



**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE: EO Examination**

Release Number: 201541013
Release Date: 10/9/2015

Date:
May 29, 2014
Employer Identification Number:
Person to Contact/ID Number:

Contact Numbers:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

In a determination letter dated October, 20XX, you were held to be exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(3) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(3) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights.

Our adverse determination was made for the following reasons:

IRC 501(c)(3) of the Internal Revenue Code exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual...

Treasury Regulation Section 1.501(c)(3)-1(c)(2) states 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.

Treasury Regulation 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for charitable purposes unless it serves a public rather than a private interest. 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.

You have not established that you are operated exclusively for exempt purposes described in section 501(c)(3) of the Code. Specifically, you have not shown that a substantial part of your activities does not serve the private interest of your officers and other individuals. Additionally, you have not demonstrated that no part of your net earnings inures to the benefit of private shareholders or individuals. Specifically, you have not shown that various payments you made have not resulted in net earnings flowing to your officers and their related businesses.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code. You are required to file Federal income tax returns on Form 1120. Those returns should be filed with the appropriate Service Center.

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 of declaratory judgment in the United States Tax Court, the United States Claims 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 rules for initiating suits for declaratory judgment. You may write to the Tax Court at the following address:

United States Tax Court,
400 Second Street NW
Washington, D.C. 20217

You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service
Taxpayer Advocate

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations or 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 in regards to this matter please contact the person whose name and telephone number are shown in the heading of this letter.

Thank you for your cooperation.

Sincerely yours,

Mary A. Epps
Acting Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

January 29, 2014

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

December 31, 20XX and 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.

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:

Taxpayer Advocate Office

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,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination
Form 6018

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

Final Revised Report

Revised Report Note 1: The examination report for _____ was previously issued for tax period ending December 31 20XX and this report is a revision in order to incorporate the tax period ending December 31, 20XX. The report is now for the examination of tax periods ending December 31 20XX, and December 31, 20XX.

While the 20XX Form 990 was prepared by _____ and the examination based on records _____ provided to the IRS examiner, the 20XX year Form 990 was prepared by the bankruptcy trustee based on _____'s records available to the bankruptcy trustee. The intervening years of tax periods ending December 31 20XX and 20XX prepared by the organization were not examined as the records and source documents for these years are limited.

Revised Report Note 2: Non-essential attachments have been eliminated.

Issues

1. Whether _____ (Foundation) failed to operate exclusively for exempt purposes because its net earnings inured to the benefit of its founder and president by paying for workers for the founder's privately held telemarketing business.
2. Whether _____ Foundation failed to operate exclusively for exempt purposes because it operated primarily to benefit the private interests of the founder's telemarketing business.

I. Facts

Background Information

_____ is the founder of Foundation.

- o _____ is sole owner of a telemarketing business, _____ (_____), that he incorporated in 19XX.
- o _____ generates profits by soliciting sales and money for clients. Expenses of a telemarketing company generally include lists (mailing

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

addresses and telephone numbers), data management, telemarketer labor, phone scripts, and brochures mailed by the telemarketers.

- o is located on in an office owned and rented by
- o Foundation functioned entirely from this office until the IRS examination commenced.

created Foundation in October 20XX to raise awareness and funds for . On Foundation's IRS application for exempt status, claimed that no professional fundraiser had been considered. Once exempt status was granted, Foundation contracted exclusively with professional fundraiser, has been Foundation's only professional fundraiser since Foundation's inception (until Foundation's recent). Foundation is entirely dependent on telemarketing receipts and has been entirely supported by revenue from Foundation.

From 20XX through 20XX, Foundation collected over \$0 million in donations relying exclusively on employees, assets, services, and location. In 20XX, the year examined, over \$0 in donations for were collected by

Telemarketing receipts for Foundation represent the majority of receipts in years 20XX and 20XX and the entirety of receipts for years 20XX through 20XX.

While the vast majority of donations collected by went to Foundation reported to the public and government that % (0/0) was spent for exempt charitable purposes under IRC 501(c). As explained below, the examination shows less than % went to health care grants. Records show % (0/0) was paid directly to 's telemarketing business, , and the remainder went to 's prior employee or to expenses that were substantially unsupported by records.

1. Application and Incorporation:

Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* was filed by Foundation, by , on October 27, 20XX.

Foundation's Form 1023 states the following:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

1. Foundation is dedicated to:
 - a. Raising awareness and education of the general public about ,
 - b. Promoting and early detection of ,
 - c. Encouraging .
 - d. Providing funds to pay for for uninsured women, and
 - e. Providing funding for research.

2. Foundation will raise awareness and education of the general public through direct contact via mailings, telephone, and e-mail activities. The contacts will promote early detection and educational literature on how to and other will be distributed. Individuals contacted will be asked to contribute and this will be the sole funding source. Excess funds will be distributed to organizations that provide to help pay for uninsured women.

3. These activities will be conducted from the organization's principal offices in . While the organization will design, manage, and oversee all activities, it may contract with experts in the direct mail, email, and telephone sectors to help it achieve its goals.

4. The president, sole officer, director, and trustee, , is to receive \$0 annual compensation.

5. No members of the governing board () are "disqualified persons" and none have a business or family relationship with "disqualified persons".

6. Foundation is not controlled by another organization and Foundation does not have a relationship with another organization because of interlocking directorates or other factors.

7. Foundation will not engage in reimbursement arrangements, performances of service, fundraising solicitations, or sharing of facilities, mailing lists/assets, or employees with another organization.

8. Expenses include printed educational materials to be utilized by Foundation .

9. Website address is marked "N/A"

Prior to the IRS' recognition of exempt status, the IRS required Foundation take corrective actions and provide information on its fundraising activities. Letter 1312, dated April 21, 20XX required the following:

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

1. Expand the number of board members and directors from one person, _____, to at least three unrelated people.
2. Provide specific detail to explain how funds are to pay for _____.
3. Provide specific professional fundraiser detail to:
 - a. Identify the professional fundraiser that the EO intended to use,
 - b. Answer whether any board members are related to the professional fundraiser,
 - c. Disclose:
 - i. Whether any directors or officers work for the professional fundraisers that Foundation will use and the amounts of compensation or benefits the individuals would receive,
 - ii. Whether the fundraiser will receive a percentage and,
 - iii. The net received, the amount turned over for charitable activities, and the basis for the fees to the fundraiser and any contracts.

Foundation's reply letter, dated May 9, 20XX, provided the following:

1. Amended bylaws that added two persons as directors, _____, and _____, as president, remained the only officer.
2. "No director or officer is receiving any compensation for their services."
3. While Foundation has stated it may hire professional fundraisers to conduct fundraising it has not identified any potential professional fundraising firms at this time. Volunteers and board members will conduct all initial fundraising activities.
4. "Yes", Foundation will only make donations to 501(c)(3) organizations.
5. Assistance will be provided to women of age 40 or up who are uninsured to help pay for a _____ "at a location in your area."
6. Assistance will be publicized through relationships with screening facilities, website to be created, media (radio, newspaper, etc.) and in cooperation with other 501(c)(3) organizations that provide support to _____ victims
7. Records will be maintained to show the assistance given, circumstances surrounding the need for assistance, names of recipients, and any relationship of the recipients.

