

Internal Revenue Service
Rockside Center III 7927 DS
5990 West Creek Road, 2nd Floor
Independence, OH 44131



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

January 23, 2007

Number: **201428031**
Release Date: 7/11/2014

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

UIL: 501.03-30

Dear :

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

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

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

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

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

Letter 3618 (04-2002)
Catalog Number 34809F

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

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

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

Thank you for your cooperation.

Sincerely,



Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

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Name of Taxpayer A	EIN B	Year Ended 20 12 & 20 12

ISSUE:

1. Whether A is a charitable organization exempt from tax pursuant to Internal Revenue Code § 501(c)(3) for the taxable years 20 & 20 .

FACTS:

A was incorporated as a corporation not for-profit under the laws of the State of . In a letter from the Internal Revenue Service, the organization received its exemption under § 501(a) as an organization described under § 501(c)(3) of the Code in August of 20 . This letter further indicated that the information provided allowed for the consideration that the organization reasonably expected to be a publicly supported organization described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

A is organized exclusively for charitable purposes including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under § 501(c)(3) of the Internal Revenue Code of 1986. The charitable purposes of the organization include the following:

- (A) to promote and support education through scholarship and tuition assistance;
- (B) to promote and support education through distributions to or for the benefit of exempt educational organizations and their related projects, programs and activities;
- (C) to promote and improve the health of the general public through distributions in support of health related projects, programs and activities;
- (D) to provide financial aid and assistance in relief of the poor and underprivileged members of the community;
- (E) to promote, assist, support, own, construct, maintain, lease, operate and manage housing facilities and improvements thereto for (1) low and moderate income families or persons; (2) families or persons displaced from urban renewal areas, or as a result of governmental action, or as a result of fire,

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- flood, accident or other disaster; and (3) elderly persons, said housing facilities designed to meet the physical, social and psychological needs of said families or persons and to promote their health, security and happiness;
- (F) to aid, assist and encourage community cultural and artistic endeavors;
- (G) to promote and develop community interest in, and to advance the knowledge and appreciation of the performing arts.

A's application, Form 1023 at Part II, Activities and Operational Information, item 1 states as follows:

"The organization will take over and pay for the charitable activities formally provided by C - . These activities include the funding of a local baseball team for high school youth, the funding of a high school government convention called . Also provided is an annual Christmas party for local children, the providing of flags for local schools and for funeral ceremonies.

All of these activities are for the benefit of the , area. The activities will be conducted by the Trustees of the organization and the members of C."

Part II, Activities and Operational Information, item 2, requesting the sources of financial support, states as follows:

"Donations from C - , a 501(c)(19) organization."

Part II, Activities and Operational Information, item 3, requesting the nature of fundraising programs both actual and planned, states as follows:

"There will be no fundraising program. The organization will accept donation only from C - ."

The trustees listed on the application represent officers and trustees of C in . C is recognized as tax-exempt under § 501(c)(19) of the Code. The application further indicates that there will be a very close working relationship with C.

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A entered into a contract with C for the purpose of being the recipient of the Post's proceeds from instant bingo ticket sales. This contract was for the calendar year of 20 . Under this contract the Post would distribute its proceeds, as required under Chapter 2915 of the Ohio Revised Code, to A with the understanding that the transferred funds would be used for charitable purposes.

A's Form 990 for the calendar year ending 20 reflects that its revenue was derived from two distinct sources:

- (1) Direct public support in the amount of \$ and,
- (2) Indirect public support totaling \$.

Schedule B of Form 990 shows that the indirect public support was received from two sources:

- (1) D in the amount of \$ and,
- (2) C in the amount of \$

A supporting schedule has been attached to Form 990 to provide a breakdown of Part II Statement of functional Expenses #22 Grants & Allocations. The amount shown on this line is \$. The following were shown as recipients:

- (1) E \$
- (2) C \$
- (3) F \$
- (4) G \$
- (5) H \$
- (6) Miscellaneous cash donations \$
- (7) I \$
- (8) N \$

A's Form 990 for the calendar year ending 20 reflects that its revenue was derived from the same two distinct sources:

- (1) Direct public support in the amount of \$ and,
- (2) Indirect public support totaling \$.

