

**Internal Revenue Service**  
Appeals Office

**Department of the Treasury**

**Employer Identification Number:**

Release Number: **201451043**  
Release Date: 12/19/2014  
Date: September 23, 2014

**Person to Contact:**

Employee ID Number:  
Tel:  
Fax:

**UIL: 501.03-00**

**Certified Mail**

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective January 1, 2008.

Our revocation was made for the following reason(s):

You are not operated exclusively for charitable purposes because you serve private rather than public interests. In addition, your earnings inure to the benefit of private individuals.

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

You are required to file Federal income tax returns on Forms 1120. 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](http://www.irs.gov).

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

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

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

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](http://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 and/or 556



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities Division

Date: *march 26, 2013*

Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:

Phone Number:

Fax Number:

Manager's name / ID number:

Manager's contact number:

Phone Number:

Response due date:

**Certified Mail - Return Receipt Requested**

Dear \_\_\_\_\_

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the

IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't 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:

Internal Revenue Service  
Office of the Taxpayer Advocate  
300 N. Los Angeles St, Room 5109  
Los Angeles, CA 90012

Phone Number: 213-576-3140

**For additional information**

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,

Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer:</b>  <b>ORG</b>	<b>EIN:</b>	<b>Year/Period Ended</b> December 31, 20XX December 31, 20XX December 31, 20XX

**LEGEND**

ORG - Organization name      XX - Date      Address - address      City - city      State - state      County - county      President - President  
Treasurer - Treasurer      Secretary - Secretary      Foundation - Foundation  
Hotel-1 through 2 - Hotel-1 through 2      Unit-1 through Unit-4

**Issue**

1. Is the ORG ("ORG") operated exclusively for exempt purposes under IRC Section 501(c)(3)? Has the income and assets inured to the benefit the ORG's officers?
2. Is the ORG liable for excise tax on Taxable Expenditures under IRC § 4945?
3. Is the ORG liable for excise tax on Failure to Distribute Income under IRC §4942?
4. Is the ORG liable for excise tax on Excess Business Holdings under IRC §4943?

**Facts**

**Articles of Incorporation**

The organization was incorporated in the State of State, on August 31, 19XX. The Articles of Incorporation state that the ORG is organized exclusively for charitable and educational purposes within the meaning of § 501(c)(3) of the Internal Revenue Code, and it is not organized for the private gain of any person.

The Articles contain a dissolution clause stating that the assets, property, profits and net income of this organization are irrevocably dedicated to charitable and educational purposes within the meaning of § 501(c)(3). The Article's also contain a clause prohibiting inurement which states that no part of the net earnings shall inure to the benefit of any incorporator, director, officer or member of the corporation, and provide that the ORG will not engage in transactions that would subject it to excise tax under Chapter 42 of the Code (including tax on undistributed income, acts of self-dealing, excess business holdings, or making taxable expenditures which would adversely affect its exempt status).

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**Form 1023 and Determination Letter**

The ORG received its exemption letter on March 19, 19XX under § 501(c)(3), classified as private ORG. According to IRS records, the ORG is classified as a non-operating private foundation.

The Form 1023 stated the ORG was formed for the purpose of distributing contributions received from President (and his family and associates) to other exempt organizations which support environmental concerns and seek to educate the general public (about the relationship between mankind and the environmental). A portion of the funds was to be distributed current, with the remainder to be accumulated as an endowment base for future support of conservation oriented activities. The ORG's initial activity purportedly consisted of screening requests for contributions from exempt organizations and making necessary investment decisions.

The Form 1023 listed its officers and directors as follows:

President – President / Director  
Treasurer – Treasurer / Director  
Secretary – Secretary / Director

Additionally, the Form 1023 acknowledged that the officers above were also members of the board of directors of the Foundation.

**Disqualified Persons**

The disqualified persons with respect to the ORG and Foundation are:

President                                      Officer/Director  
Treasurer                                      Officer/Director  
Secretary                                        Officer/Director

The ORG provides the majority of the Foundation (FDN)'s support.

