



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE: EO Examination
625 Fulton Street, Room 503
Brooklyn, NY 11201

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

UIL:501.03-01

Date: **JUL 20 2007**

Release Number: **200742029**

Release Date: 10/19/07

Taxpayer Identification Number:

Person to Contact:

Identification Number

Contact Telephone Number:

**LAST DATE FOR FILING A PLEADING
WITH THE TAX COURT, THE CLAIMS
COURT, OR THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT
OF COLUMBIA:**

Dear :

This is a final determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Recognition of your exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3) is retroactively revoked to because it is determined that you are not operated exclusively for an exempt purpose.

IRC 501(c)(3) exempts from taxation organizations which are organized and operated exclusively for charitable or educational purposes, no part of the net earnings of which inure 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 and which do not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

We have determined that you are not operating exclusively for charitable or educational purposes. Our examination reveals that you did not operate exclusively for exempt purposes because your assets inured to, and it served the private interests of your creators and other private persons.

We are revoking your exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code effective

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 1041. These returns should be filed with the appropriate Service Center for all years beginning

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:

United States Tax Court
400 Second Street, NW
Washington, D.C. 20217

United States Court of Federal Claims
717 Madison Place, NW
Washington, D.C. 20005

United States District Court for the District of Columbia
333 Constitution Avenue, NW
Washington, D.C. 20001

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 too-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,,
.....

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

Enclosure:
Publication 892

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

LEGEND:

A = NAME OF THE ORGANIZATION
 B = 1ST TAX YEAR
 C = 2ND TAX YEAR
 D = FOUNDER NO. 1 / TRUSTEE
 E = FOUNDER NO. 2
 F = DATE TRUST CREATED / EFFECTIVE DATE OF REVOCATION
 G = SUPPORTED ORGANIZATION
 H = CHARITABLE ORGANIZATION'S NAME
 I = BOARD MEMBER 3
 J = BOARD MEMBER 4
 K = BOARD MEMBER 5
 L = FOUNDERS
 M = CHARITY ORGANIZATION 1
 N = CHARITY ORGANIZATION 2
 O = UNIVERSITY 1
 P = FOUNDER'S FAMILY NAME
 Q = FAMILY MEMBER 1
 R = SUPPORTED ORGANIZATION
 S = FAMILY MEMBER 2
 T = COLLEGE
 U = TAX YEARS FOR FORM 1041 AND 990-PF
 V = TAX YEAR FOR FORM 1041
 W = SUPPORTED ORGANIZATION'S BOARD MEMBER
 X = IRS ADDRESS

PRIMARY ISSUE: Whether the IRC section 501(c)(3) tax exempt status of the A should be revoked because it is not operated exclusively for tax exempt purposes?

FACTS:

Organizing Document

The A (the "Organization") was created with a Declaration of Trust (Declaration) by D and E, (each being a "Founder") and D, ("Trustee") on F. The Declaration provides that the trust was created for the purpose of establishing an organization which is described in IRC section 501(c)(3) and IRC section 509(a)(3). The Declaration provides that the Founder renounces any power to determine or control, by alteration, amendment, revocation, termination or otherwise, the income or principal of the trust estate and renounces any interest, either vested or contingent, including any reversionary interest or possibility of reverter, in the income or principal of the trust estate.

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The Declaration requires each year the Trustee to distribute 35% of the adjusted net income of the trust to the G, the named Primary Charity. In addition to this distribution, each year the Trustee shall distribute a total of 50% of the adjusted net income to one or more organizations listed on Schedule A.

There are 109 organizations listed on Schedule A. At least one of them, H, is not a publicly supported section 501(c)(3) organization.

The Declaration provides that the Board shall be the governing body of the trust. It shall consist of five members. The members of the Board shall be determined as follows:

- Three members shall be appointed by G or its designated agent.
- Two members of the board shall be from the class consisting of D and E and their descendants.

