

Internal Revenue Service

Appeals Office
333 East River Dr., St. 200
East Hartford, CT 06108

Release Number: **201511033**

Release Date: 3/13/2015

Date: December 9, 2013

A
B

Department of the Treasury

Taxpayer Identification Number:

C

Person to Contact:

Tax Period(s) Ended: F

Certified Mail

UIL: 0503.03-30

A =
B =
C =
D =
E =
F =
G =

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 D.

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

More than an insubstantial part of the organization's activities are not in furtherance of exempt purposes. Therefore, the organization fails to meet the operational test as defined in Regulation 1.501(c)(3)-1(a)(1).

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

You are required to file Federal income tax returns on Forms E for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

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

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court,

2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Sincerely Yours,

/s/
Appeals Team Manager

cc: G

Enclosure: Publication 892

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
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LEGEND

ORG - Organization name XX - Date City - city State - state
Country - country website - website RA-1, RA-2 & RA-3 - 1ST, 2ND & 3RD
RA DIR-1 - DIR-6 - 1ST THROUGH 6TH DIR CO-1 THROUGH CO-12 - 1ST THROUGH
12TH COMPANIES

ISSUE:

Is the organization described below entitled to continued tax exempt status under Internal Revenue Code Section 501(c)(3)?

ISSUE:

Are contributions to the organization described below deductible under section 170 of the Internal Revenue Code?

FACTS:

(hereinafter referred to as the "organization ") was incorporated on July 10, 19XX in the state of State. The organization was granted tax exempt status under IRC section 501(c)(3) as a public charity described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code on January 15, 19XX.

The organization's purpose as stated in their Certificate of Incorporation is [redacted] In furtherance of its purpose, the organization provides monetary support to educational facilities to meet the religious and educational needs of Country [redacted].

The supported foreign organization has a similar name to the domestic organization which is [redacted] (hereinafter referred to as "CO-1"), and they operate a network of schools in Country.

The organization derives substantially all of its income in the form of contributions from foundations, individuals and the general public. During the examination, it was determined that the organization maintained accounts at CO-2, CO-3 and CO-3 from which funds were sent via checks or wire transfers to support the foreign organization.

The website for CO-1 (website) provides a history of the organization.

[redacted]

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Financial Information

A review of the organization's Form 990 information returns for tax years December 31, 20XX through December 31, 20XX disclosed that the organization's primary activity is providing financial support (totaling \$\$, \$\$, \$\$ and \$\$ respectively) to CO-1.

The Form 990 returns also show expenses classified as "Social Work Programs." The organization represented that this expense category was the direct payment of salaries to teachers at the Country schools. For the years under examination "salary" payments to

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individuals for calendar years 20XX, 20XX, 20XX and 20XX were \$\$, \$\$, \$\$ and \$\$ respectively.

The organization provided itemized schedules of disbursements for CO-1 and the Social Work Programs for each year under examination. The schedules revealed that a significant number of checks and wire transfer receipts including bank statements were missing. The amounts referenced on the various tables below were extracted from the schedules provided by the organization.

Per 990, the table below summarizes payments the organization represents to have been made for the benefit of CO-1 .

	20XX	20XX	20XX	20XX	Total
1. Direct support for CO-1	\$\$	\$\$	\$\$	\$\$	\$\$
2. Payments for teachers - Social Work Programs	\$ \$	\$ \$	\$ \$	\$ \$	\$ \$
3. Subtotal	\$ \$	\$\$	\$ \$	\$ \$	\$ \$

Percentage of funds earmarked for specific individuals (Total payments for teachers) \$\$ divided by Total Distributions \$\$ = %

Direct payments of salaries to teachers

The organization was asked why in addition to making direct support payments to the educational institution they also made direct payment of salaries to individuals at three of the schools. The representative stated that the foreign organization had requested that payment be made directly to the individuals in order to lessen the school's administrative burdens. In addition, he indicated that this was done in order to segregate those payments

from the Country organization's regular cash flow for budgeting purposes. This enabled them to better track the portion of their payroll that they needed to cover from other sources. The representative was also asked if these individuals receiving payments were United States citizens. He indicated that "to the best of our knowledge, these individuals are not U.S. citizens."