**Organization and Activities**

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In, 20XX, the ORG provided grants totaling \$0 to the Foundation, a related non-operating private foundation. It also provided \$0 in grants to various other charities. The ORG did not engage in any direct charitable or educational activities during 20XX.

In 20XX and 20XX, the ORG provided grants totaling \$0 and \$0, respectively, to the FDN. It also provided grants totaling approximately \$0 and \$0 to various other charities in 20XX and 20XX, respectively. The ORG did not engage in any direct charitable or educational activities during 20XX and 20XX.

The FDN's activities include construction of an educational center in State, and the operation of a botanical garden and related open space land in City, State. The physical address of the City property is Address, City, State Zip code. The property was donated by the President Corporation in the early 19XX's. It includes two parcels, and consists of approximately 255 and 9 acres, respectively. The disqualified persons retain the right to use the property for personal use in perpetuity.

The FDN's botanical garden and property is immediately enclosed by the President & Treasurer / President Corporation's 40 acre property (situs address), and the Secretary & Husband / President Corporation's 33 acre property (situs address).

The President & Treasurer's and Secretary & Husband's retain control over the FDN's property in City, State. They converted structures on FDN's property into vacation rentals which are used by Secretary in her for-profit, the Inn. Additionally, the disqualified persons control public access to the FDN's property. The County of County revoked the Organization's Conditional Use Permit (CUP), prohibiting it from advertising or being opened to the public in 20XX. The CUP, similar to a business license, permitted the organization to operate its facilities to the general public.

The FDN stated that it has hundreds of visitors annually. The FDN does not advertise its property and it is hidden from the public view. Note that similar botanical gardens in the Southern State region have between 59,000 – 500,000 visitors annually.

### City Hotel

In 20XX, the President & Treasurer's purchased property located at Address, City, State, (711) that consisted of an existing for-profit hotel named Hotel-1. Simultaneously, the FDN purchased Address, City, State (719) for \$0<sup>1</sup>. 711 consists of

\* \* \* \*

<sup>1</sup> On April 24, 20XX

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six units, and 719 consists of four units. On February 6, 20XX<sup>2</sup>, the FDN transferred the 719 property to the ORG. Both 711 and 719 properties are used to operate Hotel-2 (Hotel-2), a for-profit owned by the President & Treasurer.

On August 8, 20XX, the President & Treasurer's prepared an Application for Business Tax Identification Number. They obtained a business license doing business as (DBA) Hotel-2. The provided business description was an 'Inn' - accommodation, food services, and drinking, etc. The business started around September 9, 20XX. The application listed the principal business addresses at 711 and Address, and owners as Treasurer / CFO Owner & President, President.

The FDN renovated the 719 property and transferred Hotel-2's business license to the ORG during the property donation. The ORG currently holds the business license. The ORG stated that there are no rental agreements, lease agreements, or ownership percentages or arrangements between the President & Treasurer and the ORG.

Hotel-2 is advertised on [www.Hotel-2.com](http://www.Hotel-2.com)<sup>3</sup>. Currently, ten units are available to reserve on-line. Address consists of four units, Unit-1, Unit-2, Unit-3 and Unit-4. Treasurer owns the remaining six units. The website advertises the hotel's physical address as Address and mailing address as Address. Hotel-2 is a commercial enterprise operated similar to an ordinary hotel. The President & Treasurer have effective control over this business through their 60% ownership percentage and as controlling managers the ORG.

Reservations for 711 and 719 are made on the website. Transactions are processed through a reservation management system which is subscribed under Treasurer's name. All room revenues are deposited in Treasurer's / Hotel-2 (711) account. She subsequently issues checks from this account to the ORG for its portion of room revenue. In 20XX, the ORG received \$ in room revenue.

Hotel expenditures included house keeping/ cleaning, laundry, advertising, Comcast, utilities, property tax, commercial liability insurance, etc., totaling approximately \$0 in 20XX and \$0 in 20XX

\* \* \* \*

<sup>2</sup> Per FDN's 20XX Form 990-PF

<sup>3</sup> 1<sup>st</sup> capture of the website on archive.org is dated May 5, 20XX; blog: <http://blog.Hotel-2.com> 1<sup>st</sup> entry was dated December 18, 20XX.

