



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TEGE EO Examinations Mail Stop 4920 DAL
1100 Commerce St.
Dallas, Texas 75242

Date: November 22, 2017

Release Number: 201826015

Release Date: 6/29/2018

Tax Year Ending:

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Employee Telephone Number:
(Phone)
(Fax)

UIL: 501.03-00

CERTIFIED MAIL – RETURN RECEIPT

Dear _____ :

This is a final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Code section 501(c)(3) effective January 1, 20xx. Your determination letter dated June 24, 20xx is revoked.

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

Organizations described in section 501(c)(3) of the Internal Revenue Code and exempt from tax under section 501(a) must be both organized and operated exclusively for exempt purposes. You have failed to establish that you are operated exclusively for exempt purposes and that no part of your net earnings inure to the benefit of private shareholders or individuals.

You are not operated exclusively for charitable purposes within the meaning of Code section 501(c)(3) because your primary activity is providing _____ to the general public at rates that are competitive with other _____ clinics in the area. The operation of your clinic constitutes a trade or business regularly on within the meaning of section 513 of the Code and your clinic does not otherwise further your charitable purpose of preventing _____.

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20xx.

Organizations that are not exempt under section 501 generally are required to file federal income

tax returns and pay tax, where applicable. For further instructions, forms, and information, please visit www.irs.gov.

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, N.W.
Washington, D.C. 20217

U.S. Court of Federal Claims
717 Madison Place, N.W.
Washington, D.C. 20439

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

Processing of income tax returns and assessments of any taxes due will not be delayed if you file a petition for declaratory judgment under section 7428 of the Internal Revenue Code.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 1-877-777-4778.

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

Sincerely,

Maria Hooke
Director, EO Examinations

Enclosure:
Publication 892

IRS Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities
Exempt Organizations Examinations

Date:
July 14, 2017
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact / ID Number:

Employee ID:
Contact numbers:
Telephone:
Fax:
Manager's Name / ID Number:

Employee ID:
Manager's Contact Number:

Response Due Date:

Certified Mail-Return Receipt Requested

Dear :

Why you are receiving this letter

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

What you need to do if you agree

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

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

If we don't hear from you

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

Effect of revocation status

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

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

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

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

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

Contacting the Taxpayer Advocate Office is a taxpayer right

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

Internal Revenue Service
Office of the Taxpayer Advocate

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,

for Maria Hooke
Director, EO Examinations

Enclosures:
Report of Examination
Form 6018
Publication 892
Publication 3498

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

ISSUES:

1. Does _____ continue to qualify for tax exemption under Internal Revenue Code (Code) section 501(c)(3) due to their substantial nonexempt commercial purposes which privately benefit their founders?
2. Is _____ entitled to rely on IRS letter 1045 issued on June 24, 20xx, which determined that they were exempt from Federal income tax under section 501(c)(3) of the Code?

FACTS:

Organization Background

_____ was formed as a nonprofit corporation in the State of _____ on December 17, 20xx. The Articles of Incorporation state that _____ will operate for public charitable, educational and scientific uses and purposes within the meaning of Code section 501(c)(3). In furtherance of such purposes, the corporation shall have full power and authority:

- a) To fund, facilitate, and develop, conduct and operate activities and programs that prevent cruelty to and promote health and welfare to equine athletes, primarily through the early identification of stress fractures and the conduct of emergency and disaster relief services at regional athletic facilities;
- b) To provide experiential education and training to veterinarians, veterinarian students, other equine health care workers, horsemen and members of the general public pertaining to the correct diagnosis and appropriate treatment of injuries to equine athletes;
- c) To conduct scientific research in the field of equine exercise physiology and in particular, stress fractures of performance horses, and disseminate the findings of such research among members of the general public, the equine veterinarian community and other medical researchers, and in particular, those researchers at _____ ;
- d) For the purposes aforesaid, to acquire, maintain and operate lands, buildings, libraries, laboratories, research equipment and related facilities;
- e) To make gifts, grants, and contributions for any charitable, religious, scientific, literary or educational purpose within the meaning of Section 501(c)(3) of the Internal Revenue Code, and in particular, to _____ for the benefit of the _____

Upon dissolution, assets are to be distributed for exempt purposes described in Code section 501(c)(3) or to federal, state, or local government. None of the corporation's assets or net earnings will inure in whole or part to the benefit of any private individual except in furtherance of charitable, religious, educational, scientific or literary purposes.

