

Internal Revenue Service

Appeals Office
San Jose Appeals, MS-7100
55 S. Market St., Suite 440
San Jose, CA 95113

Department of the Treasury

Employer Identification Number:

Person to Contact:

Release Number: **201734009**

Release Date: 8/25/2017

Date: May, 31, 2017

UIL:

0501.09-03

0501.36-00

Certified Mail

Dear :

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

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

You are not operated exclusively for charitable or other exempt purposes, as required by section 501(c)(3) of the Internal Revenue Code. Your net earning inured to the benefit of private shareholders or individuals, such as your sole member. In addition, you operated for substantial non-exempt commercial purposes, and for the substantial benefit of private rather than public interests, such as for the benefit of your sole member and his closely held businesses.

Your determination letter dated June 25, 20' being retroactively revoked because you omitted or misstated material information in your application as to your conduct of prohibited or restricted activities, or, alternatively, you operated in a manner materially different from that originally represented in your application for recognition of exemption.

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

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

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

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

2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

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

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

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

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
1100 Commerce Street MS 4900 DAL
Dallas, TX 75242-1100

Department of the Treasury

Date:

December 2, 2014

Taxpayer Identification Number:

Form:

990 Return

Tax Year(s) Ended:

Dec. 31, 20XX & Dec. 31, 20XX

Person to Contact/ID Number:

Contact Numbers:

Manager's name/ID number:

Manager's contact number:

Response due date:

January 2, 2015

Certified Mail – Return Receipt Requested

Dear _____ :

Why you are receiving this letter

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

What you need to do if you agree

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

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

If we don't hear from you

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

Effect of revocation status

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

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

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

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

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

Contacting the Taxpayer Advocate Office is a taxpayer right

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service
Office of the Taxpayer Advocate

For additional information

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Director, EO Examinations

Enclosures:
Report of Examination
Form 6018
Publication 892
Publication 3498

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG.	Tax Identification Number	Year/Period ended 20XX 20XX

ISSUE

Should the tax exempt status of ORG d/b/a ORG, be revoked due to its failure to be properly organized and its failure to operate for charitable purposes as described in section 501(c)(3) of the Internal Revenue Code?

FACTS

A decade ago, in September 20XX, Founder, an attorney, founded "ORG" in the state of State. ORG, a non-profit corporation, was voluntary dissolved in State on July 13, 20XX. ORG did not obtain tax exempt status with the IRS.

The organization in issue in this case is ORG ("organization"). The tax years examined by the IRS are 20XX and 20XX. The organization was incorporated on March 15, 20XX in the State. Its founder, as per its application form to the IRS, is Member, who is Founder's brother. It obtained tax exempt status under I.R.C. § 501(a) as a section 501(c)(3) public charity from the IRS in June 20XX. Founder is the sole voting member of the organization, controls the organization, and was a signor on the organization's bank account for 20XX and 20XX. His sister, Treasurer, is its treasurer. Member was its president between 20XX and 20XX. He left the organization in December 20XX.

In July 20XX, the organization filed for the right to use "ORG" as an assumed business name. The organization uses its website, www.ORG.org to solicit timeshare owners.

The organization's website address is: <http://www.ORG.org>. The organization's home page states:

STATEMENT DELETED

I. The Organization's Relationship with Founder's Three For-Profit Entities (Private Benefit/Substantial Nonexempt Purpose)

In its website, the organization asked if a timeshare owner would like to get rid of his or her timeshare interest, and if so, would they prefer to donate their timeshare to a charity and receive a charitable deduction instead of selling their interest through a real estate agent. If the answer was yes, the organization processed the timeshare donation - which included one or two closings, a deed transfer, and a written appraisal, in the manner described below.

