

Internal Revenue Service

Appeals Office
4330 Watt Avenue SA 7890
Sacramento, CA 95821-7012

Release Number: 201902032

Release Date: 1/11/2019

Date: October 18, 2018

Department of the Treasury

Employer Identification Number:

Person to Contact:

Employee ID Number:

Tel:

Fax:

UIL: 0501.03-08

Certified Mail

Dear

This is a final adverse 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 section 501(c)(3) of the Code.

The favorable determination letter to you dated January 17, 2014 is hereby revoked, and you are no longer exempt under section 501(a) of the Code effective January 15,

We made the adverse determination for the following reasons:

You were not operated exclusively for charitable or other exempt purposes as required by section 501(c)(3) of the Code. Your net earnings inured to the benefit of private shareholders or individuals, such as your officers or founders. In addition, you operated in substantial part for the benefit of private rather than public interests, such as for the benefit of your officers and founders, an activity which does not further charitable or other exempt purposes.

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

You're required to file federal income tax returns on Forms 1120, U.S. Corporation Income Tax Return. Mail your form to the appropriate Internal Revenue Service Center per the form's instructions. You can get forms and instructions by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

You've agreed to waive your right to contest this determination under the declaratory judgment provisions of Section 7428 of the Code.

We'll make this letter and the proposed adverse determination letter available for public inspection under Section 6110 of the Code after deleting certain identifying information. We 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 have questions, contact the person at the top of this letter.

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892

cc:



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities Division

Date: August 1, 2007

Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:

Phone Number:

Fax Number:

Manager's name / ID number:

Manager's contact number:

Phone 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
1222 Spruce Street Stop 1005 STL
St. Louis, Mo. 63103

314-612-4610

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

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| Form 886A | Department of the Treasury - Internal Revenue Service | Schedule No. or Exhibit |
| Explanation of Items | | |
| Name of Taxpayer | | Year/Period Ended December 31, 20XX |

ISSUE(S):

Whether (" ") continues to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code.

FACTS:

The was granted exemption under 501(c)(3) and 509(a)(2) of the Internal Revenue Code per a determination letter issued January 17, 20XX with effective date of January 15, 20XX. The organization's purpose per its bylaws is to "Provide and promote quality, affordable, gymnastics instruction, education, and development." president is (is her spouse).

operates in the space formerly occupied by was a for-profit entity controlled by and . The building from which operates is also owned by and through a Limited Liability Company called . On December 22, 20XX suddenly shut down and opened in its place. started with funds which came from a check written from bank account, and deposited into the account (\$0 of the \$0). maintains the same staff, equipment, and customers. Of the staff, and her daughter continue to receive wages from , and were reported on a W-2. continued to accept checks made out to maintains control of , as all financial decisions were made by her or her spouse. The board of was comprised of , her daughter, and two former employees of ; thus the board is not independent.

The agent reviewed the organization's financial records for 20XX, and noticed numerous payments made to an charge card for a total of \$0 that were paid from bank account. The charge card was listed under the name and and . There were no other cards issued to any other person. The agent requested detail from the Power-of-Attorney regarding which transactions were for exempt purposes made on the Card. The agent received the statements, and the agent made determinations of which transactions were for . The agent also received journal entries relating to the charges. The agent was unable to match the entries to the statements. Some of the entries were sums of the transactions for the month, debit into expense accounts and credit liability. Others entries did not add up to what was on the statements.

The agent went through the statements and summed up all the transactions the agent determined were for use; those transactions totaled \$0. The agent went through those and was able to identify \$0 of the transactions that were for purposes, and \$0 that appeared to be personal. The agent requested additional detail regarding the \$0, and from that, was able to establish an additional \$0 for purposes. In summary:

| | |
|---|-----|
| Expenditures made by or on card: | \$0 |
| Amounts identified for exempt operating purposes: | \$0 |
| Amounts unsubstantiated and deemed personal: | \$0 |
| | \$0 |

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While examining the financial records for 20XX, the agent discovered that the customer credit card payment transactions were no longer being deposited into the organization's checking account. The agent requested further information on where these deposits were going, and the organization's Power-of-Attorney presented the agent with bank statements from . These statements were for personal checking account. The agent analyzed the bank statements and identified the credit card deposits from customers. The credit card deposits totaled \$0. There were also processing charges for the credit card transactions, which amounted to \$0. There were transfers made back to the organization's bank account, which totaled \$0. The balance of \$0 remained in personal bank account. In summary:

| | | |
|------------------------------------|------------------------|----------|
| Customer credit card deposits into | personal bank account: | \$0 |
| Credit card processing fees: | | <u>0</u> |
| Net deposits: | | \$0 |
| Less: Amounts transferred back to | : | \$0 |
| Amount retained by | : | \$0 |

LAW:

§ 1.501(c)(3)-1 Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Operational Test:

- 1) *Primary activities.* An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.
- 2) *Distribution of earnings.* An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treasury Regulations section 1.501(c)(3)-1(d)(1)(ii) states that 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 inurement and private benefit issues. While it is difficult to prove a negative, the organization is certainly in a better position than the Service to know the detailed facts surrounding its formation and operation. Therefore, in an exemption application case the organization is required to furnish the Service with the documents setting forth its purposes and rules of operation as well as a detailed explanation of its operations. See Rev. Proc. 84-46, 1984-1 C.B. 541.