<sup>4</sup> 1<sup>st</sup> capture of the website on archive.org is dated May 5, 20XX; blog: <http://blog.Hotel-2.com> 1<sup>st</sup> entry was dated December 18, 20XX.



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Form 990-PF

Year	20XX	20XX	20XX
1. Contributions Gifts Grants <sup>4</sup>	0	0	0
3. Interest on Savings and Temp cash Investments	0	0	0
4. Dividends & Interest from Securities	0	0	0
5. Gross Rents	0	0	0
6a. Net Gain (loss) from sale of assets (securities, stocks, etc)	0	0	0
6b. Gross sales price	0	0	0
12. Total Revenue	0	0	0
14. Other employees salaries & wages	0	0	0
16. Legal Fees	0	0	0
Accounting	0	0	0
Other prof fees	0	0	0
17. Interest		0	0
18. Taxes	0	0	0
19. Depreciation	0	0	0
20. Occupancy	0	0	0
21. Travel conferences and meetings			
23. Other Expenses	0	0	0
24. Total operating and admin	0	0	0
25. Contribution, gifts & grants paid	0	0	0
26. Total expenses and disbursements	0	0	0
27. Excess of revenue over expenses	0	-0	-0

The ORG expenditures included administrative, hotel and expenses incurred to maintain the investment properties.

\* \* \* \*

<sup>5</sup> From Trust

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Grants totaled:

	20XX	20XX	20XX
FDN/ Related	\$0	\$0	\$0 <sup>5</sup>
Other	\$0	\$0	\$0
	0	0	0
	96%	96%	94%

**Assets**

The ORG's assets include:

	20XX	20XX	20XX
Average Monthly Cash Balances:			
State Bank	0	0	0
Rabo Investment	0 <sup>6</sup>	0	0 <sup>7</sup>
County Commerce	0	0	0
Bank of State	0	0	0 <sup>8</sup>
Loan	0	0	0
Schwab	0	0	0
Building	0	0	0
Address	0	0	0
Address	0	0	0
Lot	0	0	0
Address	0	0	0

Notes Receivable

Ramos	0	0	0
Doyle	0	0	0

\* \* \* \*

<sup>6</sup> \$0 ICEC

<sup>7</sup> EOY balance

<sup>8</sup> EOY balance

<sup>9</sup> EOY balance

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Rivera	0	0	0
<u>Dexter</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Total</b>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

The Forms 990-PF did not reveal the City hotel activity. The Forms 990-PF did not reveal the relationship between the ORG and the FDN.

Part X, Minimum Investment Return, Part XI, Distributable Amount, and Part Xii, Qualifying Distributions were incomplete and incorrect for THE 20XX AND 20XX years.

The ORG provided negative responses by stating "No" to questions on Part VII-B, Statements regarding Activities for Which Form 4720 may be required.

Lines 1a (1), (2), (3), (4), (5), asked "during the year did the ORG pay or incur any amount to":

- (1) Engage in the sale or exchange, or leasing of property with a disqualified person?
- (2) Borrow money from, lend money to, or otherwise extend credit to (or accept it from ) a disqualified person?
- (3) Furnish goods, services, or facilities to (or accept them from) a disqualified person?
- (4) Pay compensation to, or pay or reimburse the expenses of, a disqualified person? [Note: Answered "yes" in 20XX]
- (5) Transfer any income or assets to a disqualified person (or make any of either available for the benefit or use of a disqualified person

Item 5a (4) & (5):

5a (4) "During the year did the ORG pay or incur any amount to an organization other than a charitable, etc., organization described in section 509(a)(1), (2), or (3), or section 4940(d)(2)?"

Line 5a (5) "During the year did the ORG pay or incur any amount to provide for any purpose other than religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals?"