In 20XX and 20XX, the organization hired three for-profit entities: 1) CO-1 ("CO-1"); 2) CO-2 ("CO-2"); and 3) CO-3. CO-1 conducted marketing and closing services for about 0% of the timeshare inventory held by the organization, and was wholly owned by Founder. It was also listed as the client on all of the appraisals performed for timeshare owners who elected to get appraisals. CO-2, the organization's broker, sold the donated timeshares. CO-3 was used exclusively by CO-1 in providing written appraisals to timeshare donors, and was wholly owned by Founder. Indv-1, Indv-2, and Founder prepared the appraisals for CO-3. It does not appear that Founder meets the requirements of a qualified appraiser under Treas. Reg. §1.170A-13(c).

In response to IDR 001, the organization provided three contracts: a marketing service contract, a closing services contract, and a sales contract reflective of some of the business arrangements above.

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In 20XX and 20XX, CO-2 communicated directly with potential donors through the organization's website. It obtained information to determine if the timeshares should be accepted for processing. If accepted, CO-2 informed CO-1. During all of 20XX and January 20XX, CO-2 listed the timeshare for sale on Company. From February 20XX through December 20XX, an employee of CO-1 listed the timeshare on Company. Timeshares usually were listed for sale for seven days on Company.

CO-1 performed real estate closing services, including deed drafting and recording, title searches, and ownership verification. It processed the timeshare donation after it received an "up front" processing fee from the donor payable directly to CO-1.

From 20XX to 20XX, donors were not charged an up-front processing fee, broker commissions, transfer fees, closing costs or any other fees. This changed in early 20XX. In its March 27, 20XX response to the IRS's Information Document Request ("IDR") 001, the organization stated:

Since the Organization was established, it has applied the following policies regarding donations of timeshare interests: 1) it rejects proposed contributions of timeshare interests which it believes can never be sold for more than the Organization's costs; and 2) it will not charge transfer fees, closing costs, etc., in connection with donations it believes can be sold for more than the Organization's costs.

Beginning in February, 20XX, the Organization instituted a third policy in connection with donations where there was uncertainty about whether the timeshares could be re-sold for more than the Organization's costs. For these, donors were required to pay an initial amount 'up front.' This was necessary because approximately 0% of the donations were being rejected because the organization believed the re-sale price would be less than the cost.

As such, beginning in February 20XX, the organization required most if not all donors to pay an up front fee of \$0. In IDR 001, the organization claimed that with respect to the up front fee, the \$0 covered the cost of two real estate closings, two recording fees, up to \$0 in resort transfer fees, and other expenses. It also claimed that if the organization was unable to find a buyer for the timeshare, the organization notified the donor and returned the \$0 fee.

In July 20XX, the up front fee was raised to \$0. In February 20XX, it was raised to \$0. In July 20XX, it was raised to \$0. The organization claims the reason for the increases was a decline in the timeshare re-sale market. According to the organization from 20XX to 20XX the average sales price for timeshare interests fell from \$0 to \$0.

When a timeshare was sold, the proceeds were deposited into CO-1's escrow account. The organization received net proceeds from CO-1 after CO-1 deducted its own expenses and fees. The expenses and fees CO-1 deducted consisted of: closing fees (usually there are two closings per sale typically in the amount of \$0 and payable to CO-1), a Form 8283 fee (typically in the amount of \$0 and payable to CO-1), and a DFC processing fee (typically in the amount of \$0 and payable to CO-1). Furthermore, CO-1 retained a portion of the sale proceeds outright (between \$0 to \$0 per timeshare and payable to CO-1).

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There are other fees, such as recording fees, transfer fees, maintenance fees, and miscellaneous fees which also make up the up front fee.

With the net proceeds it received from CO-1, the organization withheld a portion for the payment of its administrative costs such as salaries, contract fees to CO-2, and sharing costs with CO-1 (i.e. rent, computers, printers, utilities, etc.). With the remainder, the organization paid the public charity the timeshare donor chose in advance. In the event that the donor did not choose a charity, the organization kept 0%.

