

DEPARTMENT OF THE TREASURY

**Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424**

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Number: **200740013**
Release Date: 10/5/2007

UIL: 501.03-01

July 10, 2007

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN: NUM

LEGEND:

ORG= Name of Organization
NUM = EIN Number
Date1 = Effective Date
Date 2= Year end of Effective Date

ORG

**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. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked retroactively to Date 1.

Our adverse determination was made for the following reasons:

You failed to meet the requirements of IRC section 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for the benefit of private interests and your assets inured to the benefit of outsiders.

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, Taxpayer Advocates Office, Local 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
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TEGE EO Examination
31 Hopkins Plaza, Room 1400
Baltimore, MD 21201

July 10, 2007

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

December 31

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:

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,

Marsha A. Ramirez
Director, E.O. Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

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

LEGEND:

ORG =Name of Organization

Promoter = Name of Promoter

Rep = Representative of Promoter

Affiliates = Name of Affiliates

Founders = Name of Founders

State =Name of State

ISSUE:

Should The ORG's Charitable Supporting Organization's tax exempt status be revoked because the organization was not organized and operated exclusively for exempt purposes?

FACTS:

The Org's Charitable Supporting Organization ("CSO") was established as an integral component of an arrangement called the Master Financial Plan ("MFP"). The MFP was designed specifically for Founder by a now-defunct tax shelter promoter. The MFP purported to provide the Founders with income tax avoidance, asset protection and estate planning benefits.

1. Entities participating in and/or created to implement the Master Financial Plan

a. Affiliated Entities of Promoter & Associates, Ltd – the Promoter

The promoter and all affiliated entities, listed below, have come under Federal investigation by the Securities and Exchange Commission ("SEC"), Federal Bureau of Investigation and the Internal Revenue Service ("Service") for promoting numerous tax shelter schemes involving offshore transactions, including the repatriation of funds in the form of tax-free borrowing. The Promoter entities are as follows:

- (1) Promoter & Associates, Ltd., ("Promoter"), was a Bahamian company, headquartered in Nassau. PROMOTER claimed to be a leading firm in the business of providing tax reduction and asset protection through the establishment of offshore entities and accounts. It was organized as a parent company, charged with

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coordinating the actions of its subsidiaries, as well as , an affiliated law firm.

- (2) Promoter & Associates, Inc., ("PROMOTER"), was a State corporation, incorporated in 1993. PROMOTER's function was to provide the office space and the staff who provided services to PROMOTER and its investors, and served as the office through which investors are solicited. PROMOTER and PROMOTER also regularly induced clients to purchase securities, including those issued by Securities Firm. PROMOTER was located in State.
- (3) Overseas Advisors, Ltd., was a Bahamian entity that acted as an investment adviser and a "mutual fund company" for Promoter investors. Advisor managed "mutual funds" that had been sold to Promoter investors. It also maintained accounts with brokerage firms into which investor securities were placed.
- (4) Affiliate, was an entity organized under the laws of a Caribbean island. Affiliate ostensibly acted as an issuer of many of the investment products (e.g., LOI insurance policies) sold to Promoter investors. Affiliate also controlled the funds of Promoter investors that were to be repatriated to those individuals from accounts located in the Bahamas.
- (5) ("AFFILIATE"), was a Bahamian entity and a State limited liability company. AFFILIATE was an international legal firm that operated as PROMOTER's legal advisors. It also shared offices with PROMOTER in Nassau, Bahamas and PROMOTER in State. AFFILIATE's legal tax opinion, supporting the legality of the Master Financial Plan, was used by PROMOTER to solicit wealthy clients.
- (6) Affiliate Funding, ("Affiliate"), was an arm of Promoter and was based in Nassau, Bahamas. Affiliate was set up to receive wire transactions from investors at an account it established with the Bank.
- (7) Affiliate Capital, LLC, ("Affiliate"), was a State Company used to facilitate the repatriation of client funds.
- (8) PROMOTER Leasing, LLC, (PROMOTER Leasing"), was a State Limited Liability Company used to hide a client's interest in property.

b. Affiliated Entities of Founder – the Clients

The following entities were established to implement the Master Financial Plan:

