

INTERNAL REVENUE SERVICE

Release Number: 201517027

TE/GE TECHNICAL ADVICE MEMORANDUM

Release Date: 4/24/2015

Date: January 28, 2015

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Year(s) Involved:

Conference Held:

Uniform Issue List  
7805.00-00

LEGEND

<u>State</u>	=
<u>Claimants</u>	=
<u>Program</u>	=
<u>Agency</u>	=
<u>LLC</u>	=
<u>B</u>	=
<u>M</u>	=
<u>Date1</u>	=
<u>Date2</u>	=
<u>Date3</u>	=

ISSUE:

Whether the Commissioner, Tax Exempt and Government Entities Division, should exercise discretion to grant the Taxpayer relief under § 7805(b) of the Internal Revenue Code (I.R.C.) to limit the retroactive effect of revocation of its exempt status under § 501(c)(3).

FACTS

**Application for Recognition of Exemption**

Taxpayer applied for tax-exempt status, describing its activities on the Form 1023 as lessening the burdens of government by providing financing to accelerate Program fund claim payments to Claimants. Additionally, Taxpayer stated that it would operate its financing program in conjunction with Program funds in several states, including State.

The attachment to the Form 1023 provides the following narrative description:

Taxpayer is modeled on State's award winning Agency M Program (the "Agency Program"). State terminated the Agency Program and authorized Taxpayer to begin providing services formerly provided by the program on Date1. Taxpayer will expand the program developed by Agency to other states. Through an arrangement with a State governmental bond issuer and various banks, Taxpayer is able to provide low cost financing to Claimants.

The Form 1023 also disclosed a related party transaction, servicing agreement and compensation agreements with LLC. The servicing agreement noted that LLC was contracted to provide operational and management services to Taxpayer in the same manner as it had with Agency. Taxpayer disclosed in its Form 1023 that it would compensate LLC for its services and would reimburse LLC for all marketing costs. Furthermore, the Form 1023 disclosed the relationship of B, its founder and the sole owner of LLC and disclosed the related party transaction with LLC on its Form 1023.

Taxpayer provided no additional information or details in the Form 1023 regarding its relationship with State or any other state in which it would be operating.

Based on these representations, the Service issued a favorable determination letter to Taxpayer.

#### **Examination and Appeal of Recommendation**

The examination concluded that during the years under exam, Taxpayer did not qualify for tax-exempt status under § 501(c)(3). The examination recommended revocation of Taxpayer's tax-exempt status based the following issues:

- Its operations do not further one or more exempt purposes;
- It operates for the substantial non-exempt purpose of providing a commercial financing service;
- Its net earnings inured to the benefit of B, its founder and board member, through LLC; and
- It operates for the more than incidental private benefit of B through LLC.

Furthermore, the examination concluded that revocation should be retroactive to the first day of the taxable year under examination, Date2, because Taxpayer made material misstatements on its Form 1023 with respect to its operations. Examinations did concede that the Taxpayer disclosed its business relationship with LLC and B on its Form 1023. Specifically, the examination stated that Taxpayer's Form 1023 wrongly implied that State granted Taxpayer the exclusive right to acquire claims from Claimants. And left that issue as the only remaining basis for the recommendation to revoke retroactively.

Taxpayer appealed the proposed revocation. The Office of Appeals sustained the revocation. Section 4.04 of Rev. Proc. 2014-5, 2014-1 I.R.B. 172 states that all requests for § 7805(b) relief are mandatory TAMs with respect to all exempt organizations. Delegation Order 30-1 (formerly DO-96, Rev. 13) delegates authority to the Commissioner, Tax Exempt and Government

Entities (TEGE), to prescribe the extent to which any ruling relating to the internal revenue laws shall be applied without retroactive effect.

Taxpayer requests that the Commissioner TEGE exercise discretion and grant relief to limit the retroactive effect of revocation under § 7805(b) to the date that a final adverse determination letter is issued or Date3, the date of the notice of proposed revocation.

#### LAW

I.R.C. § 7805(b)(8) provides that the Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.

Treas. Reg. § 1.501(a)-1(a)(2) states that an organization that has been determined by the Commissioner to be exempt under § 501(a) may rely upon such determination so long as there are no substantial changes in the organization's character, purposes, or methods of operation, and subject to the Commissioner's inherent power to revoke rulings because of a change in the law or regulations, or for other good cause.