_____ filed form 1023, Application for Recognition of Exemption under Code section 501(c)(3), on September 24, 20xx. Form 1023 stated that _____ purposes were to "...prevent cruelty to and promote the health and welfare of equines, primarily through the early identification of stress fractures and the

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

conduct of emergency and disaster relief services at a race track facility located in .”
 To accomplish their purposes, stated that they would conduct the following activities:

- Operate a facility with a nuclear bone scanner and magnetic resonance imaging (MRI) machine, capable of diagnosing normally latent injuries through nuclear scintigraphy;
- Provide veterinarians, veterinarian students, other equine health workers, horsemen and members of the general public with experiential education both at the facility and through regarding correct diagnosis and appropriate treatment of equine injuries;
- Make gifts, grants and contributions to to promote further medical research into equine physiology and stress fractures of performance horses;
- Conduct scientific research in the area of equine physiology and stress fractures in performance horses and to disseminate their findings to and the general public;

The Form 1023 stated that revenues would be derived from fees and donations. According to , fees were to be set well below fair market value with the intention of covering the costs associated with the services provided as well as an annual grant made to . Any situations where costs exceeded revenues from services provided were to be covered by donations. Further, stated that they would charge reduced diagnostic and clinic fees to owners of horses that participated in their scientific studies and that two of research projects would be funded through grants and donations. Volunteers, including members of board, would solicit donations and host fundraising events. Activities were to be conducted in the State of by their board of directors and paid staff.

listed the following officers on Form 1023:

- , President
- , Vice President
- , Secretary
- , Treasurer
- , Director

The only officer that shared the same address as the organization was . The bylaws were signed on January 1, 20xx, by and .

projected that more than half of their income in their first two years of operations would be derived from public contributions and approximately x% of gross revenues would be distributed to . The

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last four digits)	Year/Period ended 12/31/20xx

following budget was submitted with their Form 1023:

	20xx	20xx	20xx
REVENUE			
Gifts, Grants, Contributions	\$ X	\$ X	\$ X
Fees for services	\$ X	\$ X	\$ X
Total Revenue:	\$ X	\$ X	\$ X
EXPENSES			
Grants to	\$ X	\$ X	\$ X
Scanning Machine	\$ X	\$ X	\$ X
Computer	\$ X	\$ X	\$ X
Insurance	\$ X	\$ X	\$ X
Office Supplies	\$ X	\$ X	\$ X
Health Set-up fee	\$ X	\$ X	\$ X
Animal Stalls	\$ X	\$ X	\$ X
Drugs	\$ X	\$ X	\$ X
Radiology Fee	\$ X	\$ X	\$ X
Feed/Bedding	\$ X	\$ X	\$ X
Regular Waste Disposal	\$ X	\$ X	\$ X
Hazardous Waste Disposal	\$ X	\$ X	\$ X
General Manager	\$ X	\$ X	\$ X
Technician	\$ X	\$ X	\$ X
Stall Cleaner/Feeder	\$ X	\$ X	\$ X
Business and Occupation Tax	\$ X	\$ X	\$ X
Total Expenses:	\$ X	\$ X	\$ X

During the 1023 application process, submitted the following information regarding their educational and charitable programs:

1. **Educational Activities:** and will conduct at least x educational programs in 20xx. One program was provided to the with the purpose of informing the association members about and the potential benefits of advanced diagnostic imaging techniques for the welfare of horses. Another program was provided to the The purpose of this program was to update the veterinary community about the results of ongoing research with , a procedure used to treat lameness in performance horses.
2. **Scientific Research:** and will conduct research regarding , a new anti-inflammatory treatment for osteoarthritis in horses; Stress fractures in performance horses using nuclear scintigraphy; MRI evaluation of horses with

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last four digits)	Year/Period ended 12/31/20xx

clinical signs of Navicular Disease; Osteochondral Allografting for horses with joint defects. The research was to be conducted at . The purpose of the research was to evaluate the efficacy of the anti-inflammatory treatment in performance horses. Funding for the and Stress fracture research was projected to come from fees for services. Owners of horses participating in the research studies were to pay reduced diagnostic and clinic fees. With regard to the MRI Evaluation and Osteochondral Allografting research, those projects were set to be funded through donations and grants.

board was to approve all scientific research projects and research results were to be owned by and shared with the general public. Research was to be conducted at the Animal Hospital Facilities at and at

3. **Lease of facilities and purchase of equipment:** "[t]he facilities leased by and equipment to be purchased by [were to] allow the organization to conduct research, to provide low-cost diagnostic services to equines, and to present educational programs to veterinarians and the general public."

was issued a favorable letter of determination of tax exempt status under Code section 501(c)(3) on June 24, 20xx.