October 20, 20XX Foundation filed Articles of Incorporation, with the _____ that show the following:

1. No part of net earnings will inure to the benefit, or be distributable to, its trustee officers, or other private person, except for distributions in furtherance of its purpose.
2. It's purpose is education, prevention _____, and funding of research ("distributions to organizations that qualify as exempt under §501(c)(3)").

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

3. The board of directors consisted of " " of
4. Upon dissolution, assets, after payment of liabilities, shall be distributed for exempt purposes within the meaning of the Internal Revenue Code or to state or local government.
5. The date of incorporation is October 20, 20XX. of
signed as the incorporator and is the sole person under the Board of Directors.
6. A May 9, 20XX amendment adds and as board members.

May 22, 20XX, the IRS issued letter 1045 recognizing Foundation as exempt under Federal income tax under section 501(c)(3) of the Code and to be treated as a public charity under an advanced ruling period.

August 29, 20XX, Foundation's initial () application states:

- o Activities as "
- o Email:
- o Address:
- o Expenditure Authority, Director and "No other officers at this time".
- o Fundraising through: "Telemarketing" and "Direct mail" are checked
- o signature is dated July 15, 20XX.

2. Related Entities:

Foundation's Current Board Members:

20XX to 20XX
20XX to 20XX
20XX to 20XX
20XX to 20XX

Foundation's Past Members:

20XX - October 20XX
20XX - 20XX

October 4, 20XX, volunteered to step down as executive director but elected to continue to support the mission as a volunteer.

December 20XX, interviewed for a part time position as Executive Director.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

_____ was added as an officer for Foundation, after IRS required that, for exempt status, someone, besides only _____, needed to be an officer and director.

- o _____ was president of, a printing and mailing, and marketing consultant company.
- o _____ was located in _____.
- o _____ advertised that he was a marketing consultant and could use a donor's gift history to ask for a greater gift. His website stated, " ____ ". (See 20XX)
- o _____ designed Foundation's website October 27, 20XX.

_____ was added as an officer at the same time.

- o _____ is a " _____ " and works in the professional fundraising business.

Corporation:

_____ was incorporated April, 16, 19XX as (_____) at _____ before relocating to _____ as _____.

Based on reports _____ filed with the _____ office, other _____ charity clients include:

1. _____ : Out of over \$0 million of donations collected over five years, less than % went to charitable programs, and nearly all of the money was used to pay fundraiser fees, salaries, and benefits packages. Donors were falsely told their money would be used to fund _____ research and _____ screenings through a mobile van. _____ was also accused of advertising bogus ties with the _____ was shut down by _____ State.
2. _____ Foundation was incorporated August 6, 20XX, at _____ home address on _____ (_____ wife), is President, (_____ manager) is Secretary, and (_____ employee), is Treasurer.
3. While _____ listed _____ as a client, _____ noted for 20XX that they "have not yet finalized their schedule with _____, nor have they signed contracts. However, no contract was subsequently registered with the state.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

website, telemarketing.net stated in part:-

- Services include consulting, direct mail, fax & email campaigns, and predictive dialing.
- Call Center applications include: Appointment setting, Lead qualification, Product and Technical support, Customer satisfaction surveys, Customer service, Marketing research, Surveys, Statistical analysis Polling, Get-out-the-vote, Direct Sales, and Fundraising.
- The most important factor in the success of a direct marketing program is the list. In fact, the list accounts for % of a campaign's success, while the offer (%), the message (%) and the format (%) make up the rest.
- services can:
 - Ramp sales quickly with a proven sales process.
 - Any "output" from our TSRs must be verified by a supervisor and our auditing department before you ever see the results.
 - All of our conversations are monitored or recorded for training and verification purposes.

4. Foundation's Contracts for Services:

Two Versions of Contract:

Contract One.

October 17, 20XX the () office received a "Fundraising Service Contract Registration" from Telemarketing Corporation. The types of services are managing or conducting direct mail and telephone solicitations. and registration signatures are dated September 15, 20XX. The one-page contract attached to the registration is the contract released to the public until 20XX.

On this contract:

- Foundation will have reasonable access to financial records and operations regarding the solicitations. The terms are open ended.
- telemarketing services are to begin October 1, 20XX,
- There is a single cost:
 - "Telemarketing: \$0 per hour."

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

- signed as signed the contract as owner and president, and Foundation Director.

Contract Two.

In year 20XX, the office received a complaint that Foundation was not adhering to the 20XX contract (Contract 1). The directed Foundation to cease collections through until the contract issue was resolved.

December 30, 20XX, in response to letter, Foundation sent a different (six-page) contract with

On this version, and signed as Foundation board members. This contract is dated September 8, 20XX.

Contract Two states, in part:

- Each contact may include an incidental request for financial support. These contacts will be to households that include women within the target group. will require telephone representatives to adhere closely to approved scripts.
- will be responsible for all costs of the marketing effort.
- will invoice Foundation of all costs but total costs cannot exceed 80 percent of the gross proceeds actually received, less credits for stop payment checks and refunds.
- Foundation will receive no less than percent of the gross proceeds, after stop payment checks.
- All proceeds shall be directed to a representative of Foundation and deposited into a bank account in the name of Foundation.
- A representative of will "make all arrangements necessary to pay [] its portion of collections cleared in the account monthly and deposit."
- will pay, from its share of the proceeds, all proper and bona fide expenses of the campaign.
- will cooperate fully with Foundation to review or audit the terms and conditions set forth in this agreement. This shall be a material condition. Foundation will have reasonable access to 's financial records relative to its fundraising activities on behalf of Foundation.
- Persons on the contact list, who respond positively to contact, will remain property of both and Foundation.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

- The terms of the contract are 0 years with an automatic renewal, barring either parties' cancelation.

Selection of _____ and Lack of Due Diligence Documentation:

Beginning on Foundation's first 20XX Form 990, Foundation has consistently claimed:

- _____ was chosen in a competitive bidding process, and
- Contract terms are no more than fair market value.
- The examiner requested all documentation of comparison and selection to support these claims. (IDR #2)
 - Foundation had no documents related to _____ or market rates.
 - Foundation had not relied on expert reports or any outside data.
 - Foundation stated that, to their recollection, no other _____ would agree to their terms.
 - Officer _____ stated she had no records or notes of the selection of _____. She believed Foundation entered into contract with _____ in good faith and the telemarketing contract was within the "industry standards" for with charitable organizations. However, _____ stated, "As a _____, I have long believed in the necessity to acquaint the public with the benefits of taking action and _____. She believes herself to be ethical and of high integrity and is a multi-year member of a Rotary Club", and, she has spent over _____ years of her working career in fundraising for charities and believes "it costs money to raise money". (IDR #4)
 - And, after _____ initial selection, any subsequent requests for bids or offers of services from other telemarketers were issued, reviewed, and responded to by _____. Afterward, _____ reported back to the board of his findings.
- The examiner requested a detailed explanation of what made up their "extensive call-to-action campaign" to provide assistance to women who are uninsured to get a _____
- Foundation's reply:
 - It is to get women to understand the importance of _____ and _____ recommend that they receive annual _____

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

- The examiner requested an explanation of what specific "expertise" had to be sole manager of their "extensive call-to action campaign" to prevent
- Foundation's reply:
 - had the expertise to conduct this extensive call to action campaign because " is a professional fundraising firm."
- The examiner asked for the basis of their persistent public claim that is only "part owner" of
- Foundation's reply:
 - Foundation has no reason to know whether this is correct because was a separate company from Foundation and ownership information is confidential. Also, Foundation does not know who, other than would be receiving profits from because they "do not know their financial status or policies".
- Notes:
 - The public 990 forms claiming was only a part owner are all signed by
 - IRS and records show has always been sole owner of S-Corporation and receives % of net profit distributions.

