



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE - EO Mandatory Review
1100 Commerce Street, MC 4920-DAL
Dallas, TX 75242

Release Number: 201451035
Release Date: 12/19/2014
Date: January 7, 2009
UFL Code: 501.03-03

Employer Identification Number:

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer To:

CERTIFIED MAIL - Return Receipt Requested

**LAST DAY FOR FILING A
PETITION WITH TAX COURT:
April 7, 20xx**

Dear _____

This is a Final Adverse Determination revoking your exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

The _____ Foundation has failed to provide evidence you are currently operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). You are not a charitable organization within the meaning of Treasury Regulations 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. We determined that your activities confer a substantial private benefit upon your founders, your internal controls are deficient, and there was no evidence of any qualified charitable activity; therefore, you do not operate exclusively for exempt purposes.

Based upon the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code effective November 5, 19xx.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax return Form 1041. These returns should be filed with the appropriate Internal Revenue Campus for the year ending December 31, 20xx and for all years thereafter, the prior year returns were previously submitted to the District Office.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax exempt status was determined by calling _____, faxing _____ or writing to: Internal Revenue Service, Taxpayer Advocates Office,

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals process, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax 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.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely,

Renee B Wells
Acting Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE: EO Examinations
1100 Commerce Street
Dallas, TX 75242

August 1, 2007

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

December 31, 20xx & 20xx

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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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PRIMARY ISSUE:

Should the IRC section 501(c)(3) tax exempt status of the _____ Foundation be revoked because it is not operated exclusively for tax exempt purposes?

FACTS:

During the interview with _____, he stated that sometime prior to the creation of the _____ Foundation, he attended a seminar conducted by _____, an attorney from _____. The seminar covered estate planning and different ways to protect investment income. According to _____, the main focus of the estate planning consisted of creating charitable supporting trusts.

The _____ Foundation was created with a Trust Agreement dated November 5, 19xx. In the Trust Agreement, _____ and an organization referred to as the _____ were listed as the initial trustees. Pursuant to the Trust Agreement, _____ was created exclusively as a supporting organization as described under section 509(a)(3) of the Code. _____ was to be the supported organization and have 60% control over the activities and operation of _____. _____ was to have 40% control over _____ and was acknowledged to be a disqualified person and, as such, a disqualified trustee.

The Trust Agreement calls for a prohibition on political activity, inurement and private benefit. There were to be no substantial legislative activities.

Article 6 of the Trust Agreement states that at all times the Board of Trustees shall consist of a sixty-forty split with regard to non-disqualified and disqualified trustees. The article further states that a trustee may resign at any time, by written instrument, to the extent that the resignation does not cause any disqualified person to be put in control of the Trust.

Article 12 of the Trust Agreement also covers resignation, removal or absence of non-disqualified or disqualified trustees. In the event that a non-disqualified trustee decides to withdraw or resign, the remaining disqualified trustee is not allowed to make distributions until a new non-disqualified trustee is appointed.

The Trust Agreement states that both non-disqualified and disqualified trustees have the power to make investments, or cause monies or assets to be invested at any time. The Trust Agreement further states that distributions to supported organizations can only be made by non-disqualified trustees.

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filed an application for Recognition of Exemption, Form 1023, on November 5, 19XX. It requested exempt status under 501(a), as an organization described in section 501(c)(3) of the Code with a foundation status of 509(a)(3). The purposes of as listed on the application were consistent with the Trust Agreement. However, the supported organization on the application is different from the supported organization as listed in the original Trust Agreement. The Trust Agreement called for to be the supported organization. The application states that was to be the supported organization.

According to , at some point between the time that the original Trust Agreement was signed and the filing of the application, it became evident to Attorney that was not going to receive tax exempt status under section 501(a) of the Code as an organization described in section 501(c)(3). As such, Attorney identified as the supported organization. was never recognized as exempt.