The organization stated that CO-1 periodically submitted a request listing the names of individuals and the amounts to be paid to each on behalf of the foreign organization. The

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organization drafts the checks payable to the identified individuals, sends the checks to the foreign organization who in turn distributes them to the payees.

The Service issued an Information Document Request (IDR) dated August 2, 20XX in which the organization was asked what controls were in place to determine that the individuals are employed by the schools in Country and to submit personnel files for these individuals. The organization's representative indicated that the board members visit the Country organization on a monthly basis. During the visitation, they inspect records and make unannounced onsite visits of the schools. A board member resides in Country and constantly monitors usage of funds provided by the organization.

The organization provided documents in [REDACTED] both hand written and printed from the school facilities operated in Country. The documents included photo identifications, W-4 equivalents and personnel files, as verification that the individuals receiving payments are in fact employees of the Country schools. However, the organization did not provide photo identifications for all individuals who received direct payments. Additional correspondence received from the director of the schools in Country listed the names, employment dates, school locations and job function for each of the individuals to whom payments were made by the organization. The Service did not accept these documents as evidence that the individuals are employees of the schools because they were unofficial documents and appeared to be self-serving. Furthermore payments earmarked for specific individuals are not deductible under Section 170 of the Internal Revenue Code. A discussion of this issue is presented under the law section of this Form 886-A.

Payments made to the Director of CO-1 and other individuals

The organization's representative stated that the school is often in need of immediate cash to cover operational expenses. When this results, the representative stated that the director frequently advances his own funds and the organization reimburses the director. The organization also made payments to other individuals for which they did not provide records to establish the exempt purpose of these disbursements. The table below summarizes these payments.

	20XX	20XX	20XX	20XX	Total
1. DIR-1 Director	\$\$	\$\$	\$\$	\$\$	\$\$
2. DIR-2	\$\$	\$\$	\$\$		\$ \$
3. DIR-3		\$ \$			\$ \$
4. DIR-4		\$ \$			\$ \$
5. DIR-5		\$\$	\$\$		\$ \$
6. DIR-6			\$ \$		\$ \$

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7. Subtotal	\$\$	\$\$	\$\$	\$\$	\$\$
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Percentage of non-substantiated payments to Director of CO-1 and other individuals (Total payments to director & individuals) \$\$ divided by Total Distributions \$\$ = %

Payments made to non-exempt entities

The organization made payments totaling \$\$ to CO-4 , \$\$ to CO-5 and \$\$ to CO-6. These entities were not listed in the Publication 78 as organizations to which contributions are deductible. The table below summarizes these payments.

	20XX	20XX	20XX	20XX	Total
1.CO-4		\$\$			\$\$
2. CO-5	\$\$				\$\$
3. CO-6				\$\$	\$\$
4. Subtotal	\$\$	\$\$		\$\$	\$\$

Percentage of payments to non-exempt entities (Total payments to non-exempt entities) \$\$ divided by Total Distributions \$ = %

Other questionable payments and transactions

Based on the breakdown of disbursements on Form 990 for CO-1 and the schedules provided, there were other questionable transactions that required further substantiation to establish that funds were used for section 501 (c)(3) purposes. The table below summarizes these transactions.

	20XX	20XX	20XX	20XX	Total
1.Loans made directly by individuals to Country					
2. RA-2					
3. Transfers classified as "Suspense"					
4. School					
5. CO-7					
6. Withdrawal					
7. CO-1					
8. Subtotal					

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Percentage of other non-substantiated transactions (Total other questionable transactions) \$ divided by Total Distributions \$\$ = %

Review of cancelled checks, wire transfers & bank statements

A sampling of the cancelled checks issued to teachers disclosed that a significant number of the checks were deposited into the same account of a particular bank in _____ for tax year 20XX. However, for tax years 20XX through 20XX checks issued to individuals were cashed at various financial institutions located in Country. The organization's representative indicated that the checks were cashed at a check cashing agency that in turn deposits the checks in the CO-8.

It was also determined that a few of the payments to teachers represented to be working overseas were deposited in local U.S. banks. Checks payable to one individual were routinely deposited in an account maintained at CO-2 located in State. Checks payable to another individual were regularly deposited into CO-9, located in City, State. The representative indicated that some of the checks were deposited to US banks because those teachers have American bank accounts managed by relatives who live in the US and requested their checks to be deposited to those accounts. It was also noted that the checks made payable to the Director of the schools were deposited into an account maintained at CO-2 based in State even though he resides in Country.