Working Relationship of and Foundation:

Foundation's physical location was at office at , with post office boxes in the states of , , , and .

Foundation operated entirely from office until after IRS's examination commenced. explained to the examiner (April 26, 20XX telephone contact) that the IRS examination could not be conducted at office because Foundation no longer functioned from office and they were in the process of seeking a new location. (stated the attorney general's (AG's) office requested data from Foundation November of 20XX. She stated a had been stirring up trouble for Foundation and she assumed the IRS had also received a complaint from .) During the exam, a new location was found but was vacated months later when Foundation filed for bankruptcy.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

The office is owned by _____ and rented to _____ from _____ Properties. The rent value was donated to Foundation by _____ and _____

Foundation shows that it owns no assets other than cash. The cash is in bank accounts under _____ and Foundation's names. Foundation had no employees until 20XX and all collections, deposits, transfers to _____, and accounting were performed by _____ employees. Foundation's donations for years 20XX through 20XX exceeded \$0.

_____ received and processed all donations. _____ deposited the funds into a bank account (_____ #0), then _____ transferred its share to another account leaving Foundation with the remainder.

On Foundation's _____ registration/renewal form for year 20XX, _____ and _____ also have authority to expend funds and incur obligations on behalf of Foundation, and _____ is the contact for _____. All Foundation checks are signed by _____.

_____ employs telemarketers directly and hires temporary telemarketers from an employment agency.

Through the work of the telemarketers, Foundation:

- Provided free _____ through their telemarketing mailing.
- For women who wanted a _____, telemarketers gave the women a phone number listed on the State Department of Health website (the State provides phone numbers to locations with free and low cost _____). The women would then call this number for assistance in setting up an appointment for _____ (Note: No records were kept to support who or how many women were given the telephone number.)

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

and Foundation Revenue Compared:

and Foundation reported receipts and expenses as shown below:

Tax Year:	20XX	20XX	20XX	20XX	20XX	20XX	20XX
1	Foundation Donation Receipts (per Forms 990)	0	0	0	0	0	0
2	Paid to (per Forms 990)	0	0	0	0	0	0
3	% Donations Paid to						
4	Net Retained by Foundation	0	0	0	0	0	0
5	Foundation Direct Charitable Services (Per)	0	0	0	0	0	0
7	% Used for Charitable Services (line 5 divided by line 1)						
8	Grants Paid by Foundation: (per Forms 990)	0	0	0	0	0	0
9	Donations to Grant % (line 8 divided by line 1)						
10	Gross Donations (Per)	0	0	0	0	0	0
11	Retained by Charities:	0					
12	% of Gross from Foundation (line 1 divided by line 10)						
13	Clients (per):						
14							
15							
16							

Discrepancies in Amounts Reported:

For most of the years that Foundation was only client, gross receipts (line 10) are more than Foundation's reported receipts (line 1). The excess in receipts (line 10 less line 1) not reported as Foundation's are \$0 (year 20XX),

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

\$0 (year 20XX), \$0 (year 20XX) and \$0 (year 20XX). The year prior to 20XX were not examined by IRS and the actual recipient or owner of these amounts is unresolved.

Foundation reported amounts paid directly to charitable services (lines 5) far above the amounts of grants that they paid out (line 8). This is partly explained by Foundation's improper practice of allocating a substantial percentage of fundraising costs to direct charitable services. (See , later.)

For example, in year 20XX, Foundation reported that % of donation revenue (0/0) was spent directly on charitable services, while actually, received % of donation revenue (0/0) and zero grants were given.

For the same year, 20XX, total receipts of \$0 include \$0 of Foundation receipts. reports \$0 of \$0 was retained by its charity clients. Yet, Foundation retained only \$0 of the \$0 collected by

If \$0 of \$0 of receipts was retained by charities, would receive only \$0, yet Foundation alone paid them \$0.

Communications: False Claims on Script and Joint Costs:

June 20XX the issued a letter challenging Foundation's % allocation of joint fundraising costs to program services costs. The instructed Foundation to follow the coded allocation rules in and . rejected over million of reported program service expenses because the expenses were actually classified as fundraising expenses per code. The asked Foundation to amend its Forms 990.

responded with several emails containing various protests, questions, and explanations (including complaints that the directions of allocations were too complicated, and amendment of the Form 990 would cost a lot of money).

provided a copy of a "20XX" telemarketer script. This script states that Foundation pays for for uninsured women, cost about \$0, and "We are asking folks if they can help women at \$0?".

By July 20XX, the advised that the first line of their telemarketer script still needed to identify the caller as telemarketers and not as a caller from the charity. Further, the script falsely states that Foundation pays for where they actually make donations to health programs which do this. By August 2, 20XX, the was still requesting corrections to false statements and advised

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

and Foundation that Foundation's script still contained the claim that the telemarketer is "with the _____".

Other:

November 11, 20XX, News reported its attempts to interview _____ to inquire about a conflict of interest between Foundation and _____. Insiders with the telemarketer told the news reporter that they typically start off by asking for a donation of \$0. They tell prospective donors that \$0 would help two women, and that they believe the money is for just one thing: "for women to get _____" and _____ and Foundation share the same post office box and storefront. And Foundation has been _____ only nonprofit client since 20XX. The relationship has made millions. According to the charity's IRS filings, since 20XX, Foundation has paid out almost \$0 for for uninsured women. But over that same period, the charity, through telemarketing, raised nearly \$0. After expenses, the charity has paid _____ nearly \$0. An individual (_____) who was asked for a donation said the _____ telemarketer was clear about where his donation would go: "During the phone call, they assured me all the money would go to pay for _____." That's what two _____ employees, one past and one current, confirm they were told to say. One woman, who asked to remain anonymous, told the _____ she was told to say "that we're raising money so that uninsured women can receive _____."

Foundation's First Year:

October 27, 20XX, _____ website was created. The "admin" and "owner phone" is 000-000-0000. The address, _____, (Per " _____ ")

The telephone number listed, 000-000-0000, belongs to _____ located at _____

Foundation's initial website (through year 20XX) stated:

The _____ Foundation was founded in 20XX by _____ in response to the need for affordable _____ for uninsured women in _____. When several of _____ former employees were diagnosed with _____, he educated himself about the disease, learning that _____ has the highest rate of _____ in the country. His concern about the health of his employees, coupled with his impending retirement, led him to explore what he could do to help women - particularly those with no health insurance.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

During 20XX the outreach effort of the Foundation reached 0 women and referred many to their local health clinics for Foundation distributed 0.

Foundation's 20XX, financial activities:

Income:	\$0	
Expenses:	\$0	
Grants or Assistance:		00
Balance carried forward:	\$ 0	

Recent Website (accessed January 11, 20XX) posts statistical information (rates of diagnoses and death from cancer). Several sections and automatic functions of the website solicited donations .

