



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE Exemption Organizations Examination
1100 Commerce Street, MC 4980 DAL
Dallas, TX 75242

January 22, 2009

Release Number: 201327015
Release Date: 7/5/2013
ORG
ADDRESS
501-04.00

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Renee B. Wells
Acting Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A	Explanations of Items		Schedule number or exhibit
Name of Taxpayer ORG	Tax Identification Number EIN	Year/Period ended 20XX12, 20XX12, 20XX12	

LEGEND

ORG - Organization name XX - Date EIN - ein State - state CO-1,
CO-2 - 1st & 2nd COMPANIES motto - motto DIR-1 & DIR-2 - 1st & 2nd DIR

ISSUE:

Whether ORG (ORG) continues to qualify for exemption under Section 501(c)(4) of the Internal Revenue Code?

Whether there was inurement or private benefit in the use of organization funds by the President?

Whether IRC §482 can be applied to the funds deposited into the ORG CO-1 account?

FACTS:

Exemption

ORG filed Articles of Incorporation with the State of State on August 16, 19XX.

ORG filed Form 1024, Application for Recognition of Exemption Under Section 501(a) of the Internal Revenue Code, on September 12, 19XX. The organization's stated purpose was to educate the public and policy-makers about issues related to motto. It also states that ORG is established in conjunction with CO-2 (CO-2), which is currently applying for recognition as a §501(c)(3) organization.

The organization planned to do this through several media:

- a. The organization plans to educate the general public about motto by developing pamphlets and other printed material and distributing them at fairs, public gatherings, on their website, and through advertising.
- b. Sponsor and work for the passage of initiatives to permit the unregulated production of industrial motto.
- c. Educate policy-makers in various administrative agencies - such as the State Health Department and the State Liquor Control Commission – on issues such as the medical use of motto.
- d. Plans to fund legal battles that emerge when legislation pertaining to motto and motto is passed.

The Form 1024 also stated that the organizations sources of financial support would be "Contributions, benefits".

Exemption was granted under §501(a) and §501(c)(4) of the Internal Revenue Code, on January 26, 20XX.

Form 886-A 20XX	Explanations of Items	Schedule number or exhibit
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Activity

President, President of both ORG and CO-2 (CO-2), stated in the initial interview for the examination of CO-2, held on December 18, 20XX, that ORG was currently inactive.

In a subsequent telephone conversation on, June 12, 20XX, President stated that ORG has not been active since about 19XX.

President stated that prior to the establishment of a bank account for CO-2, credit card payments from the operation of its (CO-2) clinics were deposited into the ORG account at CO-1.

Examination of ORGs bank statements indicate that the majority of deposits made into the account were from credit card payments made to clinics operated by CO-2.

Year	Total Deposits	Credit Card Deposits	Other Deposits	Percentage CC Deposits
20XX		*		%
20XX		**		%
20XX		***		%
Totals				%

Notes: * In 20XX ORG had deposits of \$ in debt reversals that were included with other deposits. If these deposits were not included in other deposits, the total credit card deposits would % of total deposits, (/ (-)).

** In 20XX ORG had deposits of \$ (\$ in cash, \$ in checks from CO-2, and \$ in purchase returns / check reversals) that were included with other deposits. If these deposits were not included in other deposits, the total credit card deposits would % of total deposits, (/ (-)).

*** In 20XX ORG had deposits of \$ that were check reversals included in other deposits. If these deposits were not included in other deposits, the total credit card deposits would % of total deposits, (/ (-)).

Transfers in the form of checks written from the ORG CO-1 account to the CO-2 account were.

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Transfers from ORG to CO-2

<u>Year</u>	<u>Amount</u>
20XX	
20XX	
20XX	

Inurement / Private Benefit

ORG's Board of Directors consists of the President, President, DIR-1, and DIR-2. Both DIR-1 and DIR-2 are independent contractors contracted by CO-2 to work in its clinics.

Examination of ORG's summoned bank records revealed that the President, President used funds deposited into ORG's CO-1 account for personal expenses such as house rent, car payments, and cash withdrawals.

<u>Year</u>	<u>Expenses Paid by Organization</u>	<u>Reported by President</u>
20XX		0
20XX		0
20XX		0
Total		0

President failed to report any of the payments on his Form 1040

IRC §482, Allocation of income and deductions

Examination of ORG's summoned bank records revealed that the President, President used CO-2 funds deposited into ORG's CO-1 account for personal expenses such as house rent, car payments, and cash withdrawals totaling \$.