Treas. Reg. § 301.7805(b)-1 grants to the Commissioner authority to prescribe the extent to which any ruling issued by his authorization shall be applied without retroactive effect.

Rev. Proc. 2014-5, 2014-1 I.R.B. 169, states in § 4.04 that all requests for relief under § 7805(b) must be made through a request for technical advice (TAM). Section 19.04 further provides that when, during the course of an examination by EO Examinations or consideration by the Appeals Area Director, a taxpayer is informed of a proposed revocation, a request to limit the retroactive application of the revocation must itself be made in the form of a request for a TAM and should discuss the items listed in section 18.06 as they relate to the taxpayer's situation.

Section 18 of Rev. Proc. 2014-5 lists the criteria necessary for granting § 7805(b) relief as well as the effect of such relief. Section 18.06 states, in part, that a TAM that revokes a determination letter is not applied retroactively if:

- (1) there has been no misstatement or omission of material facts;
- (2) the facts at the time of the transaction are not materially different from the facts on which the determination letter was based;
- (3) there has been no change in the applicable law; and
- (4) the taxpayer directly involved in the determination letter acted in good faith in relying on the determination letter, and the retroactive revocation would be to the taxpayer's detriment.

Rev. Proc. 2014-9, 2014-2 I.R.B. 281, sets forth procedures for issuing determination letters (from EO Determinations) and rulings (on applications for recognition of exempt status by EO Technical) on the exempt status of organizations under § 501. These procedures also apply to revocation or modification of determination letters or rulings.

Section 12.01 of Rev. Proc. 2014-9 states, in part, that the revocation or modification of a determination letter or ruling recognizing exemption may be retroactive if the organization omitted or misstated a material fact, or operated in a manner materially different from that

originally represented. In certain cases an organization may seek relief from retroactive revocation or modification of a determination or ruling under § 7805(b) using the procedures set forth in Rev. Proc. 2014-4, which further refers to Rev. Proc. 2014-5, §§ 18 and 19.

Section 12.01(2) of Rev. Proc. 2014-9 states that, in the case where a determination letter or ruling is issued in error or is no longer in accord with the Service's position and § 7805(b) relief is granted (see sections 13 and 14 of Rev. Proc. 2014-4), ordinarily, the revocation or modification will be effective not earlier than the date when the Service modifies or revokes the original determination letter or ruling.

Delegation Order 30-1 delegates authority to the Commissioner, Tax Exempt and Government Entities, to prescribe the extent to which any ruling relating to the internal revenue laws shall be applied without retroactive effect.

In Lesavoy Foundation v. Commissioner, 238 F.2d 589 (3d Cir. 1956), the Court of Appeals for the Third Circuit determined that the Commissioner abused his discretion by retroactively revoking the Foundation's exempt status under § 501(c)(3). Upon examination, the Commissioner retroactively revoked the Foundation's exempt status to the date it acquired Clover Spinning Mills, an enterprise that manufactured cotton yarn and cloth. The Foundation disclosed this acquisition on its information return for the year. Accordingly, the court concluded that the Foundation committed no fraud and made no misstatement. Therefore, the court saw no grounds for sustaining retroactive revocation.

#### ANALYSIS

In the present instance, Taxpayer did not: (1) omit or misstate any material facts in its Application; (2) operate in a manner materially different from the facts set forth in its Application; or (3) engage in any prohibited transactions. Lesavoy Foundation v. Commissioner, 238 F.2d 589 (3d Cir. 1956).

Taxpayer disclosed its operations and activities in full, including its relationship with LLC and B in its Form 1023. Nothing in Taxpayer's Form 1023 implied that State granted it the exclusive right to acquire claims from Claimants. Taxpayer provided no additional information or details in the Form 1023 regarding its relationship with State or any other state in which it would be operating. No other relationship was disclosed or implied in the information provided in the Form 1023. Furthermore, Taxpayer operates in exactly the same manner as described in its Form 1023. Taxpayer acted in good faith in relying on its determination letter.

#### CONCLUSION

The Commissioner, TE/GE, has exercised discretion to grant relief under § 7805(b) to limit the retroactive effect of revocation of exempt status under § 501(c)(3). Revocation is effective as of Date3, the date of the notice of the proposed revocation.