The Department of Health's telephone numbers for free , (provided by the telemarketers) was not posted for the public on Foundation's website. Instead, a link for " " led to a form for personal information and a claim that "may be able to pay the total cost or help supplement the cost of at a location in your area".

Notes:

The examination findings show that Foundation has not and does not pay for . Instead, a portion of the net profit, in most years, was given to a health organization and some portion of that may be used for

Also, while and Foundation claimed to the examiner that they did not have data on who or how many women were contacted or referred by website form collected a great deal of specific and personal data of the person who wanted

Form 990 for Year 20XX:

The examiner issued IDR #1, April 18, 20XX, requested all books and records, including an unaltered copy of Foundation's accounting software (Quickbooks), and all documents received from and contracts with . Foundation's representative did not provide the Quickbook records because it contained data outside of the examination year.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

To prove the millions in expenses paid to _____, Foundation could only provide the monthly invoices created by its founder's company.

The examiner made several attempts to secure documentation to support the expenses. The examiner referenced Foundation's contract's condition that Foundation will have reasonable access to _____ financial records relative to its fundraising activities on behalf of Foundation and asked Foundation if it had ever requested any information from _____.

Foundation responded that they had never had a reason to question charges.

Financial Audit Results:

The results of the IRS audit of the Form 990 for the tax period ending December 31, 20XX follow:

Revenue:

	20XX 990 REVENUES		
	Per 990	Per Audit	Difference
Gross Contributions Collected:	0		
(Donations)		0	
(Grant Income)		0	
Total Contributions Collected	0	0	0
Investment Income :	0	0	0
Other revenue: Recovered Income: Grant Deducted in Prior Year and Returned to Foundation in 20XX Year:	0.00	0	0
TOTAL REVENUE	0	0	0

- The gross income on Form 990 was underreported by \$0.
 - Form 990 reported \$0 as gross collected.
 - The bank deposits, of donation/grant income, total \$0.
 - Foundation's accounting records show fundraising income of \$0 before NSF deductions of \$0
 - Foundation accounting records show \$0 of interest income and Foundation's Form 990 only \$0. The actual interest income, reported by the bank, totals \$0.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

While the contract did not address it, and the finances did not account for it, requested donors add Shipping Income. The telemarketers' donation form requests that donors add \$0 to each donation to "defray shipping costs". made no record of these receipts to nor did reduce for any shipping cost to the \$0 of shipping charged to Foundation as shown on the monthly invoices. Neither of the contracts, and none of Foundation's documents address the approval or treatment of this shipping income solicited by on behalf of Foundation.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

Expenses:

		EXPENSES			
		Per 990 20XX	Audit Sub- totals	Audit Totals	Difference
1		0	0		
2		0	0		
3	DOH	0	0		
4	DOH	0	0		
5	Health-Training Seminar Tuition	0	0		
6	Total Grants	0		0	0
7	Unexplained Expense Tuition (allowed)	0		0	0
8	Other Salaries and Wages	0		0	0
9	Payroll taxes and Payroll Fees	0		0	0
10	Accounting Fees	0		0	0
11	Information Technology per Form 990 Charge Data Management	0	0		
12	List Purchase per Form 990 Charge List Purchases	0	0		
13	Data Entry per Form 990 Charge Data Entry	0	0		
14	Fees for Services Total: \$0 (\$0paid to)	0			
15	(\$0 Disallowed)			0	
16	Office Exp: (0 Paid to)	0	0		
17	Professional Fundraising Fees	0			
18	Phone Verizon (\$0 Disallowed)			0	0
19	American Express (\$0 Disallowed)			0	0
20	Hourly Labor Charge		0		
21	Telephone Charge		0		
22	Mailing Services Charge		0		
23	Charges: Postage		0		
24	Printing Charge		0		
25	Expenses subtotal: Lines 11-24:	0		0	0
26	Misc: PO Box (\$0 Disallowed)	0		0	0
27	Misc: License Fees	0		0	0
28	NSF Bank Debits (Expense Added)	0		0	0
29	TOTAL EXPENSES	0		0	0

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

Disallowed Expenses Explained:

- o Line 14: Foundation's Form 990 reports \$0 of contractor fees paid to "other" payees where \$ of this was paid to , and is correctly includible in the total fundraising expenses (\$0).
- o Line 15: Foundation expensed the remaining \$0 (\$0 - \$0) contractor fees based on payments to for grant writing services. Foundation's only documents are "invoices" for consulting services addressed to Foundation. Of the \$0 in payments, the first recorded payment of \$0 is not supported by the bank records. And of the remaining payments of \$0, bank records show these as cash withdrawals (bank debits of June 30, September 9, October 22, and December 2). And, no Form 1099 MISC or other type information return was issued for the expense of \$0.
- o Line 16: Form 990 reports office expenses of \$0. Of this, \$0 was paid to (\$0). The remaining \$0 was recorded as phone and bank card expenses. Charge card fees on a bankcard and American Express card services totaled \$0, yet no records for these charged expenses were provided to explain how these furthered Foundation's purposes. Verizon phone charges of \$0 were similarly unsupported. Also, Foundation worked exclusively out of office and Foundation already paid \$0 in phone charges supported only by the invoice produced by .
- o Line 26: Form 990 reports miscellaneous expenses of \$0 which were recorded as license and PO Box fees. However, the recorded P.O. Box fees of \$0 are only supported by cash withdrawals.
- o Line 28: Form 990 shows zero bank fees. Yet, NSF bank fees of \$0 for insufficient or reversed check charges (on donations secured by telemarketers) were supported by the bank statements. Foundation deducted the fees prior to reporting the gross revenue. The examination results reflects the increase in gross revenue (see 20XX Revenue above: Bank collection revenue total of \$0) and in expenses of \$0 (NSF Bank Debit expense).

February 14, 20XX. Foundation explained "Due to the move and transition in staff, the organization is unable to find the files to support the expenses paid in 20XX. Please note that the majority of the expenses are paid to and itemized on invoices."

Foundation Temporarily Hires Employee:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

In 20XX, Foundation's first employee, _____, was _____ long time employee.

Foundation stated there were no differences in _____ duties from when she worked for _____ and Foundation. And that moving her to a Foundation position seemed logical because she was spending all of her time on Foundation.

March 6, 20XX, Foundation decided that _____ would re-hire _____ by April 20XX. (Per Foundation minutes.)

Records show _____ held the following positions:

- _____ employee: 20XX – 20XX
- _____ contractor: 20XX – 20XX
- _____ Treasurer: 20XX
- _____ Foundation employee: 20XX – 20XX
- _____ employee: 20XX – 20XX

(* _____, _____, founded in 20XX by _____.)

When Foundation began paying _____ full wages, she continued the same duties she had performed as a _____ employee. _____ made no adjustment to reduce any (employment, data entry, mail services, etc.) costs that _____ continued to charge Foundation. Documents show that _____, of _____, was to evaluate her work.

