



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

A= Taxpayer
B= Employer Identification Number
C= Person to Contact
D= Identification Number
E= Telephone Number
F= Location 1
G= Date 1
H= Date 2
I= Tax Court
J= Taxpayer Advocate's Office

Number: **200623070**
Release Date: 6/9/2006

UIL: 501.03-05

Date: October 24, 2005

Taxpayer Identification Number:

B

Person to Contact:

C

Identification Number:

D

Contact Telephone Number:

E

LAST DATE FOR FILING A PLEADING
WITH THE TAX COURT, THE CLAIMS
COURT, OR THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT
F: _____

Dear Sir or Madam:

This is a Final Adverse Determination Letter as to **A** exempt status under section 501(c)(3) of the Internal Revenue Code.

Recognition of your exemption from Federal Income Tax as an organization described in Internal Revenue Code section 501(c)(3) is retroactively revoked effective **G** for the following reasons:

You have not demonstrated that you are operated exclusively for charitable, educational, or other exempt purposes. You operate for the benefit of private interests and your net earnings inured to the benefit of private shareholders or individuals.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending H, and for all years thereafter.

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

If you decide to contest this determination in court, you must file a pleading seeking a declaratory judgment in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia before the 91st day after the date this final determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing pleadings for declaratory judgments and refer to the enclosed Publication 892. You may write to these courts at the following addresses:

I

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling (615) 250-5000, or writing to:

J

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

R.C. Johnson
Director, EO Examinations

Enclosure:
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear Sir or Madam:

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)
Catalog Number 34809F

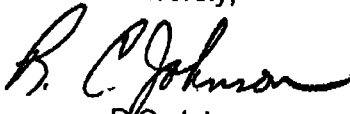
If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

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

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,



R.C. Johnson
Director EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

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

ISSUE

Is revocation of exempt status appropriate due to the purchase of assets, costing in and in , for the private benefit and personal use of the then President ?

FACTS

(herein after called) was formed on , as a not-for-profit organization to rehabilitate and re-sell housing in the City of had directors and one President on the Board of Directors, as follows:

President, Director
 Chairman of the Board of Directors, Director
 Director, Director
 Director, Director

Employees identified included as executive director. And two project managers, and CPA, provided accounting services.

received grant funds from the Federal Department of Housing and Urban Development through the City of to subsidize rehabilitation of housing and resale to residents of the City of . The City's records show that received for the rehabilitation of homes, for infill, and for administration. Infill is described as the purchase of vacant lots and construction of new homes thereon.

accounting records indicate purchase and rehabilitation of residences at a total cost of , which were sold for a total of . accounting records indicate costs to rehabilitate at least partially 8 additional properties at a cost of . When sold a residence, it deposited sales proceeds in one of its bank accounts. These proceeds were available to use for rehabilitating other residences, for administrative costs, or other purposes.

operated from a leased office at . From its inception through accounting records report cash expenditures for administrative services totaling

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The City of _____ Division reviewed financial records of _____ on _____ and conducted a follow-up review on _____ issued a finding that _____ lacked documentation to support income eligibility of clients. _____ also reported its concerns about incomplete and disorganized client files, the need for documentation to support match funds and absence of detailed statements of receipts and disbursements by property and for administrative costs. _____ reported that _____ had failed to complete an external audit of its financial statements, as required under its contract with the City and pointed this out in a letter to _____ dated _____

Under terms of its contract with the City, _____ was required to provide audited financial statements from its inception through _____, no later than _____. The City did not receive audited financial statements from _____ at that point or subsequently. On _____ the City notified _____ that it had suspended distribution of grant funds pending receipt of audited financial statements. _____, Deputy City Manager for the _____ contacted _____ on _____ was engaged by the City on _____, to conduct an initial assessment of the condition of _____ financial records. On _____, the City specified additional procedures for _____ perform in order to complete their investigation.

_____ filed Federal Form 990 "Return of Organization Exempt from Income Tax" for the period ended _____. No other such forms were filed for subsequent periods.

On _____, _____ President of _____ was arrested by _____ Police when an undercover officer saw him exposing himself inside his vehicle at _____. Shortly after the arrest, the Board of Directors voted to remove _____ as President of the organization for moral reasons and for misappropriations of organizational funds.