Reported Activities

mission as reported on their 20xx Form 990 included the following:

1. The prevention of cruelty to horses
2. Promote the health and welfare of horses primarily through early detection of stress fractures
3. The advancement of education to the veterinary medical community and the general public
4. The advancement of veterinary science through research and financial support provided to
5. The involvement of the clinic in stem cell research and interleukin therapy as well as education outreach
6. Establish an emergency preparedness plan to be implemented at

The 20xx Form 990 listed as President and and as Directors. signed Form 990 as President of every year since 20xx. has been listed on Form 990 as a director since 20xx.

reported that they operated a non-veterinary hospital out-patient surgical center and lameness examination referral service. In furtherance of their charitable purpose of promoting the health and welfare of horses, they provided the only local x-ray equipment for radiological reads of horse injuries which provided access to the treatment of horses in the local area to avoid long distance transfer to cross state facilities.

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last four digits)	Year/Period ended 12/31/20xx

sole source of revenue in 20xx was \$xxx,xxx in program service revenues derived from fees charged to horse owners for lameness exams, surgery, anesthesia, use of the surgical facility, ultrasound, and x-rays. Fees were determined by evaluating the usual and customary fees in the geographic market for these same services. \$xx,xxx was reported as compensation paid to their officers: and . In addition, \$xx,xxx was reported as fees paid to non-employees. incurred \$xx,xxx in expenses for medical supplies; \$xx,xxx in expenses for facility rental; \$x,xxx in other expenses; \$x,xxx in legal fees, malpractice insurance and depreciation; and \$x,xxx in equipment rental expenses. other expenses were composed of the following:

Merchant Chargeback	xxxx
Accounting Fees	xxxx
State Business & Operations Tax	xxxx
Banking Fees	xx
Licensing Fees	xx
Other	xxx
Total Miscellaneous Expenses	xxxx

assets consisted of \$xx,xxx in cash and depreciable assets (prefabricated barn and anesthesia equipment) with an adjusted basis of \$x,xxx. had no liabilities.

20xx Form 990, Schedule O, stated the following:

FORM 990, PART VI, SECTION B, LINE 15	IS PAID A FEE AS AN INDEPENDENT CONTRACTOR FOR ANESTHETIZING A HORSE THAT IS UNDERGOING SURGERY IS PAID A FEE FOR PERFORMING SURGERY AND A SEPARATE FEE (WHEN CALLED FOR) FOR LAMENESS EXAMS THE HORSE OWNER IS CHARGED A FEE BY THE CHARITY FOR THE SURGERY AND ANESTHESIA SERVICES AS WELL AS THE USE OF THE SURGICAL FACILITY THEY ARE ALSO CHARGED A SMALL FEE FOR ULTRA SOUNDS AND X-RAYS FEES FOR THE ABOVE SERVICES WERE DETERMINED BY EVALUATING THE USUAL AND CUSTOMARY FEES IN THE GEOGRAPHIC MARKET FOR THESE SAME SERVICES
---------------------------------------	--

Activities for the Year of Examination

In 20xx, primary activity was to provide veterinary services to the general public for a fee. Services were provided x-x days per month and included stem cell therapy, lameness treatments, and surgeries on performance horses. xx.x% of the horses treated by in 20xx were performance horses and x% were race horses. In 20xx, approximately xxx horses were treated by and only x of them were involved in scientific research studies (x.x%).

also had an emergency relief plan in place for to house horses in the case of a natural disaster. They allowed veterinary students, volunteers, horse owners, and others to come and observe their surgical procedures and they co-sponsored an Equine Anatomy Clinic with .

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last four digits)	Year/Period ended 12/31/20xx

Until December 20xx, _____ and _____ were listed by the _____ Secretary of State as officers. In December 20xx, _____ and _____ changed their positions on the board to that of "Governor", which is the equivalent of a director under _____ State law. As of 20xx, _____ and _____ removed themselves as _____ governors.