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The information shown on A's general ledger indicates that the indirect public support is comprised of the following:

- (1) J in the amount of \$;
- (2) K in the amount of \$; and
- (3) C in the amount of \$.

The general ledger also reflects how the contributions received have been put to use. The following is a partial summary of the different accounts which show how the funds were used and/or distributed by A for the year ending 20 12 :

5300 - Donation

53001 - C	\$	
53002 - L	\$	
53003 - E	\$	
53004 - I	\$	
53005 - Organizations		\$
Included: J		
K		
M		
53006 - Individuals		\$
5300 - Other		\$

5401 - Rental Expense - L \$

The general ledger has also disclosed various ancillary expenses that were made by A on behalf of C. Since both entities occupy the same location, many office and administrative expenses were paid through A's account.

A does not have a facility of its own. It shares office space with C within C's own facilities. Significant rental expenses amounting to \$ in 20 12 has been paid to C. This represents a payment for partial use of C's Finance Officer's office.

The information provided by A's filed Form 990 and its general ledger disclosed very limited activity that would represent engaging in activity of a charitable nature.

During the periods under examination C, the E, I, G, J, K and M are not § 501(c)(3) entities to which this organization can make

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charitable distributions. Individuals also do not represent a charitable class to which charitable distributions may be made. A has made substantial distributions to entities and/or classes that are not charitable.

LAW:

Section 170(b)(1)(A)(vi) of the Internal Revenue Code provides, "an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public."

Section 501(a) of the Internal Revenue Code provides, "An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503."

Section 1.501(a)-1(a)(2) of the Income Tax Regulations provides, in part, ". . .An organization, . . .is not exempt from tax merely because it is not organized and operated for profit. In order to establish its exemption, it is necessary that every such organization claiming exemption file an application form as set forth. . .Subject only to the Commissioner's inherent power to revoke rulings because of a change in the law or regulations or for other good cause, an organization that has been determined by the Commissioner or district director to be exempt under section 501(a) or the corresponding provision of prior law may rely on such determination so long as there are no substantial changes in the organization's character, purposes, or methods of operation. . ."

Section 1.501(a)-1(c) of the Income Tax Regulations provides, "Private shareholder or individual" defined. The words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization."

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Section 501(c)(3) of the Internal Revenue Code provides, "Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

Section 1.501(c)(3)-1 of the Income Tax Regulations provides, "Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. (a) Organizational and operational tests. (1) In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt. (2) The term "exempt purpose or purposes", as used in this section, means any purpose or purposes specified in section 501(c)(3), as defined and elaborated in paragraph (d) of this section."

Section 1.501(c)(3)-1(c) of the Income Tax Regulations provides, "Operational test. (1) Primary activities. An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. (2) Distribution of earnings. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or

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individuals. For the definition of the words "private shareholder or individual", see paragraph (c) of section 1.501(a)-1."

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides, "An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides, "Charitable defined. The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such terms include: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization which is organized and operated for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes. The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under section 501(c)(3) so long as it is not an "action" organization of any one of the types described in paragraph (c)(3) of this section."

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Section 509 of the Internal Revenue Code provides, "Private Foundation Defined. (a) General Rule. For purposes of this title, the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than - (1) an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii))."

Revenue Ruling 71-447, 1971-2, C.B.230 held: ". . .All charitable trusts, educational or otherwise, are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy. . ."

In Rev. Rul. 75-286, 1975-2 C.B. 210, an organization with membership limited to residents and businesses on a city block formed to preserve and beautify public areas in the block was held not exempt under IRC 501(c)(3) because the benefits to private individuals whose property abutted the public property outweighed benefits to the general public.

Revenue Ruling 78-232, 1978-1 C.B. 69, describes the ABC Church, whose membership consisted of an individual, the individual's spouse, their two minor children, and a few family friends. The individual was employed by a state government and deposited his salary checks in the Church's bank account. The Church's account was primarily used to furnish the individual and his family with lodging, food, clothing, and other living expenses. The individual was denied a deduction under IRC 170 for the salary checks deposited in the Church's account because the Church was operated for the private purposes of the individual and its income inured to the individual and members of his family.

