

Internal Revenue Service

Appeals Office
San Jose Appeals, MS-7100
55 S. Market St., Ste. 440
San Jose, CA 95113

Department of the Treasury**Taxpayer Identification Number:****Person to Contact:**Number: **201350047**

Release Date: 12/13/2013

Date: September 18, 2013

ORGANIZATION

UIL: 501.03-20

501.30-02

501.32-00

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, during your operation, you did not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective Date.

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

- You did not meet the operational test under section 501(c)(3) of the Code because you were not operated exclusively for the benefit of the public but rather of the grantors.
- The sale of land to a related entity provided favorable terms to the buyer. For example, although the transaction called for a seven percent interest, the interest only note with the principal payable upon completion of the project, with no defined deadline, served private inurement to disqualified persons and caused the transaction to be not an arms-length transaction.
- Not only did the family member trustees violate provisions in the Trust Agreement that prohibited disqualified persons from voting on any matter affecting the disqualified persons, their only signatures on the agreements pertaining to the transaction demonstrated the lack of involvement and control by non-family member trustees.

Contributions to you were 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 revocation, 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,

Acting Appeals Team Manager

Enclosure: Publication 892

cc:



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: August 4, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = State
C = Name of Supported Organization
D = Name of Supported Organization
E = Trustor
F = Trustor
G = Trustee
H = Trustee
J = Board Member
K = Board Member
L = Name of Family Trust
M = Name of LLC
N = Address (Parcel I)
O = Address (Parcel II)
P = Location
Q = Location
R = Attorney
S = Name
T = Name of Trust Under Agreement
U = Name
V = Board Member
W = Location
X = Date
Y = Date
Z = Date
aa = Date
bb = Date
cc = Date
dd = Date
ee = Date
ff = Date
gg = Date

UIL Nos.:

501.03-03
501.03-30
501.30-01
501.30-02
501.32-00
509.01-00

Letter 4036(CG)(11-2005)

hh = Date
ij = Date
kk = Date
ll = Date
mm = Date
oo = Date
pp = Date
b dollars = Amount
c dollars = Amount
d dollars = Amount
e dollars = Amount
f dollars = Amount
g dollars = Amount
h dollars = Amount
i dollars = Amount
k dollars = Amount
m dollars = Amount
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o dollars = Amount
p dollars = Amount
q dollars = Amount

Dear :

This letter supersedes our previous letter dated March 30, 2009. We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below:

ISSUES

1. Do you, an organization that received a donation of two parcels of real estate from your donors, qualify for exemption under section 501(c)(3) of the Code? No, for the reasons stated below.
2. If you are exempt, are you a supporting organization as described in section 509(a)(3) of the Code? No, for the reasons stated below.

FACTS

Letter 4036(CG) (11-2005)

Your Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, was submitted on X. Information submitted with your application indicates that you were created as a trust in the State of B effective Z and the laws of that state will govern your trust.

You requested tax exemption as a public charity under section 509(a)(3) of the Code. Your Schedule D states you will be "operated in connection with" one or more publicly supported organizations described in section 509(a)(1) or 509(a)(2). The supported organization is C.

Your Trust Instrument was executed by E and F as Co-Trustors and G, H, V, J and K as Co-Trustees. Article 2.1, while stating that the trust is irrevocable, also states that the Trustees shall have the power to amend this Instrument to change, add or delete the charitable beneficiaries designated in Article 2, paragraph 2.3.1. Article 2.2 states the foundation is organized and shall be operated exclusively for religious, charitable, medical, scientific and educational purposes within the meaning of Sections 501(c)(3), 2055 and 2522 of the IRC.

Section 2.3.1 of the trust identifies the charitable beneficiaries of the Instrument as C and D. Section 2.3.3 provides that each charitable beneficiary shall have the authority to enforce the Instrument and to compel an annual accounting from the Trustees.

Section 3.1 of the trust provides the names of the 5 initial Co-Trustees of the Foundation. This section indicates that any Co-Trustee, with the exception of G and H, may be removed and replaced, with or without cause, upon the unanimous consent of the remaining Co-Trustees. This section also provides that Co-Trustees may nominate their own successors upon their resignation.

Section 3.1.7 states that whenever the Trustee is authorized or directed to exercise any power, judgment or discretion, or to take or fail to take any action with respect to the Foundation ("Exercise of Discretion"), the Trustee shall be held harmless for the Trustee's Exercise of Discretion if the Trustee shall act in good faith, and the B Probate Code shall not be applicable to the Exercise of Discretion. In the Trustee's Exercise of Discretion, the Trustee may disregard the rights of any beneficiary or group of beneficiaries, and may act in any manner the Trustee shall deem appropriate. The Trustor intends that any Exercise of Discretion shall not be subject to review by any court, provided that the Trustee shall act in good faith. Any determination made by the Trustee pursuant to the Trustees Exercise of Discretion shall be binding upon all persons interested in the Foundation. Reliance by the Trustee on an opinion of counsel shall be conclusively presumed to be in good faith, but the Exercise of Discretion without an opinion of counsel shall not be construed against the Trustee in determining whether the Trustee did act in good faith.

Section 3.1.8 of the Trust Instrument provides that notwithstanding the foregoing, upon the death of G or H, their Co-Trustee positions shall be filled, if reasonably possible, with direct lineal descendants of E or F.

Section 3.2.1 of the Trust Instrument provides that except as otherwise expressly provided, the vote of the majority of the Trustees shall be the decision of the Trustees and binding on the Foundation.

Section 3.2.2 of the Trust Instrument provides that in the event that a Trustee is deemed a disqualified person under the Code, such Trustee shall not be permitted to vote on any matter affecting the disqualified person.

As stated, the Co-Trustees ("Trustees") of the organization are G, H, V, J and K. Both G and H are children of the Trustors, E and F. The Trustees of V and J have had a business relationship with the family members as, respectively, a certified public accountant and an B attorney. The remaining Trustee, K, is President of C and has no family or business relationship with the Trustors.

According to your application, you will support the charitable purposes of C, a section 501(c)(3) organization. Your support will primarily take the form of distributions of income to the charity, although you may also conduct or sponsor activities, programs, or events on behalf of the charity or perform the exempt functions or charitable purposes of the charity by conducting programs or activities that further the charity's exempt functions or charitable purposes.

Your application further states that you provided earmarked support to ultimately make health-related information available to the general public via the internet. Currently, public access to the information is gained by contacting the charity, the charity physically gathering the information and transmitting the same via U.S. Mail. In order to better serve and educate the public, it was felt automation of this program was necessary. Your support provided nearly all the necessary funding and resources for their project. In support of this, you referenced an attached letter from the President of C, who is K. This letter was subsequently obtained. The letter, dated ii, indicates you offered to contribute b dollars – c dollars annually to cover this activity, and that the funds will be earmarked solely for this purpose and will be kept separate and apart from any other donations. Your application further states that support to the charity began in 2004 and will continue thereafter.

Your application states that you accepted a start-up grant of c dollars from E and F, as your primary contributors in your initial year. Your application also states that E and F are substantial contributors and "disqualified persons" under IRC 4946, but they do not serve on your Board of Trustees.

The financial data provided with your initial application indicates you received c dollars in 2004 and that you expected to receive b dollars per year in 2005, 2006 and 2007. While showing no disbursements for 2004, the budgets indicate you expected to disburse b dollars per year in 2005, 2006 and 2007. The Balance Sheet reflected c dollars in cash and d dollars in land.

Your application states that you were formed in 2004 and no reports have been made to the charity yet; however, an annual report to the charity is anticipated after each fiscal year end which will include a copy of the most recent Form 990.

In response to our request for additional information regarding the financial information provided in your application, you indicated these figures were just estimates, and to the extent there is a discrepancy between the estimates made in Part IX of the application, the actual figures are set forth in the IRS Form 990 that had been filed. You also repeatedly referred to the Form 990's in various other requests for specific information regarding the financial data and operations. After repeated requests for copies of these Form 990's, you subsequently stated you discovered you had not filed Form 990's, and provided us with copies of the 2004 and 2005 Form 990's.