The organization checked "No" to questions 5a (4) & (5) above in 20XX, 20XX, and 20XX. The response for each of the years was "No." The correct answer was "Yes,"

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since FDN received grants from the ORG. The FDN is not a section 509(a)(1), (2), or (3) organization. As a result of the incorrect answer to item 5(a)(4), the related questions in 5(c) were marked "N/A." 5(c) asked, "If the answer is yes to 5(a)(4), does the ORG claim exemption from the tax because it maintained expenditure responsibility for the grant? If yes, attach a statement required by Regulations section 53.4945-5(D). The correct answer to 5(a)(4) was "Yes" rather than "N/A," and a "Yes" answer to 5(a)(4) would have called for the attachment of the "statement required." No such statement was attached in any of the three returns.

Part IX-A, Summary of Direct Charitable Activities, asked to list the ORG's four largest direct charitable activities during the tax year. The ORG responded in an attached statement "The ORG primarily supports one ORG, the Foundation. This organization has two environmental education centers; one of which is an educational and scientific institution that has a botanic garden specializing in Mediterranean regions of the world.

Part XV, Supplementary Information, regarding ORG managers, asked, "(b) List any managers of the ORG who own 10% or more of the stock of a corporation (or an equally large portion of the ownership of a partnership or other entity) of which the ORG has a 10% or greater interest." The ORG stated "none" for 20XX, 20XX, & 20XX.

### Law

I.R.C. § 501(c)(3) provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that an organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code in order to be exempt as an organization described in such section.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it is engaged primarily in activities that 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.

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Treas. Reg. § 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.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, 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, shareholders, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(a)-1(c) defines a private shareholder or individual as those persons having a personal and private interest in the activities of an organization. In general, a private shareholder or individual is considered an "insider" with respect to the exempt organization.

### Cases

*Better Business Bureau v. United States*, 316 U.S. 279 (1945), holds that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption under section 501(c)(3). An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such purposes.

*Manning Association v. Commissioner*, 93 T.C. 596 (1989); 93 T.C. No. 50, holds that Manning Association, Inc., is not exempt from tax under sec. 501(c)(3) of the Code as an organization operated "exclusively for educational purposes." Notwithstanding the existence of truly educational purposes based largely upon a historic Manning homestead and historic artifacts, the association's operations were also conducted for the benefit of members of the Manning family, a nonexempt purpose that is found to be "substantial in nature." *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945). There is no 10-percent "safe harbor" of nonexempt activities within which an organization may conduct its affairs without running afoul of the disqualifying test of *Better Business Bureau*. Contrary to petitioner's position, no such safe harbor rule was established by *World Family Corp. v. Commissioner*, 81 T.C. 958 (1983), and in any event the record fails to establish that the Manning Association's activities in fact came within any such arbitrary percentage limitation.

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*Benedict Ginsberg and Adele W. Ginsberg v. Commissioner, 46 T.C. 47 (1966)*, holds that petitioners contributed money to a corporation organized to conduct the dredging of certain waterways. The corporation was organized and operated primarily for the benefit of those persons owning property adjacent to the waterways dredged rather than for public or charitable purposes, so that contributions to it are not deductible under *section 170, I.R.C. 1954*.

*American Campaign Academy, Petitioner v. Commissioner, 92 T.C 1053, 1065-1066 (1989)*, Petitioner taxpayer academy sought a declaratory judgment under 26 U.S.C.S. § 7428(a) that it was exempt from federal income taxation under 26 U.S.C.S. § 501(a) as an organization meeting the requirements of 26 U.S.C.S. § 501(c)(3). The court found in favor of respondent Commissioner of Internal Revenue, holding that petitioner was nonexempt under 26 U.S.C.S. § 501(c)(3). The court found that petitioner cited no compelling authority in support of its contention that nonincidental benefits must be controllable by the organization. Moreover, the court found that the administrative record supported respondent's contention that petitioner was formed with a substantial purpose to train campaign professionals for service in Republican entities and campaigns. The court held that petitioner failed to persuade the court that this was not the case. The court found that secondary benefits that advanced a substantial purpose could not be construed as incidental to petitioner's exempt educational purpose.