The board members in , , , and were

- D
- E
- I
- J
- K

The Declaration provides that upon winding up and dissolution of the trust, the assets shall be distributed to a non-profit fund, foundation or corporation, which is organized and operated exclusively for charitable, educational, religious, and/or scientific purposes and which has established its tax exempt status under section 501(c)(3).

The Declaration also states that in the event the trust does not obtain tax exempt status under sections 501(c)(3) and 509(a)(3) of the Code, the assets of the trust shall go to the L, as a contingent remainder.

The Organization was recognized by the Service as exempt from Federal income tax under section 501(a) as an organization described in section 501(c)(3) and it was classified as an organization that is not a private foundation because it is described in section 509(a)(3). During the application process, the Organization did not disclose that a substantial portion of its "grants" to G would be used to make tuition payments for members of the L.

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Income and contributions

The following income and expenses were reported on Form 990.

Contributions
Interest income
Gain/loss on sale of investments

Total income

Charitable Grants

G
M
N

Total gifts to charity

The Forms 990 also showed Investments – Other. While the Form 990 and the Instructions thereto require investments to be described in a schedule, the Organization did not describe its investments.

Expenditures to benefit members of the L

As noted above, G is named as the primary charity.

On July 30, , G deposited \$ from the A. On July 30, , G wrote check #361 for \$3,760 to O. The memo line was noted “P Q”.

On June 28, , R deposited \$2,650 from the A. On June 28, , G wrote check #708 for \$ to O, with “P” on the memo line.

D, Trustee of the A, stated that R paid tuition for another member of the L, S. In the year , R paid \$ tuition for S at T.

Mr. P stated, “We asked R if they would consider providing our children with Scholarships out of their funds. We understood that when we made a contribution to R, R had complete control as to determine how their money was to be used. After we asked, they then made the final decision.”

The Organization reports that it does not keep minutes. They state that the board meets once or twice a year and discusses the investments and income.

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LAW:

IRC section 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Treas. Reg. section 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. section 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. section 1.501(c)(3)-1(d)(1)(ii) provides 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, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

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 section 501(c)(3). See also American Campaign Academy v. Commissioner, 92 T.C. 1053, 1065-66 (1989) (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); Old Dominion Box Co., Inc. v. United States, 477 F2d 340 (4th Cir. 1973) (operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose).

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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 Church of World Peace, Inc. v. Commissioner, T.C. Memo. 1994-87, aff'd, 75 A.F.T.R.2d (RIA) 2082 (10th Cir. 1995), the Tax Court held that a church did not operate exclusively for religious purposes because the church facilitated a circular tax-avoidance scheme. The facts showed that individuals made contributions to the church and claimed charitable contribution deductions. The court found that the church then returned the money to the individuals claiming that the payments were for housing allowances and reimbursement of expenses. The court further found that such payments were in fact unrelated to the church's operations.

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 section 501(c)(3).

GOVERNMENT'S POSITION:

The IRC section 501(c)(3) tax exempt status of A (the "Organization") should be revoked because it is not operated exclusively for tax exempt charitable purposes. More than an insubstantial purpose of the organization is to serve the needs of its founders, D and E. Additionally, the net earnings of the Organization have inured to the benefit of insiders.

As substantial contributors, D and E are disqualified persons and insiders. They have operated the A for their private interests. There is no indication that contributions made by the Foundation were considered by the Board. While the Ps state the Board met once or twice a year, there are no minutes if such meetings took place.

The dates that the supported organization, G, paid the tuition of the L members are the same dates that the G received funds from the A. The tuition paid by R is equal to the amount that G received from the A on those dates. The timing of the disbursements suggests that the payments of tuition were prearranged. Although the funds were deposited into the bank account of G, they were controlled by D and E and paid out for the benefit of the L at the request of D and E. These amounts, \$ in , \$ in and \$ in , are amounts spent by the A at the direction of D and E for the benefit of their family members.