The 2004 Form 990 reflected direct public support of e dollars and no expenses. The e dollars contribution was shown as "Two Lots Raw Land W", and the Form 990 indicated this was contributed by E and F on Y. The description of the land indicates they are N and O (also known as Parcel I and Parcel II, respectively).

The 2005 Form 990 reflected direct public support of f dollars, interest on savings and temporary cash investments of g dollars, and other revenue of h dollars. Of the f dollars shown as direct public support, j dollars was shown as a donated noncash property contribution of a time-share resort unit from E and F, received kk. The h dollars in other revenue was described as interest on installment sale. The Form 990 showed k dollars in expenses, consisting of legal fees, insurance, equipment rental and maintenance, and postage and shipping. The Form 990 also stated that all assets were distributed to C on cc. The assets distributed were shown as cash of m dollars, a Note Receivable of p dollars, the time share Q as j dollars, and O as n dollars, for a total of o dollars distributed.

Both Form 990's indicate the books are in the care of R, your representative, and were signed by V as the paid preparer.

In your responses to our correspondence, you also indicated that effective as of ee, the Board of Trustees voted pursuant to Section 2.4 of the Trust Instrument to terminate and dissolve into the supported organization, C. You also provided a copy of the Unanimous Written Consent of the Trustees, authorizing your termination effective ff, and conveying the assets to C. This consent was executed by all five Co-Trustees.

You provided a copy of the Quit Claim Deed Out of Trust to Trust Foundation to show the transfer of N (Parcel I) and O (Parcel II) to you. This document was effective Y. The Grantor is shown as E and F, as L's Trustees. The Grantee is shown as G and H, as your Co-Trustees. Both Grantee and Grantor show an address of P. The transferred properties are shown as N (Parcel I) and O (Parcel II), with physical descriptions of the properties included.

An appraisal was provided for N and O, described as two contiguous undeveloped parcels. The purpose of the appraisal was to estimate the market value of the fee simple properties. The date of the appraisal report was oo, and the effective date of the value estimate was dd. N (Parcel I) was shown to have a market value of p dollars, while O (Parcel II) was shown to have a market value of n dollars. The appraisal report was addressed to you, Attn: E, at P.

You provided a copy of the Quit Claim Deed Out of Trust Foundation to Limited Liability Company. This document was effective aa. The Grantor is shown as G and H, as your Co-Trustees, or their successor(s) in Trust. G and H also executed the document as authorized signers on your behalf. The Grantee is shown as M, an B Limited Liability Company. Both Grantor and Grantee show an address of P. The transferred property is shown as N (Parcel I).

In return for N (Parcel I), M provided a Promissory Note, executed bb, payable to you. The Promissory Note was for the principal sum of p dollars with interest thereon at the rate of 7% per annum payable monthly in installments. The note provides that "Interest is payable monthly. All principal and interest is due upon completion of the project and sale of the land, the legal description of which is listed on a Deed of Trust between the parties of this date." The note also provides that it is secured by a Deed of Trust of the same date between you and M. The Promissory Note was executed on behalf of M by S, Trustee as a representative of T, and E, Trustee as a representative of L.

The Deed of Trust referenced in the Promissory Note was provided. This document, effective bb showed the Trustor as M and the Trustee as U with you as the Beneficiary. The Obligation Secured is described as the Promissory Note dated bb in the principal amount of p dollars, and the subject real property used to secure the note is shown as N (Parcel I). The Deed of Trust was executed on behalf of M by S, Trustee as a representative of T and E, Trustee as a representative of L, as well as by U as the Trustee.

An Assignment of Promissory Note was provided, with an effective date of cc. The Assignor was shown as G and H, as your Co-Trustees, and the Assignee was shown as C. The property assigned was described as the Promissory Note Secured by a Deed of Trust between you, as Payor and M, as Payee, dated bb. The document was executed on your behalf by G and H as Trustee/Grantor and by K on behalf of C.

Additionally, an Assignment of Beneficial Interest Under Deed of Trust, signed cc, was provided. In this document, you as the Assignor-Beneficiary assigned and transferred all beneficial interest under the Deed of Trust of bb to C. The document was executed by G and H as Trustees for you, the Assignor-Beneficiary and by K, as President of C, the Assignee.

A Quit Claim Deed Out of Trust Foundation To Foundation was provided to show the transfer of O (Parcel II) from you to C. This document had an effective date of cc, and was executed by G and H as Trustee/Grantors on your behalf.

Regarding the conveyance of N (Parcel I) from you to M, we requested specific information regarding how and to whom this property was marketed for sale, including copies of any advertisements, public listings, etc. regarding the marketing and subsequent sale of this property. In response, you stated "We are not aware (sic) of any advertisements or other public marketing materials." We again requested that you explain in detail how and to whom the property was marketed for sale, or to provide any other supporting information. In response, you stated "We are unaware of how and to whom the property was marketed for sale."

In reference to your Promissory Note with M, which indicated all principal and interest is due upon the completion of the project and sale of the land, we requested a description of the project that would be completed on the property before its subsequent sale and the completion date. In addition, we inquired if any members of the donor's family or other disqualified persons had any financial interests or involvement with the project or sale and any other documentation regarding the sale of the property to M. In response, you simply listed the deeds and notes you had previously provided, and stated "The terms of the documents speak for themselves and any reportable activity is set forth in the Form 990s." We again requested the specific information regarding the terms of the transaction and related details, stating that the information we were seeking was not found in the documents you cited. In your subsequent response, you stated "...such documents do speak for themselves and we cannot provide arbitrary interpretations." Additionally, you stated that you were not in possession of any other documentation. You further stated that based upon confirmation from individual counsel for E and F, the completion of the development is scheduled for the fourth quarter of 2007. You also confirmed that E was a Manager and L, with E and F as Co-Trustees, held a fifty percent interest in M in II, the time of the sale of the property.

In response to our request for copies of all meeting minutes from your inception through dissolution, you replied that there were no minutes of the Foundation per se, as it was a charitable trust and not a non-profit corporation. However, you did point out that attached to the IRS Form 990 for tax year 2005 there was a Unanimous Written Consent of the Trustees (similar to minutes) authorizing the termination to dissolution of the Foundation to C. For clarification, we asked whether this was the only record of meetings, votes, etc. by your organization and, if not, for you to provide copies of any other types of records regarding meetings, votes, etc. In response, you stated the only "meeting minutes" are the unanimous written consent of the trustees authorizing the termination and dissolution, and that you are unaware of any other records regarding meetings, votes, etc.

ISSUE 1 - IRC 501(c)(3)

Law

Section 501(a) of the Code provides, in part, that organizations described in section 501(c) are exempt from federal income tax. Section 501(c)(3) of the Code describes, in part, an organization which is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states in order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(a)(2) of the Regulations states the term "exempt purpose or purposes", means any purpose or purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(1) of the Regulations states 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. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

In **Better Business Bureau v. United States, 326 U. S. 279 (1945)**, the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of statutorily exempt purposes. Thus the operational 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).

In **P.P.L. Scholarship v. Commissioner, 82 T.C. (1984)**, an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar accountant, also the director of the bar, as well as two players. The board was self-perpetuating. The Court reasoned that since the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners.

In **Leon A Beeghly v. Commissioner**, 35 T.C. 490 (1960), provided that where an exempt organization engages in a transaction with a related interest and there is a purpose to benefit the private interest rather than the organization, exemption may be lost even though the transaction ultimately proves profitable for the exempt organization.

In **Best Lock Corporation v. Commissioner**, 31 T.C. 620 (1959), the court upheld the denial of an organization that loaned funds to members of the founder's family, even though the loans were repaid. The court determined that loans to family members and unsecured loans to friends of the founder and his family promoted private rather than charitable purposes.

In **Salvation Navy v. Commissioner**, T.C.M. 2002-275(2002), the court found that one of reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that its net earning would not inure to the benefit of a private individual, its founder.

In **Bubbling Well Church of Universal Love, Inc. v. Commissioner**, 670 F.2d 104 (9th Cir. 1981), the court affirmed the tax court's decision that held that the organization supplied no evidence showing that the payments to its controlling members were reasonable and the court also found that the potential for abuse created by the family's control of the organization required open candid disclosure of facts.