LAW:

IRC §501(a) provides that an organization described in §501(c) (4) is exempt from income tax. Code §501(c)(4) exempts from federal income tax civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership

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of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

IRC §501(c)(4)(B) states that the exemption shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Regulation §1.501(c)(4)-1(a)(1) provides that in order to be exempt as an organization described in Code §501(c)(4), a civic league or organization must be both not organized or operated for profit and operated exclusively for the promotion of social welfare.

Regulation 53.4958-4 (a)(1) defines an excess benefit transaction as any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person, and the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit. Subject to the limitations of paragraph (c) of this section, to determine whether an excess benefit transaction has occurred, all consideration and benefits exchanged between a disqualified person and the applicable tax-exempt organization and all entities the organization controls (within the meaning of paragraph (a)(2)(ii)(B) of this section) are taken into account.

Government's Position:

ORG does not continue to qualify for exemption under Section 501(c)(4) of the Internal Revenue Code because it has failed to operate exclusively for the promotion of social welfare.

Exemption

ORG filed Articles of Incorporation with the State of State on August 16, 19XX.

ORG filed Form 1024, Application for Recognition of Exemption Under Section 501(a) of the Internal Revenue Code, on September 12, 19XX. The organization's stated purpose was to educate the public and policy-makers about issues related to motto. It also states that ORG is established in conjunction with CO-2 (CO-2), which is currently applying for recognition as a §501(c)(3) organization.

The organization planned to do this through several media:

- a. The organization plans to educate the general public about motto by developing pamphlets and other printed material and distributing them at fairs, public gatherings, on their website, and through advertising.

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- b. Sponsor and work for the passage of initiatives to permit the unregulated production of industrial motto.
- c. Educate policy-makers in various administrative agencies - such as the State Health Department and the State Liquor Control Commission – on issues such as the medical use of motto.
- d. Plans to fund legal battles that emerge when legislation pertaining to motto and motto is passed.

The Form 1024 also stated that the organizations sources of financial support would be “Contributions, benefits”.

Exemption was granted under §501(a) and §501(c)(4) of the Internal Revenue Code, on January 26, 20XX.

In order to be exempt as an organization described in Code §501(c)(4), a civic league or organization must be both not organized or operated for profit and operated exclusively for the promotion of social welfare, Regulation §1.501(c)(4)-1(a)(1).

ORG has not actively conducted itself as a social welfare organization for the period under examination. President, President of both ORG and CO-2, stated in the initial interview for the examination of CO-2, held on December 18, 20XX, that ORG was currently inactive. In a subsequent telephone conversation on June 12, 20XX, President stated that ORG has not been active since about 19XX.

This failure to operate exclusively as for the promotion of social welfare, does not allow ORG to qualify for exemption under Section 501(c)(4) of the Internal Revenue Code, Regulation §1.501(c)(4)-1(a)(1).

Activity

President stated that prior to the establishment of a bank account for CO-2, credit card payments from the operation of its (CO-2) clinics were deposited into the ORG account at CO-1.

Examination of ORGs bank statements from its CO-1 account indicate that the majority of deposits made into the account were from credit card payments made to clinics operated by CO-2.

Year	<u>Total Deposits</u>	<u>Credit Card Deposits</u>	<u>Other Deposits</u>	<u>Percentage CC Deposits</u>
20XX				%
20XX				%
20XX				%
Totals				%

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- Notes: *
- * In 20XX ORG had deposits of \$ in debt reversals that were included with other deposits. If these deposits were not included in other deposits, the total credit card deposits would % of total deposits, (/ (-)).
 - ** In 20XX ORG had deposits of \$ (\$ in cash, \$ in checks from CO-2, and \$ in purchase returns / check reversals) that were included with other deposits. If these deposits were not included in other deposits, the total CC deposits would % of total deposits, (/ (-)).
 - *** In 20XX ORG had deposits of \$ that were check reversals included in other deposits. If these deposits were not included in other deposits, the total credit card deposits would % of total deposits, (/ (-)).

Examination of the records showed that the majority of the withdrawals from the account were for the personal use by the president of ORG, President. The rest of the checks written were written to employees of CO-2, to doctors paid as independent contractors for their work in the CO-2 clinics, or as transfers in the form of checks to the CO-2 account.