The Trust Agreement was amended on March 26, 2Cxx, to add as a supported organization. remained on the Trust Agreement at that time. The Trust Agreement was amended a second time on December 4, 2Cxx. This amendment removed from the Trust Agreement and left as the sole supported organization.

On January 31, 2Cxx, was issued a determination letter and received exempt status under section 501(a) of the Code as an organization described in section 501(c)(3). The foundation status was determined to be 509(a)(3).

The Trust Agreement was amended for the third time on December 1, 2Cxx. This amendment removed , as the supported organization and added lost its tax exempt status in 20xx. remained the sole supported organization per the Trust Agreement for the period beginning December 1, 2Cxx and ending sometime after the conclusion of the 2Cxx tax year.

In correspondence received from , acting as the representative for the organization, stated that was briefly associated with Attorney from the Fall/Winter of 20XX as a supported organization. In the Spring of 2CXX it terminated any association with and . She further stated that her organization never received any distributions from and that there were no board meetings or elections of any type with regard to

The Trust Agreement was never amended to reflect the fact that terminated their association with . In fact, Trust

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Agreement kept _____ as the supported organization for over eighteen months after it requested to have its association terminated.

In 19XX, _____ transferred \$ _____ from his personal bank account to an account established in the name of the _____ Foundation. 19XX Form 1040, Schedule A, shows that _____ claimed the \$ _____ as a charitable contribution deduction.

In 20XX, _____ transferred an additional \$ _____ from his personal bank account to an account established in the name of the _____ Foundation. 20XX Form 1040, Schedule A, shows that _____ claimed \$ _____ as a charitable contribution deduction.

In 20XX, _____ transferred another \$ _____ from his personal bank account to an account established in the name of the _____ Foundation. 20XX Form 1040, Schedule A, shows that _____ claimed the \$ _____ as a charitable contribution deduction.

For the period of December 19XX through the end of the tax year ended December 31, 20XX, there had been no grants to any of the above referenced supported organizations.

During the period of the examination from January 1, 20XX through December 31, 20XX, there are no Board of Director's minutes for any meetings. There are no records of any meetings of any kind. There were no elections of any board members. There are no documents explaining why grants were not made. There is no documentation indicating that there were any transactions other than the transfers of _____ funds to Attorney _____ described below.

In the December 8, 20XX telephone interview with _____, he stated that he relied on Attorney _____ to take care of all _____ business matters as well as investing _____ funds.

_____ also stated that at some point after he donated the funds to Attorney _____ called _____ and requested that the money in the _____ account be transferred to _____. There is no written documentation of this conversation, only the written explanation provided by Attorney _____. In the December 8, 20XX, telephone interview with _____, he confirmed that the transfer of funds occurred with his permission via a telephone conversation with _____.

_____ does not have records that provide any detail of legal fees that received for establishing and investing for _____. In the interview with _____ he had no recollection for how much _____ got paid or any recollection as to _____.

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what the original agreement called for. Attorney did not respond to inquiries into how much he received.

Attorney states in an email to , CPA and Power of Attorney for , that Trust account records show receipt of funds on three separate dates. The first being February 17, 20xx in the amount of \$, the second being on June 25, 20xx in the amount of \$ and the third being on August 13, 20xx in the amount of \$

In that same email message, states that the \$ received from was invested in of . At an undisclosed date, sold its assets to . The date is undisclosed because has no records detailing any investment transactions.

In a letter from to this office, disclosed that he is on the Board of Directors for . and is also a shareholder. disclosed that he received verbal confirmation from to invest the money from in

has produced a stock certificate that shows ownership of shares of . That same stock certificate shows Attorney daughter, as the Secretary for

An unrelated U.S. District Court Case 3:05-cv-1328-(BD) references the value of stock and the low value that it has. The court agreed to a value of \$ per share. Therefore, the total value of stock held by has a current value of \$

During the interview was asked if he knew that was a stock holder and Chairman of the Board for , and stated that he did not know that. daughter, , is Secretary for

LAW:

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one

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that is both organized and operated exclusively for one or more purposes specified in that section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(c)(2) provides that 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 individuals. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, 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 1.509(a)-4(e)(1) of the regulations addresses permissible beneficiaries in that it specifies that a supporting organization will be regarded as "operated exclusively" to support one or more specified publicly supported organizations only if it engages solely in activities which support or benefit the specified publicly supported organizations. An organization will be regarded as "operated exclusively" to support or benefit one or more publicly supported organizations if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3).