In **Gregory v. Helvering**, 293 U.S. 465 (1935), the court held that where a transaction has no substantial business purpose other than the avoidance or reduction of Federal tax, the tax law will not regard the transaction. The doctrine of substance over form is essentially that, for Federal tax purposes, a taxpayer is bound by the economic substance of a transaction where the economic substance varies from its legal form.

In **Zand, J. J.**, (1996) TC Memo 1996-19, the Petitioner claimed deductions for interest paid to the trusts that were attributable to loans made by the trusts established for the benefit of petitioner's three daughters. The three trustees of each trust were the petitioner's longtime employee, and two attorneys in the law firm used by petitioner. The terms of the trust agreements placed investment discretion solely in the hands of the three trustees acting in unison and not separately. The funds in the trusts were invested in entities controlled by petitioner. The court stated, "The trustees, acting in unison, were independent and not subordinate or subservient to petitioner, the grantor."

Rev. Rul. 67-5, 1967-1 C.B. 123, holds that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation. This resulted in the foundation's ownership of common stock that paid no dividends of a corporation controlled by the foundation's creator and his family, which prevented it from carrying on a charitable program commensurate in scope with its financial resources. This ruling concluded that the foundation was operated for a substantial non-exempt purpose and served the private interest of the creator and therefore, was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 70-186, 1970-1 C.B. 128, in which it was found that it would be impossible to accomplish the organization's charitable purposes of cleaning and maintaining a lake without providing benefits to certain private property owners: In the quantitative sense, to be incidental, the benefit to private interest must not be substantial in the context of the overall public benefit conferred by the activity.

Application of Law

Section 501(c)(3) of the Code and Section 1.501(c)(3) -1(a) of the Regulations sets forth two main tests for qualification for exempt status. An organization must be organized and operated exclusively for purposes described in section 501(c)(3) of the Code. Because your Trust Instrument states purposes described in section 501(c)(3) of the Code and upon dissolution all assets will go to organizations that are exempt under section 501(c)(3) of the Code, you pass the organizational test.

You must, however, satisfy the operational test. The key requirement is that an organization be operated exclusively for one or more purposes described in section 501(c)(3) of the Code. The facts submitted show that your activities benefit E and F and the benefits are substantial. Therefore, you are not operated exclusively for purposes described in section 501(c)(3) of the Code.

In 2004, you received a contribution of two parcels of unimproved land, deemed N (Parcel I) and Q (Parcel II). While the application submitted aa also showed a contribution of cash in 2004 of c dollars, the Form 990's that you eventually provided indicated this contribution was not made, and you subsequently stated that that figure was an "estimate." There were no disbursements in 2004.

In 2005, the primary sources of income were f dollars in contributions, of which j dollars was a contribution of a time share, and h dollars in interest on an installment sale, presumably related to the sale of N (Parcel I). With the exception of very minor operational expenses, no substantial disbursements were made in 2005 until the dissolution of the trust on cc, at which time the assets of the organization were distributed to the supported organization. Apparently, no support was provided to the supported organization from your inception until the time of your termination and dissolution, when assets were distributed. There were no minutes or records of meetings dealing with exempt activities. The only record of a meeting was the Unanimous Written Consent of the Trustees authorizing the dissolution.

The only substantial transaction made by you during 2005 was the sale of N (Parcel I) on aa to M, a limited liability corporation in which E and F hold a 50% interest. Additionally, E acts as a manager of the limited liability corporation; therefore, he controls M. The sale price of p dollars matches the value placed on the parcel by the appraisal obtained by E on oo, with an effective date of the value estimate as dd. This was also the value placed on the parcel by you on the 2004 Form 990.

There are no recorded meeting minutes or records regarding the sale of N (Parcel I) to M. The terms of the Promissory Note used as payment for N (Parcel I) specified that all principal and interest "...is due upon completion of the project and sale of the land..." You were unable to describe what the project was or when the land was expected to be sold, and had no supporting documentation to determine such. Rather, you stated the documents "speak for themselves" and that you "...cannot provide arbitrary interpretations" of these documents, apparently despite the fact you entered into them. No description of the project, which evidently is a key factor in determining when the principal of the note would be due, was ever provided, and you apparently had to obtain confirmation from individual counsel for E and F to determine that the completion of the project was scheduled for the fourth quarter of 2007. You state that you are "...unaware of how and to whom the property was marketed for sale" and you are not aware of any advertisements or other public marketing materials relating to the sale. The Quit Claim Deed out of Trust Foundation to Limited Liability Company, where you quit claim the rights, title and interest to M, was executed on your behalf by G and H as Trustee/Grantor's. It is noted that the address given for G and H, as Grantors, on the deed was the same as that of M as Grantee. No evidence was provided of any discussion, analysis, participation, or voting by any Trustees other than G and H, who are disqualified persons.

It is apparent that E and F are in a position of influence. E and F were the sole donors to the trust, whose Trustees include their sons, G and H. Thus, G and H are also considered disqualified persons. In addition to their sons, Trustees include V and J, who have had a business relationship with the family members as, respectively, a certified public accountant and an attorney. The remaining Trustee, K, is President of C and has no family or business relationship with the Trustors.

E and F have indirect control over the trust through having these familial and business relationships with four of the five directors. These relationships put them in a position of influence over these directors. The fifth director, K, could be considered to be indirectly controlled since the other Trustees could remove him as a director, and C as a beneficiary, at their pleasure.

Reg. 1.501(c)(3)-1(c) (2) clarifies that an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private individuals. The information submitted shows that E and F made a contribution to you through L, and took a sizeable deduction for this contribution. In a transaction that only appears to have involved the sons of E and F, G and H, on your behalf, one of the two parcels of land was sold to an entity in which L, and thus E and F, have a substantial financial interest. The sale price was apparently determined by an appraisal obtained by E, and the property was apparently not advertised or marketed for sale to the general public. The note provided by M provided that interest only would be paid until the completion of a project and sale of the land. You could not describe what the project was, and had no documentation detailing the project, despite the fact it would be a key factor in determining when the principal payment would be due.

Private benefit has both qualitative and quantitative connotations. In the qualitative sense, to be incidental, the private benefit must be a necessary concomitant of the activity that benefits the activity at large, i.e., the benefit to the public cannot be achieved without necessarily benefiting private individuals. In Rev. Rul. 70-186 it was found that it would be impossible to accomplish the organization's charitable purposes of cleaning and maintaining a lake without providing benefit to certain private property owners. In the present case, the direct sale of the real estate to M, a Limited Liability Company controlled in part by the donor was not at all necessary to complete your charitable purpose, as this property could have and should have been made available to the general public in a commercial manner to obtain the maximum market price for the land. In a quantitative sense, to be incidental, the private interests must not be substantial in the context of the overall public benefit conferred by the activity. The sale of the property was your only substantial transaction. You made no contributions to the charity until the trust decided to terminate and dissolve its existence. Therefore, there was a substantial non exempt purpose benefiting the donors through their for profit Limited Liability Company.

Control is an important factor in determining whether an organization operates for the benefit of private interests. Similar to the organizations in P.L.L. Scholarship v. Commissioner, supra, Leon A Beeghly v. Commissioner, supra and Rev. Rul. 67-5, you are controlled by E and F. Furthermore, E and F are substantial contributors and disqualified persons as defined by section 4946 of the Code by the fact that they contributed all of your assets, either directly or through their interests in L. They were the sole donors to the trust, whose Trustees include their sons, G and H. Thus, G and H are also considered disqualified persons. Additionally, Trustees include V and J, who have had a business relationship with the family members as, respectively, a certified public accountant and an attorney. The remaining Trustee, K, is President of C and has no family or business relationship with the Trustors.

E and F have indirect control over the trust through having these familial and business relationships with four of the five directors. These relationships put them in a position of influence over these directors. The fifth director, K, could be considered to be indirectly controlled since the other Trustees could remove him as a director, and C as a beneficiary, at their pleasure.

To be qualitatively incidental, the private benefit to the donors must be a necessary concomitant of the activity that benefits the public at large. As indicated in Best Lock Corporation v. Commissioner, supra loans to other entities might also be considered as being made for the personal purposes of the founder. Even though E and F have not received any loans per se, the purchase of the property for terms which include interest only payments until the completion of a project and sale of the property is very similar in nature to a loan. Therefore, the private benefit has been shown to not be a necessary concomitant of the activity benefiting the public at large, and the private benefit is not qualitatively incidental.