Year	Employee Contractor Amount	Transfers ORG to CO-2 Amount
20XX		
20XX		
20XX		

Examination of the ORG's CO-1 account confirms the statements made by its President, President, that the account was used by CO-2 as a depository for credit card payments made relating to the operation of CO-2 clinics. There is no indication that any of the deposited funds were used for any activities by ORG for the promotion of social welfare. ORG has failed to be operated exclusively for the promotion of social welfare, Regulation §1.501(c)(4)-1(a)(1).

Inurement, private benefit of the President.

Code §501(c)(4)(B) states that the exemption shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

ORG's Board of Directors consists of the President, President, DIR-1, and DIR-2. Both DIR-1 and DIR-2 are independent contractors contracted by CO-2 to work in its clinics.

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Examination of ORG's records revealed that the President, President used funds deposited in the ORG account for personal expenses such as house rent, car payments, and cash withdrawals in the amounts listed below:

<u>Year</u>	<u>Expenses Paid by Organization</u>	<u>Reported by President</u>
20XX		0
20XX		0
20XX		0
Total		0

In John Marshall Law School and John Marshall University v. United States, 228 Ct. Cl. 902, 81-2 the court sustained the Service's revocation of the school's exempt status based on inurement. The court found inurement existed when the school provided family members who were officers, interest free loans, unsecured loans payments for non-business travel, payments for non-business entertainment, and personal health spa membership.

As in John Marshall Law School and John Marshall University v. United States, 228 Ct. Cl. 902, 81-2 the, the use of CO-2 funds for non-business use by the President, President, constitutes inurement. The President not only used CO-2 funds deposited into ORG's CO-1 account for his own personal expenses, he, as the one responsible for the day-to-day operations of ORG, failed to report any of the funds used as compensation for employment tax and W-2 wage reporting purposes.

CONCLUSION:

On the basis of the statements made by its President, President and examination of the books, records, and activities of ORG, the organization fails to qualify for exempt status under IRC §501(c)(4). ORG failed to operate exclusively for the promotion of social welfare.

President, President of both ORG and CO-2, stated in the initial interview for the examination of CO-2, held on December 18, 20XX, that ORG was currently inactive. In a subsequent telephone conversation dated, June 12, 20XX, President stated that ORG has not been active since about 19XX. Examination of the ORG CO-1 account confirms the statements made by its President that the account was used by CO-2 as a depository for credit card payments made relating to the operation of CO-2 clinics. There is no indication that any of the deposited funds were used for any activities by ORG for the promotion of social welfare. This inactivity causes ORG to fail that portion of Regulation §1.501(c)(4)-1(a)(1) that provides that in order to be exempt as

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an organization described in Code §501(c)(4), a civic league or organization must be operated exclusively for the promotion of social welfare.

President, President of both ORG and CO-2, is the only one who signs checks and approves billing. He authorized payments of his own personal expenses including house rent, car payments, and cash withdrawals. During the audit years \$ was expended on personal expenses. President failed to report any of these payments as compensation on Form 990 or Form 1040. By statute President, as an organization officer, is an employee of the organization, Regulation §31.3121(d)-1(b). IRC §501(c)(4)(B) states that the exemption shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual. The payment of \$ constitutes inurement to President.

As President of both ORG, President had complete control over the operations of ORG and the movement of funds into and out of the ORG CO-1 account.

Based on the determination that the funds deposited into the ORG CO-1 account were from CO-2 clinic operations while ORG was an inactive organization, the following will apply:

1. The credit card deposits from the CO-2 clinic operations made into ORG's CO-1 account will be added into the income calculations of the CO-2 examination. The income reflected in the ORG account should be allocated to the CO-2 account to clearly reflect the correct income for CO-2, IRC §482.
2. The payments made to the President, and the additional checks written to employees and independent contractors of CO-2 constitute wages. As President of both ORG and CO-2, President is an employee of each organization, Regulation §31.3121(d)-1(b). Therefore all expenses paid to the President, other CO-2 employees, and independent contractors should be treated as wage expenses generated from CO-2 activities. As such, the expenses paid in the ORG account should be allocated to CO-2 to clearly reflect the correct wage expense deductions for CO-2 operations, IRC §482.

Based on the examination of the books, records, and activities, revocation of ORG's exempt status is being proposed effective January 1, 20XX.