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under IRC section 501(c)(3).

American Campaign Academy v. Commissioner, 92 TC 1053 (1989): Defines private benefit as "non-incidental benefits conferred on disinterested persons that serve private interests."

Securities and Exchange Commission v. Megafund Corporation, Stanley A. Leitner, Sardaukar Holdings, IBC., and Bradley C. Stark, CIG, LTD., and James A. Rumpf, Individually and d/b/a Cilak International, 3:05-cv-01328: Sets value of Moondoggie stock.

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Revenue Ruling 76-206: Service provided to a private party that they would have otherwise had to purchase.

In Rev. Rul. 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under IRC section 501(c)(3).

GOVERNMENT'S POSITION:

The section 501(c)(3) tax exempt status of the _____ Foundation should be revoked, effective November 5, 19xx, because it is not operated exclusively for tax exempt purposes.

In contrast to section 1.501(c)(3)-1(d)(ii) of the regulations which calls for an organization to be organized and operated for a public rather than a private benefit, _____ has indulged in substantial acts of private benefit with regard to its dealings with Attorney _____. The activities of _____ also stand in contrast to section 1.501(c)(3)-1(c)(1) of the regulations in that more than an insubstantial part of its activities have been for the private benefit of Attorney _____.

_____ has not engaged in any charitable activities since its inception and has made no charitable grants from its inception until late 20xx. _____ donated \$ _____ to _____ over the three year period from 19xx through 20xx and received the tax benefit on his personal federal tax return in the form of charitable contribution deductions totaling \$ _____. The only other activity engaged in by _____ was the transfer of money from the _____ bank account to Attorney _____ over that same time frame. This transfer of funds was accomplished, not with written documentation, but by verbal approval from _____ to Attorney _____.

During the two year period beginning January 1, 20xx and ending December 31, 20xx, _____ did not make any grants to any section 501(c)(3) charity. In fact, according to _____ there never were any grants to a section 501(c)(3) charity prior to the two year period being examined, and there were no grants to a section 501(c)(3) charity until sometime in the later half of 20xx.

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funds, instead of being distributed to a legitimate and designated section 501(c)(3) charity, went to Attorney who in turn invested these funds in a company called purportedly for

At some undisclosed point in time, transferred its assets to a company called Attorney is a shareholder of and has admitted to being the Chairman of the Board for . A further connection between Attorney and is that daughter is an officer of where she holds the position of Secretary.

Further evidence of the private benefit to Attorney is the fact that from the time that transferred their funds to in 19XX, 20XX and 20XX, until sometime after the end of the tax year ended December 31, 20XX, had exclusive access to funds to invest or do with as he pleased. claims it was unable to locate and maintain a relationship with a qualified section 501(c)(3) charity to whom to distribute money. It is beyond any reasonable measure to accept as fact that could not find one single qualified organization to support since inception.

As the only activity of was the transfer of funds for Attorney personal use, private benefit to Attorney made up more than an insubstantial part of activities. With the only activity of being the transfer of funds to Attorney, has operated more for a private rather than a public benefit.

As in the case of Better Business Bureau of Washington, D.C. v. United States, the private benefit present in this case is substantial and destroys the exempt status of the organization. The only activity and only apparent purpose of was the transfer and subsequent use of funds by Attorney to invest as he saw fit for his personal gain.