In order to be quantitatively incidental, the private benefit must be insubstantial in the context of the overall public benefit. E and F, who have control over you, contributed two parcels of land to you. Your only significant transaction, during your time of existence, was the sale of one parcel to an entity which E and F held a 50% interest in. You could not explain specific details of the transaction (such as what the project was). Furthermore, the land was not marketed to the public in any discernable manner and the land was apparently valued using an appraisal obtained previously by E. There were no contributions to the supported organization until you chose to dissolve the trust. Thus, you do not satisfy the "not more than an insubstantial part of its activities" standard of section 1.501(c)(3)-1(c)(1) of the Regulations. You have a non-charitable purpose that is substantial in nature. See Better Business Bureau v. United States, supra.

In Leon A Beeghly v. Commissioner, supra, revocation of a foundation's exempt status was sustained even though the foundation emerged from the transaction without financial loss. The court noted in that case that the foundation's primary objective in entering into the transaction was to benefit the stockholders of a particular business corporation with "the objective of ultimately benefiting charities running a poor second" Thus, the test is not the ultimate profit or loss but whether, at every stage of the transaction, those controlling the exempt organization guarded its interests and dealt with related parties at arm's length. Your primary transaction did not satisfy this test. Rather, you entered into the sale with M, an entity in which donors and disqualified persons E and F have a 50% ownership interest in through L, without making the property commercially available to the general public. You apparently utilized an appraisal that was provided by E. The deed was executed on your behalf by the sons of E and F, G and H, who are also disqualified persons through their familial relationship with E and F. There was no evidence, such as minutes, meeting records, etc. of any participation in the sale decision by any other Trustees. The note obtained through the sale is favorable to the purchasers, as it provided for interest-only payments for a period that you could not even define, due to not knowing what the project to be completed was. There was no related documentation to the sale explaining what the project was nor when the land was to be sold. This was primarily a sale among family members, acting on behalf of both the buyer and seller, to return the property to the control of E and F. The transaction was not at arms-length, and there is no evidence the interests of the exempt organization were being promoted and guarded. Rather, all facets of the transaction appear to be in favor of, or for the benefit of, M.

Similar to the organizations described in Salvation Navy v. Commissioner, supra and Bubbling Well Church of Universal Love, Inc. v. Commissioner, supra, you have not shown that the net earnings did not inure to the benefit of E and F, the Trustors, either directly or through their interests in M or L. You failed to provide any evidence or documentation to show that the sale of land back to an entity the Trustors have a financial interest in was an arms-length transaction, or that the terms of the sale were reasonable and prudent. As indicated in Bubbling Well Church of Universal Love, Inc. v. Commissioner, supra, since your entity has the potential for abuse created by the Trustors and family control of the organization, an open candid disclosure of facts is required. The substantial lack of details and documentation regarding this transaction did not satisfy this requirement.

Reg. 1.501(c)(3)-1(c) (2) clarifies that an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private individuals. Based on the information submitted your net earnings inured to the private interest of E and F and you did not operate exclusively for purposes described in section 501(c)(3) of the Code. The only significant transaction during your existence, which was controlled by the Trustor/donors, was the sale of a donated parcel of real estate to an entity the Trustor/donors held a substantial interest in. The transaction was executed on your behalf by disqualified persons related to the Trustor/donors, with no evidence of participation or a vote by the other Trustees. The specific terms of the transaction could not be explained and you provided no supporting documentation. In conclusion, the primary purpose resulted in private benefit and inurement to E and F. Accordingly, you serve a private purpose rather than a public purpose.

Similar to the organization described in Gregory v. Helvering, Supra, you have no substantial exempt purpose other than the reduction of Federal income tax and control of assets that were supposed to be for an exempt purpose under IRC 501(c)(3).

DETERMINATION – ISSUE 1

Based on the information provided in your application and supporting documentation, we conclude that you are not operated exclusively for purposes described in section 501(c)(3) of the Code. You have not shown that your activities are exclusively for purposes described in section 501(c)(3) of the Code. The only substantial activity of your trust was to benefit your creators and donors through their business relationship with their for profit business. Therefore, your organization does not qualify for exemption under section 501(c)(3) of the Code because you are not operated exclusively for 501(c)(3) purposes. Based on the above facts your organization was formed and operated primarily for the benefit of E and F.

ISSUE 2 - IRC 509(a)(3)**Introduction**

We have also considered your application for supporting organization status (non-private foundation status) under section 509(a)(3) of the Code in the event that you would qualify for exemption under section 501(c)(3). Our conclusion regarding your private foundation classification under section 509(a)(3) of the Code is based on a number of factors discussed in the following material.

Section 509(a)(3) of the Code provides that the term "private foundation" does not include an organization which:

- (A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2),
- (B) is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2), and
- (C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in section 509(a)(1) or (2).

Section 509(a)(3)(A), in effect, describes as a public charity, an organization which is organized and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or carry out the purposes of one or more specified organizations described in sections 509(a)(1) or 509(a)(2). In our discussion of these issues, we are cognizant of the fact that at all times you are asserting qualification under section 509(a)(3) under the "operated in connection with" relationship provided in section 1.509(a)-4(i) of the Income Tax Regulations.

For an organization to qualify as a supporting organization it must pass the organizational and operational test (509(a)(3) (A)), relationship test (509(a)(3)(B)) and a control test (509(a)(3)(C)). Your organization does not pass the operational test, the relationship test, and control test.

Organizational Test

Section 509(a)(3)(A) of the Code provides that, in order to qualify under section 509(a)(3) an organization at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2).

Reg. 1.509(a)-4(b)(1) provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of" one or more specified publicly supported organizations. If it fails to meet either the organizational test or operational test, it cannot qualify as a supporting organization.

Reg. 1.509(a)-4(c)(1) provides that a supporting organization's governing instrument (i.e. trust document) must meet the following requirements:

- It must limit the organization's purposes to one or more purposes set forth in IRC 509(a)(3)(A);
- It must not expressly empower the organization to engage in activities that are not in furtherance of the authorized purposes;
- It must state the specified publicly supported organizations on whose behalf the organization is to be operated; and
- It cannot expressly empower the organization to support or benefit any organization other than the specified publicly supported organizations.

However, there is some flexibility permitted by the Regulations, including for organizations seeking to satisfy the "operated in connection with" relationship test ("test 3") of section 509(a)(3). The flexibility permitted in the Regulations for supporting organizations seeking to meet the test 3 relationship test is conditioned on appropriate language in the governing instrument.

Reg. 1.509(a)-4(d)(4)(i)(a) provides that a supporting organization will not be disqualified merely because its organizing document permit a supported organization designated by class or purpose, rather than by name, to be substituted for the supported organization designated by name in the articles, but only if the substitution is conditioned on an event "beyond the control" of the supporting organization, such as loss of exemption.

Reg. 1.509(a)-4(d)(4)(i)(b) provides that a supporting organization may operate for the benefit of a beneficiary organization which is not a publicly supported organization, but only if such supporting organization is currently operating for the benefit of a publicly supported organization and the possibility of its operating for the benefit of other than a publicly supported organization is a remote contingency.

Reg. 1.509(a)-4(d)(4)(i)(c) provides that the articles may permit the supporting organization to vary the amounts of its support between different supported organizations, so long as the amounts meet the requirements of the integral part test of Reg. 1.509(a)-4(i)(3) with respect to at least one beneficiary. A third exception primarily deals with support of a beneficiary that is not publicly supported, and is not applicable to this situation.

In Quarrie Charitable Fund v United States, 603 F.2d 1274 (7th Cir., 1979), the trust document allowed the trustee to transfer the income to a supported organization other than the designated charity when, in the trustee's sole discretion, the charitable uses would become unnecessary, undesirable, impractical, or no longer adapted to the needs of the public. The court found that the language failed the organizational requirement of Reg. 1.509(a)-4(d)(4)(i)(a). The court explained that the problem was not that the charitable use may become impractical or undesirable, but that in the trustee's discretion, such use may become impractical or undesirable etc. In contrast, the Regulations establish objective standards of when the charitable recipient may be changed.