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The funds that the A claimed to contribute to G, were always controlled by the A and were directed to the personal expenses of the P children.

Total income

Total grants to charity

Tuition paid by R

Personal benefit as a percent of Organization's income	%	%	%	%
Personal benefit as a percent of Organization's grants	%	%	%	%

An organization is described in section 501(c)(3) only if no part of its net earnings inures to the benefit of any private shareholder. The inurement prohibition is designed to insure that charitable assets are dedicated to exclusively furthering public purposes. An organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders or individuals.

A gift to a charitable organization must be a voluntary transfer of money or property without the receipt of adequate consideration, made with charitable intent. Hernandez v. Commissioner, 490 U.S. 680, 690 (1980). To claim a deduction under section 170, a donor must surrender dominion and control over the gift. United States v. Estate Preservation Services, 202 F.3d 1093, 1101 (9th Cir. 2000). The Ps transferred assets to the Organization and claimed a deduction under section 170. A charity's assets are required to be irrevocably dedicated to charitable purposes. Treas. Reg. § 1.501(c)(3)-1(b)(4). The inurement prohibition serves to prevent the individuals who operate the charity from siphoning off any of a charity's income or assets for personal use. By transferring assets to G with the expectation that those monies would be used to pay tuition expenses for members of the L, the Organization breached the dedication requirement and its net earnings have inured to the benefit of the disqualified persons.

Although the inurement prohibition is stated in terms of net earnings, it applies to any of a charity's assets that serve the interests of its private shareholders. Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6th Cir. 1974). The transfer of funds to G which then used the monies for the benefit of disqualified persons, served the financial interests of the disqualified persons and G

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The facts show that the earnings of the Organization are indirectly used by the founders for their personal expenses. The Organization's net earnings have inured to the benefit of insiders. Treas. Reg. section 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966).

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Business Bureau v. United States, 326 U.S. 279 (1945); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). See also Old Dominion Box Co., Inc. v. United States, 477 F2d. 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. American Campaign Academy v. Commissioner, supra at 1065-1066.

The Organization does not qualify for exemption because the Organization confers benefits on members of the L, through tuition payments for their children, directed by D and E through the vehicle of G.

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:

Accordingly, the Organization's status as an organization described under section 501(c)(3) should be revoked, effective F, because it did not operate exclusively for exempt purposes because its assets inured to, and it served the private interests of, its creators and other private persons.

Form 1041 U.S. Income Tax Return for Estates and Trusts should be filed for tax years ending U, V, and W. Subsequent returns are due no later than the 15th day of the 4th month following the close of the trust's accounting period.

Returns should be sent to the following mailing address:

Internal Revenue Service
X
X

For tax year ending V Form 1041 is due April 15, 2007, and should be sent to the following address:

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Internal Revenue Service Center
Ogden, UT 84201

ALTERNATIVE ISSUE: Whether the A should be reclassified as a private foundation?

FACTS:

The facts concerning the Declaration of the Organization and the indirect personal benefit received by the Ps are listed above.

The Organization does not conduct any independent charitable activities.

The Declaration provides that the Organization is classified as a section 509(a)(3) organization that is operated, supervised or controlled by the supported organization.

There is no evidence that representatives of any of the supported organizations ever attended or participated in any meetings of the Board, or had any input or oversight on the investments of the Organization. Furthermore, there is no evidence that any financial reporting was made to any of the supported organizations.