_____ paid the following related entities for their services in 20xx: _____ and _____ . In addition, they leased space and equipment from _____

_____ was incorporated in 19xx and is a private equine veterinary clinic co-owned and operated by _____. The corporation shares the same post office box as that of _____. _____ issued form 1099-MISC to _____ each year since 20xx to report payments made to _____ for his services as Veterinary Anesthesiologist. _____ has no website.

_____ was incorporated in 20xx and is a private equine veterinary clinic owned and operated by _____. _____ issued form 1099-MISC to _____ to report payments made to _____ for his services as Veterinary Surgeon. _____ has a website _____ which states that _____ provides lameness evaluations and treatment methods at two state of the art facilities: _____ in _____, and _____ in _____. _____ contact number is listed on the _____ website as (xxx) xxx-xxxx. According to *Reverse Look-up*, this phone number is registered to _____

_____ is a for-profit entity that subleases space and equipment to _____ at the _____ located at _____. The facility is owned by _____ dba "_____" . _____ is one of xx members of this organization and one of _____ workers, _____, serves as the director of clinics for _____. _____ is one of three doctors that has a permanent office at _____ facility. According to _____, _____ was originally recognized as a tax-exempt entity under Code section 501(c)(3), but, it later dissolved and is currently a for-profit cooperative organization that manages the hospital facility at _____. _____ pays \$xxx per day for rent and \$xxx-\$xxx per surgery performed to sublease their facility and equipment. (The lower rate of \$xxx is charged when _____ performs services on race horses.)

In 20xx, veterinary surgeries were performed by _____ served as the veterinary anesthesiologist during the surgeries. In addition to _____ officers, the clinic paid three veterinary technicians, an office worker, and a scheduler for their services in 20xx. The clinic operated 1-2 days every other week from 9:00 a.m. until the final surgery was completed. Approximately xx.x% of the horses treated by _____ were referrals from _____ and _____. The bulk of _____ referrals came from other veterinarians. According to _____, _____ leased the following equipment to _____:

Equipment	Lease Rate Charged Per Use
Radiograph	\$xx
Ultrasound	\$xx

_____ has never had a sliding scale fee schedule for their clients based on their ability to pay. Their fees are set to cover costs, but, not to make a profit. According to _____, they had to re-evaluate their fees periodically due to rising costs and unexpected expenses. To ensure that they operated on a cost-basis, _____ periodically raised their fees and consolidated their expenses. Beginning in 20xx, _____ considered dissolving the non-profit corporation and setting up a for-profit limited liability corporation. _____ board

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last four digits)	Year/Period ended 12/31/20xx

meeting minutes from 20xx reference "profit vs nonprofit" status and the need to "find out competitor's prices and raise fees. During the initial interview conducted March 1, 20xx, representative, indicated that no donations had been received since 20xx and was experiencing cash flow problems. As a result, he advised them to consolidate expenses and raise fees such that they are similar to those charged by , a for-profit entity located in

Through a Google search, Agent obtained copies of 20xx invoices issued by to for veterinary services. The invoices included \$xx radiograph fees and \$xxx ultrasound fees. 20xx fee schedule and copies of their 20xx invoices included the same fees for radiograph and ultrasound services. Copies of the 20xx invoices issued by to were presented to during the audit conducted December 21, 20xx. Copies of these documents are attached as Exhibit A.

In an effort to obtain additional information with regard to usual and customary fees charged for veterinary services in the area, the Agent contacted two local clinics in the area and indicated that she was pricing lameness treatments for her horse. She did not disclose who she was or any other identifying information during the calls. The results of these calls are outlined below:

VETERINARY FACILITY	FEES CHARGED FOR VETERINARY MEDICAL PROCEDURES IN 20XX			
	Ultrasound Fee*	Lameness Exam Fee	Radiographs Fee	Stem Cell Therapy
	\$ xxx.xx	\$ xxx.xx	\$ xx.xx	\$ x,xxx.xx
	\$ xxx.xx	\$ Unknown	\$ xx.xx	Unknown
VETERINARY FACILITY	FEES CHARGED FOR VETERINARY MEDICAL PROCEDURES BY LOCAL CLINICS IN 20XX			
	Ultrasound Fee*	Lameness Exam Fee	Radiographs Fee	Stem Cell Therapy
	\$ xxx.xx	\$xxx-\$xxx	\$ xx.xx	unknown
	\$ xxx.xx	\$ xxx	xx**	\$ x,xxx.xx
*Ultrasound fees vary depending on the location on the area scanned				
**\$xx for first radiography and \$xx for each additional radiograph				