As in the case of American Campaign Academy v. Commissioner, there were non-incident benefits conferred on disinterested persons that serve private interests. The benefit enjoyed by Attorney is not incidental but is more reasonably construed as a purposeful event caused by Attorney and, trustee for . The benefit enjoyed by Attorney constitutes private benefit in that the public was denied the receipt of any benefit because no grants were distributed to a supported organization.

As has not operated exclusively for charitable purposes and considering the extensive private benefit enjoyed by Attorney, the tax exempt status of should be revoked. Retroactive revocation is appropriate because failed to disclose in its application that it would be operated primarily for the benefit of Attorney

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and/or an organization which he owns and controls. It failed to disclose that it would make no grants to public charities.

TAXPAYER'S POSITION:

The taxpayer has agreed to revocation of exempt status.

ALTERNATIVE ISSUE # 1: Should The Foundation be reclassified as a private foundation?

FACTS:

The Foundation was created with a Trust Agreement dated November 5, 19xx. In the Trust Agreement, and the were listed as the initial trustees. Pursuant to the Trust Agreement, was to be a supporting organization and was to support the exclusively. The supported organization was to have 60% control over the activities and operation of was to have 40% control over

From March 26, 2Cxx through December 1, 2Cxx, the Trust Agreement was amended three times. Each amendment changed the organization that was to be supported. Each new supported organization was to have 60% control over the Trust.

The December 1, 2Cxx amendment added as the sole supported organization.

In correspondence received from acting as the representative for the organization stated the following: was briefly associated with Attorney from the Fall/Winter of 2Cxx as a supported organization. When told by IRS agents in the Spring of 20xx that Attorney was under investigation, she terminated any association with and the Foundation. She further stated that her organization never received any distributions from and that there were no board meetings or elections of any type with regard to

The Trust Agreement was never amended to reflect the fact that terminated its association with In fact, Trust Agreement kept as the supported organization for over eighteen months after it requested to have its association terminated.

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There were no grants made to any supported organization. There was no measure of control provided by any supported organization. There were no elections of directors by any supported organization, and there were no board meetings of any kind attended by any of the above referenced supported organizations.

_____ has stated that at some point after he "contributed" the funds to _____, Attorney _____ called _____ and requested that the money in the _____ account be transferred to _____ complied with _____ verbal request and transferred all of the money in the _____ account, \$ _____, to _____.

There is no written documentation of this conversation, only the written explanation provided by Attorney _____. In the December 8, 20XX telephone interview with _____, he confirmed that the transfer of funds occurred with his permission via a telephone conversation with _____.

The only activity ever conducted by _____ was to transfer _____ funds to the promoter so that he could "invest" the funds as he saw fit. The funds were ultimately "invested" in a company in which Attorney _____ held stock and was the Chairman of the board and his daughter was an officer.

At no time from _____ inception through the years under examination did any of the above listed supported organizations attend meetings, elections or exert any measure of control over _____.

For additional facts, see Facts section of the primary position (revocation).

LAW:

Code section 509(a)(3) defines a supporting organization as an organization which:

509(a)(3)(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 paragraph 509(a)(1) or 509(a)(2) and:

509(a)(3)(B) is —

509(a)(3)(B)(i) operated, supervised, or controlled by one or more organizations described in paragraph 509(a)(1) or 509(a)(2),

509(a)(3)(B)(ii) supervised or controlled in connection with one or more such organizations, or

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509(a)(3)(B)(iii) operated in connection with one or more such organizations, and

509(a)(3)(C)- is not controlled directly or indirectly by one or more disqualified persons (as defined in Code section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2).

Code section 4946(a)(1)(A) states that the term "disqualified person" means, with respect to a private foundation, a person who is a substantial contributor to the foundation.

Code section 4946(d) defines disqualified persons as members of the family of an individual as ones spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Regulation section 1.507-6(a)(1) defines the term "substantial contributor" as, except as provided in subparagraph (2) of this paragraph, with respect to a private foundation, any person (within the meaning of section 7701(a)(1)), whether or not exempt from taxation under section 501(a), who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the private foundation before the close of the taxable year of the private foundation in which a contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust. Such term does not include a governmental unit described in section 170(c)(1).