Revenue Ruling 80-278, 1980-2 C.B. 175, established a three-part test to determine whether an organization's activities will be considered permissible under section 501(c)(3) of the Code: (1) the purpose of the organization is charitable; (2) the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions; and (3) the activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.

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Revenue Ruling 81-94, 1981-1 C.B. 330, a nonprofit organization was formed by a professional nurse. The organization described itself as a church. The nurse functioned as the church's minister, director, and principal officer and "donated" the money from his/her outside employment to the church. The only function the church performed was acting as a vehicle for handling the nurse's personal finances. The revenue ruling holds that the church was not exempt because it served the private interests of a designated individual rather than the public interest.

Better Business Bureau v. U.S., 326 U.S. 279 (1945), Ct. D. 1650, C.B. 1945, 375, in construing the meaning of the phrase "exclusively for educational purposes", the Supreme Court of the United States said,

"This plainly means that the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

This rationale applies equally to any category of charitable purpose under section 501(c)(3).

American Campaign Academy v. Commissioner, 92 TC 1053 (1989), the Service argued that the Academy substantially benefited the private interests of Republican Party entities and candidates, thereby advancing a nonexempt private purpose. The relationship between the Academy and "Republican party entities and candidates" was not one of control, although the Academy was an outgrowth of a training program operated by National Republican Congressional Committee. In fact, the Academy argued that the prohibition against private benefit is limited to situations in which an organization's insiders are benefited. The Tax Court, however, disagreed with this view, and stated that an organization's conferral of benefits on disinterested persons may cause it to serve a private interest within the meaning of 1.501(c)(3)-1(d)(1)(ii).

Wendy L. Parker Rehabilitation Foundation, Inc. v. C.I.R., T.C. Memo. 1986-348, the Tax Court upheld the Service's position that a foundation formed to aid coma victims, including a family member of the founders, was not entitled to recognition of exemption.

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Approximately 30% of the organization's net income was expected to be distributed to aid the family coma victim. The Court found that the family coma victim was a substantial beneficiary of the foundation's funds. It also noted that such distributions relieved the family of the economic burden of providing medical and rehabilitation care for their family member and, therefore, constituted inurement to the benefit of private individuals.

Church by Mail v. Commissioner, 765 F. 2d 1387 (9th Cir. 1985), aff'g TCM 1984-349 (1984), the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated:

"The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

Church of Gospel Ministry, Inc., (CGM), Plaintiff, v. United States of America, Defendant, 640 F. Supp. 96, the court found:

". . . In order to establish that is qualified for tax-exempt status, CGM has the burden of proving three elements contested by the IRS: (1) that CGM is a corporation operated primarily for religious and/or charitable purposes, 26 U.S.C. @ 170 (c)(2)(B), 501(c)(3); 26 C.F.R. @ 1.501(c)(3)-1(c)(1); (2) that no part of CGM's net earnings inure to the benefit of any private shareholder or individual, 26 U.S.C. @ 170(c)(2)(C), 501(c)(3); 26 C.F.R. @ 1.501(c)(3)-1 (c)(2), and (3) that CGM maintains records sufficient to demonstrate that it is entitled to tax-exempt status, 26 U.S.C. @ 001; 26 C.F.R. @ 1.6001-1(c), 31.6001-1. . ."

Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980) aff'd, 670 F.2d 104 (9th Cir. 1980), the Tax Court considered the qualification for exemption of an organization

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purporting to be a church. The applicant was controlled by three family members. The court stated:

"While this domination of petitioner by the three Harberts, alone may not necessarily disqualify it for exemption, it provides an obvious opportunity for abuse of the claimed tax-exempt status. It calls for open and candid disclosure of all facts bearing upon petitioner's organization, operations, and finances so that the Court, should it uphold the claimed exemption, can be assured that it is not sanctioning an abuse of the revenue laws. If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that petitioner fails to meet the requirements of section 501(c)(3)."

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

GOVERNMENT'S POSITION:

For the taxable years of 20 & 20 , A. was not a public charity exempt from tax pursuant to I.R.C. § 501(c)(3). A's primary and predominant business activity during these years was operating as a vehicle to satisfy the State of gaming law requirements as they apply to C. This was accomplished by A being a recipient of funds mandated by State law upon C to be distributed to an entity exempt under § 501(c)(3). A was created by C as the instrument to achieve this purpose. After receipt of the required distributions, A would return these funds to C, an organization exempt under I.R.C. § 501(c)(19). Additional distributions were also made to entities that

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are not public charities or entities exempt under § 501(c)(3). Accordingly, A does not qualify as a public charity within the scope of § 501(c)(3).

