



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

Release Number: 200709066

Release Date: 3/2/07

UIL Code: 501-03-01

Legend:

ORG=Name of Organization

NUM=Employer ID Number

Date1= Effective Date

Date 2=End of the first taxable period

June 16, 2006

ORG

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN: NUM

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: _____

Dear :

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

Our adverse determination was made for the following reasons:

ORG. has not been operating exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3). ORG is also is not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. You operate substantially for a non-exempt purpose, for private benefit, and its earnings inure to the benefit of private individuals.

Based upon these reasons, we are retroactively revoking your IRC section 501(c)(3) tax exempt status to Date1

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 Date2, 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 initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

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 writing to: Internal Revenue Service, Local Taxpayer Advocates Office.

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,

Marsha A. Ramirez
Director, EO Examinations



TAX EXEMPT AND
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DEPARTMENT OF THE TREASURY
Internal Revenue Service

July 6, 2006

Taxpayer Identification Number:

Name of Taxpayer

Form:
990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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:

IRS
Local Taxpayer Advocates Office

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

Thank you for your cooperation.

Sincerely,

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A	EXPLANATION OF ITEMS	Issue No.
Name of Taxpayer		Year(s) Ended
ORG, Inc.		

Legend:

ORG = Name of Organization

Date1 = Date of exemption

Date2 = Effective Date

I. ISSUES

- Whether the organization ORG, Inc. , properly reported and deducted expenditures according to a proper purpose and within the rules and regulations?
- Determine the relationships of all persons doing business with the exempt organization and determine if those persons' private interests are being served at the organization's expense. Purchases, sales, leases, and sharing arrangements should be evaluated carefully. Accurate valuation of the property in question is necessary. Insubstantial acts of private benefit should be noted as the basis for an advisory letter and for future reference.
- Determine whether any part of the net earnings of which, inures to the benefit of any private shareholder or individual? Determine the consequences for any private benefit or incidental private benefit.
- Review travel (accountable plan), printing, publications, employee benefits and grants. Determine if organization operated a lease or other agreement based on fair market value.

II. FACTS:

ORG, Inc. received exemption as a 509(a)(1) foundation effective Date1 and determined exempt per IRC section 501(c)(3).

The general purpose of the organization was to provide a homeless shelter. We could not determine when the organization changed the requirement primarily for homeless veterans. Per the President, the lack of resources provided nationally for homeless veterans, was a main reason that the organization was structured to serve those who are veterans and need shelter.

The organization did not show that they maintained minutes, elections nor had 3 or more officers. The President of the organization is the sole officer of ORG, Inc. The President makes all the director decisions on behalf of ORG, Inc. When the organization first began operating, it included a full board of 4 directors. Over the years, those board members died out or left the organization with the President serving as the remaining officer. No other officers were added to the organization.

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Name of Taxpayer		Year(s) Ended
ORG, Inc.		

The organization has three homes (owned by the President) which are used for the homeless veterans. The housing is located at:

Location 1 - 6-8 residents

Location 2 - 6-8 residents

Second home (right behind) - 1-2 residents

The President owns the buildings which are used by the tenants and she directly finances the building. There were no contributions or state funding for/on behalf of the shelters. There is no knowledge of application to the veterans housing administration or local administration for any sort of funding for the shelters or on behalf of the homeless veterans. There were no known HUD grants received.

There was no lease agreement for the housing between the President and ORG, Inc. The President had full access to the general account and disbursed funds as she determined for all costs related to the housing upkeep, rent and the operation of the shelter.

Bingo proceeds were ORG's only source of revenue and it included income from pull-tabs. Bingo proceeds and pull tab income is maintained in a separate bingo trust account at Bank. The organization transferred monies from two bingo trust fund accounts via checks (100% of the time) to the general account. The President did not maintain or manage the Bingo Trust Fund Account, although she maintained signature authority on the account. The Bingo manager maintained the trust fund accounts.

The President maintained control over the general checking account. The President would not always deposit the transfer bingo trust fund check into the general account, but rather cash the bingo trust fund check, deposit part of the proceeds into the general account, and withhold the cash for disbursements for ORG, Inc. and other expenditures (some unexplained).

The President did not maintain adequate records to determine the amount paid, date paid, purpose, payee, or any corroborative evidence including receipts or requisitions.

Per reconstruction of records we were able to determine some of the expenditures of ORG, Inc. were related to the operation of the shelter. The organization has provided the following amounts to reflect direct related costs of the organization:

Form 886-A	EXPLANATION OF ITEMS	Issue No.
Name of Taxpayer		Year(s) Ended
ORG, Inc.		

III. EXAM DISCUSSION:

An otherwise qualifying organization will be disqualified for exemption if it excessively benefits private interests, either through inurement of its net earnings to certain "insiders" or by primarily benefiting the interests of persons who, though not "insiders", do not comprise a charitable class. In this case the bingo operator and the charitable organization officers are unrelated parties. The bingo operator is not a member of a related organization and therefore the operator cannot be deemed an insider.

The commensurate test involves organizations that raise funds for charitable purposes by conducting an activity that is not itself charitable ("bingo"). The proceeds from the activity are turned over to the charitable organization in part. Our concern is whether the charitable organization whom the bingo fundraiser is setup is benefited and they maintain a public rather than a private purpose, versus the bulk of the funds accruing to the fund-raiser as a fee for services and other charges.