LAW:

Treas. Reg. section 1.509(a)-4(c) regarding the organizational test that a 509(a)(3) organization must meet provides:

(1) *In general.* —An organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization (as defined in section 1.501(c)(3)-1(b)(2)):

- (i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);
- (ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;
- (iii) State the specified publicly supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and
- (iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

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Treas. Reg. section 1.509(a)-4(e) regarding the operational test a 509(a)(3) organization must meet provides:

(1) *Permissible beneficiaries.* —A supporting organization will be regarded as “operated exclusively” to support one or more specified publicly supported organizations (hereinafter referred to as the “operational test”) only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by a specified publicly supported organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in section 53.4945-4(a)(4) of this chapter. Similarly, an organization will be regarded as “operated exclusively” to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

(2) *Permissible activities.* —A supporting organization is not required to pay over its income to the publicly supported organizations in order to meet the operational test. It may satisfy the test by using its income to carry on an independent activity or program which supports or benefits the specified publicly supported organizations. All such support must, however, be limited to permissible beneficiaries in accordance with subparagraph (1) of this paragraph. The supporting organization may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations, or for the permissible beneficiaries.

Treas. Reg. section 1.509(a)-4(f) regarding the nature of relationships required for section 509(a)(3) organizations provides:

(1) *In general.* —Section 509(a)(3)(B) describes the nature of the relationship required between a section 501(c)(3) organization and one or more publicly supported organizations in order for such section 501(c)(3) organization to qualify under the provisions of section 509(a)(3). To meet the requirements of section 509(a)(3), an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. If an organization does not stand in one of such

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relationships (as provided in this paragraph) to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

(2) *Types of relationships.* —Section 509(a)(3)(B) sets forth three different types of relationships, one of which must be met in order to meet the requirements of subparagraph (1) of this paragraph. Thus, a supporting organization may be:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with, one or more publicly supported organizations.

(3) *Requirements of relationships.* —Although more than one type of relationship may exist in any one case, any relationship described in section 509(a)(3)(B) must insure that:

(i) The supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and

(ii) The supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported organizations.

(4) *General description of relationships.* —In the case of supporting organizations which are “operated, supervised, or controlled by” one or more publicly supported organizations, the distinguishing feature of this type of relationship is the presence of a substantial degree of direction by the publicly supported organizations over the conduct of the supporting organization, as described in paragraph (g) of this section. In the case of supporting organizations which are “supervised or controlled in connection with” one or more publicly supported organizations, the distinguishing feature is the presence of common supervision or control among the governing bodies of all organizations involved, such as the presence of common directors, as described in paragraph (h) of this section. In the case of a supporting organization which is “operated in connection with” one or more publicly supported organizations, the distinguishing feature is that the supporting organization is responsive to, and significantly involved in the operations of, the publicly supported organization, as described in paragraph (i) of this section.

Treas. Reg. section 1.509(a)-4(g)(1) provides guidance on the meaning of “operated, supervised, or controlled by” as follows:

(i) Each of the items “operated by”, “supervised by”, and “controlled by”, as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any of these terms is comparable to that of a parent and subsidiary,

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where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations.

Treas. Reg. section 1.509(a)-4(j) regarding control by disqualified persons provides:

- (1) *In general.* —Under the provisions of section 509(a)(3)(C) a supporting organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more publicly supported organizations. If a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a foundation manager of the supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly supported organization, then for purposes of this paragraph such person will be regarded as a disqualified person, rather than as a representative of the publicly supported organization. An organization will be considered “controlled”, for purposes of section 509(a)(3)(C), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of any substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization. Except as provided in subparagraph (2) of this paragraph, a supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization. Thus, if the governing body of a foundation is composed of five trustees, none of whom has a veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered to be controlled directly or indirectly by one or more disqualified persons by reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting rights with respect to stocks in which members of its governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

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GOVERNMENT'S POSITION:

As set forth above, it is the government's primary position that the tax exempt status of A (the "Organization") should be revoked. Alternatively, the Organization should be reclassified as a private foundation.

Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private foundation is intentionally inclusive so that all organizations exempted from tax by IRC section 501(c)(3) are private foundations except for those specified in IRC sections 509(a)(1) through(4). Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566; Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7th Cir. 1979). The Organization currently is excepted from private foundation status because it is currently classified as an organization described in section 509(a)(3), which defines supporting organizations.