In Trust Under the Will of Bella Mabury v. Commissioner, 80 R.C. 718, 1983, the U.S. Tax Court applied these regulations in concluding that an organization was not a supporting organization because the organizational documents of the entity expressly empowered it to benefit organizations other than specified publicly supported organizations.

Application of Organizational Test

You are not organized exclusively for the benefit of specified publicly supported organizations as required by section 509(3)(a)(A). Article 2.1 of the trust provides, in part, "...the Trustees shall have the power to amend this Instrument to change, add or delete the charitable beneficiary or beneficiaries designated in Article 2, paragraph 2.3.1." Further, Article 3.1.7 states, in part, "In the Trustee's Exercise of Discretion, the Trustee may disregard the rights of any beneficiary or group of beneficiaries, and may act in any manner the Trustee shall deem appropriate."

The power of trustees to change, add or delete charitable beneficiaries in general (no conditions were set forth regarding these actions), and the stated power to disregard the rights of the beneficiaries, in the trustee's own discretion, do not meet the requirements that the organization must be formed, and will at all times be operated, exclusively to benefit the supported organizations. The powers of the trustees, to change beneficiaries and disregard the rights of beneficiaries, in their own discretion, are too broad. These powers are very similar to those described in the Quarrie Charitable Fund v United States, supra, where the court held that that entity failed the organizational test requirements. Similar to the Trust Under the Will of Bella Mabury, supra, the organizational document (trust instrument) expressly empowers the organization to benefit organizations other than the specified publicly supported organizations, primarily through granting the powers to change beneficiaries at any time and to disregard the rights of any beneficiaries.

Conclusion

Based on the facts you have failed to meet the organizational test of Section 509(a)(3)(A). As described in Section 1.509(a)-4(c)(1) of the Regulations, your organizational document, the Trust Instrument, cannot expressly empower the organization to support or benefit any organization other than the specified publicly supported organizations. Therefore, you are not "operated in connection with" the supported organization.

Letter 4036(CG) (11-2005)

Operational Test

Section 509(a)(3)(A) of the Code provides that, in order to qualify under section 509(a)(3) an organization at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2).

Reg. 1.509(a)-4(b)(1) provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of" one of more specified publicly supported organizations. If it fails to meet either the organizational test or operational test, it cannot qualify as a supporting organization.

Reg. 1.509(a)-4(e)(1) provides that a supported organization will be regarded as "operated exclusively" to support one or more specified public supported organization only if it engages solely in activities which support or benefit the specified publicly supported organizations.

Application of Operational Test

You are not operated exclusively for the benefit of specified publicly supported organizations as required by section 509(3)(a)(A). E and F contributed two parcels of land, for which they took a charitable deduction. E and F subsequently reacquired one of these parcels in a transaction that was not arms-length by purchasing the parcel through M, an entity that E and F hold a 50% interest in. This was the only major transaction during the trust's existence, until you voted to terminate. You operated to benefit the financial interests of E and F.

Relationship test

Section 509(a)(3)(B) of the Code provides that, in order to qualify under section 509(a)(3), an organization must be "operated, supervised, or controlled by," "supervised or controlled in connection with," or "operated in connection with" one or more publicly supported organizations.

Section 1241(c) of the Code indicates that CHARITABLE TRUSTS WHICH ARE TYPE III SUPPORTING ORGANIZATIONS shall not be considered to be operated in connection with any organization described in paragraph (1) or (2) of section 509(a) of such Code solely because—

- (1) it is a charitable trust under State law,
- (2) the supported organization (as defined in section 509(f)(3) of such Code) is a beneficiary of such trust, and
- (3) the supported organization (as so defined) has the power to enforce the trust and compel an accounting.

CHARITABLE TRUSTS WHICH ARE TYPE III SUPPORTING ORGANIZATIONS-shall take effect-

(A) in the case of trusts operated in connection with an organization described in paragraph (1) or (2) of section 509(a) of the Internal Revenue Code of 1986 on the date of the enactment of this Act, on the date that is one year after the date of the enactment of this Act, and (B) in the case of any other trust, on the date of the enactment of this Act.

Reg. 1.509(a)-4(f)(3)(i) provides that the supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and (ii) the supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported organizations.

Reg. 1.509(a)-4(i)(1)(i) provides that generally a supporting organization will be considered as being "operated in connection with" one or more publicly supported organizations only if it meets the "responsiveness test" and the "integral part test."

Reg. 1.509(a)-4(i)(2)(i) provides that a supporting organization will meet the "responsiveness test" if the organization is responsive to the needs or demands of the publicly supported organizations.

Reg. 1.509(a)-4(i)(2)(iii) provides that one way a supporting organization may establish "responsiveness" is by satisfying the following three requirements: (a) The supporting organization is a charitable trust under State law; (b) Each specified publicly supported organization must be a named beneficiary under such charitable trust's governing instrument; and (c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

Reg. 1.509(a)-4(i)(3)(i) provides that a supporting organization will be considered to meet the "integral part test" if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. A supporting organization may satisfy the "integral part test" by meeting either the "functional support" test, also known as the but-for test, or the "attentiveness" test.

Reg. 1.509(a)-4(i)(3)(iii)(a) provides that a supporting organization will meet the "attentiveness" test if the supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations is sufficient to insure the attentiveness of such organizations to the operations of the supporting organization. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations which meet the attentiveness requirement of this subdivision with respect to such supporting organization. Generally, the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. However, if such supporting organization makes payments to, or for the use of, a particular department or school of a university, hospital or church, the total support of the department or school shall be substituted for the total support of the beneficiary organization.

Reg. 1.509(a)-4(i)(3)(iii)(b) provides an exception to the general "attentiveness" test for earmarking. Even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary organization's total support, the amount of support received from a supporting organization may be sufficient to meet the requirements for "attentiveness" if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks the support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization's primary program or activity so long as such program or activity is a substantial one.

Revenue Ruling 76-208 states that in order to satisfy the "substantially all" requirement of section 1.509(a)-4(i)(e)(iii)(a) of the Income Tax Regulations, a supporting organization must distribute 85 percent of its income to or for the uses of one or more publicly supported organizations.

Notice 2006-109, 2006-51 I.R.B. 1121, This notice provides interim guidance regarding the application of certain requirements enacted as part of the Pension Protection Act of 2006, Pub. L. No. 109-208, 120 Stat. 780 (2006) ("PPA"), that affect supporting organizations. As provided by sections 1241 and 1243 of the PPA, the existing integral part test regulations contained in section 1.509(a)-4(i)(3) will be amended. Until final guidance is issued that defines these organizations must meet the "payout/responsiveness requirements of the current regulations.

Application of Relationship Test

In general, supporting organizations have been identified by the type of relationship they have with their supported IRC 509(a)(1) or (2) organizations. Under the PPA of 2006, supporting organizations are classified into Type I, Type II, or Type III supporting organizations. These names merely reflect the existing three relationships with supported organizations described in the current regulations. Type I supporting organizations are operated, supervised, or controlled by one or more IRC 509(a)(1) or (2) organizations. Type II supporting organizations are supervised or controlled in connection with one or more IRC 509(a)(1) or (2) organizations. Type III supporting organizations are operated in connection with one or more IRC 509(a)(1) or (2) organizations.

Your Schedule D indicated that you are a Type III supporting organization which is "operated in connection with" your supported organization, C.

Effective August 17, 2006, an alternative responsiveness test applicable to charitable trusts has been eliminated by Section 1241(c) of the Pension Protection Act (PPA). However, charitable trusts that met the operated in connection with test on August 17, 2006 could continue to rely on the alternative responsiveness test until August 17, 2007. After that date such trusts must meet the responsiveness test described above to continue to qualify as Type III supporting organizations.

You meet the "responsiveness test" requirements of Reg. 1.509(a)-4(i)(2)(iii) since you are a charitable trust under State law, the supported organization was a named beneficiary in the Trust Instrument, and the supported organization had the power to enforce the trust and compel an accounting under State law. Thus, the "alternative" responsiveness test was satisfied at that time. This alternative responsiveness test option has since been eliminated, per the Pension Protection Act of 2006.