A review of the bank statements showed a very high frequency of large deposits and subsequent withdrawals of the same amounts within a matter of days. The CO-2 statements showed significant transfer of funds but did not identify the beneficiary. The CO-3 statements showed substantial transfers of funds that named the beneficiary as "____". Although the bank statements for CO-3 and CO-3 identified the beneficiary of the wire transfers, the Service was unable to determine whether the wire transfers represented to have been made in support of foreign entity were used for section 501(c)(3) purposes because of inadequate recordkeeping by the organization.

Failure to respond to requests for information that would verify exempt purpose of payments

The Service issued Information Document Requests (IDR) dated February 28, 20XX for each year under examination. The IDR included specific requests for missing checks, wire transfer receipts, bank statements, documents to substantiate reimbursements to the Director, records to substantiate that funds were used for section 501(c)(3) purposes, records to substantiate loans made directly by individuals to Country and clarification on particular transactions. The organization did not respond to our request for information.

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Tax Attaché

Due to the taxpayer's lack of substantiation of payments sent overseas, the Area Office sought the assistance of the Service's Foreign Tax Attaché. The Foreign Tax Attaché contacted the Country taxing authority and conducted a collateral investigation. The following is a summary of their interview with officials of the foreign entity.

According to the report, the CO-1 employs approximately [REDACTED] workers in different educational institutions in Country. Eighty percent of the workers ([REDACTED] workers) are employed directly by CO-1 and some are being paid by the Country [REDACTED]. Twenty percent of the workers ([REDACTED] workers) are being paid only by the Country [REDACTED].

CO-1 receives revenues from the Country [REDACTED], Municipalities, Tuition fees and Donations from abroad. It maintains four bank accounts which are CO-10 (acct##), CO-10 (acct# #), CO-11(acct##) and CO-12(acct##).

The foreign organization's manager, RA-3, claims all of the wire transfers and checks of the US organization were deposited in one of the bank accounts of CO-1. He also claims that there was no case of a donation received from abroad and transferred to the account of one of the employees.

CO-1 is registered as a non-profit organization, but is not recognized as an organization that Country citizens can donate to and receive a tax credit according to article [REDACTED] of the Country Tax Ordinance.

Some of the workers who were listed on the Social Work Programs schedule were found to be registered employees of CO-1. However, the checks sent from the organization specially for these teachers were not recorded on the books of CO-1.

In addition to the report, the Service received the foreign entity's bank statements from the Country authorities. Notations within a number of the statements indicated that funds totaling approximately [REDACTED] (approximately [REDACTED] U.S. dollars today) were returned to the U.S. based charity during the years 20XX through 20XX.

LAW:

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

Section 170 (c)(2) allows a charitable contribution deduction for a gift to or for the use of a corporation, trust community chest or foundation that is created or organized in the United States, or in any possession thereof, or under the laws of the United States, any State, the District of Columbia, or any possession thereof, but only if the gift is made for exclusively public purposes.

Section 1.501(c)(3)-1(c)(1) of the income tax regulations (the "regulations") provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations 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. Section 1.501(a)-1(c) of the regulations provides that the terms "private shareholder or individual" as used in section 501(c)(3) 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, in order to meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

In *Better Business Bureau v. United States*, 326 279 (1945), the Supreme Court stated that the presence of a single, nonexempt purpose, if more than insubstantial in nature, will defeat exemption under section 501(c)(3) of the Code, regardless of the manner or importance of the truly exempt purposes.

An organization is not described in section 501(c)(3) if it serves a private interest more than incidentally. See Rev. Rul. 69-545, 1965-2 C.B. 117; Rev. Rul. 78-86, 1978-1 C.B. 151; and Rev. Rul. 76-152, 1976-1 C.B. 151. If, however, the private benefit is only incidental to the exempt purposes served, and not substantial, it will not result in a loss of exempt status.

Rev. Rul. 71-460, 1971-2 C.B. 231, provides that a domestic organization that conducts some or all of its activities outside the United States is not precluded from qualifying for exempt status under section 501(c)(3).