The IRS agent analyzed thousands of electronic documents the organization provided and determined that for the 20XX year, CO-1 retained a combination of fees and sale proceeds totaling \$0 out of a total of combined up front fees and proceeds of \$0 in 20XX. This equates to 0%. In contrast, the organization made donations in furtherance of its tax exempt purpose (grants to other public charities) of \$0 in 20XX. This equates to about 0%.

For 20XX, because of the sheer volume of electronic files the organization provided (without the benefit of any workable ledger), it was impossible for the IRS agent to tally total sales proceeds and total fees for all 0 timeshares. The organization did not maintain records in this fashion. Thus, the agent compiled the rough data by taking a sample of every 10th timeshare (amounting to 0 timeshare sales in the sample). The agent determined that CO-1 retained a combination of fees and sale proceeds totaling \$ out of a total of combined up front fees and proceeds of \$0 in 20XX, as per the sample. This equates to %.

In 20XX, the organization made donations of \$0 as per the sample of 0 timeshares. This equates to about 0%. In 20XX, as per its return, it made total donations of \$0.

When asked about this further in the IRS's IDR 006, the organization protested (in its response dated July 11, 20XX) that it was not required to review the IRS agent's work in compiling the rough data it provided, and that being asked to do so was unduly burdensome, among other things. Also, the organization contended that the up front fees were in the nature of cash contributions to the organization so it refused to comment further on the agent's charts other than to say that the fees were not income to either the organization or CO-1. The organization refused to admit that CO-1 was providing services in exchange for the up front fees because doing so would be an admission that its Donor Receipts (Cash Acknowledgment Letters) were misleading. This point is discussed further below.

With respect to specifically the 20XX year, the organization also stated that the IRS agent's numbers were inaccurate because some of the fees and proceeds (specifically \$0) belonged to an entity called CO-4 rather than CO-1. The IRS contends however that it is not improper to lump these entities' fees together because CO-4 is also owned by Founder. In addition, CO-4 provided the same services as CO-1, and began providing these services only in November 20XX. Further, in the IRS's IDR 007 issued in August 20XX, the IRS gave the organization the opportunity to substantiate, by any alternative means it chose, the income of CO-1 and all other for-profit companies owned by Founder in 20XX and 20XX relating to the organization. To date, the IRS has received no response to IDR 007 despite the IRS agent's two month extension to the organization to provide its answers.

If a donor requested an appraisal, the organization referred the donor to CO-3 and CO-1. To obtain an appraisal, the donor paid an additional \$0 to CO-1 (in addition to the up front fee). Of the \$0 fee, \$0 was paid to CO-3, and the remaining \$0 was paid to Indv-2 or Indv-1 for their appraisal work. However, if the appraisal was performed by Founder, the entire \$0 was paid to CO-3.

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In 20XX, the organization processed _____ ionations. Of this amount 0, or 0% included a written appraisal along with the processing. The percentage of appraisals performed by Founder himself was 0%.

In 20XX, the organization processed about 0 donations. Of this amount it appears that a large portion of the donations included written appraisals along with the processing. For instance, 0 out of the 0 sampled files, or 0%, included written appraisals. 0% of this amount (again, from the sampling) were performed by Founder himself.

The above illustrates the extensive financial connections between Founder, who controls the organization, and Founder, who owns and runs CO-1, CO-4, and CO-3. The organization fails the operational test because it conferred an excessive private benefit on Founder in 20XX and 20XX. Its primary purpose was attracting customers who would otherwise have gone elsewhere to sell their timeshares. KJ's Fund Raisers v. Commissioner, T.C. Memo. 1997-424, aff'd 166 F.3d 1200 (2d Cir. 1998).

II. Business Practices (Substantial Nonexempt Purpose)

Cash Acknowledgement Letters

The organization issued donation acknowledgment letters to the donors when processing the timeshares. Two types of letters were issued per donor. One letter was a cash acknowledgment letter and the other was a non-cash acknowledgement letter.