In this case the State authorized for profit operators to lease their buildings, equipment and other to non-profit organizations who received a tax exempt ruling from the Internal Revenue Service. The State Bingo law allows the operators to charge up to 50% of the net profit from the bingo operation plus the cost of paper and babysitting. The operators or lessors all charge 50% of the net profit from the bingo operation. This is therefore deemed the prevailing rate, since all in the industry are charging the same rate. Can there be an abuse in this situation?

An intent on whom to benefit needs to be determined in whether the exempt organization's intent was to benefit private interests versus public interest. This case indicates that the public purpose was to use the proceeds from the fundraising to teach youth how to play competitive baseball through training and structured leagues and tournaments. Whereas, the benefits of a charitable purpose appears to be accomplished, however, we have to weigh whether the greater benefit achieved is for the private interest of the operator.

If the fundraising consumed substantially all of the proceeds received from the fundraiser then this appears to be a stronger consideration for asserting private benefit. The fundraising did not consume all of the proceeds and the exempt activities of the organization were maintained for the period.

The concern then is whether the operator/lessor charged a fair value with regard to the lease of the facility for the bingo operation. Due to the nature of the business it may difficult to determine the fair market value of a bingo property. Also, bingo leases include the lease of a particular property that has been converted for primarily the holding of bingo games.

Further, the State allows only one licensee to conduct bingo games at a given location on any one day and games conducted at the leased premises, must allow for at least 44 hours to elapse at that leased

Form 886-A	EXPLANATION OF ITEMS	Issue No.
Name of Taxpayer		Year(s) Ended
ORG, Inc.		

premises or any other leased premises within 1000 feet of that leased premises before another game of bingo may be played. Each premises may be used to conduct bingo games up to 3 days in any calendar week. However, each licensee is limited to a maximum of 2 days in any calendar week. All games must be conducted in the county where the licensed organization is located. We determined the organization has met all the stated requirements of State law.

As stated earlier all lease agreements between leased premises and licensed organizations must be submitted for approval to the State Administrator. All lease agreements must be in writing and signed by the lessor and lessee. We determined the organization has met all the stated requirements of State law.

In determining fair market value then the property must consider those effects. We have determined with assistance from an engineer, that the best value method for determining fair rental value is using the county commercial rates. A commercial rates takes into consideration a building valuation, utility costs, maintenance, security and other overhead costs.

The rate for county commercial property averages at approximately \$2 per year for each square foot of commercial property.

We determined that the rent assessment of 50% of the net profit

The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization. Reg. 1.501(c)(3)-1(c). It places the focus of the inurement proscription on those who, by virtue of a special relationship with the organization in question, are able to influence the expenditure of its funds or the use of its assets, rather than on the general public. See, for example, Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985); est. of Hawaii v. Commissioner, 71 T.C. 1067 (1979). This case is exactly the reason for deeming excess benefits or payments to insiders as inurement.

IV. LAW AND OPINION:

IRC 501(c)(3) expressly forbids the inurement of net earnings to the benefit of a private shareholder or individual.

To be charitable, an organization must serve a public rather than a private interest. Reg. 1.501(c)(3)-1(d)(1)(ii). 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.

Reg. 1.501(c)(3)-1(c)(2) clarifies that an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private individuals.

Form 886-A	EXPLANATION OF ITEMS	Issue No.
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ORG, Inc.		

Where an exempt organization engages in a transaction with an insider and there is a purpose to benefit the insider rather than the organization, inurement occurs even though the transaction ultimately proves profitable for the exempt organization. The test is not ultimate profit or loss but whether, at every stage of the transaction, those controlling the organization guarded its interests and dealt with related parties at arm's-length. See *Leon A. Beeghly Fund v. Commissioner*, 35 T.C. 490 (1960). (Inurement occurred when organization entered a transaction to benefit the stockholders of a particular business corporation, not to benefit the charity, even though corporation suffered no financial loss.)

The Court in *Est. of Hawaii v. Commissioner*, 71 T.C. 1067 (1979) stated, "Nor can we agree with the petitioner that the critical inquiry is whether the payments made to international were reasonable or excessive. Regardless of whether the payments made by petitioner to International were excessive, International and Est, Inc., benefited substantially from the operation of petitioner.

V. TP's POSITION:

The TP is in General agreement with the revocation and has signed the revocation per Form 6018.

VI. CONCLUSION:

The organization did not maintain good internal controls or enter into arm's length transactions. Further, there are no contracts regarding any payments to the officer as compensation, for rental or lease of property, or for other purposes. The unexplained disbursements to the officer were for the benefit of the officer. The officer is deemed an insider and therefore the payment is for a personal or private benefit and not for the benefit of the organization. While there is some basis that other expenditures may have been expended for the benefit of the exempt organization for repairs, capital construction, food for homeless and other miscellaneous costs, the officer did not maintain adequate records to allow any additional deductions. The organization has not met the requirements per IRC 501(c)(3).

The unexplained payments to the sole officer for the respective year ended Date2 in the amount of \$ and are deemed inurement per Reg. 1.501(c)(3)-1(c). The President had total control of funds from the general account and was responsible for the operations and financial activities of the organization.