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Revenue Ruling 63-252 1963-2 C.B. 101 holds that for a contribution to a domestic organization to be deductible under section 170 a grant that is sent to a foreign entity must be reviewed and approved by the domestic organization. This ensures that the grant is not earmarked and subject to the control of the domestic organization.

Revenue Ruling 66-79 1966-1 C.B. 48 clarifies Revenue Ruling 63-252. Rev. Ruling 66-79, 1966-1 C.B. 48, provides rules for determining whether a domestic charitable organization has and exercises sufficient control as to the use of contributions for the purposes of section 170(c). Contributions to a foreign charity generally are not deductible. While a domestic charity can use the contributions abroad, it cannot merely transfer them to a foreign charity. Revenue Ruling 66-79 describes the following factors that indicate that the domestic organization has discretion and control over the use of monies sent abroad.

The bylaws of the corporation provide, in part, that: (1) The making of grants and contributions and otherwise rendering financial assistance for the purposes expressed in the charter of the organization shall be within the exclusive power of the board of directors; (2) in furtherance of the organization's purposes, the board of directors shall have power to make grants to any organization organized and operated exclusively for charitable, scientific or educational purposes within the meaning of section 501(c)(3) of the Code; (3) the board of directors shall review all requests for funds from other organizations, shall require that such requests specify the use to which the funds will be put, and if the board of directors approves the request, shall authorize payment of such funds to the approved grantee; (4) the board of directors shall require that the grantees furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and (5) the board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.

This revenue ruling concluded that contributions to this organization are deductible because gifts received were used for the domestic organization's charitable purpose and the domestic organization maintained control and discretion over the use of the funds.

Rev. Rul. 68-489, 1968-2 C.B. 210, provides that an exempt organization under section 501(c)(3) does not jeopardize its exempt status by distributing funds to organizations not themselves exempt under section 501(c)(3), provided the exempt organization:

- 1) retains control and discretion as to the use of the funds;

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- 2) maintains records establishing that the funds were used for section 501(c)(3) purposes; and
- 3) limits distributions to specific projects that are in furtherance of its own exempt purposes.

Revenue Ruling 56-304 1956-2 C.B. 306 holds that an organization described in section 501(c)(3) may make distributions of their funds to individuals, provided such distributions are made on a true charitable basis. Organizations that make distributions to individuals should maintain adequate records and case histories to show the name and address of each recipient of aid; the amount distributed to each; the purpose for which the aid was given; the manner in which the recipient was selected and the relationship, if any, between the recipient and (1) members, officers, or trustees of the organization, (2) a grantor or substantial contributor to the organization or a member of the family of either, and (3) a corporation controlled by a grantor or substantial contributor, in order that any or all distributions made to individuals can be substantiated upon request by the Internal Revenue Service.

RATIONALE:
Exemption

In order to qualify for tax exempt status under section 501(c)(3) an organization must engage primarily in activities which accomplish one or more exempt purposes and no more than an insubstantial part of its activities may be in furtherance of a nonexempt purpose. (Section 1.501(c)(3)-1(c)(1))

The organization does not satisfy the conditions outlined in this regulation.

A review of the charts in the Facts section of this report indicates that over a four year period approximately []% of \$ [] dollars were disbursed as follows: []% to teachers, []% to the director of CO-1 and other individuals, []% to non-exempt entities and []% for other questionable transactions.

The representative stated that some payments to individuals were for salaries and to reimburse a director of organization for advances he made to CO-1. The organization did not substantiate that the payments made to the teachers were to subsidize CO-1's salary expense. Over the four year examination period the "salary expense" was \$ []. But assuming that the representative's oral testimony is accurate and this was indeed a valid salary expense, having the organization make these payments instead of CO-1 serves to frustrate the administration of the Country income tax laws by having these monies escape reporting requirements. This is a substantial nonexempt purpose.

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If these payments were not for salary expense, then the organization did not maintain the records outlined in Revenue Ruling 56-304 to establish that a charitable purpose was served by these payments. In either event more than an insubstantial part of the organizations activities were not in furtherance of exempt purposes.

