the investment. Like the relationship between the partners in Housing Pioneers, Inc., supra, ORG had no management responsibilities and could only describe vaguely the operations of the Company. In fact, ORG ceded control of the Company to the donor, despite its voting rights.

And, like the for-profit partners of *est of Hawaii,* RA-5 and RA-7, through their alleged managing interest in CO-19 and RA-5, were able to use the non-profit, CO-5 at ORG to further their for-profit purposes.

ORG Burden of Proof

The courts have consistently affirmed the importance of compliance with the recordkeeping requirements imposed by IRC §6033. The court in *Church of Scientology v Commissioner* "found the taxpayer's argument to be unpersuasive in large part because the taxpayer presented little documentation ..." Likewise in *Bubbling Well Church of Universal Love v. Commissioner,* the failed to establish that it was not operated for private benefit because the taxpayer did not make an open and candid disclosure of facts. The court found that there was no evidence provided to show that payments were reasonable. And, in *Church in Boston v. Commissioner,* the court concluded that the operational test was not satisfied where the taxpayer could not adequately document grants that it made. In deciding *New Concordia Bible Church v. Commissioner,* the court noted that complete information about disbursements was required to ensure there is no inurement.

ORG has provided no documentation validating the exempt purpose of the payments to CO-19. Instead, ORG has used its claim that it was not the management member of the alleged limited partnership to explain its failure to adequately document the charitable purpose for the disbursement of virtually all the income of the down-line interest to the control of the donor.

TAXPAYER POSITION

In correspondence dated December 3, 20XX, DIR-1 stated that ORG was inactive for several years following its incorporation with the exception of its receipt of the CO-12 down-line

interest. According to DIR-2, ORG sought to maintain the value of the interest via the only means possible, payment of the costs necessary to sustain its ongoing value. DIR-2 continued by quoting the Uniform Management of Institutional Funds Act, and enumerated a list of circumstances a board should consider in administering a fund.

During that same meeting, ORG attorneys expressed the belief that the exempt status should not be revoked because ORG did not receive a "portfolio of blue-chip stocks which produced capital gains and dividend to sustain its initial existence..."

ORG has denied knowledge of the existence of the RA-5 lien prior to acceptance of the down-line interest and maintain that, as a "junior partner" in the Company, it had no rights to enforce its request for documents related to actual expenses which it paid as requested by RA-5.

ORG has asserted that CO-12 account ## held by the RA-5 Foundation at CO-2 benefited from the operations of the Company, as well.

GOVERNMENT POSITION

Based on the facts in this case, the IRS has determined that:

- RA-5 built a successful business through her association with CO-12. In the mid 19XX's, RA-5 stopped filing Federal Income Tax Returns to report her income. As a result, RA-5 amassed an unpaid tax liability exceeding $. In 20XX, RA-5 removed a portion of her income from IRS collection efforts by transferring CO-12 account ## to the RA-5 Foundation at CO-2. Subsequently, in 20XX, her efforts to protect the CO-12 account ## from taxation and collection led her to discussions with ORG, a relatively new donor advised fund organization controlled by the same individuals who ran CO-2.

- ORG officers were aware of RA-5's outstanding tax liability and the attention that the IRS was focusing on RA-5 and her assets prior to accepting the CO-12 down-line interest.

- The preliminary discussions between ORG and RA-5 focused on how to best structure the ORG subaccount to deflect IRS attention from the income received from CO-12 CO-22 account ##. Then, ORG proceeded to accept ownership of the down-line interest, but did not report the value of the donation as a contribution or an asset.

- ORG has failed to demonstrate due diligence in accepting % ownership of the Company (CO-19) and in documenting the exempt purpose of subsequent payments to the Company.

• ORG demonstrated little knowledge concerning the operations of the LLC which allegedly supported the organization's valuable asset.

• Over the 3+ years after the Company donated the down-line interest, virtually all the income received was returned to the donor, the Company (LLC). And, because the Company was controlled by RA-5 and RA-7, much of the income was used to support the operations of businesses owned by RA-5 and RA-7.

• ORG alleged that additional charitable benefits were served through its support of the RA-5 Foundation at CO-2. However, ORG has failed to meet its burden of proof by providing any detailed explanations or financial records of the relationship between the RA-5 subaccount at CO-2 and the Company.

ORG did not provide evidence of-the structural controls necessary for donor advised funds- as set forth by *CO-18.* Instead, after accepting the down-line interest, ORG promptly accepted an ownership interest in CO-19, the purported donor of the CO-12 CO-22 interest, and allowed the Company to continue to manage that interest. Then ORG disclaimed any control over the operations of the Company.

ORG that allowed RA-5 and RA-7 to freely and effectively employ the transferred assets and income derived there from in furtherance of their own private interest and benefit. ORG's pattern of returning the income generated by the CO-12 account as operating expenses to CO-19, which continued to be managed and controlled by RA-5 and RA-7, suggests that the donor did not truly relinquish ownership and control over the donated funds and property. Rather, the CO-19 managers were allowed to treat ORG as a conduit to shield CO-12 income from IRS tax collection efforts against RA-5. Salary payments to RA-7 and ORG income that was diverted to CO-13 and RA-7 RA-5 have resulted in substantial private benefits to both RA-5 and RA-7.

CONCLUSION

The Internal Revenue Service has concluded that ORG does not operate exclusively for charitable, educational, or other exempt purposes. Therefore, the Internal Revenue Service should revoke its exempt status effective January 1, 20XX.