Regulations section 1.509(a)-4(c), regarding the organizational test of a 509(a)(3) organization, states that:

(1) In general. —An organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization (as defined in §1.501(c)(3)-1(b)(2)):

- (i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);
- (ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;
- (iii) State the specified publicly supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and

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(iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

(2) Purposes. —In meeting the organizational test, the organization's purposes, as stated in its articles, may be as broad as, or more specific than, the purposes set forth in section 509(a)(3)(A). Therefore, an organization which, by the terms of its articles, is formed "for the benefit of" one or more specified publicly supported organizations shall, if it otherwise meets the other requirements of this paragraph, be considered to have met the organizational test. Similarly, articles which state that an organization is formed "to perform the publishing functions" of a specified university are sufficient to comply with the organizational test. An organization which is "operated, supervised, or controlled by" (within the meaning of paragraph (g) of this section) or "supervised or controlled in connection with" (within the meaning of paragraph (h) of this section) one or more section 509(a)(1) or (2) organizations to carry out the purposes of such organizations, will be considered as meeting the requirements of this paragraph if the purposes set forth in its articles are similar to, but no broader than, the purposes set forth in the articles of its controlling section 509(a)(1) or (2) organizations.

(3) Limitations. —An organization is not organized exclusively for the purposes set forth in section 509(a)(3)(A) if its articles expressly permit it to operate to support or benefit any organization other than those specified publicly supported organizations referred to in subparagraph (1)(iii) of this paragraph. Thus, for example, an organization will not meet the organizational test under section 509(a)(3)(A) if its articles expressly empower it to pay over any part of its income to, or perform any service for, any organization other than those publicly supported organizations specified in its articles (within the meaning of paragraph (d) of this section). The fact that the actual operations of such organization have been exclusively for the benefit of the specified publicly supported organizations shall not be sufficient to permit it to meet the organizational test.

Regulations section 1.509(a)-4(d) pertains to the organizational test and provides a definition of the term "specified organizations" used in Code section 509(a)(3)(A).

(1) In general. —In order to meet the requirements of section 509(a)(3)(A), an organization must be organized and operated exclusively to support or benefit one or more "specified" publicly supported organizations. The manner in which the publicly supported organizations must be "specified" in the articles for purposes of section 509(a)(3)(A) will depend upon whether the supporting organization is "operated, supervised, or controlled by" or "supervised or controlled in connection with" (within the meaning of paragraph (g) and (h) of this section) such

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organizations or whether it is "operated in connection with" (within the meaning of paragraph (i) of this section) such organizations.

(2) Nondesignated publicly supported organizations; requirements

(i) Except as provided in subdivision (iv) of this subparagraph, in order to meet the requirements of subparagraph (1) of this paragraph, the articles of the supporting organization must designate each of the "specified" organizations by name unless:

(a) The supporting organization is operated, supervised, or controlled by (within the meaning of paragraph (g) of this section), or is supervised or controlled in connection with (within the meaning of paragraph (h) of this section) one or more publicly supported organizations; and

(b) The articles of organization of the supporting organization require that it be operated to support or benefit one or more beneficiary organizations which are designated by class or purpose and which include:

(1) The publicly supported organizations referred to in subdivision (i)(a) of this subparagraph (without designating such organization by name); or

(2) Publicly supported organizations which are closely related in purpose or function to those publicly supported organizations referred to in subdivision (i)(a) or this subparagraph (without designating such organization by name).

(ii) If a supporting organization is described in subdivision (i)(a) of this subparagraph, it will not be considered as failing to meet the requirements of subparagraph (1) of this paragraph that the publicly supported organizations be specified merely because its articles of organization permit the conditions described in subparagraphs (3)(i), (ii), and (iii) and (4)(i)(a) and (b) of this paragraph.