20xx bank statements reconciled to the 990 return. Any variances were deemed de minimis. Payments to officers and related for-profit entities are outlined below:

Payee	Amount	Purpose
	\$xx,xxx	Payments to officer for services performed as a veterinary anesthesiologist
	\$x,xxx	Rental of equipment
	\$xx,xxx	Payments to officer for services performed as a veterinary surgeon.
	\$xx,xxx	Rental of equipment and surgical space.

TAX LAW:

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

Section 501(c)(3) of the Code 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.

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for-profit shall not be exempt from taxation under Code section 501 on the grounds that all of its profits are payable to one or more organizations exempt under section 501.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c), which includes section 501(c)(3).

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 of the Code.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (Regulations) provides that, in order to be exempt as an organization described in Code 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.

Section 1.501(c)(3)-1(c)(1) of the Regulations 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.

Section 1.501(c)(3)-1(d)(1)(i)(g) of the Regulations provides that an organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for the prevention of cruelty to children or animals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that to be charitable, an organization must serve a public rather than a private interest. The organization must demonstrate 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. The private benefit restriction is not limited to benefits provided to insiders. Rather, the restriction applies to benefits provided to any individual, whether or not the individual is in a position to control or influence the organization. The private benefit restriction operates against all parties who receive a benefit not accorded the public as a whole.

Section 1.513-1(a) of the Regulations provides that gross income of an exempt organization subject to tax imposed by section 511 of the Code is includible in the computation of unrelated business taxable income if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

Section 1.513-1(b) of the Regulations provides that, in general, any activity of an exempt organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute "trade or business" within the meaning of section 162 of the Code is a trade or business for purposes of Code sections 511-513. The Regulation further provides that the term "trade or business" generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(d)(1) of the Regulations provides that, in general, gross income derives from "unrelated trade or business," within the meaning of section 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question – the activities, that is, of producing or distributing the goods or performing the services involved – and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the Regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes, and is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services is not derived from the conduct of a related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

A number of activities are classified as charitable because they are beneficial to the community. See IV A.Scott, *The Law of Trusts* 374(3ed. 1967); *Restatement (Second) of Trusts* 374 (1959). Among such activities are those described under the general heading, "Relief of Animals". The American Law is summarized as follows: A trust to prevent or alleviate the suffering of animals is charitable. Thus, a trust for the prevention of cruelty to animals, a trust to establish a home for animals is charitable, or a trust for the prevention or cure or treatment of diseases or of injuries to animals is charitable.

Rev. Rul. 72-369, 1972-2 C.B. 245, provides that an organization formed to provide managerial and consulting services to unrelated section 501(c)(3) organizations does not qualify for tax exemption under section 501(c)(3). The organization entered into agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The ruling states that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for-profit. The fact that the services in this case were provided at cost and solely to exempt organizations was not sufficient to characterize them as charitable.

Rev. Rul. 73-127, 1973-1 C.B. 221, states that a nonprofit organization that operates a cut-price retail grocery outlet and allocates a small portion of its earnings to provide on-the-job training to the unemployed does not qualify for exemption from income tax.

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

Rev. Rul. 73-587, 1973-2 C.B. 129, states that a nonprofit organization formed to prevent the overbreeding of cats and dogs by providing funds to pet owners who wish to have their pets spayed or neutered but cannot afford the cost of such operations qualifies for exemption under section 501(c)(3) of the Code.

Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), held that the presence of a single nonexempt purpose, if substantial in nature, will preclude tax exemption under section 501(c)(3) of the Code.