The case further states that, when an organization operates 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, the organization by definition does not operate exclusively for exempt purposes. Prohibited private benefits may include an "advantage; profit, fruit; privilege; gain; [or] interest." Occasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefits. Thus, should \* \* \* [the organization] be shown to benefit private interests, it will be deemed to further a nonexempt purpose under section 1.501(c)(3)-1(d)(1)(ii), Income Tax Regs. This nonexempt purpose will prevent [the organization] from operating primarily for exempt purposes absent a showing that no more than an insubstantial part of its activities further the private interests or any other nonexempt purposes.

*John E. Thorne v. Commissioner, 99 t.c. 67*, the court found that the taxpayer made numerous grants to organizations that were not tax-exempt, that he did not exercise expenditure responsibility under § 4945(h) over grants made, and that he made grants to friends and relatives for personal purposes, such as travel, the payment of medical bills, or to avoid eviction. Consequently, these were taxable expenditures for which

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deficiencies and penalties could be assessed. The court further found that the violations were both knowing and willful.

*Hans S. Mannheimer Charitable Trust v. Commissioner* 93 TC 35 (1989). Petitioner, a private foundation, made grants to two other private foundations, all three of which had been established by the same person to promote his interest and concern about animals and nonhuman primates. Some of the same officers and trustees held similar positions in all three foundations. Held, on the facts of this case, petitioner is subject to the excise tax on "taxable expenditures" imposed by sec. 4945(a)(1) of the Internal Revenue Code, since its contributions to the other two foundations during 1981-1983 were "taxable expenditures" within sec. 4945(d)(4), by reason of its failure to exercise "expenditure responsibility" with respect to such contributions within any one of the three requirements of sec. 4945(h), as implemented particularly by sec. 53.4945-5(b), (c), and (d), Private Foundation Excise Tax Regs.

Rev. Rul. 75-286 states that a nonprofit organization with membership limited to the residents and business operators within a city block and formed to preserve and beautify the public areas in the block, thereby benefiting the community as a whole as well as enhancing the members' property rights, will not qualify for exemption under section 501(c)(3).

Rev. Rul. 67-5, 1967-1 C.B. 123 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 did not operate a charitable program commensurate in scope with its financial resources, rather the foundation was only able to carry out minimal charitable activities. The ruling stated 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 I.R.C. § 501(c)(3).

*Rev. Rul. 70-186, 1970-1*, distinguished, states that a nonprofit organization formed to preserve and improve a lake used extensively as a public recreational facility qualifies for exemption under section 501(c)(3) of the Code.

*Rev. Rul. 78-85, 1978-1*, distinguished, states that a nonprofit organization with membership open to the general public that was formed by residents of a city to help preserve, beautify, and maintain a public park located in the city and whose support is derived from membership dues and contributions from the general

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public is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code; Rev. Rul. 75-286 distinguished.

In determining the effective date of revocation, an organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, §14.01 (cross-referencing §13.01 et seq.), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Rev. Proc. 2007-52, 20078-30, IRB 222.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Rev. Proc. 2007-52, 2007-30 IRB 222.

#### **IRC § 4946**

Section 4946(a)(1) of the Code defines the term "disqualified persons" with respect to a private foundation as including a substantial contributor to the foundation, a foundation manager, and an owner of more than 20 percent of the total combined voting power of a corporation which is a substantial contributor to the foundation. It also includes a member of the family of any individual described above. The definition includes a corporation of which the persons described ante own more than 35 percent of the total combined voting power. In addition it includes a trust or estate in which persons described above hold more than 35 percent of the beneficial interest.

Section 4946(b) of the Code defines the term foundation manager as including an officer, director, or trustee of a foundation or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation. Section 4946(d) of the Code states that the term "a member" of the family of a disqualified person includes the spouse, children of and grandchildren of a disqualified person.

Treas. Reg. § 53.4941(d)-1. Definition of self-dealing

(a) In general - For purposes of section 4941, the term "self-dealing" means any direct or indirect transaction described in §53.4941(d)-2. For purposes of this section it is



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immaterial whether the transaction results in a benefit or a detriment to the private foundation.