You meet the "attentiveness test" requirements of Reg. 1.509(a)-4(i)(3)(iii)(a) due to the fact you distributed your assets to the supported organization near the end of your first full year of existence. The amount of the assets, considered support in this situation, represents a sufficient part of the supported organization's total support for that year so as to meet the general attentiveness requirement.

Conclusion

Based on the facts you have satisfied the relationship test of Section 509(a)(3)(B).

Control Test

Section 509(a)(3)(C) of the Code, in effect, provides that public charity status under section 509(a)(3) is precluded for an organization that is controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) and (2).

Section 4946(a) of the Code defines a disqualified person as a substantial contributor to the foundation. Section 4946(a)(1)(C) includes in its definition of a substantial contributor an owner of more than 20%, (i) the total combined voting power of a corporation, (ii) the profits interest in a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise which is a substantial contributor to the Foundation.

Section 1.509(a)-4(j)(1) of the Regulations provides that if a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a foundation manager of the supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly supported organization, then for purposes of this paragraph, such person will be regarded as a disqualified person rather than as a representative of the publicly supported organization.

An organization will be considered "controlled," for purposes of section 509(a)(3), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of a substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting

organization.

Rev. Rul. 80-207, 1980-2 C.B. 193, held that for purposes of classification as a supporting organization under section 509(a)(3) of the Code, an employee of a corporation owned (over 35 percent) by a substantial contributor, a disqualified person, will be considered under the indirect control of a disqualified person for purposes of the control test.

Application of Control Test

You are controlled indirectly by disqualified persons. Section 509(a)(3)(C), in effect, provides that public charity status under section 509(a)(3) is precluded for an organization that is controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) and (2).

Even if the organization appears not to be controlled by E and F, all pertinent facts and circumstances will be taken into consideration in determining whether a disqualified person does in fact control the supporting organization. Even though the Trust Instrument states that the organization will not be controlled by disqualified persons, there is strong evidence that shows the supporting organization is controlled indirectly by E and F.

E and F are substantial contributors and disqualified persons as defined by section 4946 of the Code. While E and F, the Trustees, do not act as Co-Trustees of the Foundation, their sons, G and H, do. Through the family relationship, G and H are also disqualified persons.

Two additional Co-Trustees, V and J, have had a business relationship with the disqualified person's family members as, respectively, a certified public accountant and an attorney. Per Rev. Rul. 80-207, described below, the disqualified persons are in a position of influence over these two Co-Trustees due to their outside business relationships.

Rev. Rul. 80-207 provides the following analysis:

Because one of the organization's directors is a qualified person and neither the disqualified person nor any other director has a veto power over the organization's actions, the organization is not directly controlled by a disqualified person under section 1.509(a)-4(j) of the regulations. However, in determining whether an organization is indirectly controlled by one or more disqualified persons, one circumstance to be considered is whether a disqualified person is in a position to influence the decisions of members of the organization's governing body who are not themselves disqualified persons.

Your Trust Instrument also provides that the Trustees shall have the power to amend the Instrument to change, add or delete the charitable beneficiaries designated and any Co-Trustee, with the exception of G and H, may be removed and replaced, with or without cause, upon the unanimous consent of the remaining Co-Trustees. This effectively means that K, the president of C, and C itself, could be removed at any time. Thus, K, and C, do not have a significant voice in your operations. The threat of K's removal, or the removal of C as a supported organization, would significantly limit any voice that K and C would have in your operations, as it could result in the immediate removal of the Trustee or beneficiary.

The fact there are no recorded meeting minutes or records, especially regarding the sale of N (Parcel I) to M, an entity E and F have a financial interest in, is evidence of the control exercised by the disqualified persons. This is further evidenced by the terms of the Promissory Note used as payment for N (Parcel I). While the note specified that all principal and interest "...is due upon completion of the project and sale of the land..." you did not describe what the project was or when the land was expected to be sold and you had no supporting documentation to determine such. Rather, you stated the documents "speak for themselves" and that you "...cannot provide arbitrary interpretations" of these documents, apparently despite the fact that you entered into them. No description of the project, which evidently is a key factor in determining when the principal of the note would be due, was ever provided, and you apparently had to obtain confirmation from individual counsel for E and F to determine that the completion of the project was scheduled for the fourth quarter of 2007. You state that you are "...unaware of how and to whom the property was marketed for sale," and you were not aware of any advertisements or other public marketing materials relating to the sale. The Quit Claim Deed Out of Trust Foundation to Limited Liability Company, where you quit claim the rights, title and interest to M, was executed on your behalf by G and H as Trustee/Grantor's. It is noted that the address given for G and H, as Grantors, on the deed was the same as that of M as Grantee. No evidence was provided of any discussion, analysis, participation or voting by any Trustees other than G and H, who are disqualified persons.

It is apparent that E and F are in a position of influence. They were the sole donors to the trust, whose Trustees include their sons, G and H, who are also considered disqualified persons. In addition to their sons, Trustees include V and J, who have had a business relationship with the family members as, respectively, a certified public accountant and an attorney. The remaining Trustee, K, is President of C and has no family or business relationship with the Trustors.

E and F have indirect control over the trust through having these familial and business relationships with four of the five directors. These relationships put them in a position of influence over these directors. The fifth director, K, could be considered to be indirectly controlled since the other Trustees could remove him as a director, and C as a beneficiary, at their pleasure.

Likewise, G and H can be considered to be indirectly controlling the trust. As disqualified persons, they make up two of the five Trustee positions. As V and J had a business relationship with the family members as, respectively, a certified public accountant and an attorney, G and H are considered to be in a position of influence over V and J. Again, the fifth director, K, could be

considered to be indirectly controlled since the other Trustees could remove him as a director, and C as a beneficiary, at their pleasure.

Therefore, you are directly and indirectly controlled by disqualified persons.

Conclusion

Based on the facts of the case, the trust is controlled by disqualified persons. Section 509(a)(3)(C) of the Code, in effect, provides that public charity status under section 509(a)(3) is precluded for an organization that is controlled directly or indirectly by one or more disqualified persons (as defined in section 4946).

DETERMINATION – ISSUE 2

Based on our analysis of your actual and proposed activities, you have failed the organizational test and the control test. As a result of our analysis, and in light of the applicable law, we have determined you do not qualify for exclusion from private foundation status under section 509(a)(3) of the Code.

APPLICANT'S POSITION AND PROTEST

You were previously issued a proposed adverse determination letter of tax exempt status under section 501(c)(3) of the Code as well as a proposed denial of classification as a section 509(a)(3) supporting organization.

You submitted a protest that asserts the IRS had to "disregard and assume false the statements that were made under penalty of perjury. The IRS also had to assume as a foundational premise that the Trustees would violate their own ethical and fiduciary duties and obligations." Furthermore, you requested a favorable determination letter granting tax exempt status under section 501(c)(3) as a section 509(a)(3) supporting organization.

Issue 1 – IRC 501(c)(3) Exemption

The proposed adverse determination letter denied your tax exempt status under section 501(c)(3) first on the basis that the trust was not operated exclusively for purposes described in section 501(c)(3) but rather for the benefit of the creators/donors through their for-profit businesses. The protest asserts that the trust is operated exclusively for section 501(c)(3) purposes. This assertion is based upon many factors. One, all of the assets of the trust were distributed to C, the supported organization, when the trust was dissolved ee. Two, the trust agreement restricted the scope and activities of the trust to supporting the charitable beneficiaries. Three, although no assets were distributed to C during 2004, there were no assets in the trust to be distributed until gg. Four, the sale of Q (Parcel II), of which the previous proposed adverse determination

Letter 4036(CG) (11-2005)

actually referred to the sale of Parcel I not II, to M was to generate cash to fund activities. The sale was discussed, reviewed and approved by the Trustees and was made at fair market value based upon an independent appraisal of the value of the property. Five, the charitable deduction taken by E and F for the contributions of N and O (Parcel I and II) is no more than they are entitled to under the current tax laws. Six, the interest rate on the Promissory Note for the sale of N (Parcel I) exceeded the market rates by nearly 2% and a Deed of Trust was in place to secure the note. Seven, another f dollars was contributed to the Foundation during 2005. Eight, the trust was controlled by non-disqualified persons with only G and H being disqualified persons as sons of the grantors. None of the Co-Trustees held veto power over the decisions of the other Co-Trustees and the activities of the trust were voted on by all Trustees. Finally, the protest asserts that the trust was "actually operating in a prudent manner by diversifying the Foundation's portfolio to sell the real estate and get cash."