Typically the activities of a charitable organization will result in benefits to both its intended charitable class of persons, and to other business entities such as vendors of goods and services required to advance the organization's goals. The benefits to be derived from A's activities flow principally to C and to other entities that are not exempt under § 501(c)(3) and not to the general public. Accordingly, A was not engaged in the business of furthering charitable purposes.

Benefits to non-charitable entities are permissible so long as they remain incidental to the accomplishment of the charitable goals of any organization. A's application focused on the class or classes of persons or entities anticipated to be served to justify its claim to tax-exempt status. A ignored or failed to provide pertinent information which would have indicated the presence of other underlying motivations.

The statement that A must serve a public rather than a private purpose is a basic tenet of the law of charity. It can be applied in place of or in addition to the proscription against private inurement. The burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests. This requirement applies equally to the potential for inurement and for private benefit.

Thus, the close control of A, because of the potential for abuse, requires a clear demonstration that private interests will not be served. Inurement can involve benefit to insiders such as officers, trustees or directors. Private benefit, on the other hand, can involve benefits to anyone other than the intended recipients of the benefits conferred by the organization's tax-exempt operation. Here, A's trustees represent officers and/or trustees of C. The facts show that the A's activities were not dedicated exclusively or primarily to the advancement of religion, social welfare or other charitable endeavors because of the presence of substantial nonexempt purposes.

A, after making distributions to non-501(c)(3) entities, did not require them to account back that the distributions were actually

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used for charitable purposes. This failure to insure that these funds were directly used for the furtherance of charity is another example of A's failure to safeguard monies permanently dedicated to charity.

A's operation can be viewed as an extension of C. A's trustees engaged in a veteran philosophy approach to making distributions and did not apply the requirements levied by I.R.C. § 501(c)(3). Thus the majority of the distributions were made utilizing the philosophy used by veteran posts for making charitable distributions and resultantly are in conflict with I.R.C. § 501(c)(3). In order to operate as a public charity, A must have full control of the use of the donated funds and to apply that use to the goal of charitable endeavors. Instead, the intent of C in making its charitable donations was to satisfy State requirements and resultantly have A transfer the funds back to C for C's own designs.

C, as the creator of A, used the charitable distributions to defray Post operating expenses and to subsidize membership activities, recreational and social functions. The use of the charitable distributions of A by C inures to the benefit of C's members.

The amount of rental expenses paid by A to C demonstrates the abusive arrangement under which A operates. The sharing of an office within C should not require an excessive rental amount to be charged to an entity that has limited monthly operation.

If an organization does not serve a public interest but rather serves a private interest, other than incidentally, it is not entitled to exemption under I.R.C. § 501(c)(3). This proposition is simply an expression of the basic principle underlying the enforcement of charitable organizations and their exemption from federal income taxation under I.R.C. § 501(c)(3): Their income and property are exclusively devoted to purposes which are considered beneficial to the community in general, rather than particular individuals or entities. Thus, A's operations cannot be considered as beneficial to the community or the general public. A's operation clearly serves private interests, other than incidentally; it is not entitled to exemption.

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ORGANIZATION'S POSITION:

The results of the examination were discussed with _____, your organization's representative. _____ indicated disagreement with the examination findings and also indicated that he will present a position upon receipt of the 30-day letter.

CONCLUSION:

A is not a charitable organization exempt from tax under I.R.C. § 501(c)(3) for the taxable years of 20 & 20 . A charitable organization for federal income tax purposes is an organization whose primary and predominant business activity during the year is engaging in activity that represents and serves charity. A was only incidentally engaged in charitable undertakings during 20 & 20 . Instead, A's predominate activity during 20 & 20 was engaging in activity which directly benefited C. Accordingly, A is not a charitable organization for federal income tax purposes for the taxable years 20 & 20 and, therefore, is not exempt from taxation under section 501(c)(3) for 20 & 20 .