In Living Faith, Inc. v. Commissioner, 60 T.C.M., 710, 713 (1990), aff'd 950 F.2d 365 (7th Cir. 1991) the Court of Appeals upheld a Tax Court decision, CCH T.C. Memo 1990-484, that an organization operating restaurants and health food stores in a manner consistent with the doctrines of the Seventh Day Adventist Church did not qualify for exemption under section 501(c)(3) of the Code. The court found substantial evidence to support a conclusion that the organization's activities furthered a substantial business purpose, including (a) the organization's operations were presumptively commercial, (b) the organization competed directly with other restaurants and food stores, (c) the organization used profit-making prices formulas common in the retail food industry, (d) the organization engaged in a substantial amount of advertising, (e) the organization's hours of operation were competitive with other commercial enterprises, and (f) the organization lacked plans to solicit

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court held that the organization did not qualify for tax exemption under section 501(c)(3) of the Code. In this case, the B.S.W. Group, Inc. was formed for the purpose of providing consulting services primarily in the area of health, housing, vocational skills and cooperative management. The consulting clients were tax-exempt organizations. Consulting services were provided at or close to cost, however, fees were sufficiently high to enable B.S.W. to retain at least a "nominal" administrative fee. The Internal Revenue Service denied exemption to the organization under section 501(c)(3) because the organization did not meet the operational test of section 1.501(c)(3)-1(c) of the Regulations, since it was primarily engaged in an activity which is characteristic of a trade or business. The Court agreed with the Service's adverse ruling, noting that B.S.W.'s activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for-profit.

In Est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), several for-profit Est organizations exerted significant indirect control over Est of Hawaii, a nonprofit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the nonprofit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion that Est of Hawaii did not qualify as an organization described in section 501(c)(3) of the Code.

In Partners in Charity, Inc. v. Commissioner, 141 T.C. (2013), the court held that the organization was not described in section 501(c)(3) of the Code because their down-payment assistance program was not operated for a charitable purpose and they were engaged in substantial commercial activities that did not further an exempt purpose. In arriving at their decision, the court considered the following:

When an organization engages in substantial fee-for-service or other business activities, the regulations under section 501(c)(3) provide two overlapping standards to consider: (1) whether the organization was "organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513", 26 C.F.R. sec. 1.501(c)(3)-1(e), and (2) whether the activity

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last four digits)	Year/Period ended 12/31/20xx

fails to further the organization's exempt purpose, 26 C.F.R. sec. 1.501(c)3)-1(c)(1). If the answer to either of those is yes, then the organization is not operated exclusively for an exempt purpose. PIC fails under both standards.

We are to "consider all the circumstances" in determining whether PIC is operated for the primary purpose of carrying on an unrelated trade or business or whether PIC's fee-generating activity furthered a charitable purpose. Important factors indicating a nonexempt commercial purpose include "the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits".

Ultimately, the court concluded that Partners in Charity, Inc.'s (PIC) "primary purpose was to broker as many transactions as possible and thus to generate significant net profits, regardless of whether the transactions achieved a charitable end." Accordingly, they were unable to conclude the PIC was operated for charitable purposes within the meaning of Code section 501(c)(3).

Government's Position:

Tax exemption under Code section 501(c)(3) should be revoked because is conducting commercial activities regularly carried on which privately benefit and their related for-profit entities, , and was originally granted tax exemption under section 501(c)(3) of the Code based on the presumption that they would prevent cruelty to animals and advance education. They proposed to accomplish these purposes by providing experiential education; conducting scientific research in the public interest; making charitable contributions to ; providing a disaster relief program for ; and providing veterinary services at cost with reduced rates for those participating in research studies with excess costs covered by donations.

failed to operate in the charitable manner proposed. Rather than preventing cruelty to animals and educating the public, they are providing lameness treatments to horses on a fee for service basis which privately benefits their founders. Providing veterinary services to the general public on a cost basis is not substantially related to the prevention of cruelty to animals and does not serve a charitable purpose within the meaning of section 501(c)(3) of the Code. In the year under audit, less than x% of the horses that treated participated in clinical research studies; no charitable contributions were made to ; and conducted very limited educational programs. primary activity was operating a veterinary clinic for the treatment of lameness in performance horses. was funded entirely through fees for veterinary services and operated in direct competition with other equine clinics in the area which provided similar services on a for-profit basis. As a result, does not continue to qualify for tax exemption under section 501(c)(3) of the Code.