On _____, _____ personnel met with _____ at _____ offices. _____ provided access to the office of _____ and described the general layout of records contained in the office. _____, with the assistance of City of _____ personnel, collected all available documents relating to the operations of _____ and assembled the collection in approximately 22 boxes. City of _____ employees later that week collected the boxes from _____ office and stored them with the City record custodian. (The boxes were subsequently turned over to attorney's from the Department of Justice and are currently under their control)

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, Chairman of Board of Directors, participated voluntarily in an interview by on provided with useful information that he had gathered concerning operation, particularly with respect to vehicles purchased by A transcript of findings is at workpaper through

Imaged hard drives of the desktop and laptop computers in office.

CPA, provided copies of the QuickBooks electronic records that he had prepared and maintained for recovered and copied bank statements from the office of also found undeposited payroll checks totaling

The City of provided with contracts with and folders submitted to the City by containing receipts for expenditures related to each property rehabilitated, documents, correspondence, and analysis prepared by the City of staff during inspections conducted at , and e-mail and other correspondence related to

provided copies of all their work papers and copies of other information retained in their audit files concerning the above referenced investigation into the assessment of the condition of financial records to the Internal Revenue Service on

Subsequent to the arrest of on and prior to , Director and Director resigned from the Board of Directors of

On , the remaining members of the Board of Directors voted three (3) to one (1) to, "...dissolve the Board of Directors by unanimous vote and according to our contract with the City of do relinquish all assets belonging to and pertaining to to the City of

was the lone Board member voting against the dissolution of the Board. According to the City of attorney no formal documentation for the dissolution of has been filed with the state of

purchased assets totaling in as follows:

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On _____ issued a teller check for _____ to _____ for the purchase of a _____ . Sales tax of _____ , registration fees of _____ , Documentary fee _____ and trade payoff tax _____ brought the purchase price to _____ .(workpaper _____ . Title for this automobile was found in the _____ office listing _____ as the purchaser.(workpapers _____ through _____ . A review of the general ledger showed the purchase price being recorded as a cost of sales in account "Materials". (workpaper _____

purchased assets totaling _____ , in _____ as follows:

On _____ issued check number _____ to _____ for _____ (workpaper _____ . Instructed the accountant to charge the expense to the _____ property as machinery costs.(workpaper _____ . A review of the general ledger for _____ showed the cost was entered into the fixed asset account "Machinery and Equipment".(workpaper _____ . The _____ review of _____ records and a separate investigation by _____ Chairman of The Board for _____ revealed that the purchase was for a _____ boat. Title for this boat has not been located.

On _____ issued check number _____ to _____ for _____ had in their files an invoice with a _____ header for the cut out and removal of a chain link fence, the removal of a wood fence, the cutting down and removal of three trees and the leveling of a back yard. _____ stands for _____ (workpapers through _____ . The invoice was actually for the purchase of a _____ . A review of the certificate of title, found in _____ office, showed _____ as the purchaser of the _____ . (workpaper _____ through _____ . A review of the general ledger for _____ showed the cost of the _____ being charged to the _____ property as a cost of goods sold in account "Cost - Subcontract". (workpaper _____

On _____ issued check number _____ for _____ to _____ father. The check was recorded on the general ledger as a loan in account "Other Loans". A Car Title was found in the _____ office showing _____ as the owner and the sales price as _____ . (workpapers _____ through _____ 23). An Application for _____ Title, dated _____ , was also found in the _____ office. This title showed the _____ being gifted to _____ workpaper _____

On _____ issued a check to the _____ or _____ . A cashier's check was then issued to _____ used the cashiers check to purchase a _____ from _____ A review of the general _____

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ledger indicated the purchase of the motorcycle was recorded in cost of sales account 4000 "Purchases". (workpaper . A motorcycle was found in the garage area of the partnership office. The title was found in office. The application for certificate of title was attached and a blank check, signed by was attached to pay the registration. (workpaper through . The check was . The title is dated was listed as the owner/applicant. noted that a check was written to on . An application for title was filed out indicating sold the motorcycle to signed the title. (workpapers through

On . a manual check number was written to for . A cashier's check copy was found in an checkbook made out to (workpaper . The cost was charged to property as a subcontract cost in a cost of goods sold account . A title was found in office for a Boat, but it is open and does not indicate the name of the purchaser (workpaper . Per a discussion between and a man named and told him that he had sold his boat to The boat was owned by his wife's company . The seller's name on the title was

On . Issued check number for , to for payment of an invoice received for repairs to a boat (workpaper . These costs were entered into general ledger account "Other Loans".