The cash acknowledgement letter was issued by CO-1 to the donor and stated or implied that the donor's up front fee that he or she paid to CO-1 may be characterized as a cash donation to a charity. The organization steadfastly contends that the up front fees are donations as opposed to payments to CO-1 for its services. In reality, the up front fees are precisely connected to the services provided by CO-1 and are the exact services contemplated in the service contracts between the organization and CO-1.

Appraisals and Internet Claims

In instances where donors paid for written appraisals, the IRS agent determined a significant difference between a timeshare's selling price and its appraised value. For 20XX, the agent determined that the average appraised value of a timeshare was 0% higher than a timeshare's sale price (arrived at on Company). For 20XX, and based on the agent's sampling of 0 files, the average appraised value of a timeshare was 0% higher than a timeshare's sale price. In addition, the agent believes that the appraisals contained incorrect sales data and included the appraisal fee as part of the appraised value. Also, the agent questions whether Founder was a qualified appraiser in 20XX and 20XX.

Further, if the donor paid the appraisal fee, then the donor received an appraisal report, and a signed Form 8283. The organization claims it is a donor's responsibility to ensure he or she is complying with all necessary tax rules by conferring with a tax professional when computing the amount of its donation on his or her tax return. Notwithstanding, the Form 8283 often contained the appraised value on the form itself prior to it being mailed to the donor.

The organization's Frequently Asked Questions Page site provides the following:

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It is up to you to determine the fair market value of your donation. We will send you a receipt which describes the donated property and you write in the value. We offer appraisals from a licensed third party, should you require one. Please contact our donation specialists for more information regarding the appraisal of your timeshare.

In combination with the above, during the years in issue, the predecessor of CO-2, CO-5 maintained a website that contained statements that donors of timeshares are entitled to take a deduction on their tax returns in the realm of thousands of dollars (\$0-\$0), and referred donor's to the organization's website. This same information was contained in various timeshare blogs that featured the principle businessman of CO-5, Indv-3. In IDRs to the organization the IRS agent inquired about these other websites and blogs. The organization remained silent as to the implications involved and merely stated that the organization has but one website under its control.

Form 1023 Application

There is a large disparity between the organization's stated purpose to make gifts, grants, etc, to tax exempt organizations with contributions including that of real property that "donors may offer to donate including interests in time shares," and the actual undertakings of the organization in 20XX and 20XX.

Commercial Hue

The activities of the organization, in that it was principally operating to serve the business needs of CO-2, CO-1, CO-4, and CO-3, four for-profit companies, means that it was conducting itself as a commercial, profit-making enterprise.

Inconsistent Documents

In response to the examiner's request, organizational meeting minutes were provided. For reasons unknown, two differing sets of minutes were provided.

The two sets of meeting minutes show the same dates of the meetings, meeting starting times, and meeting ending times. However, the directors and officers listed on the first set of meeting minutes were not the same directors and officers listed on the second set of meeting minutes, except for the president, President (a.k.a. President). Also, except for the president, the officers and directors who were listed on the second set of the meeting minutes were not listed as directors and officers on the Annual Report provided to the State of State on March 10, 20XX and May 13, 20XX.

There were also two sets of annual meeting minutes provided for the year 20XX. There were three individuals (Indv-4, Indv-5, and Indv-6) listed in attendance in the first set of annual meeting minutes, provided on March 27, 20XX, who were not listed on the second set of annual meeting minutes provided on February 26, 20XX. Conversely, there were three individuals (Indv-7, Indv-8, and Indv-9) listed in attendance in the second set of minutes provided on February 26, 20XX, who were not listed on the first set of minutes provided on March 27, 20XX.

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In its response dated July 11, 20XX, the organization claimed that Founder's assistant made a mistake regarding the roster of attendees.