Foundation's position description for _____ is signed by _____ and _____ on December 17, 20XX. The position description duties show the following:

- Auditing, processing, and mailing of daily pledges and reminders
- Opening and processing deposits and credit card receipts
- Responding to requests of prospects, donors, sponsors, etc.
- ~~Coordinating with _____ staff.~~
- Providing administrative support to _____ staff as needed
- Data entry of pledge card errors, fulfillment
- Maintaining and updating DNC log and update in computer
- Stamping, assembling, and delivering mail
- Print reminders,
- Correct pledge card errors

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

- Other duties as assigned.

Grant Recipients:

Per Foundation, all grant recipients were first vetted by _____, then submitted his recommendations to the board.

The 20XX year Form 990 states, Foundation paid out \$0 in "grants" to pay for _____. This \$0 total does not take into consideration a reduction for the \$0 refused by and returned from _____.

In December 20XX, _____ returned to Foundation \$0 of a grant received from Foundation. _____ letter stated that "the reality is that the services provided by _____, owner of _____ (_____) are unparalleled". No adjustment was made to the total grant amount nor to receivables on the 20XX or 20XX Forms 990. No explanation was documented in meeting minutes.

Foundation made a \$0 grant to _____ (referenced by _____) in 20XX year. _____ is a private and for profit company owed by _____.

Also, \$0 _____ was not a grant or payment toward _____ but a tuition payment for an unidentified individual to attend a class. The business purpose was not explained. Foundation states it does not issue grants to individuals.

Incorrect Use of Joint Costs Rules- AICPA Statement of Position (SOP) 98-2:

Foundation reported fundraising expenses paid to the founder's company as amounts paid for charitable purposes by claiming that they qualified to use joint cost. Based on this claim, Foundation filed public reports showing millions as paid to "direct charitable services" that actually went directly to _____. (See _____ and _____ Revenue Compared Chart shown earlier.) Foundation's "reasonable allocation" of joint cost, under SOP 98-2, resulted in their re-assigning _____ % of _____ costs out of fundraising costs and into money spent on direct charitable service.

To use joint costs, the criteria of Accounting SOP 98-2 must be met. Per _____ 98-2, if any of the criteria of purpose, audience, and content are not met, all costs of the activity should be reported as fund-raising costs.

98-2 states that when a compensation contracts provides that compensation for performing the activity is not to exceed a specified portion of contributions raised (as is the case in Foundation's _____ % of contributions limit), and the stated maximum percentage is met (as was the case for Foundation), then compensation is considered based on amounts raised and the activity fails the purpose

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

criterion. Therefore, based on this factor (the compensation or fees test), the activity fails the purpose criterion and the special rules of allocating joint cost can not be used.

Per Marketing Service Agreement Part II (received by in 20XX), Costs exceeding %, of the gross revenue received by the Client, "can be carried forward and offset in future months.

And, the stated maximum percentage was met. Foundation's excess costs for labor exceeded % and were carried forward for months February through October. monthly invoices also show the stop loss of % of the total collected starting with January's charges that include a deferred payment of \$0 from the prior year and totaling \$0 for January.

Per 98-2, if the rules are not met, charities must show all costs paid to fundraisers as fundraising costs, not as amounts spent on charitable purposes.

_____:

Foundation's 20XX year Form 990 published that Foundation reached 0 women and "referred and scheduled many of these women for services".

The IRS examiner asked Foundation for documentation of the 0 women that they reached and for documentation of the women who they referred and scheduled for

Foundation, stated:

- The number of women reached is based on reports of households reached.
- The women who are called may be referred to a clinic that provides , but neither Foundation nor actually schedules appointments.

The examiner asked Foundation to define the "assistance program" and "pro Bono media message" or coordination with other 501(c)(3) organizations as claimed on their application for exempt status. Foundation referred the examiner to their website.

~~However, the website does not define Foundation's assistance program or any pro bono media message.~~

Form 990 for tax period ending December 31, 20XX:

filed Chapter 7 bankruptcy, July 3, 20XX, prior to the close of the IRS examination. The bankruptcy trustee arranged for preparation of the 20XX Form 990 based on records made available to the trustee. By the date of the trustee's

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

appointment, all of the officers and directors had resigned. The trustee provided the prepared form to the examiner. This shows total revenue of \$0 from contributions and total expenses of \$0 leaving net revenue of \$0. The types of expenses resembled those on the 20XX year Form 990. Joint cost were not utilized.

II. APPLICABLE LAW

Exempt Status:

Internal Revenue Code:

§501(c)(3) of the IRC provides for exemption from Income Tax for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster certain national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treasury Regulations

§1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

§1.501(c)(3)-1(c)(1) 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.

§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 IRC and regulations specifically forbid the inurement of earnings to private shareholders or individuals. (Reg. §1.501(c)(3)-1(c)(2)). The prohibition of inurement, in its simplest terms, means that a private shareholder or individual cannot misappropriate the organization's funds to himself except as reasonable payment for goods or services. Inurement of contributions is as fatal to exempt status as inurement of 'net earnings.' See People of God Community v. Commissioner, 75 T.C. 127 (1980). In addition, this Court has held that net earnings may inure to an individual in ways other than through the distribution of dividends. See Unitary Mission Church v. Commissioner, 74 T.C. 507,

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

512-513 (1980), affd. without published opinion 647 F.2d 163 (2d Cir. 1981); Lowry Hospital Association v. Commissioner, 66 T.C. 850, 857 (1976).

§1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for charitable purposes unless it serves a public rather than a private interest. 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.

§1.501(c)(3)-1(d)(1)(iii) Example 2 describes a situation where artists directly benefit from the sale of their art, therefore, the principal activity serves the private interests of these artists. The organization gives 90 percent of the proceeds from its sole activity to the individual artists, the direct benefits to the artists are substantial and the organization's provision of these benefits to the artists is more than incidental to its other purposes and activities. This arrangement causes the organization to be operated for the benefit of private interests in violation of the restriction on private benefit in paragraph (d)(1)(ii) of this section. Based on these facts and circumstances, the organization is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

Example 3. describes an educational organization "O" whose purpose is to train individuals in a program developed by its president. All of the rights to the program are owned by Company K, a for-profit corporation owned by the president. Prior to the existence of O, the teaching of the program was conducted by Company K. O licenses, from Company K, the right to conduct seminars and lectures on the program and to use the name of the program as part of O's name, in exchange for specified royalty payments. Under the license agreement, Company K provides O with the services of trainers and with course materials on the program. O may develop and copyright new course materials on the program but all such materials must be assigned to Company K without consideration if and when the license agreement is terminated. Company K sets the tuition for the seminars and lectures on the program conducted by O. O has agreed not to become involved in any activity resembling the program or its implementation for 2 years after the termination of O's license agreement. O's sole activity is conducting seminars and lectures on the program. This arrangement causes O to be operated for the benefit of P and Company K in violation of the restriction on private benefit in paragraph (d)(1)(ii) of this section, regardless of whether the royalty payments from O to Company K for the right to teach the program are reasonable. Based on these facts and circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

Revenue Rulings Private Benefit

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

In Rev. Rul. 70-186 an organization was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. Although the organization clearly benefitted the public, there necessarily was also significant benefit to the private individuals who owned lake front property. It was determined that the private benefit was incidental in a qualitative sense. Any private benefit derived by the lake front property owners did not lessen the public benefit flowing from the organization's operations. In fact, it would have been impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

In Rev. Rul. 76-152, 1976-1 C.B. 151, a group of art patrons formed an organization to promote community understanding of modern art trends. The organization selected modern art works of local artists for exhibit at its gallery, which was open to the public. If an art work was sold, the gallery retained a commission of ten percent and paid the remainder to the artist. Direct economic benefit was conferred on the individual artists by the gallery's sale and rental of the art works that defeated exemption even though the organization's other activities furthered the arts.