Over a four year period the taxpayer made payments of over [REDACTED] dollars directly to a director of CO-1 . The oral testimony of the representative indicated that these payments were reimbursements for advances by the director of CO-1 . If the director did advance CO-1 that much money and the organization wanted to assist in alleviating the foreign organization's debt, the organization could just as easily given the money to CO-1 and not the individual. The organization has not established that these payments did not serve private interests more than insubstantially. (See Section 1.501(c) (3) -1(d)(1) of the income tax regulation)

The organization made other questionable payments and transactions totaling 50% of disbursements for which no substantiation was provided to establish whether the funds were used for a 501 (c)(3) purposes. The organization also made contributions to non-exempt entities and did not maintain records to establish that an exempt purpose was served by these disbursements.

Deductibility

In order for contributions to be deductible, the domestic charitable organization must ensure that grants made to a foreign organization or monies paid to an individual have been reviewed and approved in advance to ensure that the exempt purpose of the domestic charity is furthered.

Revenue Rulings 63-252 and 66-79 dealing with deductibility of contributions, hold that if payments are made to a foreign organization that have not been reviewed and approved in advance by the Board of the domestic organization then contributions to the domestic organization are not deductible because the domestic organization is acting as a conduit for the foreign organization and the domestic organization cannot establish that the funds were not earmarked for the foreign organization.

A foreign organization should be viewed as a non-exempt organization since that entity has not established that it meets the requirements of tax exempt status under section 501(c)(3). Based on Revenue Ruling 68-489 an exempt purpose can be established if a grant made to a non-exempt organization is subject to the discretion and control of the exempt charitable organization. The organization described in the revenue ruling accomplished this by

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limiting its grant to a specific project that it reviewed in advance and by maintaining records to establish that an exempt purpose is served.

Foreign organizations should be treated as non-exempt entities since they have not established that they meet the requirements for exemption under section 501(c)(3) and the rationale in Revenue Ruling 68-489 should be applied.

[REDACTED]

For the years under examination substantially all of the organization's disbursements were reportedly made to or for the benefit of CO-1. These payments were not for specific projects, but for the general operating expenses of CO-1. The organization did not maintain records to establish that:

- (1) The making of grants was within the exclusive power of the board of directors;
- (2) The board of directors reviewed all requests for funds and required that the recipient organization specify the use to which the funds will be put;
- (3) The board of directors required that the grantees furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and
- (4) The board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.

The organization has not established that it maintained contemporaneous written substantiation to verify that it maintained discretion and control of its funds to comply with the contribution deductibility rules outlined in Revenue Rulings 63-252 and 66-79. The organization did not establish that it funded specific projects reviewed in advance. Instead the organization acted as a conduit for CO-1, in effect making CO-1 the actual donee organization.

GOVERNMENT'S PRIMARY POSITION:

Based upon our examination, we determined that more than an insubstantial part of

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the organization's activities are not in furtherance of exempt purposes and, as a result, the organization fails to meet the operational test as defined in Regulations Section 1.501(c)(3)-1(a)(1).

With respect to payments made to individuals represented by the organization as employees of the schools, the organization has failed to provide acceptable documentation as proof that these individuals are employees. With respect to the payments to a director of CO-1 the Service asserts that payments to him serve a private rather than a public interest. See Section 1.501(c)(3)-1(d)(1)(ii).

GOVERNMENT'S SECONDARY POSITION:

If the Government's primary position is not sustained, the government secondary position is that contributions to the organization are not deductible.

The organization failed to exercise discretion and control of monies sent abroad. The organization acted as a conduit. Contributions are only deductible if made to a domestic organization for the use of the domestic organization's exempt purpose. To establish that monies sent outside the United States serve the domestic organization's exempt purpose the domestic organization must establish discretion and control over the use of the funds. The organization did not exercise discretion and control and acted as a conduit for CO-1. Accordingly, contributions to the organization are not deductible under section 170(c).

TAXPAYER'S POSITION:

Information Document Requests submitted to the organization regarding their position on the issues contained herein remain unanswered.

CONCLUSION:

Based upon the fact stated herein, we determined that the organization does not qualify for exemption under Section 501(c)(3) of the Code. We, therefore, propose to revoke its exemption under IRC Section 501(c)(3) effective January 1, 20XX.

Secondarily, the organization acted as a conduit for a foreign organization and contributions to the organization are not deductible.