In sum, deceptive business practices are evidence of a substantial nonexempt purpose. Sharp business practices, including deceptive contracts and untrue statements about the law or an organization's business methods, are incompatible with the purpose of an organization claiming to be charitable.

LAW

I.R.C. § 501(c)(3) exempts from federal income tax, organizations organized and operated exclusively for religious, charitable, scientific, or educational purposes whereby no part of the net earnings inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not intervene on behalf of (or in opposition to) any candidate for public office.

Treas. Reg. § 1.501(c)(3)-1 states 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 purposes specified in such section. If an organization fails to meet either the organizational or the operational test, it is not exempt. An organization is organized exclusively for one or more exempt purposes only if its articles of the organization as defined in subparagraph (2) of this paragraph: (a) Limit the purposes of such organization to one or more exempt purposes; and (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

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

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) provides that the terms "private shareholder or individual" as used in section 501 refer to persons having a personal and private interest in the activities of the organization.

Treas. Reg. § 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.

Treas. Reg. § 1.501(c)(3)-1(e) states that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if it operates the trade or business in furtherance of its exempt purposes. The organization must not be organized or operated for the primary purpose of carrying on an unrelated trade or business.

Rev. Rul. 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) because it gave preference to employees of business operated by the individual who also controlled the organization. The ruling reasoned that,

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although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

Rev. Rul. 80-287, 1980-2 C.B. 185, held that a nonprofit lawyer referral service, which was open to all members of the community, did not qualify for exemption under section 501(c)(3). Providing services of an ordinary commercial nature, even though the undertaking is conducted on a nonprofit basis, is not regarded as conferring a charitable benefit on the community unless the service directly accomplishes one of the established categories of charitable purposes. Although the organization provided some public benefit, a substantial purpose of the program was the promotion of the legal profession.

In *P.L.L. Scholarship Fund v. Commissioner*, 82 T.C. 196, (1984), the taxpayer was a nonprofit corporation formed to raise money for college scholarships. It planned to raise money through the operation of bingo games held at the Pastime Lounge, a lounge owned by two members of the board of directors. The other board members consisted of an accountant and director of the lounge and two "bingo players." The board was self-perpetuating, with the existing directors selecting future directors. *Id.* at 197. The owners of the Pastime Lounge ran the bingo games during regular business hours. Employees of the Pastime Lounge solicited orders for food and drink from the bingo players. However, the accounts of the Pastime Lounge were kept separate and distinct from those of the taxpayer. *Id.* at 197-198. The Court held that the taxpayer had a nonexempt purpose which was "substantial in nature"; i.e., to promote business at the Pastime Lounge through the medium of the bingo games. *Id.* at 199-200. The Court based this conclusion in part on the identity of the taxpayer's board of directors with the owners and associates of the Pastime Lounge. Since the owners controlled the board and appointed its future directors, the Court reasoned, the taxpayer's activities could be used to the advantage of the Lounge.

In *International Postgraduate Medical Foundation v. Commissioner*, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under section 501(c)(3) of a nonprofit corporation that conducted continuing medical education tours. The petitioner had three trustees. Mr. Helin, who was a shareholder and the president of H & C Tours, a for profit travel agency. Mr. Regan, an attorney, and a third director who was ill and did not participate. Mr. Helin served as executive director. The petitioner used H & C Tours exclusively for all travel arrangements. There is no evidence that the petitioner ever sought a competitive bid. The Court found that when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes.