(3) Nondesignated publicly supported organizations; scope of rule. —If the requirements of subparagraph (2)(i)(a) of this paragraph are met, a supporting organization will not be considered as failing the test of being organized for the benefit of "specified" organizations solely because its articles:

(i) Permit the substitution of one publicly supported organization within a designated class for another publicly supported organization either in the same or a different class designated in the articles;

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(ii) Permit the supporting organization to operate for the benefit of new or additional publicly supported organizations of the same or a different class designated in the articles; or

(iii) Permit the supporting organization to vary the amount of its support among different publicly supported organizations within the class or classes of organizations designated by the articles.

(4) Designated publicly supported organizations

(i) If an organization is organized and operated to support one or more publicly supported organizations and it is "operated in connection with" such organization or organizations, then, except as provided in subparagraph (2)(iv) of this paragraph, its articles of organization must, for purposes of satisfying the organizational test under section 509(a)(3)(A), designate the "specified" organizations by name. Under the circumstances described in this subparagraph, a supporting organization which has one or more "specified" organizations designated by name in its articles, will not be considered as failing the test of being organized for the benefit of "specified" organizations solely because its articles:

(a) Permit a publicly supported organization which is designated by class or purpose, rather than by name, to be substituted for the publicly supported organization or organizations designated by name in the articles, but only if such substitution is conditioned upon the occurrence of an event which is beyond the control of the supporting organization, such as loss of exemption, substantial failure or abandonment of operations, or dissolution of the publicly supported organization or organizations designated in the articles;

(b) Permit the supporting organization to 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; or

(c) Permit the supporting organization to vary the amount of its support between different designated organizations, so long as it meets the requirements of the integral part test set forth in paragraph (i)(3) of this section with respect to at least one beneficiary organization.

(ii) If the beneficiary organization referred to in subdivision (i)(b) of this subparagraph is not a publicly supported organization, the supporting

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organization will not then meet the operational test of paragraph (e)(1) of this section. Therefore, if a supporting organization substituted in accordance with such subdivision (i)(b) a beneficiary other than a publicly supported organization and operated in support of such beneficiary organization, the supporting organization would not be described in section 509(a)(3).

In Revenue Ruling 79-197, 1979-1 CB 204 it was held that a newly created nonprofit organization is to pay its future income until a specific amount has been paid to specified organizations described in section 509(a)(1) or (a)(2) of the Code that appoint a majority of its governing body. The organization will dissolve after the specific amount has been paid and will distribute its assets to such specified organizations that a contributor, named in its articles of organization, selects. The organization is a private foundation and not a supporting organization.

Regulations section 1.509(a)-4(e) references the operational test a 509(a)(3) organization must comply with.

(1) Permissible beneficiaries. —A supporting organization will be regarded as “operated exclusively” to support one or more specified publicly supported organizations (hereinafter referred to as the “operational test”) only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by a specified publicly supported organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in §53.4945-4(a)(4) of this chapter. Similarly, an organization will be regarded as “operated exclusively” to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

(2) Permissible activities. —A supporting organization is not required to pay over its income to the publicly supported organizations in order to meet the operational test. It may satisfy the test by using its income to carry on an independent activity or program which supports or benefits the specified publicly supported

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organizations. All such support must, however, be limited to permissible beneficiaries in accordance with subparagraph (1) of this paragraph. The supporting organization may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations, or for the permissible beneficiaries.

Regulations section 1.509(a)-4(f) regarding the nature of relationships required for section 509(a)(3) organizations provides:

(1) In general. —Section 509(a)(3)(B) describes the nature of the relationship required between a section 501(c)(3) organization and one or more publicly supported organizations in order for such section 501(c)(3) organization to qualify under the provisions of section 509(a)(3). To meet the requirements of section 509(a)(3), an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. If an organization does not stand in one of such relationships (as provided in this paragraph) to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

(2) Types of relationships. —Section 509(a)(3)(B) sets forth three different types of relationships, one of which must be met in order to meet the requirements of subparagraph (1) of this paragraph. Thus, a supporting organization may be:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with, one or more publicly supported organizations.