- (1) Founder Charitable Supporting Organization, ("CSO") is a non-profit organization exempt from Federal income tax under section 501(a) of the Internal Revenue Code by virtue of being recognized as a supporting organization as described under §501(c)(3) and §509(a)(3) of the Internal Revenue Code. Promoter literature claims the objectives of setting up a supporting organization are as follows:

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- To create a vehicle which permits charitable giving with up to 100 percent tax deductibility;
 - To take advantage of the tax benefits of charitable giving while maintaining a high degree of ultimate control over the donated asset; and
 - To create a conduit for tax-free investing offshore.
- (2) An S corporation set up in the State on behalf of Mr. Founder by a State-based attorney and CPA who represented Promoter in its initial dealings with the Founders. Corp was set up to receive Mr. Founder's annual lottery income, to purchase the Loss of Income insurance plan and to participate in a VEBA. Mr. Founder is the 100 percent shareholder of S Corp.
- (3) Affiliate Properties, Ltd., ("Affiliate"), an S corporation set up on behalf of Mrs. Founder by an attorney and CPA who represented Promoter in its initial dealings with the Founders. Affiliate was set up to receive Mrs. Founder's annual lottery income, to purchase the Loss of Income insurance plan and to participate in a VEBA. On December 28, the Founders issued a check, on Affiliate Properties' checking account, payable to the Fund for \$. This amount was for Affiliate's VEBA policy. Mrs. Founder is the 100 percent shareholder of Affiliate.
- (4) A Corp, was an international business corporation set up in the Bahamas to borrow funds from CSO in exchange for interest payments at an annual rate of five percent.
- (5) B Corp was a hybrid guarantee company set up on behalf overseas to avoid U.S. income taxation as a "controlled foreign corporation" under section 957 of the Internal Revenue Code.
- (6) Investment, LLC, was a Limited Liability Company set up in the State.
- (7) Investments was an international business corporation.
- (8) Ventures was an international business corporation.
- (9) Leasing was a State Limited Liability Company set up to purchase and lease shipping containers from a separate business Mr. Founder owns.
- c. Supported Organizations – the entities CSO supports**
- (1) Hearing Association is a §501(c)(3) organization that promotes the use of spoken language and hearing technology for the deaf and the hard of hearing.
- (2) Pilot Association is a §501(c)(3) organization comprised of pilots and other volunteers that provides free air transportation for any person facing a life crisis or requiring life-saving medical treatment.

2. Background

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a. Promotion and Design of the Master Financial Plan

On March 26, .Founder and his spouse,.Founder, won the Powerball Lottery. Their lottery payout was \$ million per year for 20 consecutive years. At the time of their winning, Mr.Founder was employed by a manufacturing concern as a controller. Mr.Founder has a B.S. degree in Economics and M.S. degree in Accounting. Mrs.Founder has a B.S degree in Political Relations.

In the fall , Mr. Founder contacted Promoter to discuss his annual lottery income and the tax and estate planning arrangements Promoter had available for individuals like the Founders. Mr .Founder first learned about Promoter in a Promoter brochure called “ ,” later changed to “ .” This was a brochure that was enclosed in his subscription to the Report, a monthly magazine.

The Founders were contacted by Attorney shortly after leaving their name and telephone number with Promoter. Rep indicated that he was a representative of Promoter and an attorney in State. Mr. Rep scheduled a meeting with the Founders sometime in January or February.

During the initial meeting, Rep stated that Promoter was a State-based financial and legal firm specialized in helping selectively chosen clients of wealth, accepting as clients only those individuals they could help at a 1 to 5 ratio. This means that if Promoter charged a fee of \$100,000, it would help the client save \$500,000 through tax and estate planning arrangements. The savings would come in the form of a reduction in income taxes paid.

Rep further discussed the backgrounds of Promoter officers, which included one former IRS employee. The Founders requested client references, but Rep claimed he was prohibited from providing client references to the Founders, due to the sophistication of the planning techniques. The client references would be made available once the Founders agreed to use Promoter, however, Promoter never provided such references and the Founders did not press the issue.

Rep also provided promotional materials to the Founders called the “due diligence package,” which contained a list or representatives (including their credentials), a list of Promoter entities (e.g., leasing arm, estate planning arm; investing arm, etc.), and legal opinions supporting the legality of Promoter products.