An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989) The court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with a particular political party and that most of the organizations graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organizational "insiders", the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve private interests within the meaning of § 501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner. "American Campaign Academy", 92 T.C. at 1077.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

In KJ's Foundation Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 1998 U.S. App. LEXIS 27982 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under § 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of KJ's Place, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of KJ's Place. The organization derived most of its funds from its lottery ticket sales. The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations. Although supporting charitable organizations may be a charitable activity, the Tax Court nevertheless upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of KJ's activities was to benefit KJ's place and its owners by attracting new patrons, by way of lottery ticket sales, to KJ's Place, and by discouraging existing customers from abandoning KJ's Place in favor of other lounges where such tickets were available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of §501(c)(3).

In Wendy L. Parker Rehabilitation Foundation, Inc. v. C.I.R., T.C. Memo. 1986-348, the Tax Court upheld the Service's position that a foundation formed to aid coma victims, including a family member of the founders, was not entitled to recognition of exemption. Approximately 30% of the organization's net income was expected to be distributed to aid the family coma victim. The Court found that the family coma victim was a substantial beneficiary of the foundation's funds. It also noted that such distributions relieved the family of the economic burden of providing medical and rehabilitation care for their family member and, therefore, constituted inurement to the benefit of private individuals.

In est of Hawaii, 71 T.C. at 1081, the court identified certain kinds of contractual provisions as indicating non-exempt purposes. These include agreements not to compete, significant control by a for-profit of an exempt organization's activities, a requirement that the exempt organization maintain exempt status, a lengthy term, and any other provisions that appear to favor the for-profit. All of these factors are present between _____ and Legacy.

The court held that an association formed in a private real estate development to operate parks, swimming pools, boat docks and other recreational facilities did not

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

qualify as § 501(c)(3) organization. Although the organization provided some benefit to the general public, the primary intended beneficiaries were the residents and property owners of the private development. Thus, the organization operated for a substantial non-exempt purpose rather than for exclusively charitable purposes. Columbia Park & Recreation Association v. Commissioner, 88 T.C. 1 (1987), aff'd.

A number of courts have held that unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control can constitute inurement. Parker v. Commissioner, 365 F.2d 792, 799 (8th Cir. 1966); Kenner v. Commissioner, 318 F.2d 632 (7th Cir. 1963); Church of Scientology, 823 F.2d at 1316-17, 1319.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), the Ninth Circuit held that a church that conducted its activities by mail did not qualify for exemption under § 501(c)(3) because a substantial purpose of its activities was to benefit a for-profit corporation controlled by the church's insiders. The church employed an advertising agency controlled by its insiders to provide all of the printing and mailing services for the church's mass mailings. The advertising agency devoted approximately two-thirds of its time to the work for the church. The majority of the church's income was paid to the advertising agency. Although the advertising agency claimed to have clients unrelated to the church, it did not advertise its services and refused to identify its other clients. The Ninth Circuit held that the church was operated for the substantial non-exempt purpose of "providing a market for [the advertising agency's] services" and, thus, primarily served the private interests of the advertising agency and its owners rather than a public purpose. In so holding the Ninth Circuit rejected the church's argument that the income paid by the advertising agency should not be included in the determination of reasonableness and treated this income as indirect inurement of the church's earnings to the church's insiders.

The prohibition on inurement in § 501(c)(3) is absolute. The Service has the authority to revoke an organization's exempt status for inurement regardless of the amount of inurement. See, Spokane Motorcycle Club, *supra*; The Founding Church of Scientology, 412 F.2d at 1202.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if TAXPAYER P's DPA program were directed to exclusively low-income individuals or disadvantaged communities, organization's total reliance for financing its DPA activities on home

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Other:

Form 990 Instructions, (Line 26, Joint Costs) allow fundraising cost to be allocated only if a charity follows SOP 98-2. The instructions states "Do not check the box unless the organization followed SOP 98-2 (ASC 958-720) in allocating such costs."

AICPA Accounting Statement of Position (SOP) 98-2 and Joint Costs states, in part, the "purpose criterion" must be met to use joint costs and provides the following directions:

- a. .10 The following factors should be considered, in the order in which they are listed, 5 to determine whether the purpose criterion is met:
- b. .10.a Whether compensation or fees for performing the activity are based on contributions raised. The purpose criterion is not met if a majority of compensation or fees for any party's performance of any component of the discrete joint activity varies based on contributions raised for that discrete joint activity.6,7
- c. 6 Some compensation contracts provide that compensation for performing the activity is based on a factor other than contributions raised, but not to exceed a specified portion of contributions raised. For example, a contract may provide that compensation for performing the activity is \$10 per contact hour, but not to exceed 60 percent of contributions raised. In such circumstances, compensation is not considered based on amounts raised, unless the stated maximum percentage is met. In circumstances in which it is not yet known whether the stated maximum percentage is met, compensation is not considered based on amounts raised, unless it is probable that the stated maximum percentage will be met (emphasis added).
- d. 7 The compensation or fees test is a negative test in that it either (a) results in failing the purpose criterion or (b) is not determinative of whether the purpose criterion is met. Therefore, if the activity fails the purpose criterion based on this factor (the compensation or fees test), the activity fails the purpose criterion and the factor in paragraph .10b should not be considered. If the purpose criterion is not failed based on this factor, this factor is not determinative of whether the purpose criterion is met and the factor in paragraph .10b should be considered (emphasis added).

III. Government's Position

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

Our position is that Foundation does not qualify for exemption from tax under section 501(c)(3) because it has failed to operate exclusively for exempt purposes as is required by sections 501(c)(3) and 1.501(c)(3)-1(a)(1).

First, Foundation was not operated exclusively for exempt purposes because its net earnings inured to the benefit of its founder and president by paying for workers for the founder's privately held telemarketing business, in contravention of section 501(c)(3) and 1.501(c)(3)-1(c)(2).

Second, Foundation was not operated exclusively for exempt purposes because it was operated primarily to benefit the private interests of the founder's telemarketing business, in contravention of section 1.501(c)(3)-1(d)(1)(ii).

Primary and Substantial Activities

Per section 1.501(c)(3)-1(c)(1) of the regulations 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 exempt purposes. Further, only an insubstantial part of non-exempt purpose activities are allowed.

Foundation is not operated exclusively for exempt purposes because its primary activity, as measured by financial income and costs and by actual services performed, is collecting donations and paying _____; and this, accomplishes the private purpose of increasing the founder's profits to himself and his for-profit fundraising business.

More than an insubstantial part of Foundation's activities furthered private purposes rather than purposes described in section 501(c)(3). Its substantial activity is performed through its contract with _____ and persuading people to donate money is not, in itself, an exempt activity. Nor is it made into an exempt activity by occasionally providing a phone number.