The commercial nature of activities are evident in the schedule O to the 20xx Form 990, which stated that, revenues were derived from surgery and lameness examinations on horses and that the fees for these services were set by evaluating the usual and customary fees in the geographic market for these same services. The competitive nature of fees was confirmed by their representative in the initial interview, their 20xx board meeting minutes, the agent's own analysis of commercial fees for similar services in the area, and copies of 20xx invoices that show the same charges for ultrasound and radiographs on horses. Finally, has stated that they do not offer their services for free or at reduced rates to clients who cannot afford to pay. simply provided their services to the general public for a fee in a manner which is indistinguishable from other for-profit entities in the area. Based on the aforementioned facts, is operated for the primary purpose of providing veterinary services for horses

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last four digits)	Year/Period ended 12/31/20xx

on a fee for service basis, which constitutes the operation of a trade or business for-profit within the meaning of Code section 502(a) and section 1.513-1(b) of the Regulations. Ultimately, is not tax exempt under Code section 501(c)(3) because they lack the donative element necessary to classify their activities as charitable.

Further, operations privately benefit their founders, and , and the for-profit corporations that they have ownership interests in: , and . Since incorporating in 20xx, and have effectively controlled board of directors and they have been the only veterinarians that have provided veterinary services *on a consistent basis* to the organization. private corporation, , shares the same address as website: , advertises that he performs services at the facility and instructs potential clients to contact him to schedule an appointment by contacting located in . The phone number listed on website to contact is registered to indicated in the interview conducted March 1, 20xx, that and are paid through their private practices and that they charge the same standard fee as that of their related for-profit entities.

With regard to , is one of founding members. He is one of xx equine veterinarians that practice at on a full-time or part-time basis and he is one of three doctors that have a permanent office at facility. is currently serving as Vice President of this for-profit entity, though he states that he was not an officer in 20xx. Director of Clinics also provides Vet Tech services to owns equipment and leases space from . The equipment and facility space is then subleased to on a per surgery fee for service basis (\$xxx per day for rent and \$xxx-xxx for each surgery performed). Owners of race horses pay the reduced fee of \$xxx. In 20xx, payments to the founders and their related for-profit entities, including , totaled xx% of expenses. No documentation was submitted to explain how selected , and the related for-profit entities that they have ownership interests in: , and did not indicate that they conducted a competitive bidding process or other objective means of selecting these particular individuals nor their related for-profit entities to provide services to

For all intents and purposes, acts as a shell organization through which charitable assets are diverted to and the x related for-profit entities that they have ownership interests in. The factors that indicate shell status are as follows:

- Thin capitalization per balance sheet: assets are diverted to three for-profit entities through related party transactions.
- Minimal corporate assets: leases the majority of its equipment from and . The only assets listed on the balance sheet are \$xx,xxx in cash and a prefabricated barn and anesthesia equipment with a book value of \$x,xxx.
- The use of the same office or business location: , and all operate out of the same facility as .

Pursuant to sections 1.501(c)(3)-1(c)(2), 1.501(c)(3)-1(d)(1)(ii), and 1.513-1(a) of the Regulations, tax exemption under section 501(c)(3) should be revoked because (1) they serve the private interests of

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

their founders rather than the public interests of the community and (2) they are operating a trade or business ordinarily carried on for-profit the conduct of which is not substantially related to the performance of exempt functions.

Like the organization described in Rev. Rul. 72-369, primary activity is providing commercial services on a regular basis to the public at cost. The fact that the services are provided at cost is not sufficient to characterize them as charitable. As a result, is not described in section 501(c)(3) of the Code because they lack the donative element necessary to establish their activities as charitable.

is similar to the organization described in Rev. Rul. 73-127 because they also provide commercial services for a fee to the community. The fact that they allow for observation of their veterinary services by outside individuals and groups; they have established a relief plan for ; and x of the horses treated in 20xx participated in clinical trials for stem cell treatments does not change the commercial nature of activities.

is dissimilar to the organization described in Rev. Rul. 73-587 which provided funds to low-income pet owners to cover the costs to have their pets spayed or neutered. Unlike the organization described in the ruling, works on a fee for service basis to provide treatments for lameness in horses exclusively to clients with the ability to pay. does not take into account the financial means of their potential clients such that their services would be provided at a free or reduced cost. They operate in direct competition with other for-profit equine clinics in their area. As a result, is not preventing cruelty to animals within the meaning of section 501(c)(3).

does not meet the requirements of section 1.501(c)(3)-1(c)(1) of the Regulations because more than an insubstantial amount of their activities are in furtherance of non-exempt purposes. They are similar to the organization described in Better Business Bureau of Washington, D.C. Inc. v. United States, because they operate for the substantial commercial purpose of providing veterinary services for a fee to the general public. This substantial non-exempt purpose destroys claim for exemption regardless of the number or importance of their truly exempt purposes.