After the presentation was made, the Founders asked for a letter (issued Feb 2) detailing the fees they were expected to pay in exchange for Promoter’s services. The letter provides that \$ was to be paid to Rep for tax planning services. The Founders believed that Rep would also receive a commission from Promoter, since he was Promoter representative bringing in business as a salesman. As part of his services, Rep established Affiliate Properties Limited, S Corporations formed in April to receive the Founder’s lottery winnings.

The letter also provides that \$ was to be paid to Promoter as an initial retainer fee. If the Founders retained Promoter, their total fees would not exceed \$, of which the initial retainer will be credited. Promoter, in turn, guarantees income tax savings of at least \$ to the Founders if they agreed to implement all of Promoter’s proposed strategies.

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Later that spring, the Founders received a second letter regarding "Developing a Plan for Reducing Your Taxes." This letter discussed the Master Financial Plan, an analysis of the Founders' personal and financial situation, providing recommendations of specific Promoter products to reduce the Founders' income tax liability. This letter also required the Founders to pay a \$ fee, which was paid from an account..

After the first meeting, the Founders spoke to Rep by telephone bimonthly to discuss tax planning ideas, Promoter and the possibility of a site visit to the PROMOTER office . During these conversations, Rep talked about the other services Promoter provided, e.g., asset protection, overseas brokerage accounts, annuities, insurance products and other techniques that would allow the Founders to meet their objectives through tax planning and asset protection strategies.

In July, Rep arranged to meet the Founders at the PROMOTER office . During the presentation, Promoter officials presented the Master Financial Plan. The Founders received a financial summary sheet which stressed the severity of tax situation the Founders' daughter could face should they both die prematurely. As an example of the failure to properly plan, Promoter gave the Founders a tax court opinion involving a person who died prematurely and suffered adverse tax consequences. The Founders felt the opinion required them to undertake some action immediately to avoid this result. At this point, Promoter stated that their Master Financial Plan was proven, accepted and a legal product; used by their clients for many years. In support of this claim, Promoter cited tax opinions contained in their package.

b. SEC Description of the Master Financial Plan

In its complaint against Promoter, the SEC stated that Promoter offered a product known as a Master Financial Plan whose function is to provide a means by which the investor can invest cash and securities offshore, usually in the Bahamas or another Caribbean nation, and receive tax-free gains from the investment activity. The basic structure of the plan involves the transfer of an investor's income and/or assets into offshore entities established on behalf of the investor. These funds and assets are then used to purchase investment and other products offered by PROMOTER and its affiliates.

The Master Financial Plan also provides investors with a means to repatriate assets through transactions that hide the actual ownership of the assets, thereby enabling the investors to utilize the untaxed funds without paying tax obligations. For instance, in its sales manual, Promoter states:

Once money is invested offshore, there are several ways to repatriate part or all of it. These include such non-taxable methods as with secured credit cards, personal or corporate loans, mortgages, personal withdrawals or through insurance policies. Capital can also be repatriated through taxable means such as through salaries or annuities.

Promoter promises its clients that, through the implementation of the Master Financial Plan, the clients will reduce their taxes by significant percentages, have their investments grow offshore in a

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tax free environment, and will be able to protect their assets from unwanted liabilities and encumbrances.

The SEC contends that the Master Financial Plan essentially establishes the framework through which the Promoter investor invests and protects cash and assets, avoids payment of taxes and repatriates his or her funds.

c. Description of the Founder's Master Financial Plan

Promoter designed the Master Financial Plan to further the income tax reduction, asset protection and personal estate planning objectives of the Founders. It involved the establishment of several offshore and domestic entities; the purchase of several insurance plans; and the execution of transactions through which the Founders invested their lottery proceeds.

The types of entities employed by Promoter for the Founders included International Business Corporations ("IBC"), Voluntary Employee Beneficiary Associations ("VEBA"), Support Organizations ("SO"), S Corporations ("S Corp") and Limited Liability Companies ("LLC"). The insurance arrangements included products such as Loss-of-Income ("LOI") insurance policies and Foreign Variable Annuities ("VFA").

Mr. Founder indicated that the components of the Master Financial Plan were essentially individual plans designed to achieve the goals of income tax reduction and asset protection and that he retained to provide such products and strategies.