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C. 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because the organization conducted its activities in a commercial manner, the court found that it operated for commercial purposes, rather than tax-exempt purposes. Courts consider multiple factors when assessing commerciality, including evaluating the organization's competition with for-profit companies; the extent and degree of its below-cost services and pricing policies; the reasonableness of its financial reserves; its use of commercial promotional methods, such as advertising; and the extent to which it receives charitable donations. In *American Campaign Academy v. Commissioner*, 92 TC 1053 (1989), the Service argued that the Academy substantially benefited the private interests of Republican Party entities and candidates, thereby advancing a nonexempt private purpose. The relationship between the Academy and

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"Republican party entities and candidates" was not one of control, although the Academy was an outgrowth of a training program operated by National Republican Congressional Committee. In fact, the Academy argued that the prohibition against private benefit is limited to situations in which an organization's insiders are benefited. The Tax Court, however, disagreed with this view, and stated that an organization's conferral of benefits on disinterested persons may cause it to serve a private interest within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

In *Better Business Bureau of Washington, D.C., Inc. v. United States*, 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 *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352, 356-58 (1978), the court stated that providing services at cost is not sufficient to characterize the activity as charitable as it lacks the donative element necessary. "[T]he critical inquiry is whether [the organization's] primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for [the organization]." Evidence of a "forbidden predominant purpose" includes such factors as the particular manner in which the organization conducts its activities, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. The Court concluded that the petitioner was not an organization described in section 501(c)(3) because its primary purpose was not educational, scientific, or charitable, but commercial.

In *Easter House v. United States*, 12 Cl. Ct. 476 (1987); *aff'd*, 846 F. 2d 78 (Fed. Cir. 1988), *cert. denied*, 488 U.S. 907 (1988), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) because the primary purpose of the agency was a nonexempt commercial purpose. The organization placed children for adoption in the same manner as a commercial adoption agency. The organization's sole source of income was the fees it charged adoptive parents; it did not receive contributions from the public. The relevant inquiry, the court noted, was whether the organization's primary purpose was to promote exempt purposes or business purposes; which is a question of fact. The court found "that the business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service [was] its primary goal." *Id.* at 485-86. Plaintiff competed with other commercial organizations providing similar services, thus coloring its activities with a commercial hue. Accordingly, the court held that the organization was not operated exclusively for purposes described in section 501(c)(3).

In *Federation Pharmacy Services, Inc. v. Commissioner*, the court acknowledged that, if merely dealing in drugs converts an organization to an exempt organization under section 501(c)(3), "then so could a store selling orthopedic shoes, crutches, health foods, or any other product beneficial to health. Virtually everything we buy has an effect, directly or indirectly, on our health." *Id.* at 692. The law does not entitle an organization whose purpose is to benefit health to an automatic exemption, as Congress did not intend "to exercise its grace in such an expansive manner."

Government's Position:

The organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked. The majority of its activities are regularly carried on as a business, and are not substantially related to furthering the exempt purpose of the organization. As the owner of CO-1, CO-4, and CO-3, Founder, received a substantial business benefit from the sale of donated timeshares in 20XX and 20XX.

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Treas. Reg. § 1.501(c)(3)-1(c)(1) states that an organization will be regarded as "operated exclusively" for one or more purposes only if it engages primarily in activities which accomplish one or more such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests. This requirement applies equally to the potential for inurement and for private benefit.

Not Operated for Charitable Purposes

Section 501(c)(3) uses the term "charitable" in its generally accepted legal sense and defines the term "charitable" as including the relief of the poor and distressed or of the underprivileged. Treas. Reg. § 1.501(c)(3)-1(d)(2). The organization claims its operations are charitable because it provides cash donations to charitable organizations through its timeshare donation program.

The organization's facts are similar to *P.L.L. Scholarship Fund v. Commissioner*, 82 T.C. 196, 1984 WL 15531 (1984). In that case, the court held that the taxpayer had a nonexempt purpose which was "substantial in nature"; i.e., to promote business at the Pastime Lounge through the medium of the bingo games. *Id.* at 199-200. The court based this conclusion in part on the identity of the taxpayer's board of directors with the owners and associates of the Pastime Lounge. Since the owners controlled the board and appointed its future directors, the court reasoned, the taxpayer's activities could be used to the advantage of the Lounge.