(3) Requirements of relationships. —Although more than one type of relationship may exist in any one case, any relationship described in section 509(a)(3)(B) must insure that:

(i) 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.

(4) General description of relationships. —In the case of supporting organizations which are "operated, supervised, or controlled by" one or more publicly supported organizations, the distinguishing feature of this type of

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relationship is the presence of a substantial degree of direction by the publicly supported organizations over the conduct of the supporting organization, as described in paragraph (g) of this section. In the case of supporting organizations which are "supervised or controlled in connection with" one or more publicly supported organizations, the distinguishing feature is the presence of common supervision or control among the governing bodies of all organizations involved, such as the presence of common directors, as described in paragraph (h) of this section. In the case of a supporting organization which is "operated in connection with" one or more publicly supported organizations, the distinguishing feature is that the supporting organization is responsive to, and significantly involved in the operations of, the publicly supported organization, as described in paragraph (i) of this section.

Regulation section 1.509(a)-4(g) defines the meaning of "operated, supervised, or controlled by".

(1) (i) Each of the items "operated by", "supervised by", and "controlled by", as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any one of these terms is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations.

(ii) A supporting organization may be "operated, supervised or controlled by" one or more publicly supported organizations within the meaning of section 509(a)(3)(B) even though its governing body is not comprised of representatives of the specified publicly supported organizations for whose benefit it is operated within the meaning of section 509(a)(3)(A). A supporting organization may be "operated, supervised, or controlled by" one or more publicly supported organizations (within the meaning of section 509(a)(3)(B)) and be operated "for the benefit of" one or more different publicly supported organizations (within the meaning of section 509(a)(3)(A)) only if it can be demonstrated that the purposes of the former organizations are carried out by benefiting the latter organizations.

Regulations section 1.509(a)-4(j) regarding control by disqualified persons states that:

(1) In general. —Under the provisions of section 509(a)(3)(C) a supporting organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation

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managers and other than one or more publicly supported organizations. 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)(C), 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 any 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. Except as provided in subparagraph (2) of this paragraph, a supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization. Thus, if the governing body of a foundation is composed of five trustees, none of whom has a veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered to be controlled directly or indirectly by one or more disqualified persons by reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting rights with respect to stocks in which members of its governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

GOVERNMENT'S POSITION:

As set forth above, it is the government's primary position that the tax exempt status of the _____ Foundation should be revoked. Alternatively, the _____ Foundation should be reclassified as a private foundation.

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Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private foundation is intentionally inclusive so that all organizations exempted from tax by IRC § 501(c)(3) are private foundations except for those specified in IRC § 509(a)(1) through(4). Roe Foundation Charitable Trust v. Commissioner, See Quarrie, supra. currently is excepted from private foundation status because it is currently classified as an organization described in section 509(a)(3) which defines supporting organizations.

Public charities (organizations described in section 501(c)(3) that meet the requirement of sections 509(a)(1) or (2)) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations are similarly excepted from private foundation status. Supporting organizations are excepted if they are subject to the scrutiny of public charities that provide sufficient oversight to keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie, 603 F.2d at 1277-78.

Section 509(a)(3) organizations must meet all three of the following tests:

- 1) Organizational and Operational Tests under section 509(a)(3)(A)
- 2) Relationship Test under section 509(a)(3)(B)
- 3) Lack of Disqualified Person Control Test

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons. The first and third tests are not satisfied in this case.

1) Operational Test

fails the operational test set forth in Treas. Reg. § 1.509(a)-4(e)(1). A supporting organization will be regarded as "operated exclusively" to support a specified publicly supported organization(s) only if it engages in activities which support or benefit the specified publicly supported organizations(s). As was discussed under the Primary Issue above, has served private interests and has operated for the benefit of Attorney and/or an organization which he owns and controls. Therefore, it has not established that it operated exclusively for the benefit of the publicly supported organizations.