(1) Description of Component Entities

(a) International Business Corporations

The SEC report stated that Promoter sales literature described IBC's as corporations formed in a tax haven but not authorized to do business within that country. They are intended to be used as an investment or asset protection vehicle. The Promoter investor transfers personal assets or an investment portfolio to the IBC.

Promoter tells clients the offshore entities are not owned or controlled by the clients for tax purposes. Rather, nominee officers or directors act on behalf of the clients to control the entities and effect transactions. In fact, Promoter personnel have authority to effect the transactions, retaining sole signatory authority over all accounts. Typically, in order to effect a transfer of funds, senior personnel at Affiliate or must authorize the transfer.

(b) Supporting Organizations

SO's are described as charitable organizations established for the benefit of an individual client. Among the stated benefits of an investor establishing an SO over using a domestic charitable organization is that investment funds transferred to the investor's personal SO can grow tax free. These investment gains are available to the donor/investor through access to the offshore corporations that manage the investments of the SO.

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Promoter states that the Founders, as CSO's trustees, are able to make investment decisions, including the ability to borrow indirectly from the contributed funds, and direct charitable contributions, giving them a high degree of control over the donated assets. In addition, salaries and other administrative expenses may be paid to the Founders and/or their family members in the approximate amount of 25 percent of the CSO's gross income.

(c) Voluntary Employee Beneficiary Association

Promoter defines a VEBA as an employee benefit program that permits employers to take tax deductions for certain employee benefits payments such as the payment of life, sick, accident, death or other benefits. The investment gains of these payments grow tax deferred. Under certain circumstances, the gains can be accessed tax-free; e.g., borrowing funds to pay for the children's college education through a VEBA trust.

Mr. Founder described the VEBA as an IRS-approved plan that would allow him to purchase life insurance for union-affiliated employees. He would be able to purchase a whole life insurance policy as an investment and deduct the policy premiums. The union members would include family members, including Mr. Founder's father and his father-in-law.

(d) S-Corporation

Separate S-Corp's were established for Mr. Founder and Mrs. Founder to shield the payments of their lottery winnings, paid in the form of an annual annuity, from frivolous lawsuits. Gains from wagering are not considered wages, compensation for services, trade or business income, gross receipts or sales – all of which are otherwise called earned income.

The S-Corp model is also used to implement the VEBA and requires at least two employees. Under the VEBA arrangement, the employees would join the union and the employer would contribute tax deductible premiums to the VEBA trust. If the insurance policy accumulates cash value, the trust that administers the arrangement can issue loans to participants if certain conditions are met, viz., (1) paying uninsured medical expenses; (2) paying for post-secondary education of dependents; and (3) unusual, unexpected hardship events. Although repayment is anticipated, any outstanding loan balances at death can be paid off by the death benefit.

(e) Limited Liability Company

An LLC offers personal protection and tax savings but does not require the reporting and record keeping of a corporation.

(2) Description of Insurance Products

The types of investment products sold by Promoter include Loss of Income Policies ("LOI"), Equity Management Mortgages ("EMM") and Foreign Variable Annuities ("FVA"). The Founders implemented LOI and FVA.

(a) Loss of Income Insurance Program

An LOI is an agreement between the Promoter client and Affiliate whereby the client purchases a policy to insure against a future loss of income.

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An LOI policy is usually purchased for coverage until the earlier of a specified term, such as 1 year, or the date of death of the insured. The insurance company typically holds the net premium in a separate account, along with the net premiums of other LOI insurance policies. Creditors cannot access policy reserves. The insurance company guarantees a fixed return on such premiums. Most LOI policies provide that your premiums, plus a guaranteed return, will be paid back to the policy holder at the end of a specified period (usually 10 years).

The sales manual also states that investment decisions are made by the insurance company. The funds received by Affiliate for the sale of LOI's are pooled in an account at Bank maintained by Affiliate in the Bahamas.

SEC contends that, in reality, LOI's are not purchased as insurance, but as a vehicle to make offshore and tax-free investments of funds which can be repatriated as desired by the investor. No Promoter investor has ever filed a claim against an LOI for a loss of income. What, in fact, occurs is that the investor purchases the LOI from Affiliate and then borrows back a percentage of the premium through a note or investment contract, usually in the form of a "mortgage," called an Equity Management Mortgage or EMM.