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Treasury Regulations section 1.62-2(c)(2) (c) Reimbursement or other expense allowance arrangement— (1) Defined. For purposes of §§ 1.62-1, 1.62-1T, and 1.62-2, the phrase “reimbursement or other expense allowance arrangement” means an arrangement that meets the requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section. A payor may have more than one arrangement with respect to a particular employee, depending on the facts and circumstances. See paragraph (d)(2) of this section (payor treated as having two arrangements under certain circumstances). (2) Accountable plans— (i) In general. Except as provided in paragraph (c)(2)(ii) of this section, if an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, all amounts paid under the arrangement are treated as paid under an “accountable plan.”

Treasury Regulations section 1.274-5T(2)(c)(i) *In general.* —To meet the “adequate records” requirements of section 274(d), a taxpayer shall maintain an account book, diary, log, statement of expense, trip sheets, or similar record, and documentary evidence which, in combination, are sufficient to establish each element of an expenditure or use specified in paragraph (b) of this section. It is not necessary to record information in an account book, diary, log, statement of expense, trip sheet, or similar record which duplicates information reflected on a receipt so long as the account book, etc., and receipt complement each other in an orderly manner.

Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969), cert. den., 397 U.S. 1009 (1970), an organization argued that it had paid its founder for expenses incurred in connection with his services, made reimbursements to him for expenditures on its behalf, and made some payments to him as repayments on a loan. The organization could produce no evidence of contractual agreements for services, documents evidencing indebtedness, or any explanation regarding the purposes for which expenses had been incurred.

Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the presence of private benefit, if substantial in nature, will destroy the exemption regardless of an organization’s other charitable purpose or activities.

John Marshall Law School and John Marshall University v. United States, 82-2 USTC 9514 (Ct. Cl. 981), the Service revoked the exemption of both organization on the ground that part of the net earnings of the organization inured to the benefit of private shareholders or individuals.

GOVERNMENT POSITION:

In accordance with the above-cited provisions of the Code and Regulations under 501(c)(3), Treasury Regulation §1.501(c)(3), and court cases listed above, the is not the type of an organization for which an exemption from tax was intended. Although the activities of were within the definition of the Regulations, the conduct of the organization was for the benefit of the owners.

Distribution of earnings – An organization is not operated exclusively for exempt purpose if it provides either benefits to insiders, known as inurement, or substantial, non-incident benefits to any private individual. Regs. 1.501(c)(3)-1(d)(1)(ii) states that 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 inurement and private benefit issues. In this case, the agent

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identified questionable transactions on the _____ account that were not substantiated as being for an exempt purpose. These transactions were personal in nature, and for the benefit of _____ and _____. These payments totaled \$0 for 20XX. The agent also identified credit card transactions that were deposited into _____ personal checking account. The net deposits after subtracting charges and transfers are \$0. These payments were not reported as wages or other compensation.

TAXPAYER POSITION:

The organization wishes to continue as an 501(c)(3) exempt organization. The organization stated it is willing to make the necessary changes to retain exemption.

CONCLUSION:

In accordance with the above-cited provisions of the Code and Regulations under 501(c)(3), Treasury Regulation §1.501(c)(3), and court cases listed above, _____ is not the type of an organization for which an exemption from tax was intended. When _____ began its existence in January of 20XX, it didn't change its nature as a private enterprise, or ownership, from the prior entity of _____. The Board of Directors is the same as the prior business. _____ is being operated for the benefit of, and under the control of the _____. The organization provided significant private benefits to the founder, _____, and her spouse, _____, by the fact that _____ paid for _____ and _____ card purchases, and organization funds were diverted into _____ personal checking account. The organization currently leases the building and equipment from the _____. _____ continues to teach lessons at the organization, and still has access to the organization's checking account. Due to this relationship, and private benefits uncovered, the agent recommends revocation of the organization's exempt status as of January 15, 20XX.

Form 1120, U. S. Corporation Income Tax Return, should be filed for 20XX and 20XX, and each year thereafter as long as the organization remains subject to federal income tax. If the proposed revocation becomes final, appropriate state officials will be notified of such action in accordance with section 6104(c) of the Internal Revenue Code.