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2) Relationship Test

As set forth in Treas. Reg. § 1.509(a)-4(f)(2), there are three permissible relationships:

- (a) operated, supervised, or controlled by; (b) supervised or controlled in connection with; and
- (c) operated in connection with one or more publicly supported organizations.

The relationships "operated, supervised or controlled by" and "supervised or controlled in connection with" presuppose a substantial degree of direction over the policies, programs and activities of the supporting organization by a publicly supported organization. The "operated, supervised or controlled by" relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity or the membership of the publicly supported organization. The "supervised or controlled in connection with" relationship is established by the fact that there is common supervision or control by the persons supervising or controlling both the supporting and the publicly supported organizations (i.e.; that control or management of the supporting organization is vested in the same persons that control or manage the publicly supported organization).

In the present case, there are two trustees. On paper, the publicly supported organization is supposed to have 60% of the voting control while _____, a disqualified person, has 40% of the voting control. Therefore, _____ has technically satisfied the requirements of being in a relationship "operated, supervised or controlled by" the primary charity. As set forth below, in actuality this requirement was not satisfied.

3) Control by a Disqualified Person

_____ is under the control of a disqualified person. _____ is not a supporting organization under Code section 509(a)(3) because it is controlled directly or indirectly by one or more disqualified persons.

_____ is a disqualified person because he is a substantial contributor as defined in Code section 4946(a)(1)(A). He is the only contributor to _____. While the Trust Agreement provides for two trustees with the publicly supported charity having 60% of the vote, there were no board meetings or other indication that any publicly supported organization had any involvement in the operations of _____.

The first listed supported organization, _____, never received tax exempt status. The second listed supported organization, _____, lost its tax exempt status in 20____. The third listed _____

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supported organization, organization but thought it withdrew as described below never had any input into

is a qualified section 501(c)(3) trustee in early 20XX and as operations.

was the designated supported organization per the Trust Agreement from December 20XX until sometime after the end of the December 31, 20XX tax year. never asked for and was not provided with any monetary grants. During the examination it was determined that had no contact with the beneficiary organization. There were no meetings, no elections and no support provided. In addition, the beneficiary had no influence over any decisions made.

remained listed as a trustee despite its request that the relationship be terminated. It acknowledged that it had no control over operations. The only activity of was the distribution of all of its funds to Attorney . This was accomplished by a telephone call between Attorney and . There is no evidence the board considered this action or approved it.

Treas. Reg. § 1.509(a)-4(j)(1) provides that for purposes of section 509(a)(3)(C), an organization will be considered "controlled" if the person, by reason of his position or authority, may require the organization to perform any act which significantly affects its operations or prevents such organization from performing such act. All facts and circumstances are taken into consideration in determining whether a disqualified person controls an organization. Id. There is no indication that any representatives of the specified public charities had any input into the operations of . Thus, a disqualified person, directly controlled

Accordingly, if its exempt status is not revoked, should be reclassified as a private foundation because it does not qualify as a supporting organization under the requirements set forth in Treas. Reg. § 1.509(a)-4(j). This reclassification is effective November 5, 19XX. Retroactive reclassification is appropriate because did not disclose in its application that it would not operate to benefit the specified public charity and that it would be controlled by a disqualified person.

TAXPAYER'S POSITION:

The taxpayer has agreed to revocation of exempt status.

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CONCLUSION:

The _____ Foundation does not qualify for tax exempt status under IRC section 501(a) as an organization described in section 501(c)(3) of the Code. The existence of substantial private benefit combined with the lack of proper controls and the lack of any qualified activity indicates that _____ should not be allowed to continue as a tax exempt organization. Revocation of the tax exempt status of _____ Foundation is proposed.

Alternately, The _____ Foundation should be reclassified as an organization that is a private foundation as defined in section 509(a) of the Code.