Generally, the EMM is obtained through two affiliated entities of Promoter, Affiliate and Affiliate, which act as the mortgagee. The investor's proceeds from the EMM are then placed in an IBC and invested offshore or repatriated by the investor. The net effect of the LOI/EMM transaction is that the investor (S-Corp) is able to deduct the premium paid for the LOI, encumber his property through a mortgage to himself and deduct the interest payments to himself on the mortgage. The investor can then invest the proceeds from the mortgage offshore through an IBC, with Affiliate managing the investment. The remainder of the premium left with Affiliate is then invested to provide the investor with a fixed rate of return over the ten-year life of the policy.

(b) Foreign Variable Annuities

The FVA is a variable annuity issued by Affiliate. The investor purchases the FVA by transferring cash or securities to Affiliate; Affiliate then pays the investor or his designees the principal and an agreed upon rate of return over the succeeding years. Promoter markets the FVA as a means to repatriate a client's assets without tax consequences. With respect to FVAs the Promoter sales manual states:

You could purchase a Foreign Variable Annuity Contract between you and a Foreign Insurer. During the accumulation period of the Annuity Contract you could set aside money and have it grow on a tax-deferred basis [pending] withdrawal. At retirement, or another time selected by you, the payout period begins whereby the insurance company promises to pay a steady stream of income for a fixed period of time or for life.

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Implementation of CSO

Pursuant to the arrangement, theFounders set up CSO as a trust on or about November 15. Using boilerplate Promoter Associates ("PROMOTER") language, the trust "is organized, and all times thereafter will be operated to support or benefit, as defined by Treasury Regulations section 1.509(a)-4(b)(1), one or more publicly supported organization and shall comply will all other requirements of section 509(a)(3) of the Code."

On or about April 21, CSO received a favorable exemption letter from the Service as a supporting organization under section 509(a)(3) of the Internal Revenue Code. The supported organizations included . Each supported organization was represented on CSO's board of trustees by one of their employees. One of theFounders and two family friends brought the board of director membership to five.

TheFounders made a contribution of \$ to CSO on or about December 22, and another \$ on or about December 26. They reported a charitable deduction for the amount contributed on Schedule A of their Form 1040. Additional small amounts were contributed. On or about December 28, CSO wired \$ to Affiliate's account in the Bahamas.

Some of what happened next is somewhat unclear because PROMOTER likely deposited theFounder's CSO money in a general PROMOTER account and commingled the money with other clients' money. Per SEC materials, PROMOTER likely misappropriated the Bahamas CSO/IBC money and used it to operate a Ponzi scheme, i.e., new client money was absconded to pay PROMOTER or taken to pay obligations to old clients. For practical purposes, it appears that once the CSO money reached the Bahamas theFounders lost the ability to properly track and account for the CSO money. During this period PROMOTER accountings to theFounders were generally deficient.

At the time theFounders believed the \$ of CSO money would supposedly be loaned to IBC set up for theFounders by PROMOTER to receive CSO's funds. IBC supposedly invested the funds in a separate account established for it at Affiliates. Generally, the SEC describes this as a broker/mutual fund arrangement. It appears that the loan origination papers between the CSO and the IBC were likely not prepared. Also, few interest payments to the CSO from the IBC were made.

Sometime thereafter, theFounders discovered that Promoter was under Federal investigation by the SEC and the FBI. In April , theFounders contacted the Service to disclose their tax treatment resulting from their participation in the Master Financial Plan, pursuant to Announcement 2002-2, I.R.B. 2002-2, (Dec. 21, 2001).

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Form 990

For the calendar years , CSO reported the following amounts of revenue and expenses on its Form 990:

Revenue -					
Direct Public Support	\$		\$		\$
Interest on savings and temporary cash Investments		\$			
Total Revenue	\$	\$	\$	\$	\$
Expenses -					
Bank Fees	\$	\$	\$	\$	
Accounting fees			\$		\$
Legal fees			\$		
Distributions to supported organizations			\$		
Total Expenses	\$	\$	\$	\$	\$
Excess or (deficit) for the year	\$	\$	\$	\$	\$
Nets assets at beginning of year		\$	\$	\$	\$
Other changes in net assets					
Net assets at end of year	\$	\$	\$	\$	\$

CSO received approximately \$ in interest income. CSO did not receive any further interest or dividend income from the investment (Bahamas). CSO distributed \$ to the supported organizations.