Public charities (organizations described in section 501(c)(3) that meet the requirement of sections 509(a)(1) or (2)) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations are similarly excepted from private foundation status. Supporting organizations are excepted if they are subject to the scrutiny of public charities that provide sufficient oversight to keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie, 603 F.2d at 1277-78.

To be classified as a section 509(a)(3) supporting organization, the Organization must meet all of the following tests:

- 1) Organizational and Operational Tests under section 509(a)(3)(A).
- 2) Relationship Test under section 509(a)(3)(B).
- 3) Lack of Disqualified Person Control Test under section 509(a)(3)(C).

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons.

Organizational and Operational Tests

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The Organization is not organized to benefit one or more specified publicly supported organizations. Pursuant to Treas. Reg. section 1.509(a)-4(c)(1)(iii) and (iv), an organization's governing instrument must state the specified publicly supported organization(s) on whose behalf the organization is to be operated and cannot expressly empower the organization to support or benefit any organizations other than the specified publicly supported organization(s).

The Organization's dissolution clause allows distributions to organizations other than the specified publicly supported organizations upon termination of the Organization. The possible beneficiaries are not limited to G or to the organizations specified on Schedule A of the Organization's Declaration of Trust. Therefore, the organizational test is not met. See Quarrie, supra (holding that the organizational test was not satisfied where the trustee had the power to substitute beneficiaries when, in the judgment of the trustee, the uses of the named beneficiaries became unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public).

Moreover, the operational test set forth in Treas. Reg. § 1.509(a)-4(e)(1) is not satisfied. A supporting organization will be regarded as "operated exclusively" to support a specified publicly supported organization(s) only if it engages in activities which support or benefit the specified publicly supported organizations(s). As was discussed under the Primary Issue above, the Organization has served private interests and has made payments through G for the benefit of the L. Therefore, it has not established that it operated exclusively for the benefit of the publicly supported organizations.

Relationship Test

On paper, the relationship test is satisfied because G appoints three members of a five member board. Therefore, the "operated, supervised, or controlled by" relationship is established. The "operated, supervised or controlled by" relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity or the membership of the publicly supported organization. See Treas. Reg. § 1.509(a)-4(g). Please note the discussion under the Control Test that shows that disqualified persons actually control the Organization.

Control Test

As noted above, D and E are disqualified persons because they are substantial contributors and board members to the Organization. Pursuant to section 4946(a), members of their family are also disqualified persons. I helped D and E set up the Organization. I also established G and three members of the I family, W, are R's only board members. While G had the power to appoint three board members, there is no evidence the board ever met. There are no minutes reflecting any board meetings. Rather, G acted in concert with the Founders and used a

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

substantial portion of the "grants" to it to make tuition payments for disqualified persons. Looking at all pertinent facts and circumstances, it is evident that disqualified persons controlled the Organization.

Conclusion

The organizational test is not met because the trust document allows the trustee to substitute beneficiaries on dissolution. The operational test is not met because the Organization is operated for the private benefit of the Founders. The control test is not met because the Founders make all of the decisions regarding the activities of the Organization.

Accordingly, the Organization should be reclassified as a private foundation because it does not qualify as a supporting organization under the requirements set forth in Treas. Reg. section 1.509(a)-4(c) through (j).

This modification of private foundation status is effective beginning F.

The effect of this determination will be that the Organization is required to file Form 990-PF Return of Private Foundation. Form 990-PF should be filed for tax years ending U and V. Subsequent returns are due no later than the 15th day of the 5th month following the close of the Foundation's accounting period. For tax year ending V, Form 990 PF is due May 15, 2006.

Send your returns to the following mailing address:

Internal Revenue Service
X
X

Note:

Form 990-PF is required for each tax year until Private Foundation status is terminated under IRC 507.



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
30 East 7th Street, #1130-B
St. Paul, MN 55101

JUN 27 2006

Taxpayer Identification Number:

Form:

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:

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