On . issued check number for , to for the purchase of a boat trailer. the Chairman of the Board of Directors, investigated the trailer purchased from works at contacted and asked him about the trailer. indicated that he and were going to purchase a boat trailer. They were each to contribute wrote check to indicated that the trailer was never delivered and he returned the to had no explanation for the apparent discrepancy between the agreed to pay and the check amount. general ledger recorded the purchase in account "Machinery and Equipment".

On . issued check to Auto for the purchase of a . A review of the general ledger indicated the purchase price was recorded in fixed asset account "Transportation Equipment. No title for this auto was found.

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On _____, the revenue agent for the Internal Revenue Service contacted _____ or the City of _____ in an attempt to determine the assets seized from _____ and currently in the control of the City of _____. _____ stated that the City of _____ has in their possession, the following;

Work trailer (could be a boat trailer?)
Bank Account with
Office Equipment such as desks and chairs, etc.

_____ stated that the following assets were currently in lock-down at

Boat called "the yellow boat"

_____ stated that the following assets were in the possession of

LAW, ARGUMENT AND RATIONALE

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the regulations defines a private shareholder or individual as those persons having a personal and private interest in the activities of an organization. In general, a private shareholder or individual is considered an "insider" with respect to the exempt organization.

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Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

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.

Any unjust enrichment, whether out of gross or net earnings, may constitute inurement. Section 1.501(c)(3)-1(c)(2) of the regulations states that, an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Inurement is concerned with the direct transfer of income or provision of services unrelated to exempt purposes.

Section 1.501(c)(3)-1(d)(1)(iii) of the regulations, provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. The burden is on the organization to establish that it is not organized and 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 private interests. The organization's activities must be broad enough in scope to confer a public benefit versus serving to benefit only a few.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, 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.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the promotion of education.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Bus. Bureau v. United States, 326 U.S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am.

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Campaign Acad. v. Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F.2d 340 (4th Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. Am. Campaign Acad. v. Commissioner, supra at 1065-1066.

Section 1.501(a)-1(c) of the regulations states that "[t]he words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

In John Marshall Law School v. U.S., 81-2 U.S.T.C. 9514 (Ct. Cl. 1981), the Court found that the Commissioner acted properly in revoking exemption under IRC 501(c)(3) on the grounds of inurement to the controlling officers and their families. The inurement included, but was not limited to, payments to the families as follows: automobile, education and travel expenses, insurance policies, basketball and hockey tickets, membership in a private eating establishment, membership in a health spa, interest-free loans, home repairs, personal household furnishings and appliances, and golfing equipment.

In Founding Church of Scientology v. U.S., 412 F.2d 1197 (Ct. Cl. 1969), the facts involved classic across-the-board channelling of an organization's funds to those in control of the organization. In that case, a wide variety of devices were employed, including fees, commissions, excessive rental payments, loans and excessive salaries, to divert the organization's funds to its founder, L. Ron Hubbard, and his immediate family. The principle of inurement was neatly summarized when the Court stated, "what emerges from these facts is the inference that the Hubbard family was entitled to make ready personal use of the corporate earnings."

As Stated above, Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

- purchased assets for the personal use and benefit of the private interest of the then EO President , as detailed in the FACTS section of this report.

In addition, Section 1.501(a)-1(c) of the regulations defines a private shareholder or

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Individual as those persons having a personal and private interest in the activities of an organization. In the case of _____, the personal and private interests would be those of the then President

Therefore, _____ net earnings inured to the private benefit of the President in the form of asset acquisitions in violation of Section 501(c)(3) of the Code. Thus causing the loss of exempt status.

TAXPAYER'S POSITION

The EO and/or their representatives have not provided any information as to their position at this time.

GOVERNMENT'S POSITION

Based on the facts of the examination, the organization does not qualify for exemption since the purchasing of assets for the private and personal use of the then President or persons controlled, directly or indirectly, by him clearly benefit their private interest. As noted above, an organization that operates for the benefit of private interests, such as designated individuals, by definition does not operate exclusively for exempt purposes.

CONCLUSION

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked, effective