While the organization's organizational documents may have indicated a charitable motive, in reality the organization lacked the necessary charitable purpose in 2010 and 2011. See *Partners In Charity v. Commissioner*, 141 T.C. No. 2 (August 26, 2013).

Founder's Control

By retaining sole voting authority over the activities of the organization, Founder was in direct control of the day-to-day operations of the organization. Coupled with his for-profit entities, all activities were controlled and directed for the benefit of Founder.

Founder hired all of the sales agents, and, as the organization's sole voting member, selected the organization's board of directors, and president. Founder determined the amount of up front fees to charge donors, which entity the donors should pay, and what information to put on the organization's website.¹ Through solely Founder's direction, CO-1, CO-4, and CO-3 received direct economic benefit from the timeshare donations accepted by the organization. Almost all of the fees charged for the donated timeshares were paid directly to CO-1 or CO-4 for closing processing, and to CO-3 for appraisal reports. This benefit ultimately flowed to Founder as the owner of these three businesses.

Similar to the organization in Rev. Rul. 72-147, donating the proceeds of sales to other section 501(c)(3) charitable organizations does not qualify the organization for exemption under section 501(c)(3) because

¹ For example, at the time, the organization's website stated that a donor could receive a tax "credit." During a field audit on February 26, 20XX, the IRS agent asked why the website used the term "credit" instead of "deduction." The next day, Founder informed the agent that he changed this information of the website.

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of the preference provided to its related for-profit entities. *International Postgraduate Medical Foundation v. Commissioner* holds that “[w]here a for-profit organization benefits substantially from the manner in which the activities of a related [exempt] organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.”

Commerciality

The organization’s exempt purpose as stated in its application to the IRS was to provide financial support through contributions, grants, and other financial assistance to organizations operated exclusively for religious, charitable, scientific, literary or educational purposes and exempt from tax under section 501(c)(3). Based on such, the IRS granted the organization its tax exempt status in 20XX.

An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact, in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization’s character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii).

The IRS agent questions whether the main reason Founder is not a named officer or director of the organization is to bypass the requirement on the organization’s returns that he be identified as receiving compensation from any unrelated organization for services rendered to the organization. (Form 990, Part VII, section B, and Schedule J). The IRS agent also noted that the organization did not list, on its returns for 20XX and 20XX, any of Founder’s businesses as independent contractors who received over \$0 from the organization.

If an organization’s primary purpose is conducting a service that is commercial in nature, the service must directly accomplish an exempt purpose, regardless of whether the organization conducts the service on a nonprofit basis or as a benefit to the community. See Rev. Rul. 80-287 *supra*; see also *Better Business Bureau*, 326 U.S. at 283. There are multiple factors to consider when determining whether a primary purpose that has an ordinary commercial nature directly accomplishes an exempt purpose.

Some factors to consider when evaluating commerciality include the extent to which an organization receives charitable donations and whether the organization provides free or below cost services. See *Airlie Foundation*, 283 F. Supp. 2d at 63. Here, the proceeds of the sales, and the up front fees paid by donors, are the organization’s only source of revenue. The organization did not receive any charitable contributions, or any pledges of contributions, for the years under examination.

The organization’s activities included soliciting donated timeshares, selling the donated timeshares, and donating the net proceeds to a charity or charities. The organization contracted with related for-profit entities, CO-1, CO-4 and CO-2, to perform its soliciting, selling, and closing activities. The appraisal services, which the organization referred to timeshare donors, were controlled by a related for-profit entity, CO-3. In order to fully facilitate the business aspects of this operation, the organization shared the same facilities with CO-1, CO-2, and CO-3.

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CONCLUSION

The organization's soliciting and selling of timeshares is similar to a commercial real estate business and puts the organization in direct competition with other for-profit timeshare resale entities. ORG is not an organization described in section 501(c)(3) because its activities are mainly commercial in nature, and because its activities, as further described above, serve a substantial nonexempt purpose.