Attempts made by theFounders to ascertain the whereabouts of the \$ have failed.

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Founder Settle Related Individual Income Tax Case

Founder's Individual Income Tax Return came under examination by the Service as a result of a large charitable contribution deduction taken on Schedule A. Proposed exam adjustments included among other things a denial of the Promoter ("PROMOTER") inspired transactions, in particular, a denial of the charitable deduction to the CSO and a denial of certain business deductions taken. Generally, the exam Notice disallows the claimed charitable contribution to the CSO because it represents a sham transaction entered into for purposes of personal gain rather than for reasons of disinterested generosity. Similarly, the exam Notice disallows the PROMOTER business deductions because they are sham transactions lacking economic substance.

Appeals documents indicate that a settlement was secured and therein Founder conceded the above mentioned charitable contribution deduction issue and the PROMOTER business deductions relating to the VEBA and LOI policies. The Founder individual income tax case decision document filed with U.S. Tax Court indicates that parties agreed to a \$ deficiency for the taxable year. The Form 4549 Income Tax Examination Changes for the Founders reflects the above deficiency as well as interest. With respect to Exam adjustments, Appeals documents indicate that full payment, including interest, was made.

LAW:

IRC §501(c)(3) of the Code provides, in part, for the exemption of organizations that are organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treas. Reg. §1.501(c)(3)-1(a)(1) provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Treas. Reg. §1.501(c)(3)-1(c)(1) provides that 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.

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

Treas. Reg. §1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for 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.

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Treas. Reg. §1.509(a)-4 (b)(1) provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of" (hereinafter referred to in this section as being organized and operated "to support or benefit") one or more specified publicly supported organizations. If an organization fails to meet either the organizational or the operational test, it cannot qualify as a supporting organization.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under IRC section 501(c)(3).

In Founding Church of Scientology v. United States, 412 F. 2d 1197 (Ct. Cl.1969), the court stated that loans to an organization's founder or substantial contributor can constitute inurement that is prohibited under section 501(c)(3). In that case, the church made loans to its founder and his family and failed to produce documentation that demonstrated that the loans were advantageous to the church. The church also failed to produce documentation to show that the loans were repaid. Significantly, the court stated that "the very existence of private source of loan credit from an organization's earnings may itself amount to inurement of benefit."

In Freedom Church of Revelation v. United States, 588 F. Supp 693,696 (D.D.C.1984), the court revoked a Church's exempt status because substantial activity engaged in by plaintiff was the promotion of tax-avoidance schemes. The court held that church was actively promoting tax-avoidance schemes and that its earnings were inuring to private individuals, including its leaders. The court therein stated that "evidence submitted verifies the existence of a substantial nonexempt purpose, i.e., tax avoidance."

In Western Catholic Church v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980), the court revoked a religious organization's tax exemption where income was primarily from contributions from the founder and they had control of the board and expenditures. Further, no religious services were offered on a group basis, few if any members existed, few if any outside donations were received, no place of worship existed, no grants were made for charitable purposes, and activities were limited to investment activities aimed at accumulating money to build a church. Plans to build the church never went past the preliminary drawing stage. The court characterized the circumstances as those of an incorporated pocketbook and found that the organization was not operated exclusively for an exempt purpose and that earnings inured to the benefit of private individuals.

In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under IRC section 501(c)(3).

TAXPAYER POSITION:

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In general, at Appeals and at all other times Founder maintain that they relied in good-faith on the advice provided to them by the PROMOTER promoters and representatives. Further, that theFounders changed accountants as soon as they became aware that the SEC was investigating the PROMOTER plan and that they made no further use of PROMOTER strategies in subsequent years. Further, that theFounders filed a Disclosure Notice with the Office of Tax Shelter Analysis under Announcement 2002-2 wherein theFounders disclosed the PROMOTER transaction. Further, that theFounders came forth and provided deposition testimony as well as other materials for the purpose of cooperating with the SEC investigation. Further, that due to PROMOTER frauds theFounders lost substantially all the money associated with the CSO transaction. Finally, theFounders have continued to support the organizations named as part of the CSO plan.