You submitted new information providing a copy of a payment for the loan with attached cover letter correspondence from C, dated hh, related to the sale of N (Parcel I) that was transferred to C when you dissolved. Interest of q dollars was paid to C during the term of the note. O (Parcel II) was sold to E and L in mm for d dollars. The property was transferred to C when you dissolved ee. O (Parcel II) was listed for sale to the general public for months with only one offer of q dollars. E and F bought it for d dollars cash and no note or other extension of credit was provided by C.

Issue 2 – Section 509(a)(3) Classification

The protest asserts that V, J and K are not disqualified persons nor do the two disqualified Trustees have 50% or more of the total voting power of the trust nor do they have veto power. Zand, J. J., (1996) TC Memo 1996-19, is cited in support of your position that attorney-client or accountant-client relationships do not create disqualified persons. In that case, the Petitioner claimed deductions for interest paid to the trusts that were attributable to loans made by the trusts established for the benefit of petitioner's three daughters. The three trustees of each trust were Priscilla Meier, petitioner's longtime employee, and George Hairston and David Johnston, attorneys in the law firm of George, Greek (law firm used by petitioner). The terms of the trust agreements placed investment discretion solely in the hands of the three trustees acting in unison and not separately. The funds in the trusts were invested in entities controlled by petitioner. The court stated, "The trustees, acting in unison, were independent and not subordinate or subservient to petitioner, the grantor." This case is not controlling here as specific regulations relative to section 509(a)(3) classification have been adopted. Those regulations, which supersede any prior contrary case law, provide for specific requirements to be met in order to be classified as a section 509(a)(3) supporting organization. Finally, the protest asserts that because the section 509(a)(3) guidance was published after the formation of the trust it is not controlling in this case.

SERVICE'S RESPONSE

Issue 1 – IRC 501(c)(3) Exemption

The proposed adverse determination as to your tax exempt status under section 501(c)(3) was made based upon the premise that you operated for the benefit of private interests, namely the grantors, E and F. The additional information submitted via your protest does not change the basic facts upon which exemption was denied. G and H, two of the five Trustees, are still disqualified persons as the sons of the grantors. The three remaining Co-Trustees are still indirectly controlled by the grantors who remain disqualified persons. The Bylaws specifically provide in Article 3, Section 3.1.4 that "each Co-Trustee other than [G] and [H] shall be subject to removal and replacement, with or without cause, upon the unanimous agreement of the remaining Co-Trustees." This effectively gives total and ultimate control to two Trustees, G and H, who are disqualified persons. In addition, as the CPA and attorney of the grantors, two of the Co-Trustees are still subject to the influence of the grantors based upon the facts and circumstances in this case. The Bylaws also provide in Section 3.2.2, "In the event that a Trustee is deemed a disqualified person under the Code, such Trustee shall not be permitted to vote on any matter affecting the disqualified person." This provision has been ignored by G and H and the other Co-Trustees as evidenced by the submitted approval of the sale of Parcel I to the grantors by the Co-Trustees of the Foundation. G made the motion for the sale which was seconded by H, both disqualified persons voting in a matter that affects them as sons of the buyers of the land. This is additional evidence of the control of the disqualified persons on the Board of Trustees and shows specific provisions of the Bylaws are disregarded at their pleasure.

The private inurement inherent in the transfer of N (Parcel I) to the grantors remains. The protest asserts that because the interest rate of the Promissory Note was above the customary rate at the time, the interest payments were made during the life of the note and the note was eventually paid off in full in 2008 after being assigned to C, no private inurement existed in the transaction. Based upon the relevant case law, this assertion is incorrect. In *Leon A Beeghly v. Commissioner*, supra, the foundation did not sustain a financial loss in the transaction, it was the fact that the disqualified persons involved controlled the transaction and benefitted from it. The additional information submitted in protest of the proposed adverse determination included a faxed motion for the sale of Parcel I back to the grantors. The motion was made and seconded by G and H, while the three remaining Co-Trustees voted in approval of the sale it is apparent that the sale was instituted at the behest of the disqualified Trustees. In addition, if the sale was not approved G and H could remove the dissenting Trustees without cause. Finally, the motion states "[M] has finally received the permit and now wishes to purchase the property for its appraised value of p dollars under a note and deed of trust at 7% interest payable monthly, and payable in full upon completion of the project and sale of the land." Clearly, the development of the property was initiated prior to its donation to you as the permit process is generally a time-consuming one. The land was donated with the intention of M proceeding with its development. This is clearly a transaction made in the interests of the grantors, co-owners of M. If the land were sold to another party, the planned development by M could not proceed. The fact that the interest payments were made and the note was eventually paid off does not extinguish the private inurement inherent in the transaction.

Letter 4036(CG) (11-2005)

Issue 2 – Section 509(a)(3) Classification

The proposed adverse determination letter denied your request for classification as a section 509(a)(3) supporting organization upon three bases.

One, you did not meet the organizational test because the Trust Instrument provides in Article 2.1.1 that “the Trustees shall have the power to amend this Instrument to change, add or delete the charitable beneficiary or beneficiaries designated in Article 2, paragraph 2.3.1.” Reg. 1.509(a)-4(d)(4)(i)(a) provides that a supporting organization will not be disqualified merely because its organizing document permits a supported organization designated by class or purpose, rather than by name, to be substituted for the supported organization designated by name in the articles, but only if the substitution is conditioned upon an event beyond the control of the supported organization, such as loss of exemption. The protest did not address this issue; however, a second submission of additional information from you advances the premise that this provision does not violate the organizational test because the Trustees merely have the power to “amend” the trust to change the beneficiary. Your reasoning appears to be that the power to amend the trust is not the same as the organizing document “permitting” the substitution of a supported organization. The Bylaws permit the Trustees to amend the trust document changing the beneficiary for any reason or no reason at all. Since the substitution of the supported organization in this case is not conditioned upon an event beyond the control of the supported organization as required by the regulations, the organizational test is not met.

Two, the operational test is not met under section 509(a)(3) because you were operated for the benefit of the grantors, rather than the supported organization. The protest did not address this issue.

Three, the control test is not met under section 509(a)(3) because, based upon all of the facts and circumstances, the trust was controlled by disqualified persons.

Two of the five Trustees are disqualified persons as sons of the donors. Two of the remaining three Trustees are the CPA and attorney of the donors. The fifth Trustee is the president of the supported organization. The Trust Instrument permits the two disqualified persons that are Trustees to remove any or all of the three remaining Trustees with or without cause. Although three of the Trustees are not disqualified persons they are indirectly controlled by disqualified persons due to the removal provision in the trust, which is tantamount to veto power. Reg. 1.509(a)-4(j)(1) provides that an organization will be considered “controlled,” for purposes of section 509(a)(3), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. Clearly, the ability to remove any or all of the remaining Trustees puts the two disqualified persons in a “position of authority.” Finally, Rev. Rul. 80-207 provides that in determining whether an organization is indirectly controlled by one or more disqualified persons, one circumstance to be considered is whether a disqualified person is in a position to influence the decisions of members of the organization’s governing body that are

Letter 4036(CG) (11-2005)

not themselves disqualified person. In this case, disqualified persons, the donors and their Trustee sons, are in a position to influence all of the three remaining otherwise qualified Trustees. The threat of removal as Trustee and the removal of the supported organization as the beneficiary of the trust provides influence over K as President of the supported organization. The threat of removal as Trustees as well as their personal business relationships provides influence over V and J. In fact, as E's attorney, J is required to act in his client, E's, best interest.

APPLICANT'S SUBSEQUENT PROTEST

You were issued a subsequent proposed adverse determination letter of tax exempt status under section 501(c)(3) of the Code as well as a proposed denial of classification as a section 509(a)(3) supporting organization.