Foundation's true purpose was to provide its creator with a more desirable business environment. From inception, the founder essentially captured the exempt status of Foundation to increase the founder's profits.

Foundation's founder provided an exclusive service that generated the majority of his _____ business income in years 20XX and 20XX and exclusive source of income since year 20XX. Foundation is similarly dependent on _____ provides all of Foundation's income and Foundation's expenses are almost exclusively generated by _____, while grants were made at a minimum.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

While evidence of private benefit activities are abundant, there is a paucity of those that support an exempt purpose. And any that do exist are controlled by the founder.

Any fragments of perfunctory educational material is presented only as a means to legitimize the telemarketers' appeals for donations. This is further supported by the lack of structured, intentional education, and absence of educational materials and services provided to the public. While some educational activities may further exempt purposes, here, the only educational activity was conducted by telemarketers in the form of distribution of "educational" materials such as the shower cards and provision of a government provided telephone number. While the website contains scary diagnosis and death statistic, it does not even provide the telemarketer's (government provided) telephone numbers for

Foundation does not conduct any exempt activities itself, but merely makes grants to other organizations according to suggestions.

is a savvy and experienced professional fundraiser.

The flow of private benefit to and was purposeful. As was Foundation's public misrepresentation to hide the actual profits to its founder. They did this when they filed a contract with the that misrepresented the terms and hid the true beneficiaries of profits. And, they did this when they filed annual reports with IRS and that grossly overstated donations amounts used for exempt program activities when, in actuality, they were going directly to the founder's telemarketer. Regardless that Foundation did not qualify to use joint cost allocation (because the stop loss was met), used this allocation to trick the public and government into thinking the charity was spending legitimate amounts of money on and to hide the amounts going to

Even in its application for exempt status, Foundation did not disclose information that would have caused the IRS to apply careful scrutiny to ensure an applicant organization is not under the influence of private interests, and is benefiting to those same private interests. This too appears intentional. The founder signed his completed Form 1023 stating they had no website on the day the website was created by. And while all phone, address, website data belonged to on Foundation's applications, Foundation continued to claim they had not considered as a fundraiser. By May 9, 20XX, Foundation still did not acknowledge either the website nor consideration of Foundation as a fundraiser yet, without any documentation, had managed to determine that costs were below fair market and hammer out two contracts with

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

As stated in Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980) aff'd, 670 F.2d 104 (9th Cir. 1980), where the applicant was controlled by the founder, "it provides an obvious opportunity for abuse of the claimed tax-exempt status. It calls for open and candid disclosure of all facts bearing upon petitioner's organization, operations, and finances so that the Court, should it uphold the claimed exemption, can be assured that it is not sanctioning an abuse of the revenue laws. If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that petitioner fails to meet the requirements of section 501(c)(3)"

The interrelationships and common control between your organization and the for-profit entity support a substantial non-exempt purpose similar to the operations of the organizations in International Postgraduate Medical Foundation v. Commissioner and Old Dominion Box Co. v. United States. Your existing relationship with the commonly controlled for-profit entities also constitutes a specific non-exempt purpose which precludes exemption consistent with the decision in Better Business Bureau of Washington, D.C., Inc. v. United States. The underlying objection to exemption of the organization is that its activities were oriented to its own founders benefit rather than to the general public.

Issue 1: Inurement

Foundation's earnings inure to the benefit of private individuals. This is prohibited in Treas. Reg. §1.501(c)(3)-1(c)(2). A private shareholder or individual cannot misappropriate the organization's funds to himself except as reasonable payment for goods or services. Regs. 1.501(c)(3)-1(c)(2).

Foundation is like the organization in Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), where a substantial purpose of its activities was to benefit a for-profit corporation controlled by the church's insiders. Like the church, Foundation employed an agency controlled by its insiders to provide all of the services for the Foundations mass telemarketing and mailings. Where that agency devoted approximately two-thirds of its time to the work for the church, provided all of its time for Foundation. And like the church, the majority of the Foundation's income was paid to the agency. Like the church, Foundation was operated for the substantial non-exempt purpose of providing a market for [the agency's] services and, thus, primarily served the private interests of the agency and its owners rather than a public

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

purpose. And as the Ninth Circuit treated that income as indirect inurement of the church's earnings to the church's insiders, the income here is indirect inurement to and its owner.

While Foundation added salary, bonuses, and benefits to its enormous list of expenses, continued to reap the benefit of their long time employee's work without the cost of her salary. During the period Foundation paid wages, she continued to perform the same duties as she had for continued working from office, continued under the evaluative supervision and control of , performed staff work that Foundation is already being charged for on monthly invoices (correction, fulfillment and data entry of pledge cards, update and input of DNC logs, printing reminders, stamping, assembling, and delivering mail, responding to complaints, processing and depositing donation receipts, and providing administrative support to the staff).

Yet, no allocation of her salary was made for work, and made no reduction in invoiced labor, mailing, shipping, data input, or any type of charges for which it billed Foundation.

While this increased costs for Foundation, and reduced funds to the public, this alleviated the salary expense from and increased their business income profit. Foundation's earnings have inured, in substantial part, to the benefit of and thereby, owner,

This violates §1.501(c)(3)-1(c)(2) of the Treasury Regulations.

As in Wendy L. Parker Rehabilitation Foundation, Inc. v. C.I.R., T.C. Memo. 1986-348, where private inurement occurred because 30% of net income went to the founder of the organization, thus alleviating the economic burden of its founders, and resulting in an economic benefit to the founders.

Issue 2: Private Benefit

Foundation is not operated exclusively toward one or more exempt purposes because more than an insubstantial part of its activities benefits the private interests of its founder, , and his company, . Treas. Reg. §1.501(c)(3)-1(d)(1)(ii).

Foundation is like the organization in KJ's Foundation Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 1998 U.S. App. LEXIS 27982 (2d Cir. 1998), that did not qualify for exemption under § 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founder exercised substantial influence over the

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

affairs of the organization. Although supporting charitable organizations may be a charitable activity, the Tax Court nevertheless upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. A substantial purpose of KJ's activities was to benefit KJ's place and here, to benefit

Foundation is like the organization in Rev. Rul. 76-152, 1976-1 C.B. 151, where the gallery retained a commission of ten percent and paid the remainder to the artist. There, direct economic benefit was conferred on the individual artists by the gallery's sale and rental of the art works that defeated exemption even though the organization's other activities furthered the arts. Here the direct economic benefit was conferred to

It substantially benefits _____ and his business entities to expand and extend their commercial activities. This is supported by the following:

- o Foundation generated _____ % and _____ % of _____ revenue respectively for years 20XX and 20XX, and for years 20XX through current, _____ % of _____ revenue.
- o Further, while Foundation was _____ only client, _____ collected at least \$0 (0 + 0 + 0 + 0) more than it reported to Foundation. (See _____ gross donation revenue reported to _____ earlier.) While these records are available to the public, Foundation did not question _____ figures. Therefore, Foundation's lack of oversight has allowed at least these amounts to go missing. The extent that this unreported income economically benefited _____ is likely more.
- o _____ can, and has, charged millions each year in fees based solely on invoices it creates, without back up documents and without a single question from Foundation.
- o If the charity did not participate and lend its tax exempt status to the transactions, there would be little, if any revenue collected by _____

Foundation is like the organization in Example 2 of §1.501(c)(3)-1(d)(1)(iii) where the principal activity served the private interests of the artist. The public benefit from any grants was insignificant compared to that received by the founder.