GOVERNMENT'S POSITION:

As a result of our examination of CSO for the period ending December 31, we have determined that your organization no longer qualifies as an exempt organization under IRC §501(c)(3). Revocation of exempt status is appropriate because CSO was not operated exclusively for exempt purposes. We propose a revocation of your exempt status .

In general, CSO was not organized or operated exclusively for an exempt purpose because it was established as part of an abusive tax avoidance scheme that promised to provide theFounders significant income tax savings, asset protection and personal estate planning. In reality, the CSO was part and parcel of a series of transactions that were, among other things, designed to conceal actual ownership of assets, create deductions with no economic substance and provide for supposedly tax-free investments. Essentially, the CSO transaction had abusive tax avoidance as a substantial purpose. Because the CSO had a substantial nonexempt purpose it is in contravention of IRC §501(c)(3) and should be revoked. See Better Business Bureau v. United States, 326 U.S. 279 (1945).

While PROMOTER literature routinely extolled the purported benefits of SO's, tax or otherwise, it was for the most part devoid of guidance on how such organizations were to be operated in order to maintain exemption. In general, evidence gathered indicates that CSO was not responsive to or an integral part of the named supported organizations and hence the close relationship required was not achieved. The CSO's failure to operate as a §509(a)3 organization further supports the existence of a substantial nonexempt purpose.

Key aspects of PROMOTER's SO pitch included the availability of a charitable deduction, tax-free investing offshore and a high degree of control over assets by donor. These factors are central to PROMOTER scheme because repatriation of donated funds back to the donor in the form of loans/notes/investment contracts were a hallmark of the PROMOTER scheme.

Generally, theFounders followed the PROMOTER script. Essentially, theFounders contributed \$ _____ to the CSO and claimed a charitable contribution deduction on their individual return. The CSO then wired the \$ _____ to an offshore account in the Bahamas. Apparently, an IBC created on behalf of theFounders, Affiliate, borrowed the \$ _____ and retained Affiliate as an investment advisor over the funds. Affiliate supposedly invested the funds in brokerage accounts it controlled with Affiliate. As per design, theFounders believed the CSO money was invested offshore and

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would be available if needed. TheFounders had other similar PROMOTER arrangements and did borrow from these arrangements. Up to now theFounders believed in the PROMOTER design. In reality, more likely than not the CSO money at this time was commingled with other PROMOTER clients' money and used by PROMOTER for their benefit.

In sum, and as per the above, CSO was operated as part of a tax avoidance scheme. Tax avoidance schemes do not further an exempt purpose. See Freedom Church of Revelation v. United States, 588 F. Supp 693, 696 (D.D.C.1984). Generally, CSO was designed and operated to enable theFounders to engage in financial activities which are beneficial to them and/or entities with whom they are transacting business, but detrimental to CSO. Accordingly, it is operated for a substantial non-exempt purpose. See Revenue Ruling 67-5, 1967-1 C.B. 123.

Further, even assuming, arguendo, that an abusive tax avoidance purpose did not exist, CSO would still fail to be operating exclusively for an exempt purpose because the few activities/transactions engaged in were not for an exempt purpose. In general, CSO activity was limited to making investments and facilitating the circuitous repatriation of funds back to the donor and this is a nonexempt purpose.

Furthermore, inurement would nevertheless result if activity consisted mostly of investment/loan activity. See Western Catholic Church v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980). Essentially, had the CSO money been available to theFounders, as called for by the PROMOTER design, then the CSO's net earnings would have inured to the benefit of theFounders. But for the PROMOTER fraud theFounders would have had a private source of money. In sum, the very presence of a private source of loan credit could constitute inurement and also result in revocation. See Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969).

CONCLUSION:

CSO's exempt status an IRC §501(c)(3) should be revoked because it was not organized or operated exclusively for exempt purposes.

We offered you an informal conference with the case manager. However, you declined to hold this conference. Should this revocation be upheld you may be required to file Form 1041. We will notify the appropriate state officials of the revocation in accordance with IRC §6104(c).