You submitted a subsequent protest that states throughout the determination the underlying assumption is that the entire transaction was for the benefit of E and F, the donors and Trustors and absent from the determination is any recitation that the benefit derived by E and F would not have been readily available to them through direct contribution of assets to C. You further state that also absent is the discussion of the only reason the supporting foundation was created – the President and founder of C was ill and the viability of C to continue its work was in question. There was no other reason for E and F to make the gift using this structure. Finally, you assert that the determination ignores some of the key documentation provided to the IRS in the initial protest and response. You indicate that this is an instance where E and F followed the advice of an attorney who poorly executed a transaction to donate d dollars for charitable work and this is not a situation where a supporting foundation was created to advance some "scheme or artifice."

You respectfully request that the determination be revised to grant tax exemption under section 501(c)(3) of the Code. You further state at a minimum you meet the requirements for a private foundation under section 501(c)(3). However, you state because you meet the requirements for recognition as a supporting organization defined in section 509(a)(3), and operated accordingly, you should be given that status.

Issue 1 – IRC 501(c)(3) Exemption

You state several points in the determination deserve mention and correction. First, you state:

It appears that prior counsel for the Foundation might not have communicated with the Foundation on all responses to the IRS during the examination process, particularly when he informed the IRS that no minutes or other written formation existed concerning the Trustees' actions (other than the single Consent in Lieu that terminated the Foundation). As is evident by the attached resolution [referencing pp minutes as Exhibit M to the Protest], the Trustees were contemporaneously communicating, documenting actions and all participating in decisions.

Second, you state with respect to conveyance of Parcel 1 that a resolution was signed by all Trustees.

Third, you state the determination uses post-dissolution regulations and information to establish that, during its existence, the Foundation was controlled by disqualified persons, specifically looking at the attorney and accountants as Trustees. You further state there was no indication this was to be considered as "control" and there is no actual evidence that they did not independently evaluate and make decisions.

Fourth, you state the phraseology used in the determination minimized the reality. You state the Foundation was funded and operational for only a single year and was funded two days before the end of 2004 and prior to the end of 2005 made a disbursement of over d dollars in assets to its supported organization.

Fifth, you state the determination asserts that there was indirect control by the disqualified persons over the Foundation activities, but does not have any evidence of that fact, only conjecture by the relationships.

Sixth, you indicate the determination provided an incomplete recitation of facts with respect to the organizational test. You state while the determination is correct that Co-Trustees could amend the Trust Agreement to change, add, or delete beneficiaries, this could only be done in the event that the charities specified ceased to be section 501(c)(3) entities.

Seventh, you state each point raised by the Service during the application process was addressed in the protest or response, although perhaps not in the same order or title as used by the Service.

In summary, you state the Trustees had a long-standing relationship with C, and the Foundation had a clear relationship with C, including the President of C on its Board of Trustees. You further state the Foundation distributed all of its income and principal to its supported organization within a reasonable time after being funded. The Trustees received nothing of benefit from the sale of the Parcel other than what they would have received had the contribution been made directly to C. You also assert all activities of the Foundation, including the sale of Parcel II to M were in furtherance of the Foundation's charitable purposes.

Issue 2 – Section 509(a)(3) Classifications

Your protest states your Trust Agreement clearly states the limited scope of the Foundation's activities and its directed purposes in Section 2.2. You assert that each requirement of Reg. 1.509(a)-4(c)(1) has been met.

Your protest asserts that none of the Co-Trustees are substantial contributors to the Foundation, nor do any of the Co-Trustees have 20% or more ownership interest in a corporation, profits interest in a partnership, or beneficial interest in a trust that is a substantial contributor to the Foundation. Your protest continues to assert that that V, J and K are not disqualified persons nor do the two disqualified Trustees have 50% or more of the total voting power of the trust nor do they have veto power. Again, you cited Zand, J. J., (1996) TC Memo 1996-19 in support of your position that attorney-client or accountant-client relationships do not create disqualified persons. You conclude the Foundation is not controlled, directly or indirectly, by disqualified persons.

SERVICE'S RESPONSE

Issue 1 – IRC 501(c)(3) Exemption

As previously stated, the proposed adverse determination as to your tax exempt status under section 501(c)(3) was made based upon the premise that you operated for the benefit of private interests, namely the grantors, E and F. The additional information submitted via your subsequent protest does not change the basic facts upon which exemption was denied nor our previous response to your initial protest.

The private inurement inherent in the transfer of N (Parcel I) to the grantors remains. You provided copies of a resolution signed via fax by the Trustees approving the sale of N (Parcel I); however, no minutes to any board meetings were submitted nor were any minutes referenced in the resolution. Furthermore, O (Parcel II) was transferred to C upon your dissolution and eventually sold to the E and F family at fair market value by C after being offered for sale to the public. The sale of O (Parcel II) occurred after your dissolution. The fact that the land was transferred to C as intended does not extinguish the private benefit inherent in your operations prior to your dissolution.

Issue 2 – Section 509(a)(3) Classifications

As previously stated, the proposed adverse determination denied your request for classification as a section 509(a)(3) supporting organization upon three bases.

First, you did not meet the organizational test because the Trust Instrument provides in Article 2.1.1 that "the Trustees shall have the power to amend this Instrument to change, add or delete the charitable beneficiary or beneficiaries designated in Article 2, paragraph 2.3.1." Reg. 1.509(a)-4(d)(4)(i)(a) provides that a supporting organization will not be disqualified merely because its organizing document permits a supported organization designated by class or purpose, rather than by name, to be substituted for the supported organization designated by name in the articles, but only if the substitution is conditioned upon an event beyond the control of the supported organization, such as loss of exemption. Your protest states substitution could only be done in the event that the charities specified ceased to be section 501(c)(3) entities. However, this is not what is stated in Article 2.1.1 of your Trust Agreement as described above.

Letter 4036(CG) (11-2005)

In addition, your Bylaws permit the Trustees to amend the trust document changing the beneficiary for any reason or no reason at all. Since the substitution of the supported organization in this case is not conditioned upon an event beyond the control of the supported organization as required by the regulations, the organizational test is not met.

Two, the operational test is not met under section 509(a)(3) because you were operated for the benefit of the grantors, rather than the supported organization.

Three, the control test is not met under section 509(a)(3) because, based upon all of the facts and circumstances, the trust was controlled by disqualified persons. Even if we were to conclude that V and J were not disqualified persons, G and H still maintain effective control as disqualified persons due to the fact that they cannot be removed as Trustees and they may unilaterally remove each of the other Co-Trustees. The fact remains that G and H voted on a matter that affected them. While the Trustees did all sign the resolution to sell the land, the signatures were obtained via fax, no minutes to any meetings were submitted as evidence that the matter was discussed and decided upon by the Trustees that were permitted under the Bylaws to vote on the matter.

CONCLUSION

In summary, the bases upon which the proposed adverse determination as to your tax exempt status under section 501(c)(3) as a section 509(a)(3) supporting organization still stand unchanged. You do not meet the operational test under section 501(c)(3) because you are not operated exclusively for the benefit of the supported organization, but rather for the benefit of the grantors, E and F. Furthermore, you do not meet the organizational, operational or control tests under section 509(a)(3) as required to be classified as a supporting organization. The organizational test is not met because the Trust Instrument permits the supported organization to be changed for any reason. The operational test is not met because you were operated for the benefit of the grantors. Finally, the control test is not met because the grantor has direct control or indirect control/influence over each of your five Trustees.

We have determined you do not qualify for tax exemption as an organization described in section 501(c)(3) of the Code. Even if we determined that you were described in section 501(c)(3), you would be a private foundation and not a supporting organization under section 509(a)(3) of the Code.

You have the right to file a protest if you continue to believe this determination is incorrect. To protest, you do not need to re-submit information. You must submit a statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Letter 4036(CG) (11-2005)

Types of information that should be included in your appeal can be found on page 2 of Publication 892. These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

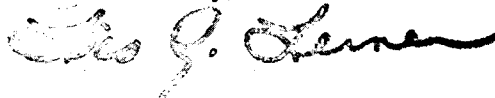
Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

A handwritten signature in cursive script, appearing to read "Lois Lerner".

Lois Lerner
Director, Exempt Organizations

Enclosure: Publication 892