Similar to B.S.W. Group, Inc., primary purpose is the conduct of an ordinary commercial enterprise which is in competition with other for-profit equine clinics in their area. is funded entirely through fees and does not provide discounted rates based on an individual's ability to pay. Fees are set high enough to recoup all projected costs and to retain a small profit. Their veterinary services resemble a trade or business that is ordinarily carried on by commercial ventures organized for-profit. As a result, tax exemption under section 501(c)(3) is precluded.

is similar to Living Faith, Inc. because they are operating as a business regularly carried on which is in direct competition with other equine clinics in the area. Like Living Faith, Inc., lacks charitable contributions and is unable to distinguish itself from for-profit equine clinics that provide similar services.

In order for private benefit to be present it is not required that payments for goods or services to related for-profit entities be unreasonable or exceed fair market value. In Est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), the Tax Court stated:

Nor can we agree with petitioner that the critical inquiry is whether the payments made to International were reasonable or excessive. Regardless of whether the payments made by

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

petitioner to International were excessive, International and EST, Inc., benefited substantially from the operation of petitioner.

Like Est of Hawaii, Inc., no longer qualifies for tax exemption under Code section 501(c)(3) because and their related for-profit entities: , , and benefited substantially from their operations.

Similar to Partners in Charity, Inc. v. Commissioner, 141 T.C. (2013), tax exemption under section 501(c)(3) of the Code should be revoked because they are engaged in substantial commercial activities that do not further an exempt purpose. Like Partners in Charity, Inc., primary activity is to operate an equine clinic which constitutes an unrelated trade or business defined in section 513 of the Code. The clinic does not further the organization's exempt purpose of preventing cruelty to animals within the meaning of section 501(c)(3) of the Code. As a result, no longer continues to qualify for tax exempt status under Code section 501(c)(3).

Section 12.03(3) of Revenue Procedure 2017-5 states that the revocation or modification of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented in an application for recognition of exemption. effective date of revocation will be retroactive to January 1, 20xx, because they operated in a manner materially different from that originally represented on Form 1023. stated on Form 1023 that they intended to "...fund, facilitate, develop, conduct, and operate activities and programs that prevent cruelty to and promote the health and welfare of equines, primarily through the early identification of stress fractures and the conduct of emergency disaster relief services..." at Form 1023 proposes that they will : set their fees at cost with excess costs covered by donations; conduct scientific research; distribute approximately x% of gross revenues to ; and conduct educational activities. The budget provided on Form 1023 projected substantial donations in their first year of operations, however, has not received gifts, grants or donations since 20xx. 20xx Form 990 states that horse owners are charged a fee for surgery, anesthesia services, and use of the surgical facility. Fees were "...determined by evaluating the usual and customary fees in the geographic market for these same services." has confirmed that they do not offer a sliding scale fee schedule based on the horse owner's ability to pay. Rather, their fees are set to cover costs and are lower than what they believe other for-profit clinics in the area are charging for similar services. Finally, in the year under audit, limited educational activities were conducted, no charitable contributions were distributed to and only x.x% of the horses treated by participated in scientific research studies.

Conclusion:

is not operated exclusively for charitable purposes within the meaning of Code section 501(c)(3) because their primary activity is providing veterinary services to the general public at rates that are competitive with other equine clinics in the area. The operation of equine clinic constitutes a trade or business regularly carried on within the meaning of section 513 of the Code and the clinic does not otherwise further charitable purpose of preventing cruelty to animals. commercial activities privately benefit founders and their related for-profit entities , , and within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the Regulations. At the time of initial Form 1023 application, it is possible that there were only a handful of equine clinics providing the veterinary services that they proposed to provide, however, there are now numerous clinics in the area that provide the same types of treatments for horses on a for-profit basis. operates in direct competition with these clinics, which results in an unfair advantage to , their founders, and their related for-profit entities: ,

Form 886-A (May 2017)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number <i>(last four digits)</i>	Year/Period ended 12/31/20xx

, and . Based on the aforementioned facts, tax exemption under Code section 501(c)(3) should be revoked effective January 1, 20xx.