The large amounts paid to _____ leave little for any public benefit. This is illustrated in the percentage of revenue spent on public interests from the first year of 20XX, when _____ was the sole beneficiary and the public received zero, through 20XX, when less than 0 (—%) went to pay grants.

Tax Year:	20XX						
-----------	------	------	------	------	------	------	------

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

Foundation Collections	0	0	0	0	0	0	0
Paid to	0	0	0	0	0	0	0
Grants Paid:	0	0	0	0	0	0	0
% paid to							
Collections by Grants							

Tax Year:	20XX-20XX Totals
Foundation Collections	0
Paid to	0
Grants Paid:	0
% paid to	
Grants/Collections	

Foundation claimed in its application that assistance will be provided to women who are uninsured to help pay for a . Yet, Forms 990, and documents filed with the state of , grossly overstate the amount of donations used for public benefit of paying for

While Foundation publicly claimed it "referred and scheduled" many of the 0 women it reached, when asked for records, it admitted neither Foundation, nor the telemarketers scheduled any , contrary to their public claims. This part of the program was so negligible, they weren't even able to show how many women the telemarketer's "referred" to clinics. For all of claims of tracking customer's data, it did not even record women who were helped or how many women were contacted. Yet, as in so many of their claims, this is inconsistent with facts as Foundation's website form collects personal data for anyone who wants a and advertises that it can track all data for its clients. As stated on contract registration, the services are limited to conducting direct mail and telephone solicitations. Not surprisingly, the personal data collected by the form, is valuable for telemarketing lists sold throughout the telemarketing business.

Foundation allowed telemarketers to falsely tell potential donors that all of their donation would go to paying for

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

The grants that were paid, may or may not have gone to _____ as some went to clinics and some to private for-profit practices. Even the total grants shown is suspect, just in the year examined, UCLA returned almost \$0 yet no adjustment for this amount was recorded.

The private benefit to _____ and _____ is not incidental to accomplishing an exempt purpose.

For private benefit to be qualitatively incidental, the benefit to the public must not be able to be achieved without benefiting certain private parties. Benefits include certain payments for goods or services, or steering business to a for-profit company.

The private benefit _____ receives is not a necessary result of the organization's operation. Certainly, the organization may contract for management expertise; however, it has the option to hire employees with experience in _____ or health care professionals, or even to hire any employee who is not selected or controlled by _____ or his company. Unlike most exempt organizations who deal with different entities to purchase goods and services, Foundation purchased all services from _____, even their only employee was selected from and supervised by _____ and their consultant was interviewed and selected by _____. All supplies and mailing lists were purchased by _____. Yet, even purchase records were not supplied to the examiner as _____ could not prove that it incurred the any of the actual costs it charged Foundation.

Foundation's relationship with _____ is similar to the structure that described in est of Hawaii. Foundation purchases virtually everything it needs to operate from _____. Foundation's ability to remove itself from the _____ management and oversight is severely impaired. If Foundation wanted to remove management and _____ contributions, it would lose its funding, lose its "education program", and, its permanent facility at _____; business office (from 20XX until recently during the examination). In fact, shortly after stepped down from officer to volunteer of Foundation, it filed for bankruptcy. As in est of Hawaii, Foundation is totally dependent on one for-profit organization for its operation.

Foundation is unlike that described in Rev. Rul. 70-186, 1970-1 C.B. 128. because any private benefits derived by _____ and his business actually do reduce any public benefits flowing from the organization's operations.

The exclusive contract with _____, and the control of _____, the founder has the effect of transferring to _____ and his business a benefit intended for actual 501(c)(3) exempt organizations.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

Despite persistent claims that _____ was chosen in a competitive bidding process and contract terms are no greater than fair market value, Foundation was unable to provide any evidence of comparable cost for similar services or that the arrangement with _____ was arrived at in a manner that was economically fair to Foundation.

Further, no evidence supports that _____ removed himself from the initial contract with his business. To the contrary, his signature is on the contract registered with the state in year 20XX.

Here, the contract was made with an insider and caused the organization to enter into a transaction that is economically detrimental to the exempt organization and good for the insider, and this becomes an inurement issue. (Rev. Rul. 66-259, 1966-2 C.B. 214)

The situation is similar to Example 3 of §1.501(c)(3)-1(d)(1)(iii) where Foundation's arrangements of its primary activity is fundraising and telemarketing cause Foundation to be operated for the benefit of _____ and _____, and as in example 3, this is regardless of whether the contracted payments from Foundation to _____ are reasonable.

All financial activities were performed through _____ telemarketers and staff, including collection, accounting, and deposit of donations.

No evidence supports that either named director added by _____ had any influence or exercised any oversight. No evidence supports that they championed the best interests of any charitable activity; rather, one made his living by selling telemarketing supplies and services, and the other made her career in fundraising.

Foundation has failed to provide specific information or safeguards regarding its selection of _____ or its oversight or control of its cancer _____ project. Internal controls were virtually absent. The founder was in control of the lucrative income from the organization he founded and of the expenses he could charge for his fundraising services. The books and records were kept at _____ office under the control of _____ and his employees. All checks are signed solely by _____ records shows only _____ and _____ have expenditure authority and identify the fundraiser contact as _____. These Foundation registrations are signed by _____. All contributions were received through _____ efforts and were processed and deposited by an _____ employee into a bank account controlled by _____. Foundation paid whatever _____ charged, no questions asked.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Periods Ending December 20XX and December 20XX

Foundation's true purpose, like the court found in the American Campaign Academy's case, was to benefit private interests by providing them with a captive client to increase revenue.

The organization has the burden of proof to establish that it is not operated for the benefit private interests in order to meet the requirements of Reg. 1.501(c)(3)-1(d)(1)(ii). It has not proven this. On the contrary, the facts above support that the organization was organized and operated for just that.

CONCLUSION:

Foundation is not an organization described in section 501(c)(3) because it is not operated exclusively for exempt purposes. First, Foundation is not operated exclusively for exempt purposes because its net earnings inured to the benefit of private shareholders or individuals. By paying for the costs of one of _____ workers, Foundation provided an impermissible benefit to the founder and president's telemarketing company.

Second, Foundation is not operated exclusively for exempt purposes because it failed to show that it serves a public rather than a private interest and, specifically, 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. Instead, Foundation's activities are oriented to its founder's benefit, rather than to the general public. Here, the entire enterprise is carried on in such a manner that the for-profit organization owned by the founder substantially benefits from the operation of Foundation.

For the foregoing reasons, Foundation is not an organization described in section 501(c)(3) and revocation of its exempt status is proposed effective January 1, 20XX.

Forms 1120 returns should be filed for the tax periods ending on or after January 1, 20XX.

Informational Note:

An corporate organization whose tax-exempt status is revoked is brought current on its filing and tax liabilities by transferring the Forms 990 data to converted Forms 1120 and filing the Forms 1120. (IRM 4.75.31.7.1(5) describes taxable contributions. This notes that gifts acquired by misrepresentation or fraud is included in gross income of the recipient.