**IRC § 4941(d) Self-Dealing. —**

4941(d)(1) In general . —For purposes of this section, the term “self-dealing” means any direct or indirect —

4941(d)(1)(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

4941(d)(1)(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation;

**IRC § 4942 –**

4942(a) Initial Tax. —There is hereby imposed on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period), a tax equal to 30 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.

**Treas. Reg. §53.4942(a)-3. Qualifying distributions defined**

*(a) In general*

(1) *Distributions generally.* —For purposes of section 4942 and the regulations thereunder, the amount of a qualifying distribution of property (as defined in subparagraph(2) of this paragraph) is the fair market value of such property as of the date such qualifying distribution is made. The amount of an organization's qualifying distributions will be determined solely on the cash receipts and disbursements method of accounting described in section 466(c)(1).

(2) *Definition.* —The term “qualifying distribution” means —

(i) Any amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or

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more purposes described in section 170(c)(1) or (2)(B), other than any contribution to

(a) A private foundation which is not an operating foundation (as defined in section 4942(j)(3)), except as provided in paragraph (c) of this section, or

(b) An organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation, except as provided in paragraph (c) of this section;

(3) *Control.* —For purposes of subparagraph (2)(i)(b) of this paragraph, an organization is “controlled” by a foundation or one or more disqualified persons with respect to the foundation if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable. “Control” of a donee organization is determined without regard to any conditions imposed upon the donee as part of the distribution or any other restrictions accompanying the distribution as to the manner in which the distribution is to be used, unless such conditions or restrictions are described in paragraph (a)(8) of §1.507-2 of this chapter (Income Tax Regulations). In general, it is the donee, not the distribution, which must be “controlled” by the distributing private foundation for the provisions of subparagraph (2)(i)(b) of this paragraph to apply. Thus, the furnishing of support to an organization and the consequent imposition of budgetary procedures upon that organization with respect to such support shall not in itself be treated as subjecting that organization to the distributing foundation’s control within the meaning of this subparagraph. Such “budgetary procedures” include expenditure responsibility requirements under section 4945(d)(4). The “controlled” organization need not be a private foundation; it may be any type of exempt or nonexempt organization including a school, hospital, operating foundation, or social welfare organization.

**4943(a) Initial Tax. —**

4943(a)(1) Imposition. —There is hereby imposed on the excess business holdings of any private foundation in a business enterprise during any taxable year which ends during the taxable period a tax equal to 10 percent of the value of such holdings.

4943(a)(2) Special rules. —The tax imposed by paragraph (1) —

4943(a)(2)(A) shall be imposed on the last day of the taxable year, but

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4943(a)(2)(B) with respect to the private foundation's holdings in any business enterprise, shall be determined as of that day during the taxable year when the foundation's excess holdings in such enterprise were the greatest.

4943(b) Additional Tax. —In any case in which an initial tax is imposed under subsection (a) with respect to the holdings of a private foundation in any business enterprise, if, at the close of the taxable period with respect to such holdings, the foundation still has excess business holdings in such enterprise, there is hereby imposed a tax equal to 200 percent of such excess business holdings.

4943(c) Excess Business Holdings. —For purposes of this section —

4943(c)(1) In general. —The term “excess business holdings” means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

4943(c)(2) Permitted holdings in a corporation. —

4943(c)(2)(A) In general. —The permitted holdings of any private foundation in an incorporated business enterprise are —

4943(c)(2)(A)(i) 20 percent of the voting stock, reduced by

4943(c)(2)(A)(ii) the percentage of the voting stock owned by all disqualified persons.

In any case in which all disqualified persons together do not own more than 20 percent of the voting stock of an incorporated business enterprise, nonvoting stock held by the private foundaion shall also be treated as permitted holdings.

4943(c)(3) Permitted holdings in partnerships, etc. —The permitted holdings of a private foundation in any business enterprise which is not incorporated shall be determined under regulations prescribed by the Secretary. Such regulations shall be consistent in principle with paragraphs (2) and (4), except that —

4943(c)(3)(A) in the case of a partnership or joint venture, “profits interest” shall be substituted for “voting stock”, and “capital interest” shall be substituted for “nonvoting stock”,